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CHARTING A NEW COURSE FOR TRANSPORTATION POLICY

INTRODUCTION

It seems to be a common congressional misconception that more federal money leads to better services. As such, Congress likely will "see and raise" President Reagan's budget request for a \$3 billion (14 percent) increase in FY 1984 funding for the Department of Transportation (DOT).

The president threatens to veto appropriations that exceed his requests and there is no better candidate for a Reagan veto than the DOT appropriation. Not only has Congress continued pressuring for a bigger, more intrusive department, it has ignored the many lessons teaching that the centralization of transportation spending leads to burgeoning costs and inefficiency. It is time that Congress was forced, by a presidential veto, to reexamine the whole thrust and rationale of the DOT budget.

Despite federal transportation expenditures which soared, nearly 250 percent in the last ten years, federal policies have resulted in few efficiencies or improvements in the nation's infrastructure and transportation systems. A major reason for this is that four fundamental flaws distort the allocation of national transportation expenditures.

1) Although 69 percent of DOT's budget supposedly is financed by "user fees," these charges are not in fact true user fees. They are simply excise taxes that distort the demand for mass transit, interstate highways, and airport activities. They are not a market clearing price.

2) DOT finances many expensive and unnecessary "pork-barrel" construction activities, the costs of which are inflated due to the Davis-Bacon Act, which requires employees to be paid at the "prevailing rate" (normally union scale), and restricts the use

of lower-paid unskilled workers. Projects also are delayed or altered by federal regulation, and salaries and payments are bloated by special interest handouts by Congress.

3) DOT's policy of matching grants encourages new construction where rehabilitation and maintenance of existing facilities would be more economical.

4) DOT operates industries that belong to the private sector, such as AMTRAK and the air traffic control system.

The DOT budget will not give the American taxpayer value for his money until these underlying structural problems are corrected. To do so requires DOT to: redesign its "user fees" into a rational price system; remove federal funding of local roads and mass transit systems and support only genuinely federal priorities; restructure grants so that they are investment neutral; and reverse the nationalization of inefficient industries by shifting AMTRAK and the air traffic control system to the private sector.

These measures are part of a strategy for the entire federal government that would transfer many federal responsibilities to private or state and local jurisdictions. Most transportation functions need not be funded and directed from Washington. Responsibility rather should be shifted to a more local and thus accountable level. The federal government should limit its active role to providing and maintaining interstate highways and bridges and to other truly national programs. Giving more discretion and cost responsibility to the user and his local representatives will cut costs and provide a more rational, user-sensitive system.

THE FEDERAL HIGHWAY ADMINISTRATION

The Federal Highway Administration's \$14 billion budget represents more than half of the DOT budget and affords significant economies by redesigning user fees and shifting the balance in state-federal responsibilities.

Federal Highway Construction Programs

Most federal highway construction activity is financed by the \$13 billion federal highway trust fund. DOT's highway "user fees" contribute toward the fund, but are riddled with inequitable and inefficient cross-subsidies. The Surface Transportation Act of 1982, for instance, raised the federal gasoline tax from 4 to 9 cents per gallon. Although most of the funds are for the general purposes of the highway trust fund, 1¢ of the tax is deposited in a mass transit capital fund. As such, California automobile drivers end up subsidizing New York City subway riders. Such cross-subsidies distort demand, leading to excessive new construction--often at the expense of needed repairs.

Failure to differentiate between federal and non-federal needs also results in the use of DOT funds for projects of exclusively parochial value. These range from local secondary roads to access roads at recreation areas to railroad crossing demonstrations to school buses. All have highly particularized benefits.

Worse still, the federal government finances construction that a locality has already rejected as being uneconomical. Thanks to "free" federal money, these politically popular but economically unsound local projects go ahead. The sums involved can be considerable. The New York Times, in an editorial supporting the controversial \$2 billion Westway project on Manhattan's west side, is quite candid about where the money will come from:

New York designed the project to take maximum advantage of federal highway subsidies. As approved, this 90 percent federal funded project would create several hundred acres of new land, including 93 acres of waterfront park. The Feds would also spend \$25 million to demolish rotting piers, \$76 million to replace an obsolete incinerator, \$28 million for a bus garage.¹

Many authorities are beginning to acknowledge the negative federal role in the development of the U.S. transportation system. A Department of Commerce study, for instance, recently concluded that "the federal aid highway programs may have set the stage for deterioration of the nation's highways by effectively subsidizing state and local construction, but not maintenance."² The General Accounting Office has reported that "in one state we studied we were told that there are no incentives for the state to maintain its federal aid roads. We were also told of the possibility of states intentionally allowing their roads to deteriorate until they reach a point where federal funds would be available for major rehabilitation."³

Recommended Reforms

Tolls: Congress should authorize toll facilities on as many interstate highways as possible. Transportation economist Fred Smith of the Council for a Competitive Economy estimates that up to \$10 billion a year could be collected in such tolls.⁴ Where tolls are impractical, interstate highways should be financed by regional taxes or general revenues. Tolls provide clear measure of

¹ "The Westway 'Luxury' is a Bargain," The New York Times, May 4, 1983.

² A Study of Public Works Investment on the U.S. (U.S. Department of Commerce, April 1980).

³ Effective Planning and Budgeting Practices Can Help Arrest the Nation's Deteriorating Public Infrastructure (GAO, November 1982).

⁴ Fred L. Smith, Toll Financing Option, A Quasi-Market Solution, (unpublished Working Paper, Council for a Competitive Economy, Washington, D.C., 1983).

the need for investment or disinvestment. As Adam Smith noted over two centuries ago, "when roads are supported by the commerce...carried on...them, they can be made only where the commerce requires them."⁵ Over 4,000 miles of toll roads were constructed in the United States prior to the development of the federal interstate system in 1956. In fact, at that time the U.S. Treasury recommended that the planned interstate highway system be financed by tolls. Today Austria, France, Italy, Spain, Portugal, and Yugoslavia have more than 6,000 miles of toll roads open to traffic.

Cancel Projects: New interstate highway construction can be reduced from \$4 billion to \$1.7 billion per year by cancelling the 56 percent of uncompleted interstate highway projects which the Congressional Budget Office concludes are economically unattractive.⁶

Return Responsibilities to the States: Congress should restrict federal funding to the national interstate transportation system. Most other highway projects eventually should be turned back to the states, along with the responsibility of financing them. In the interim, all non-interstate highway projects should be consolidated into a block grant, to allow states to adjust their spending patterns to match their plans for state financing. This block grant would be financed until 1988 by general revenues at 1983 levels.

In 1989, Congress should return the financing responsibility for non-interstate highway projects totally to the states. Meanwhile, the national gasoline tax should be reduced to its 1981 level so that states could finance their new responsibilities by state gas taxes, in addition to other appropriate means as they saw fit, such as tolls. Because they would bear the burden, local voters and users would have every incentive to insist on efficiency and accountability in highway spending.

MASS TRANSIT

The Urban Mass Transit Administration (UMTA) provides construction and operating expenses for 434 local transit systems throughout the country. Despite decreasing ridership in the 1970s, federal mass transit aid soared an average of 40 percent annually--faster than any other DOT program. Total federal UMTA authorizations are \$3.7 billion for FY 1983, with projections for FY 1984 exceeding \$4.5 billion.

⁵ Adam Smith, The Wealth of Nations (Cannon Modern Library Edition, 1937), p. 682.

⁶ Mark S. Strotzki, "Economics of Completing the Interstate Highway Systems," Congressional Record, December 15, 1982, p. S14841.

UMTA capital and operating subsidies have led to resource misallocation which has stifled proper responses to changing urban ridership patterns. Capital grants encourage inefficient new capital programs by distorting their real cost, and operating subsidies have become de facto subsidies to powerful mass transit unions, rather than to riders. The goal of Congress and the Administration should be to transfer the entire UMTA budget to state and local governments, and consequently the privatization of as many services as possible.

The Growth of Subsidies

Many proponents of federally supported public transit claim that the systems are needed to correct a permanent "market failure," by bridging the "supply gap." Yet, the existence of these systems has undermined innovative private responses to changes in the transportation market. Sometimes this is done explicitly; perhaps by limiting competition through right of way monopolies, such as "bus-only" lanes, or taxi medallions. More often the subsidies pose effective obstacles to newcomers by masking the real cost of the publicly provided service. To compete with subsidized services, therefore, private transit operators would have to operate uneconomically.

By the late 1960s, there was increasing pressure for the federal government to supplement mass transit capital grants with operating subsidies. But as many had predicted at the time, these subsidies have led inexorably to managerial inefficiency and spiralling deficits. According to DOT, transit fares cover between just one-fifth and one third of the actual cost of a journey, depending on the mode of transportation.⁷

Many of these federal subsidies are diverted into labor compensation. DOT has estimated that between 1970 and 1980 some 24 percent of all federal monies took the form of labor compensation.⁸ Despite declining labor productivity, total earnings of transit employees rose 222.6 percent between 1965 and 1980, whereas the consumer price index climbed 127 percent. By 1979, the average annual compensation of an urban public transit worker was over \$23,000, compared to a \$14,400 average for private industry. New York City bus drivers averaged \$29,705, while drivers of the most expensive private alternative earned only \$26,801.⁹

While operating subsidies encourage inefficiency and labor excesses, federal capital grants distort local investment decisions.

⁷ Douglass B. Lee, Evaluation of Federal Operating Subsidies to Transit (U.S. Department of Transportation, Cambridge, Massachusetts, March 1983), p.22.

⁸ Ibid, p. 17.

⁹ Ibid, p. 23 and James B. Ramsey, "Selling the New York Subways," National Review, February 4, 1983.

For example, the 80 percent federal matching grants available for new bus purchases have led many local authorities to ignore the economic merits of rehabilitating older buses. When UMTA discovered this, all it did was reduce the grant to 75 percent. Capital grants also encourage overdevelopment and expanded public ownership by rewarding local communities with federal monies for usurping private transportation services.

The Underlying Failure of Public Transit

The failure of public transit systems to provide efficient service should come as no surprise to transportation experts. Efficient mass transit is incompatible with federal subsidies, public monopolies and powerful transit unions.

The reasons:

- 1) The dynamics of the marketplace demand flexibility and competition. Fixed bus routes and permanent rail lines are only efficient in stable and concentrated urban centers. Such conditions rarely exist.
- 2) Federal subsidies inflate costs and waste resources more than they improve service.
- 3) Public transit has used subsidized fares as its primary marketing tactic. Yet lower fares have failed to encourage significant increases in ridership. Local governments then often respond to this by trying to discourage automobile use through restricted parking, tolls, and other charges. A faster journey is a major factor in attracting riders, but this generally requires heavy capital investment and further restrictions on automobiles, such as "bus-only" lanes.
- 4) Large vehicles are used for they are viewed as economical. Yet, the capital cost per seat increases with the size of the vehicle, since small vehicles can be mass produced at low cost while large vehicles are often custom made. Moreover, small vehicles can usually be operated nearer full capacity. It is for this reason that most private transit services employ small vans.¹⁰
- 5) Union pressure has led many public transit authorities to base labor contracts and routes on peak

¹⁰ Kenneth C. Orski, "The Changing Environment of Urban Transportation," APA Journal, Summer 1982, p. 312.

hour needs, rather than average use. Public money is wasted on excess labor capacity and empty vehicles operating in off-peak hours.

Private Alternatives

According to some transportation experts, fully private mass transit systems would provide better service to all but the five to ten largest metropolitan areas. Even in these cities there is room for increased reliance on the private sector, such as encouraging private supplemental transit during peak hours.

There are dozens of cities in the U.S. and abroad that serve as models for reducing costs by using the private sector. Phoenix, for example, subsidizes taxi operators to provide services at times and in areas where low levels of ridership would make city buses very costly, resulting in an annual saving of \$560,000. Houston contracts out one-third of its bus system, while Oak Ridge, Tennessee, subsidizes senior citizens' cab rides, saving \$50,000 a year. In Japan, private housing developers have constructed transit feeder lines from suburban developments into main metropolitan public systems. And in the Philippines, Manila's needs are well served by privately owned minibuses, adapted from World War II jeep frames.¹¹

The main argument against such private transit is that there is a need for cross-subsidization to preserve full service to uneconomic areas. Yet subsidizing fares rather than selected individuals has distinct disadvantages. It gives the power of taxation and redistribution of income to transit authorities and it eliminates true pricing--which is critical to a proper cost basis for economic decisions. It is also extremely inefficient and inequitable as means of targeting or providing assistance to the truly needy. Only one of every four transit users is from a low income household.

A model exists for privatization of mass transit. It consists of subsidies for users in the form of vouchers. First, local communities would sell their bus and rail systems to private bidders. To encourage alternative private mass transit, and to provide for proper subsidies to the needy, the community would sell transit vouchers at a percentage discount to the needy, elderly or other targeted groups. Example: a community might sell a \$1 fare card for 50¢. These fare cards would be valid on any transit system--whether taxi, bus or rail. The consumer could pay the premium for individualized taxi service or choose a cheaper alternative.

¹¹ For further examples and information see: "Falling Ridership Could Redirect Mass Transit Planning," Christian Science Monitor, October 21, 1982; "Rethinking Transit in Wichita," Corporation For Urban Mobility (Washington, D.C., 1983); Gabriel Roth and George Wynne, Free Enterprise and Urban Transportation (New Brunswick: Transaction Books, 1982).

This private alternative would encourage a dynamic transportation market. Speedy and efficient private van services would not be squeezed out of the market by regulations or subsidized public buses. Private developers would have the incentive to operate existing transit lines more efficiently, and new transit operators and routes would appear.

Encouraging the Private Sector

Steps should be taken to eliminate perverse incentives and to stimulate private innovation. Funding for new systems should be cut sharply. Cities that have not yet begun constructing major systems that are uneconomical on a cost-benefit basis, such as Los Angeles, Detroit, Baltimore, Buffalo and Miami, should have the authorized funds cancelled. Other capital funding should be cut in half by lowering matching grants. This will help assure that communities have a considerable self-interest in assessing the value of planned projects. The formula grants, largely operating subsidies, should also be cut in half in FY 1984.

Congress could encourage privatization by establishing a discretionary privatization development grant. If a community demonstrated that privatization of local transportation services would involve significant start-up costs in the short term (even though operating expenses might be much lower), it could be eligible for a grant from DOT. Such subsidies, however, would end in 1989, giving local authorities five years to restructure their systems and find alternative financing mechanisms.

AMTRAK

AMTRAK, the federally subsidized national railroad passenger corporation, received \$812 million in federal grants in FY 1983. The President requested \$682 million in his FY 1984 budget.

There is no economic or social rationale for AMTRAK's subsidy. A 1982 Congressional Budget Office study notes that AMTRAK is energy inefficient, provides service predominately to middle and upper income travellers, receives subsidies far out of proportion to all other forms of transportation, and loses millions of dollars per year. It concludes that "because the public benefits that AMTRAK conveys appear limited, continuing large federal subsidies is difficult to justify."¹²

The AMTRAK subsidy has cost the U.S. economy \$12 billion and more than 125,000 jobs in its ten year existence. In 1981 it lost nearly \$900 million, or more than 23¢ per passenger mile. This

¹² Federal Subsidies for Rail Passenger Service: An Assessment of Amtrak (Congressional Budget Office, Washington, D.C., July 1982), p. 63.

is more than 100 times the federal passenger subsidy received either by commercial airlines, private autos, or intercity buses.¹³

AMTRAK should terminate service immediately on all routes for which variable costs are substantially higher than revenues. This probably would allow the Boston-New York-Washington, the Albany-Montreal and possibly the Chicago-Peoria lines to continue until private operators are found for them. AMTRAK also should sell many of its assets, such as rights-of-way, office space and equipment, and railroad cars.

THE FEDERAL AVIATION AGENCY

Federal spending for air transportation is earmarked for improvement, operations, and maintenance of the national airspace system, and for airport grants, aeronautical research and technology. It also covers the operation of National and Dulles Airports in Washington, D.C.

The FAA suffers from the inherent problems of bureaucracy. Robert Poole, an expert on the air traffic control system, notes that the:

lack of competition removes strong incentives for economic efficiency. Obtaining revenue via taxation precludes the direct feedback from users inherent in buyer-seller relationships in the marketplace. Civil service regulations significantly restrict the efficient use of personnel. And political control makes long-range planning difficult.¹⁴

The evidence supports Poole's hypothesis. The FAA's computers are obsolete. Millions of dollars are needlessly invested each year in airport development, as a result of the FAA's poor application of user fees and grants. Many government studies, moreover, fault FAA management. In 1976, for instance, the General Accounting Office cited serious FAA planning and management problems, such as a lack of cost-effectiveness analysis, for the department's poor record.¹⁵ The Professional Air Traffic Controllers Organization (PATCO) strike served to confirm the agency's serious personnel situation.

User Fees

FAA user fees consist primarily of fuel and ticket taxes and landing fees. Neither reflects accurately the relevant service

¹³ John Semmens, "End of the Line for Amtrak," Heritage Foundation Backgrounder No. 226, November 9, 1982, p. 1.

¹⁴ Robert W. Poole, "Air Traffic Control: The Private Sector Option" (Heritage Foundation Backgrounder No. 216, October 5, 1982, p. 2.

¹⁵ Issues and Management Problems in Developing an Improved Air Traffic Control System (U.S. General Accounting Office, December 16, 1976).

costs. Landing fees, for instance, are calculated on the basis of aircraft weight and do not vary by time of day. Yet access to a controlled airway or landing slot at a busy time is a very valuable service. At a premium of zero, demand tends to exceed supply during highly desirable hours at popular airports. Moreover, smaller planes and large jets differ little in the costs they impose on the control system and its other users. Yet, general aviation pays only a fraction of its 30 percent share of total traffic control system capital and operating costs. In fact, while commercial airliners cover about 95 percent of their allocated costs, general aviation covers less than 20 percent--thus encouraging excessive use of facilities by small aircraft.

If fees were adjusted to market levels, congestion would be reduced in the entire system. This would lead to cost savings in two ways. The Congressional Budget Office has estimated that proper user fees would reduce the load on the air traffic control system sufficiently to save 10 percent in annual capital expenditures. Further, market-oriented fees would distribute users away from peak hours and peak airports thus reducing demand for expansion at these facilities.

Privatization

Robert Poole has noted that many of America's air traffic control (ATC) problems would vanish were the present system to be replaced by a non-profit structure owned by the airlines, with individual control centers contracted out to profit-making ATC operating companies. This would provide uniform nationwide operating procedures, combined with the benefits of healthy competition in the provision of services and a rational pricing structure.¹⁶

There are already private air traffic control companies in the U.S. Since 1968, Barton ATC has been building and operating control towers at low volume airports. And after the 1981 controllers' strike, a group of non-striking FAA controllers set up a firm named ATC Services Inc. The firm won a contract to reopen the tower at Owensboro-Davis County airport in Kentucky. One of the most competitive of these newcomers is Midwest ATC Services of Olathe, Kansas. Midwest's price for operating the Farmington, New Mexico, tower is \$99,00, compared to \$287,000 under the FAA system.¹⁷

Overseas, air traffic control is provided by private sector organizations in many instances. In Switzerland, for example, the system is operated by Radio Suisse, a private nonprofit corporation. In Saudi Arabia, the government contracts out the task to private firms on the basis of renewable five-year contracts.¹⁸

¹⁶ Poole, op. cit.

¹⁷ John Doherty, "Towering Entrepreneurs," Reason, May 1983.

¹⁸ Poole, op. cit.

CONCLUSION

Concentrating transportation policy making in Washington is the cause rather than the solution for the sorry state of the nation's infrastructure and mass transit systems. The federal government has proved to be a poor manager. It has encouraged deterioration of billions of dollars of the highways that it helped construct, thanks to perverse incentives within federal programs. It has also distorted the allocation of capital and services with inefficient user taxes, impeded progress in mass transit and air traffic control through subsidies and nationalization, and it has redistributed millions of dollars from taxpayers to middle class beneficiaries.

Restructuring DOT and its policies will gain little. Central planning simply cannot achieve compatibility between incentives and market demands. The long term maintenance and development of America's transportation facilities needs a decentralized market response to demographic and technological change. This is possible only if Congress gives back to the private market and state governments the responsibility for providing these vital services.

John Palffy
Policy Analyst

