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Using Market Processes to Reform Government Transportation Programs, Report No. 2: Improving Transit with Competitive Contracting

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America's transit systems confront serious financial challenges that will force them to raise fares and reduce service unless they can get better control of their costs. Carrying less than 5 percent of commuters and less than 2 percent of all urban travel and concentrated primarily in large urban areas, these faltering systems will be seeking ever-higher subsidies at a time when hard-pressed state and local governments are laying off teachers and police and the U.S. Congress is contemplating significant cuts in all transportation programs.

If public transportation is to remain viable, it must completely rethink the way it operates. Here are a few suggestions.

Public Transit in the Red. Typical is the Washington, D.C., area's Metro system, which incurred operating expenses of just over \$2 billion against operating revenues of \$727 million, leading to a loss of nearly \$1.3 billion in 2010, thereby necessitating a subsidy of a similar amount from taxpayers to stay in business. Metro's escalating losses are due to costs that are growing twice as fast as revenues.¹ New York's Metropolitan Transit Authority lost more than \$4 billion in 2009, New Jersey Transit lost nearly \$2 billion, and Chicago's Regional Transit Authority lost more than \$1 billion. Passenger fares for Portland's oft-touted light-rail system cover barely one-third of operating costs.

Getting Costs Under Control. For decades, transit's principal problem has been insufficient cost control rather than insufficient revenues. Over the

past 25 years, transit's operating costs have risen approximately \$15 billion (on a passenger mile basis). If transit agencies had been able to keep costs within inflation—as most businesses do—transit would have been able to provide 40 percent more service in 2009.

With government unable to provide more subsidies, a much better solution is for transit systems to use *competitive contracting* to reduce costs and improve the quality of service. Widely used in corporate America, the Department of Defense, and many transit systems here and abroad, competitive contracting defines the process whereby a business or a government entity solicits bids from qualified private-sector service providers to perform a specific service under contract for a defined fee.

For example, Washington's Metro could put various services out for bid, such as cleaning trains and stations, repair and maintenance of trains, the operation of an entire line, or even the whole system, as has occurred in some places. Indeed, all of the suburban transit systems in the Washington, D.C., area use competitive contracting, although most transit ridership in the region takes place on Metro.

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Importantly, the existing workforce and managers would be encouraged to bid on the contract in competition with private companies, encouraging them to use their skills and experience to seek efficiencies that were discouraged when they were protected from competition and acted as monopolists. As numerous studies of the extensive experience compiled by the Defense Department have revealed, savings over previous costs average 25–35 percent, and in many cases, the existing workforce wins the contract by restructuring its operation.

Recent Competitive Contracting Successes in Transit. In recent years, several U.S. transit systems have successfully implemented competitive contracting programs to operate a portion—or all—of their systems. Notable examples include:

- **Commuter rail.** In 2010, the Virginia Railway Express dropped Amtrak as its operator and awarded a five-year operating contract to the French firm Keolis to provide better service at lower costs. The commuter rail operations of the Massachusetts Bay Transportation Authority dropped Amtrak in 2002 and contracted with Veolia, another French firm, to operate its system. Veolia still holds the contract and is in negotiation for a third extension. The Maryland Area Rail Commuter operates three commuter rail lines connecting its suburbs with Washington, D.C., and Baltimore. Two of the lines have been operated by private providers (most recently CSX) since 1974, and negotiations are underway with Keolis to replace CSX.
- **London.** London's bus system, the largest such public system in the world (including the big double-decker buses used there by American tourists) is virtually all competitively contracted. Savings of more than 40 percent have permitted a substantial expansion of service.
- **Stockholm and Copenhagen.** Stockholm has competitively contracted all of its bus, subway, and commuter rail operations. All of Copenhagen's bus system has also been competitively

contracted. There have been substantial savings in both of these national capitals.

- **Australia.** Adelaide and Perth have also competitively contracted all of their bus service with substantial savings.
- **Long Island, New York.** In June 2011, after 40 years of operation by New York's Metropolitan Transportation Authority, officials in Long Island's Nassau County awarded the operating contract to Veolia. Veolia says it can run the system at three-quarters the current annual cost of \$141 million.²
- **New Orleans.** In July 2009, the New Orleans Regional Transit Authority approved a "delegated management" contract with Veolia. Under this contract, Veolia is responsible for performing all activities of the transit authority below the board level. Veolia is responsible for all aspects of the system, including operations, safety, maintenance, customer care, routes and schedules, capital planning, budgeting, employee salaries and benefits, human resources, marketing, ridership growth, grant administration, and all other typical transit functions.
- **Denver.** More than 45 percent of Denver's bus service is competitively contracted under a state law that was intended to reduce costs. The latest Federal Transit Administration (FTA) data indicate that the competitively contracted service is at least 50 percent less costly per hour than the service provided directly by the public agency.
- **San Diego.** More than 45 percent of San Diego's bus service is competitively contracted. The program has expanded over the past 30 years, and the competition has been instrumental in slowing the increase in public costs. The latest FTA data indicate that competitively contracted service is nearly 40 percent less costly per hour than the service provided by the public agency.

Next Steps. While some communities have used competitive contracting to reduce transit costs,

1. Washington Metropolitan Area Transit Authority, *Comprehensive Annual Financial Report for the Fiscal Year Ending June 30, 2010*, Table 2, p. 14, at http://www.wmata.com/about_metro/docs/CAFR_FY10.pdf (July 6, 2011).

2. Associated Press, "Private Firm Picked to Run LI Buses," *Wall Street Journal Online*, June 11, 2011, at <http://online.wsj.com/article/APe05e2ba5558946d2a3b5be1da7f41fb7.html> (July 7, 2011).

many others have not, and union opposition to cost-effective solutions is the key obstacle. To overcome this opposition, Congress should consider linking the ongoing availability of existing federal transit subsidies to the implementation of competitive contracting programs.

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