Competitive Contracting and the Strategic Prospects of Transit

Wendell Cox

I became interested in the concept of involving the private sector in public transportation four years before the Urban Mass Transportation Administration (UMTA) published its policy. At that time people viewed my ideas with incredulity because they seemed so farfetched. Time has borne me out, however, and over the years I have accumulated a lot of experience in this area and have contributed to the development of the philosophical basis underlying the concept of privatization in the transit industry.

Today's Strategic Situation

Let us first consider the strategic situation of transit at the moment: where we are going, what the choices are that face us, and how those factors relate to competitive contracting, the element of privatization that is especially relevant to transit today. The past being prologue to the present, we need some review of where we have been in public transit to gauge where we are going. The fact is that transit in this nation is faced with a very serious cost crisis—not a funding crisis, a cost crisis.

Since 1970, real costs of transit operation—that is, cost per mile—have risen by 52 percent. After adjustment for inflation, then, it costs more than three dollars today to buy what we bought in 1970 for two dollars. Out of the $10 billion that we as a nation are paying for public transit this year, nearly $4 billion represents cost increases in excess of inflation. In 1983, 65 percent of the operating subsidies were committed to cost increases above the inflation rate that have occurred since 1970. Only about 35 percent of the money that we have committed to operating subsidies in transit, then, has gone to lower fares or increased services—only 35 percent has resulted in public benefit.

Therefore, when people ask what we will do with the extra
money if costs decline, as a former local transit official, I can assure them that our present transit needs are more than enough to absorb the hypothetical "extra" funds. There will never be enough funds. One of our real problems is that we in transit have lost a great opportunity as a result of our failure to extract value for the subsidies already given to public transit.

The inflation in public transit costs has been so severe that it has even surpassed the increase in medical care costs. Since 1970 public transit costs have increased 37 percent more than medical care costs in this country. In my view, that means a cost crisis, not a funding crisis.

While we are perhaps justified in criticizing the industry for its performance, I do not believe that the industry could have done much to make it any better. What is important now is to look toward the future.

A regression analysis of the years 1970 through 1983 of the annual cost increases of transit suggests elements in a grim scenario for the year 2000: with no changes in present operations real costs in transit will increase by at least another 37 percent, and to continue financing today's level of service and today's real fare levels, we will need $18 billion of new revenue between now and then. I see every reason to trust this prediction.

How might we finance such a thing? One way would be to increase fares and cut services. What degree of fare increases and service cuts would it require to finance expected transit performance over the next fourteen years?

After permitting inflationary fare increases, we would still need an additional 160 percent real increase in fares, if we assume that half of the increase has to be financed by fares. We can further anticipate that we will need to see transit service decline at least 15 percent to pay for the other half of this unfunded deficit.

Another way of achieving it is to provide an increase in public funding support of about 50 percent. Analysts do not anticipate new public funding for transit, however. As I travel through the country, I see few areas eager to pass new transit taxes to pay for yesterday's service levels. As a result, I see a very serious crisis in our future; if we fail to begin dealing with it now, we may very well find ourselves with very seriously constrained urban mobility. The year 2000 may make 1986 look favorable by comparison.

Some transit officials suggest that it is unfair to compare the rise in transit costs to the inflation rate, because somehow transit is a bit different. The American Public Transit Association (APTA) has proposed an index to gauge the increases in transit costs.

I see three good reasons for rejecting this view and the circular
APTA index, however. First, the incomes of the riders are not even keeping up with inflation. Therefore, we must control the rise in transit costs to eliminate the gap between fare increases and transit cost increases, or mobility will decline for these people.

Second, the incomes of the taxpayers who pay most of the costs of operating the systems are also rising, at best, with the consumer price index. They will not be willing to subsidize public transport at levels so far above the inflation rate. These, then, are two political reasons.

But a third, more practical reason is that costs in transit can be kept within the inflation rate, as the private bus industry has proved beyond the shadow of a doubt. From 1970 to 1983, per-mile costs in the private bus industry increased at a rate 3 percent below the inflation rate. At the same time that transit costs were going up a real 60 percent, then, private costs were going down a real 3 percent, in effect creating a 39 percent relative decline in private transit costs during those same years.

Why is it that transit costs are out of control? As I see it, the present structure guarantees that costs will spin out of control. I am convinced that transit management has not failed—I am convinced that transit management could not conceivably have succeeded in the present environment. Not even Lee Iacocca himself could have made a substantial difference.

Transit’s structure is fatally flawed. For years on the Transportation Commission and in my experience since that time, I have heard excuse after excuse about why we cannot control these costs. In the middle 1970s, for example, when we hoped to control transit costs by improved performance measures, we bought new computers; we did not improve transit performance. Then we planned to improve transit performance by using part-time labor—since then analysts have shown convincingly that part-time labor had no real overall impact upon transit costs. Yes, indeed, it lowers the cost of peak-hour service, at the same time that costs of other services rose at a more than compensating rate.

Finally, a story from Los Angeles illustrates the situation well. Three years ago, we were conducting a state-mandated performance audit of the Southern California Rapid Transit District (RTD). The consultants reported that the RTD had a very serious absenteeism problem costing the system about $20 million per year. We called in the top RTD management, who assured us that although they had had a problem, they had solved it by putting in some management systems. It is not surprising to me that the latest performance audit now under way has uncovered virtually the same deficiency—indeed
nothing has improved. It is not that the RTD management failed to take absenteeism seriously: the problem is that transit has no competitive incentives; there is nothing to induce the right kind of cost performance.

The same forces operate at the policy level: the incentives are all wrong. The problem in transit is that it is a local service monopoly with no incentive to control costs. Frankly, short of injecting competition into the system, we have virtually no hope of controlling these costs.

As a result, I predict a very difficult future for transit without some substantial changes. We must recognize that tinkering with the present organization will not accomplish what is needed.

**Competitive Financing**

Let us consider the alternative of competitive contracting. Some think of competitive contracting as franchised contracting or contracting with existing operators—not so. A competitive contracting arrangement is one in which all potential operators, including the public operator, offer their bids as equals.

What does competitive contracting do? Simply stated, government buys services from the private sector. As the Citizens League of Minneapolis–St. Paul put it, "The essential function of government is deciding. Government may later itself do what it has decided should be done, but equally it may not. Its basic intention is to ensure that what it has decided should be done is in fact done." Accordingly, a multitude of municipal and county governments around the country have begun to contract or have even already contracted a number of services competitively, including the school bus service (27 percent) nationwide and services like garbage collection. The U.S. Postal Service moves its mail on the ground between major cities 100 percent by competitive contracting. And there are many other examples.

As applied to transit, under a competitive contract arrangement the authority or municipality in charge would continue to set the fares, establish routes, and decide which, if any, routes should be contracted out. Indeed, as is being done in San Diego County, California, and in Seattle and elsewhere, the public agency can specify how the buses are painted so that the system looks like an integrated service.

What would be the impact on labor? This is, obviously, a concern. And if we use the driver attrition rate (about 5 to 7 percent) to bring in contracting, we can largely eliminate the anticipated deficit that I have suggested with respect to the year 2000.
If we use the driver attrition rate of 5 percent and assume cost savings of about 30 percent in the larger and medium systems, we effectively obtain cost control in public transit between now and the year 2000. We can guarantee today’s transit employees their jobs but require that in exchange for that security we must have the authority to contract within that attrition rate, so that sufficient cost savings can be achieved to preserve service for the public.

Of course, a private sector is already in place; we do not have to create the entrepreneurial system. There are now some 18 companies nationally that are interested in contracts around the country. The private bus industry is all over the country. There are some 90,000 school buses owned by private operators, not to mention the very large complement of taxi operators. In fact, there are more than four times the number of privately owned buses in this country than are necessary to meet a daily peak requirement in the transit industry. Beyond that, an American Bus Association survey showed that about 90 percent of those operators are interested in buying new equipment if they can obtain contracts for public transit service.

What are the results, then, of competitive contracting in public transit? In Carson, California, for example, the winning private contractor submitted a bid 60 percent lower than the regional transit agencies’ operating costs alone.

Snohomish County, Washington, will be saving 38 percent directly as a result of using private contracting for its express system into the city of Seattle.

Cost savings, therefore, are the first reason why competitive contracting makes sense. The second reason is that private costs are lower than public costs, as the experience of the private bus industry illustrates; moreover, a number of studies have shown that private costs rise more slowly than public costs and remain generally within the inflation rate.

A third reason for looking at competitive contracting is that it moderates the increase in public costs. In San Diego and Norfolk public costs of the transit agency have already climbed at a slower rate, and two studies have documented the fact that private costs have created a competition that has begun to affect public costs. This parallels experiences in other disciplines in competitive contracting of public services.

Finally, a very interesting but often ignored consequence is that the public sector can buy better service from the private sector, oftentimes, than it can provide itself with its own resources. Houston, for instance, penalizes its contractors for failing to get air-conditioned buses on the street, for failing to perform on time, and the like. A
good many public transit agencies could not achieve such performance standards—indeed some don't even try to keep the air conditioning working.

An interesting incident occurred in Johnson County, Kansas, a few months ago when private operators and the potential local public agency in Kansas City were bidding for service. That local public agency, as a condition of its bidding for service, sought exemption from twenty-eight conditions of the contract. The winning private contractor sought no such exemptions.

What, then, are the factors that will determine success in competitive contracting, that will result in better service to the riders and better service to the taxpayers funding such systems?

It is critical to have public leadership that is objective, not public leadership that simply favors the private sector. The private sector is not seeking unfair advantages; this is not an affirmative action program. This is a program to bring to the public transit industry the most cost-effective service for both the riders and the taxpayers.