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R_X FOR AILING U.S. MASS TRANSIT POLICY: A DOSE OF COMPETITION

INTRODUCTION

Late last year Senator William Proxmire, the Wisconsin Democrat, presented his celebrated "Golden Fleece" award for wasteful government spending to the Urban Mass Transit Administration (UMTA) for "playing Santa Claus" to the nation's cities. Proxmire labeled the federal government's 20-year, $40 billion investment in urban transit a "spectacular flop." In accepting the award, however, UMTA Administrator Ralph Stanley pointed out that Congress really is the culprit, for it continually appropriates more money for urban transit than UMTA requests or can possibly spend efficiently.

Seldom has Proxmire's Golden Fleece been better deserved. Examples of UMTA's qualifications for it:

- Detroit's "People Mover" already has cost taxpayers $210 million to build--40 percent over original budget projections. The regional transit authority has been forced to cut back on bus service to finance the city's portion of the funding. The Detroit News, recently dubbed the People Mover "one of the most absurd transportation projects in American history."[1]
- One year after completing its $530 million underground rail system--with 80 percent federal funds--Buffalo, New York, is reducing service and may be forced to shut down this subway

1. In fact, over the past two years the Detroit News has run over a dozen editorials criticizing the People Mover project.

entirely. Ridership is only half the original projections; fares cover only 20 percent of operating costs.

- Miami's $1 billion "Metrorail," built with 80 percent federal funds, is now running an annual operating deficit of $100 million, primarily because only one percent of Dade County residents rides the system. Local taxpayers have continually rejected proposals to raise the city's sales tax to cover this huge deficit. In fact, the system is so unpopular that many Miami residents have pegged it "Metro Fail."

The reason that these cities even considered such potentially uneconomical transit projects: the federal government, rather than the cities themselves, paid for construction. UMTA reimburses cities for up to 80 percent of transit construction costs and up to 50 percent of operating costs. It is thus not surprising that cities clamor for expensive, modern, and yet totally uneconomic transit equipment. And unless Congress reforms the UMTA programs, over $20 billion more in federal transit capital funds will be disbursed for similarly wasteful new constructions over the next 15 years.

Despite the outpouring of federal funds, mass transit ridership is down. In 1963, the year before the federal government began funding local transportation projects, 9 billion trips were taken annually on public transit; by 1985, after $40 billion in federal funding, ridership had dropped by 11 percent.[2]

Predictably, federal transit funds have provided benefits mostly to groups with a political or financial stake in mass transit rather than to the riders of the systems. Beneficiaries are regional transit authorities, public transit unions, developers, local politicians, and Congressmen who control the UMTA purse strings, not the average American commuter.

It is up to Congress to change the way federal transit dollars are spent so that commuters become the main beneficiary. Cities should be given incentives to spend federal funds efficiently. To achieve this, all urban transit funds, and a portion of federal highway transportation funds, should be combined into a single "Urban Mobility" block grant with few regulatory strings. Cities will then have the freedom and incentive to use their federal funds for transit projects that best meet the needs of the public.

Congress should also ensure that transit funds promote rather than impede competition in urban mass transit. In those cities where

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2. George W. Hilton, "The Rise and Fall of Monopolized Transit," in Charles A. Lave, ed., Urban Transit (San Francisco, California: Pacific Institute for Public Policy Research, 1985), p. 45.

public and private transit companies compete, private sector costs are typically between 20 and 50 percent less than those of the public sector, and service access and choice are improved. Yet federal transit funds have often been used to choke off competition from private firms, entrenching inefficient public transit monopolies.

Finally, dramatically reduced costs and improved access to transit services for disadvantaged groups could be achieved in many more cities if the federal government encouraged cities to ease entry restrictions in their taxicab and para-transit markets. These restrictions include laws prohibiting shared-ride taxis and jitneys (taxicabs that run fixed routes) and regulations capping the number of cabs that can provide service in an urban area. The victims of these restrictions are the poor, who account for only 12 percent of all mass transit trips, but 27 percent of all taxicab rides.[3]

By presenting the Golden Fleece award to UMTA, Senator Proxmire correctly identified federal urban transit spending as one of the most wasteful programs in the federal budget. Given the increased recognition of this fact, Congress is now confronted with two choices:

1) Reform the urban transit grant structure to ensure that the federal taxpayer investment is spent economically on sensible projects. Congress must become more receptive to the innovative proposals offered by UMTA Administrator Ralph Stanley. Unfortunately, in recent years Congress has done everything possible to prevent more competition and more local flexibility in transit services, preferring instead to protect the interests of local transit monopolies. This congressional hostility to change must end.

2) Defund the federal urban transit program entirely.

With either choice the public would be served better by federal transit policies than it now is. Americans' toleration for federal waste in urban transit is surely reaching its boiling point. As such, it is not only in the interests of taxpayers, but of urban commuters as well, for Congress to initiate a new era of competition in urban transit.

THE PERVASIVE FEDERAL ROLE IN URBAN TRANSIT

For two decades, federal urban mass transit assistance has been one of the fastest growing programs in the federal budget. Launched with a $40 million budget in the early 1960s, urban transit aid now consumes $4 billion. This increase in federal funding has been

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3. Tony Snow, "The Great Train Robbery," <u>Policy Review</u>, Spring 1986, p. 49.

accompanied by an explosion in urban transit operating costs. Between 1970 and 1980, for instance, federal transit aid grew by 30 percent after adjustment for inflation. Over roughly this same period:

- o Operating expenses per vehicle mile, perhaps the best measure of transit efficiency, tripled from $1.01 to $3.11--a 60 percent increase in inflation-adjusted dollars.[4]

- o Annual operating deficits in the transit industry grew from about $100 million to about $8 billion. The farebox, which almost fully covered operating costs in the early 1960s, today covers only about 40 percent of operating costs.[5]

In many respects this hyperinflation of urban transit costs is federal aid's direct offspring. The problem lies in the current federal grant structure, which has two components: capital grants and operating subsidies. These payments reward cities for purchasing and operating inefficient transit systems.

Federal Capital Grants

Urban transit capital grants were intended to prod cities to modernize their transit infrastructure by purchasing new buses and rail systems. Under the capital grant matching formula, the federal government reimburses the city for up to 80 percent of the cost of these capital acquisitions.

These generous federal capital grants have generated a mad scramble among cities to secure federal transit dollars, rather than improve the efficiency of existing transit systems. When a city is paying only 20 cents of every dollar for new purchases, it will push ahead with any project for which it can justify as little as 20 percent of the cost. Indeed, federal capital grants actually punish cities seeking to control costs: by not including transit construction in their municipal budgets, the cities face drastically slashed federal subsidies.[6]

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4. C. Kenneth Orski, "Redesigning Local Transportation Service," in Lave, op. cit., p. 259.

5. Congressional Budget Office, The Federal Budget for Public Works Infrastructure, July 1985, p. 44.

6. To illustrate how capital grants encourage uneconomical spending, consider the debate now going on in Los Angeles concerning whether the Bunker Hill Transit Tunnel should be completed. The Los Angeles Times (March 2, 1986) calls the project "a tunnel that goes nowhere and may never carry passengers." The Los Angeles Community Redevelopment Agency wants the tunnel so as not to lose $3 million in available federal grant money.

In most large cities these capital grants also have stimulated overinvestment in buses. Nationwide, the "spare ratio" in buses, the proportion of buses not used on a given day, is between 40 and 50 percent. This means that cities use only slightly more than half of all their buses. UMTA is currently trying to revise the federal grant structure so that the spare ratio falls to 20 percent.

In sum, the net effect of federal capital grants has been to direct local transit investment into projects that will attract federal dollars, not into projects that will improve a city's overall transportation infrastructure and attract riders.

Federal Operating Assistance

Federal operating subsidies provide city planners with a remarkably perverse set of incentives: cities building transit systems that operate at a loss attract more federal funds than those with efficient, money-making operations. San Diego, California, for instance, recently built a light rail line (with federal funds), which now receives federal operating subsidies because fares cover only 80 percent of the system's cost. In contrast, the bus line replaced by this rail project operated at a profit and offered comparable service. The rub was that it was unpopular with city officials because it brought in no federal dollars.[7]

Easy access to federal operating subsidies discourages cities from contracting with private firms for transit services. Because of congressional restrictions, federal operating grants generally cannot be spent on private sector mass transit services, even if this would mean a smaller subsidy. Johnson County, Kansas, just outside Kansas City, for instance, reduced the cost of its bus service by $470,000 a year by contracting with a private transit firm in 1982. But by doing this, the city was forced to forfeit nearly $450,000 of federal operating assistance.[8] The result: the city was almost worse off by choosing a private firm over the more costly public transit agency. In view of these disincentives, it is not surprising that a UMTA study last year found that, of the $8 billion spent on federal operating subsidies, only $1 billion was used to improve or extend service. Most of the operating subsidies went for higher wages ($2 billion),

7. For a discussion of this, and similar incidents in other cities, see Snow, op. cit., pp. 44-49.

8. Urban Mass Transportation Administration, "Contracted Bus Service and Maintenance," Private Sector Briefs, May 1986.

lower employee productivity ($1.5 billion), and reduced real fares ($1 billion).[9]

HOW CONGRESS PROMOTES INEFFICIENCY IN URBAN TRANSIT

Much of the blame for the explosion of transit costs and the reduced service quality must be placed on the shoulders of Congress. Lawmakers prefer to allocate federal transit funds to projects that will yield the highest political rather than economic dividends. Indeed, Congress has been bitterly hostile to proposals by UMTA Administrator Stanley to encourage cities to save money by allowing private firms to bid for transit contracts. For the past two years, House liberals have attempted to abolish UMTA's new Office of Private Sector Initiatives (OPSI), which studies potential savings from relying more heavily on the private sector in mass transit.[10] OPSI spends $4 million a year, which is less than one-tenth of one percent of the Urban Mass Transit Administration budget. But prompted by the public transit unions, Congress has sought to impose a "gag-rule" against UMTA from even studying the possible cost savings from private transit systems--denying the American people the right to know how their money could be spent more efficiently.

Congressional determination to protect the public sector monopoly in urban transit was typified this summer in the House-passed Federal Urban Mass Transit Act of 1986. It contains a section actually entitled: "Limitation on Private Enterprise Participation." This prohibits UMTA from prescribing "a specific level of private enterprise or competitive bid participation in the provision of mass transportation services." The Senate inserted similar language. The purpose of this was to circumvent a proposal by UMTA Administrator Stanley to require cities to use up to 20 percent of their federal transit funds on projects where the private sector is invited to bid to provide the service less expensively. Disagreement in House-Senate Conference on unrelated issues killed the bill this year.

Other UMTA reforms initiated by Stanley to reduce waste also have been thwarted by congressional moves to protect public sector special interests. In 1985, for instance, UMTA developed a major capital investment policy, which would have ranked new rail starts and rail modernization projects according to a merit formula. Included in the formula were criteria measuring cost-effectiveness, potential

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9. Ralph L. Stanley, statement before the Subcommittee on Appropriations, U.S. House of Representatives, April 9, 1986, pp. 3-4.

10. Stephen Moore, "Saving Money by Saving OPSI," Heritage Foundation Executive Memorandum No. 87, July 23, 1985.

ridership, and local financial support for the project. The objective was to distinguish between economically viable transit projects and those with little potential for long-term success. Congress blocked this merit formula approach by earmarking almost all UMTA capital funds this year for specific projects. The result: local transit authorities no longer will have to demonstrate the economic soundness of new capital projects to receive federal funds.

A FOUR-POINT STRATEGY TO REVITALIZE URBAN TRANSIT

Actions by Congress to thwart cost-saving competition and other efficiency improvements in urban mass transit serve neither taxpayers nor urban residents. If lawmakers truly wish to reverse the deterioration in transit service quality, and control the acceleration in transit costs, they could make four fundamental changes in federal transit policy.

1) Inject competition into urban transit.

The failing public transit monopoly needs a strong dose of private sector competition. The 1964 Urban Mass Transit Act explicitly stated that federal funds are to be used to encourage the participation of the private sector "to the maximum extent feasible." Yet the Congressional Budget Office notes: "In most cases federal [transit] dollars were used to 'municipalize' the industry through mergers and takeovers."[11] As a result, 90 percent of all new transit fleets are now publicly owned--up from 33 percent before federal intervention. Only 4 percent of transit services are now competitively bid.[12]

Such resistance to private sector transit companies is very costly for the taxpayer. A pioneering study by Roger Teal, a transportation economist at the University of California, Irvine, has compared private transit costs in several cities where contracting out has occurred--including Phoenix, San Diego, Los Angeles, and New York--with areas that rely solely on publicly operated systems. He

11. The Federal Budget for Public Works Infrastructure, op. cit., p. 53.

12. Urban Mass Transit Administration, "For Mass Transit's Future, Competition Is the Answer," 1986, p. 3.

finds that contracted-out services are between 20 and 50 percent less expensive.[13] Other recent research has supported these findings.[14]

For many cities the budgetary gains from transit competition have been dramatic. Norfolk, Virginia, has reduced its per passenger subsidies 64 percent by switching from public bus service to privately contracted demand-response service. Dallas, Texas, contracts with Trailways to provide express commuter service. Over 10,000 passengers use the service daily, with first year savings to Dallas of $9 million.

Transit contracting has yielded similarly encouraging results abroad. Great Britain recently eased its entry controls on intercity long distance express services and local commuter services. The result: over 200 new private transit firms have been established, substantially reducing ticket prices and improving services. Transportation consultant Charles Lave reveals that "The [British government-owned] National Bus Company responded to the private challenge by improving and drastically increasing its own long distance services, and is doing well despite the private competition."[15] And after years of operating in the red, the publicly owned firm is now turning a profit.

It serves the interests of transit providers as well as of commuters to break up the public sector monopoly of inner-city transportation services in most metropolitan areas. Only by operating more efficiently and providing a better service will transit agencies attract Americans back onto buses and trains. To achieve this, Congress and the Administration should insist that federal funds are spent in accordance with the 1964 Transit Act requirement that the private sector participate in urban transit. There are three ways to do this:

> <u>Eliminate federal operating subsidies that discourage reliance on private operators</u>. If local governments were required to cover the operating deficits of their transit systems, cities would have an incentive to select the most economical provider.

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13. Roger F. Teal, "Transit Service Contracting: Experiences and Issues," paper presented at the annual meeting of the Transportation Research Board, Washington, D.C., 1985.

14. A survey of the literature is contained in: Edward K. Morlok and Philip A. Viton, "The Comparative Costs of Public and Private Providers of Mass Transit," in Lave, <u>op. cit.</u>, pp. 233-253.

15. Lave, <u>op. cit.</u>, p. 23.

Require that at least 20 percent of federal funds be spent on competitively bid transit projects. This could save local and federal taxpayers more than $1 billion annually. Eventually all local projects financed with federal funds should be subject to this requirement.

Allow cities to spend their federal capital grant funds on reimbursing private transit firms for capital depreciation. Currently, capital grants may be used only for the purchase of new equipment. But it is far cheaper for a city to reimburse private firms for the wear and tear on their equipment than to buy new buses at $150,000 each. By permitting cities to compensate private transit operators for the increment of physical capital consumed when they supply public transit service, contractor costs could be reduced by 5 to 25 percent. And the problem of cities building costly new transit systems solely to capture federal dollars would be partially alleviated.

2) Restore incentives for cities to operate efficient transit systems.

The current transit grant system should be abandoned and replaced with a single Urban Transit Block Grant comprising all UMTA funds and portions of the Federal Highway Program. Each city's portion would be based on objective criteria such as population density, rate of transit use, contribution to the gas tax, and other related factors. An operating efficiency factor, such as operating costs per passenger mile, could be built into the grant formula to reward cities for transit improvements. The block grant concept would allow the cities to set their own transportation priorities rather than have to follow the often arbitrary and inappropriate priorities that Congress establishes for them. In its Fiscal 1986 budget proposal, the Reagan Administration recommended something similar to a block grant plan, called an "Urban Mobility Block Grant." Congress dismissed the concept.

A major advantage of a block grant is that urban transit funds would be distributed among cities in a more equitable fashion. Currently urban transit funds flow mainly to those cities and states that have congressional members sitting on key committees. Between 1964 and 1980, for instance, just ten of the nation's urban areas received approximately 70 percent of all federal transit funds.

Furthermore, the amount that states contribute in gas taxes bears little resemblance to the distribution in urban transit discretionary funds. In 1985, New York residents received UMTA discretionary grant benefits of $4.57 for every dollar the state paid in federal gasoline tax; meanwhile over half the states received less than 10 cents in transit funds for every dollar contributed. A block grant would redress this inequity.

3) Turn union opposition into support.

Roughly 40 cents of every federal transit dollar has been consumed by the public transit unions in the form of higher wages and reduced productivity, not better service. Any plan to restructure federal aid must thus provide incentives for labor productivity enhancements.

Section 13(c) of the Urban Mass Transit Act should be repealed or amended. This section requires that cities receiving federal transit funds must 1) "preserve the rights, privileges, and benefits of existing collective bargaining agreements" and 2) protect individual employees from any "worsening of their positions with respect to employment." The provision has handcuffed cities' attempts to cut costs by contracting out and employing labor saving transit technologies.

As a result of Section 13(c), public transit union wages exceed those of their private sector counterparts by at least 50 percent. An UMTA comparison of starting salaries of public employees in 25 cities finds that bus drivers earn between 16 and 18 percent more than freshman police officers and fire fighters.[16] Moreover, Section 13(c) long ago fulfilled its original mandate of protecting labor interests during public takeovers of private systems.

The most urgent reason for rescinding Section 13(c) is that the act has served as a de facto prohibition against contracting out. A 1981 survey of transit collective bargaining agreements finds "75 percent of those agreements specified that the paratransit service be restricted so as not to displace or compete with existing transit service, even if the paratransit services were more efficient."[17]

Repealing Section 13(c) would not be "anti-union." Over 60 percent of the private bus industry workforce, the victims of Section 13(c), is unionized. All the regulation does is confer special treatment to one union group at the expense of another.

But even if Section 13(c) were terminated, public employee opposition still would pose a formidable barrier to transit reforms. One means of transforming this resistance into support would be to encourage worker buyouts of public agencies. The British

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16. Urban Mass Transportation Administration, "Starting Salaries of Transit Employees Compared with Starting Salaries of Other Types of Employees," 1986.

17. Urban Mass Transportation, "Repeal Section 13(c)," July 30, 1985.

privatization experience demonstrates that, with sufficient incentives, even the most vocal opponents of contracting out can become leading advocates. Example: Britain plans to sell portions of the National Bus Company, which employs 50,000 government workers, under a worker buy-out plan. This has union member approval. There is little reason why buy-outs of publicly operated U.S. transit systems could not be made attractive to American workers.

Another means of increasing public transit productivity and reducing union opposition to private sector competition is through "gain sharing," where workers receive financial dividends for cost reductions. If the public transit agency is able to win competitive contracts by reducing costs, 50 percent of these savings could be awarded to the union as a productivity improvement reward. This approach, of course, should be introduced generally as a means of offering workers an incentive to slash transit costs.

Though still a rarity in public transit, the cities that have experimented with gain sharing have recorded impressive efficiency improvements. In measuring employee productivity, 80 percent is an average rating and 85 percent is considered good. In Salt Lake City, the rating rose to 91 percent after the city refused transit wage increases unless there were corresponding productivity gains. This is an unprecedented accomplishment in the transit field.

4) <u>Make greater use of taxicabs for urban transit</u>.

It is a well-kept secret that the taxicab carries more passengers each day than all other modes of urban mass transit combined. And taxicabs are not the mode of transit for the rich, the poor are the heaviest taxi users.[18] Yet the majority of cities have erected regulations and entry controls that severely restrict the availability of taxis and thus drive up their costs. If just one percent of the $8 billion annually funded for mass transit were devoted to encouraging cities to decontrol and expand their taxi cab fleets, transit service would be more widely available and less expensive than it is today.

Cities without restrictions on taxis have lower fares and far higher rates of taxis per person than do cities with entry barriers. According to a study of taxicabs in eleven large U.S. cities by the National Academy of Sciences, the three cities without entry restrictions--Atlanta, Washington, D.C., and Honolulu--have about

18. Sandra Rosenbloom, "Urban Taxi Policies," <u>Journal of Contemporary Studies</u>, Spring 1981.

three to five times as many taxis per thousand residents than cities with numerical restrictions.[19] After Seattle and San Diego recently deregulated their taxicabs, they saw a 25 percent increase in the number of cabs.

For many small and medium-sized cities, the taxicab is also a more economical means of fulfilling urban transportation needs than are rail systems and buses. A study comparing the costs of demand responsive taxicab service versus publicly operated mass transit systems by University of Texas transportation economist Sandra Rosenbloom concludes that "Overall, taxi operations have been cheaper than the public services that they replaced or than those public services that could be implemented in their stead."[20]

CONCLUSION

After 20 years and $40 billion of federal assistance, even the staunchest supporters of federal transit aid would be hard pressed to argue that federal urban transit funds have been wisely spent. The difficult lesson is that the quality of mass transit in the nation's cities is unrelated to the amount of money Washington lawmakers pour into the problem.

Congress must not continue the $4 billion annual federal investment in urban transit without substantial changes. The most efficient and the most equitable means of allocating transportation funds is through a block grant formula. By providing cities with fixed grants, Congress will give cities an incentive to spend their federal funds in ways that will maximize transit efficiency. Congress also can foster greater innovation and cost reductions by forcing publicly owned transit monopolies to compete with private transit companies. Finally, cities could significantly reduce their transit costs, while providing wider access to the poor, if the federal government were to encourage cities to deregulate their taxicab and paratransit markets.

Nearly a year has elapsed since Senator Proxmire awarded the Golden Fleece to the federal urban transportation program. Unfortunately, this year it was business as usual in Congress; in fact, lawmakers have only further restrained UMTA Administrator

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19. Sandra Rosenbloom, "Case Studies of United States Taxicab Regulation," Economic Regulation of Urban Transportation (Washington, D.C.: National Academy of Sciences, 1977).

20. Sandra Rosenbloom, "The Taxi in the Urban Transit System," in Lave, op. cit, p. 211.

Stanley from taking steps to assure that cities spend their federal funds on economical projects. Next year Congress will again consider UMTA reauthorization. This will afford another opportunity for enacting fundamental reforms in federal transit policy. Should Congress stay on its present course, billions of federal dollars will continue to be wasted. Even worse, the quality of urban transit services will almost certainly continue to deteriorate.

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