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# Briefly Noted

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## Derailing High-Speed Rail

BY IKE BRANNON AND ELIZABETH LOWELL

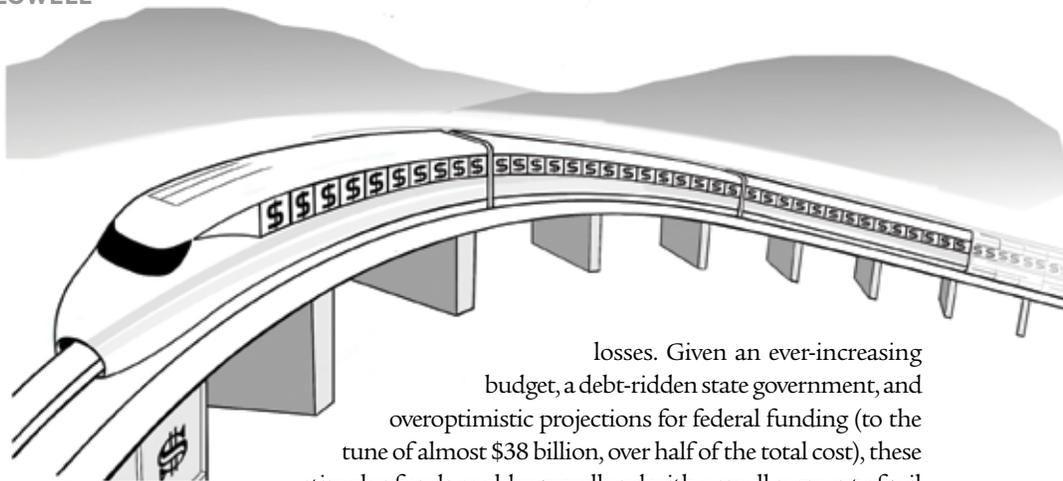
President Obama spent a chunk of his 2008 presidential campaign and a good portion of his political capital promoting the virtues of high-speed rail as a panacea for what ails the U.S. economy. His quest to have these trains running sea to shining sea petered out with the Republican takeover of the U.S. House of Representatives in 2011. However, it's important to learn the policy lessons of Obama's flirtation with high-speed rail. The debacle of California's high-speed rail project, most recently brought to light by current House investigations, has highlighted the broader economic concerns with mandating a government-directed national high-speed rail network in a deficit-ridden country the width of a continent.

**Stimulus?** | Implementing high-speed rail across the country was initially sold as part of the 2009 economic stimulus package. Assuming that temporary spending measures *could* stimulate the economy, the idea that the money required to implement high-speed rail could flow into the economy quickly has proven itself ludicrous. Of the \$3.9 billion awarded from the 2009 stimulus bill to the California high-speed rail project, only \$142 million has actually been spent as of late 2011, and that money primarily went to environmental studies and preliminary design. All federal stimulus funds are required to be spent by 2017, hardly a quick response to the 2009 recession.

The mandate to spend funds quickly has had a number of perverse side effects. The requirement meant that the Federal Railroad Administration pushed California to commit stimulus funds to an initial construction segment in the sparsely populated Central Valley, the area where the project makes the least economic sense but where it would also be the least contested. Purported to create 100,000 jobs by the California High-Speed Rail Authority, the project's environmental review estimates that, at peak construction, the project will create only 3,000–4,000 direct, indirect, and induced jobs, but that there could be an offsetting number of job

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losses. Given an ever-increasing budget, a debt-ridden state government, and overoptimistic projections for federal funding (to the tune of almost \$38 billion, over half of the total cost), these stimulus funds could very well end with a small segment of rail in the middle of nowhere, with meager job gains at best.

The California high-speed rail project has also been a managerial disaster. Elizabeth Alexis, cofounder of Californians Advocating Responsible Rail Design, testified to the House Transportation and Infrastructure Committee last December that while most of the distance that is to be covered by California's high-speed rail is through the flat Central Valley, the estimated per-mile cost is about five times the cost per mile of the latest high-speed train project in France. She further highlighted organizational concerns, depicting a project staff of seven overseeing over 100 different consulting firms to plan each section of the rail system. Initially projected to cost \$43 billion in 2008, the most recent business plan for the project predicts costs of \$68 billion and extends the completion date by a decade. Furthermore, while it has attracted no interest from the private sector so far, the plan assumes that private capital will ultimately cover approximately 20 percent of the cost and that fares will remain unrealistically low, at \$81 on average for a ticket between San Francisco and Los Angeles.

Historically, U.S. urban passenger rail projects have gone 40 percent over their original cost estimates, while U.S. passenger rail planners typically overestimate ridership by an average of 100 percent of the actual ridership. Cliff Winston, an economist at the Brookings Institution, observes that "the cost of building rail systems is notorious for exceeding expectations, while ridership levels tend to be much lower than anticipated," and notes that no U.S. railway except the BART in San Francisco comes close to breaking even.

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A study by the World Bank confirms that high-speed projects rarely meet the full ridership forecasts, nor do they cover even a portion of their capital costs with operating revenue. The study recommends that governments contemplating high-speed rail projects account for a continuing budget to support debt costs. Governments do not have a good track record at economically choosing or managing railway projects, and any promise of economic stimulus quickly drowns in the certainty of continuing debt payments long into the future.

**Ill-conceived investment** | While supporting infrastructure projects can contribute to long-run economic efficiency by reducing congestion and saving commute times, high-speed rail is not an effective transportation system in most regions of the United States. High-speed rail lines of 100–500 miles in length can make sense in populated areas where they link high-density city centers with sufficient potential ridership. The Tokyo-Osaka rail line in Japan passes through one of the most densely populated areas in the world and attracts over 150 million riders annually. The London-Paris line covers about 300 miles and connects densely populated capital cities, while the Shanghai-Beijing line connects cities with populations of 20 million each. In contrast, the California high-speed rail line is 800 miles long, passing mostly through sparsely populated areas. Furthermore, the initial construction segment would connect Fresno (with a population of 500,000) to Bakersfield (with a population of 350,000)—not the sort of major metropolitan areas necessary to make high-speed rail practical.

Being confident of ridership is the key to making high-speed rail an attractive business proposition. The California line has attracted no private capital and ridership projections remain dubious. While Wisconsin and Florida rejected federal funds to construct high-speed rail lines in their respective states because they were unwilling to subject state taxpayers to subsidizing future operating costs for lines that would not be self-sustaining, California chugs on.

A primary impediment to constructing self-sustaining high-speed rail systems is the fundamental diseconomies of scale associated with the systems: namely, that doubling train speed more than doubles cost. Amtrak operates most of the nation's passenger rail, but shares a large portion of its track with freight. Doubling average train speed requires Amtrak to build entirely new tracks, divorced completely from roads, which entails negotiating rights of way, purchasing land, and creating more tunnels, bridges, and fences. Maintenance requires costly new continuous sensors and monitoring systems. In part for these reasons, California has adopted a “blended approach” in which its proposed high-speed trains would travel at the speed of normal trains and share existing rail near San Francisco and Los Angeles.

According to Iñaki Barrón de Angoitia, director of high-speed rail at the International Union of Railways in Paris, high-speed rail projects are not profitable. Only the Paris-Lyon and Tokyo-Osaka lines break even, and only thanks to taxpayer subsidies that covered a portion of their initial capital costs. In fact, according

to a 2008 study by Amtrak, French taxpayers spend about \$10 billion per year subsidizing their high-speed rail system. Perhaps Americans are also willing to pay significant tax dollars to subsidize high-speed rail on an ongoing basis, but that is not the deal that is being presented to them.

Despite President Obama's call to copy European countries and China in their zeal for high-speed rail networks, enthusiasm in those countries for such projects has waned. According to Zhao Jian, a professor at Beijing Jiaotong University, the Beijing-Tianjin Intercity Railway and the Wuhan-Guangzhou and Zhengzhou-Zi'an high-speed rail lines in China have sustained considerable losses. Chinese cities are separated by long distances, and while high-speed rail has an economic value at small distances where shorter commute times mean time saved during the day, at long distances when travel occurs primarily at night the value of the saved time decreases. Zhao also notes that high-speed rail costs three times more than ordinary rail, deterring lower-income users. In fact, the proliferation of expensive trains in China has placed them out of reach of the masses, pushing poorer travelers back on the roads and crowding the roads with buses.

Japan faces a similar problem. While the Tokyo-Osaka line proved profitable in Japan, all subsequent Japanese lines have lost money. The Japanese National Railways has responded by raising fares, which in turn has pushed more passengers into cars.

Encouraging high-speed passenger rail may also push more freight onto the roads. About one-third of freight travels by rail in the United States, compared to only 4 percent in Japan. The share has also been declining in Europe, where now only one-sixth of freight travels by rail.

**The future** | There is one region of the United States where constructing high-speed rail would make sense: the densely populated Northeast Corridor. Yet high-speed rail has not been seriously pursued there. The Northeast Corridor is the most densely populated area in the United States, and New York City and Washington, D.C. are separated by just over 200 miles, with the large cities of Philadelphia and Baltimore in between. It is also the only region where passenger trains don't have to share track with freight trains. Over 60 percent of the urban road miles of Interstate 95 are heavily congested and the airspace above New York is the most congested in the nation. With rail infrastructure improvements, ridership on the Northeastern Corridor could easily double or triple, experts have predicted.

But rather than focus high-speed rail efforts on the Northeast Corridor, the Obama administration has scattered \$9 billion worth of grants across the country, mostly targeted to modest infrastructure upgrades. The problem with federally directed transportation funding is that optics prevent the funding of efficient projects if they favor only one region of the country. And it wouldn't be politically feasible to concentrate funding in the Northeast, especially when a swing state like Florida could receive money for a high-speed train. Ross Capon, president and chief executive officer of the National Association of Railroad Passengers, expressed the political realities that doom high-speed

rail, even for places where it might possibly make sense in the United States, when he explained to the House Transportation and Infrastructure Committee that “the High Speed Intercity Passenger Rail Program must be national, regardless of how few states are currently ready for very high speed trains.”

Making high-speed rail economically feasible requires a combination of factors: high population density, the right distance between population centers, a populace accustomed (and willing) to put their cars aside to do mass transit, and a reliable funding source for a project with large upfront costs. None of the characteristics fit the California high-speed rail project, whose latest iteration has nevertheless been approved by the California legislature. It’s only a matter of time before economic realities kill high-speed rail there and elsewhere in the country. The only question is how many billions of dollars will be spent before that reality is accepted by the politicians. **R**

## Small Business Regulation: A Case Study and Options for Reform

BY SAM BATKINS AND IKE BRANNON

**T**here is an unavoidable tradeoff regulators face between their desire to make the world safer and cleaner and the costs borne by regulated businesses to produce and sell their goods and services. Although regulators are certainly aware of that tradeoff, it is not clear that the typical regulatory agency—or the Obama administration—is terribly concerned about it.

In an attempt to engender some agency concern, Congress passed the Regulatory Flexibility Act (RFA) in 1980 with the intent of forcing agencies to identify regulatory alternatives if the cost of any proposed regulation could be deemed excessive. However, despite Congress’s intent to reduce the regulatory burden for business, the current administration has added substantially to the overall regulatory burden.

In order to demonstrate the insufficiency of the Regulatory Flexibility Act as currently written, the American Action Forum looked closely at 10 new rules that, once fully implemented, will significantly affect small businesses. We found that despite the intent of the act, small businesses will find their regulatory burden substantially higher in coming years.

These 10 regulations, listed in Table 1, will impose an estimated \$3.5 billion in annual costs and more than 28.7 million paperwork-burden hours—enough red tape to force businesses to hire an

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additional 14,300 employees simply to file the requisite paperwork. Yet none of the regulations triggered any serious discussion of the contingencies called for by the RFA. That demonstrates the need for Congress or the administration to revisit and amend the act.

**Judicial scrutiny** | Courts have helped the cause recently, striking down two of the rules that we examined. Judge David Norton, a district judge in South Carolina, found that the National Labor Relations Board exceeded its statutory authority in its union notification rule, which would have required roughly six million employers to post notices informing employees of their union rights. The NLRB failed to conduct a benefit-cost analysis for the rule but admitted that it would burden small businesses. The NLRB then argued that “the social benefits of employees’ (and employers’) becoming familiar with employees’ [labor] rights far outweigh the minimal costs to employers of posting notices informing employees of those rights.” Judge Norton disagreed.

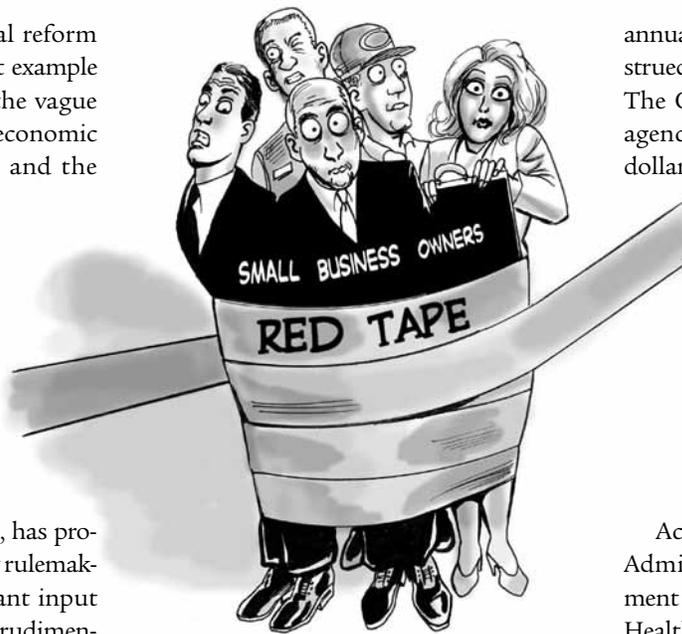
The court defeat of the Education Department’s “gainful employment” rule was perhaps more embarrassing for the Obama administration. The regulation would have forced for-profit educational institutions to meet new federal metrics on debt repayment, imposing a \$338 million revenue loss. (Curiously, the rule exempted public and nonprofit schools.) Judge Rudolph Contreras, an Obama appointee, invalidated the regulation because he found the administration’s debt repayment standard was “not based upon any facts at all” and concluded that the regulation was “not reasoned decisionmaking.”

However, the courts are unlikely to invalidate the other regulations on this list, so policymakers must ensure that such rules are not adopted in the first place. This necessitates constructing a regulatory oversight framework that protects small businesses from an administration that is intent on pursuing an ideological agenda regardless of the costs it may impose on the economy or on business. The inability of the Office of Management and Budget’s Office of Information and Regulatory Affairs (OIRA)—normally thought of as the gatekeeper for bad regulations—to do this demonstrates the need for some sort of reform that protects small business by providing transparency and a modicum of due process in the regulatory sausage factory that is the federal bureaucracy.

**Reforming a broken system** | The RFA requires all agencies to certify whether a rule will have a “significant economic impact on a substantial number of small entities [SISNOSE]” like small businesses. Agencies must also provide a factual basis for this determination. However, notions of what constitutes a SISNOSE varies widely between agencies, and only one agency (the Department of Health and Human Services) has a quantified standard.

The failure of regulatory agencies to identify what constitutes a “significant economic impact” is an unfortunate legacy of the RFA. Without any discernible metrics to determine significant impacts on small entities, many agencies simply forgo a formal analysis and fail to consult with regulated entities.

The Dodd-Frank financial reform act's Regulation E is a perfect example of the problems caused by the vague definition of a "significant economic impact." Regulated entities and the Small Business Administration both requested a small business advocacy review panel to explore alternatives to the regulation, but the newly formed Consumer Financial Protection Bureau rejected their pleas. As a result, the regulation, which imposes more than 7.6 million paperwork burden hours, has proceeded through the regulatory rulemaking process without significant input from small entities or even a rudimentary benefit-cost analysis.



The RFA's failings have not gone unnoticed in watchdog circles. Both the Government Accountability Office and the Congressional Research Service have studied the failure of the RFA to quantify SISNOSE. In a 2007 report, the GAO found that "there was confusion among the agencies regarding the meaning of key terms such as [SISNOSE]." In addition, agencies reported that RFA "requirements are less comprehensive than their discretionary reviews because they are limited to regulations with [SISNOSE]." It is clear that agency confusion about key terms do not benefit small businesses or increase regulatory accountability.

The CRS noted that the lack of a quantifiable standard for "significant economic impact" allows dozens of agencies to develop their own standards. This disparate treatment allows the Environmental Protection Agency to determine that 1,760

annual paperwork hours cannot be construed as a burden for a small business. The CRS found one case in which an agency concluded that "thousands of dollars per year on thousands of small entities did not represent a significant burden." If individual tax burdens increased by thousands of dollars annually, policymakers would no doubt view the impact as significant, but the RFA's obscure definition ensures that burdens go unnoticed and small business complaints are left unheard.

According to the Small Business Administration's "Guide for Government Agencies," only the Department of Health and Human Services has a quantifiable scale for determining SISNOSE: it

considers a rule significant if it reduces revenues or raises costs of any affected entities by more than 3 to 5 percent within five years. This would seem like a good starting point for other agencies to establish their own definitions, but the Small Business Administration has reservations about going in that direction, arguing that a one-size-fits-all standard is inappropriate.

Former OIRA administrator Cass Sunstein has placed a renewed emphasis on quantified regulatory analysis. The administration is happy to quantify benefits to justify certain regulatory actions. After four executive orders and countless memos to agencies, there is little stopping the White House from implementing a quantified SISNOSE standard for executive agencies.

A new executive order, or even an informal memo that asks for a consistent application of the RFA, would be an improvement over the current system. With that, OIRA could implement a flexible quantified standard and make it easier for regulated entities to call a small business review panel.

The current zero sum game that often leaves businesses on the losing side of regulatory fights simply can't continue. Courts won't always be the saving grace to redress regulatory hubris.

As evidenced by just a handful of these rules and their \$3.5 billion in aggregate compliance costs, the current RFA procedure is not doing small businesses any favors. A quantified but flexible standard for the RFA could at least inject some procedural transparency and be a first step toward providing regulatory relief. **R**

**TABLE 1**  
**Top Regulations Affecting Small Businesses**

Regulation	Cost	Paperwork burden (hours)
Energy Conservation Standards: Air Conditioners	\$876 million	N/A
Affordable Care Act Menu Labels	\$757.1 million	622,000
Transportation's Hours of Service Rule	\$470 million	N/A
Affordable Care Act Vending Machine Labels	\$421.3 million	842,000
NLRB's Union Notification Standards	\$386 million	12,000,000
Education's Gainful Employment Rule	\$338 million	284,028
EPA's Fracking Regulations	\$230 million	625,000
Dodd-Frank Regulation Z	\$32.2 million	6,467,000
Affordable Care Act Physician Fee Schedule	\$1 million	200,000
Dodd-Frank Regulation E	N/A	7,684,000
<b>Totals:</b>	<b>\$3.5 billion</b>	<b>28.7 million</b>