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The Future of Intercity Passenger Rail Service And Amtrak

Statement of

The Honorable Kenneth M. Mead

Inspector General

U.S. Department of Transportation

Mr. Chairman, Senator Hollings, and Members of the Committee:

Thank you for inviting us here today to discuss the Future of Intercity Passenger Rail Service and Amtrak. In the past, those futures have been intertwined to the point of being one and the same. Going forward, that may no longer be the case. We hope that the policy debate concerning the future of passenger rail does not get bogged down in or defined as "What to do about Amtrak." That has not been a fruitful focus in the past and all parties, the public, the Congress, and the Administration, will be better served by focusing on what we want intercity passenger rail service in this country to be, how we are going to produce and govern it, and how we are going to fund it. With those decisions in hand, the role that Amtrak can play in that future will be more readily apparent.

Over the last year, Amtrak's president and the Department have worked diligently to improve cost control and achieve expense savings at Amtrak and have brought more order to its accounting and financial statements. These efforts need to continue. In addition, the Department has been given more authority to oversee and control Amtrak's adherence to its budget, ensuring that it operates within the Federal funding provided.

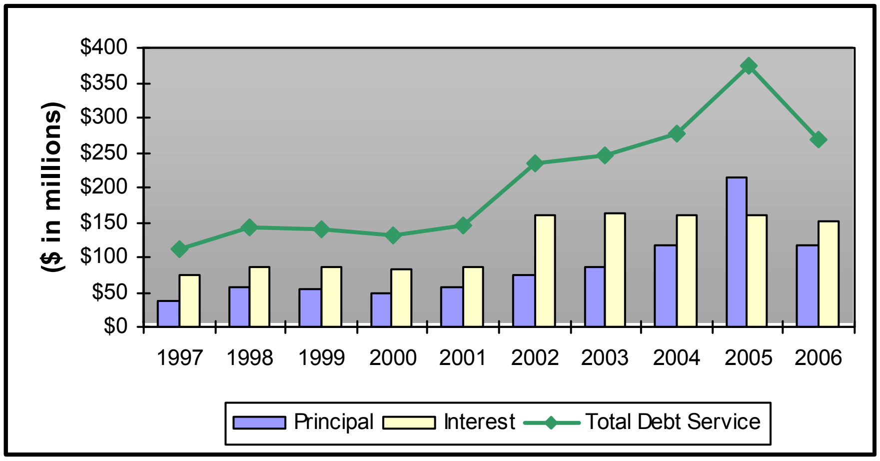
Although these are positive steps, they are not going to solve the fundamental problem: the current Amtrak model is broken and pinching pennies alone won't make this model work. What intercity rail needs to be is, first and foremost, not what it is today. By that we are not singling out any particular aspect of the current system. It is the overall approach to designing, governing, and funding the system and the outcome of that process that is broken and must be addressed in reauthorization. The problems extend beyond funding to questions of who makes the decisions about and who controls the provision of service, including commuter services. The status quo pleases no one; it will require significant increases in funding just to maintain it; and it will not meet the mobility needs of this country in the years ahead.

What is the Status Quo?

Despite multiple efforts over the years to change Amtrak's goals, its structure, and its funding, the result always seems to be a status quo that is the product of inevitable budgetary compromises. These compromises over the years have produced a system that limps along, never in a state of good repair, and perpetually one, two, or three steps from the edge of collapse. These dire straits have been repeated time and again over Amtrak's history. In the end, Amtrak has been tasked to be all things to all people, but insufficiently funded to be fully anything to anyone.

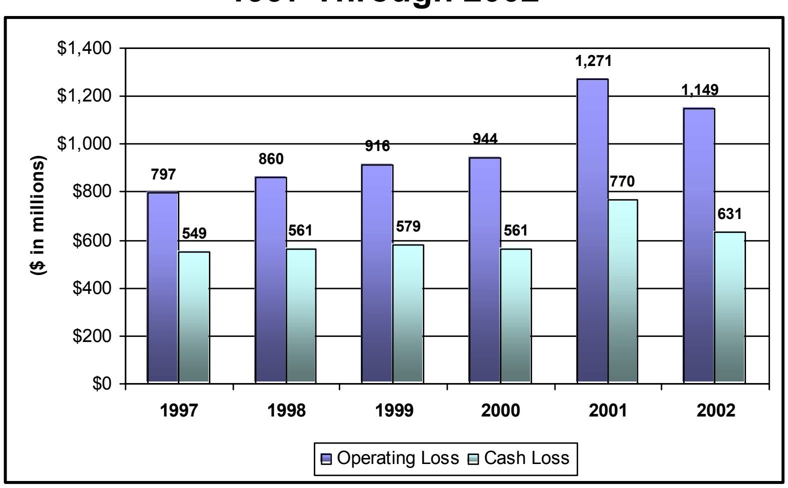
The result today is a system that is awash in debt, nearly $5 billion worth, and which will consume more than $250 million in annual Federal funding merely to service that debt.

Figure 1. Amtrak's Actual and Forecast Cash Principal and Interest Payments, 1997 through 2006



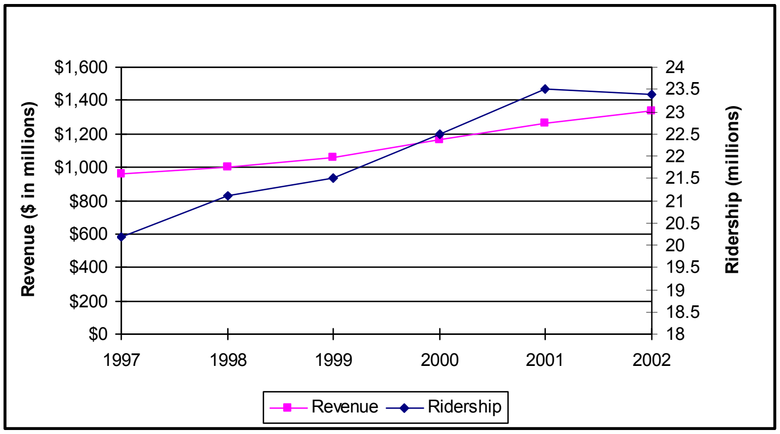
It is a system with a backlog of state–of–good–repair investments that has reached at least $6 billion. Finally, this is a system that, except for a handful of routes, continues to suffer operating losses on all services offered. In fact, the fully allocated losses on some trains (including depreciation and interest) can exceed $500 per passenger. For the company as a whole, cash operating losses have averaged $600 million for the last 6 years and are estimated to range between $700 million and $800 million over the next 5 years.

Figure 2. Growth in Amtrak's Operating and Cash Losses, 1997 Through 2002



But the news is not all bad. Over the last few years, in spite of manufacturing delays and some early operational problems, the Acela Express trainsets have been introduced to general acclaim and have affirmed and improved Amtrak's position as the leading carrier (rail and air) in the Northeast Corridor (NEC). In fact, systemwide ridership and revenue have been on an upward trend over the last 5 years, with record passenger revenue and ridership levels in the last 2 years. Both NEC and Amtrak West ridership increased 24 percent between 1997 and 2002. However, during this same period, Intercity ridership has remained essentially flat.[1]

Figure 3. Systemwide Passenger Revenue and Ridership Trends, 1997 Through 2002



In addition, Amtrak has aggressively pursued other sources of revenue that are complementary to the provision of passenger service. These include mail and express service, operation of commuter services, maintenance services for other railroads, and rental income for use of its infrastructure. These non-passenger revenues have generally been increasing as a percentage of total revenue and were about 41 percent of operating revenue in 2002.

Going forward, if we are to avoid status quo outcomes in which capital funding is continually starved, Amtrak would require, if it remains as currently structured, close to $2 billion per year in operating and capital subsidies for the foreseeable future. Amtrak will likely require about $750 million per year in cash operating subsidies. This consists of about $350 million for the operating self-sufficiency gap that has persisted for the last several years and the approximate annual costs associated with interest expense ($160 million), excess Railroad Retirement Tax Act payments ($160 million) and progressive overhauls ($80 million).[2]

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[1] Intercity trains are all corridor and long-distance trains that operate outside the NEC and the West Coast.
[2] Progressive overhauls are annual overhaul costs that are expensed rather than capitalized.

To this $750 million, add about $750 million that is required for a general capital program needed to maintain the current system just in its current state. Finally, another $500 million could and would likely need to be spent to begin addressing the system's backlog of capital investment, about two-thirds of which is in the NEC.

But the current Amtrak system has never generated the necessary political support to fully fund its operating and capital needs, and it is not clear that it can do so in the future. Change is needed. If not, what we are likely to see is the ugly status quo of too much system for too little capital investment.

So, if the status quo isn't working and is unlikely to be satisfactory over the next few years, what are our options? Where should we go with intercity passenger rail service?

What Do We Want Passenger Rail to Be?

Clearly, one possible approach is to end completely the Federal role in intercity passenger rail services and leave all service decisions and 100 percent of the funding to the states. While this approach may seem appealing from a Federal budgetary standpoint, especially with large deficits looming, it ignores the mobility needs of certain congested regions of the country and the benefits that passenger rail may provide. Although these problems exist on local and regional levels, there is a national economic interest in assisting mobility that is the foundation for the Department's transit, highway, and aviation programs.

Another option is to reduce the demand on Federal funds by eliminating all long-distance trains. Although this might eventually save $300 million or more (after labor protection and other shut-down costs are amortized), it does not come close to solving the $2 billion funding dilemma. Furthermore, in the past, the long-distance trains have been the political glue that has held together support for intercity passenger rail and Amtrak. Elimination of these trains, without a clear plan for improving mobility through a restructured Federal program, would likely lead to a continuation of a status quo, limp-along Amtrak.

A System Based on Restructured Federal/State/Private Roles and Focused on Corridor Services

A better option for the future of intercity passenger rail service lies in improving mobility in short-distance corridors around the country (not just in the NEC), and in restructuring long-distance services to complement these corridor services. It is in short-distance corridors that the Federal Government and the states should focus their investments to increase speeds, increase frequency, and improve the quality of the services offered. For the $2 billion that would need to be spent on a steady-state Amtrak system, significantly better service to a greater number of passengers is possible through a refocused Federal program that gives the states more control and authority.

Partnerships Among States and the Federal Government. For the successful development of higher speed/higher frequency, short-distance corridors, there must be a new relationship established between the Federal Government and the states. An option is a transition to a Federal passenger rail program that is modeled more on the current transit program. This transition would likely require a number of years for institutional arrangements to be developed among the states (such as multi-state compacts) and for funding arrangements to be completed.

This approach would involve Federal capital grants to the states for investment in short-distance corridors where states would have a more defined and consistent role in determining what services are provided and by whom. The states might choose to contract with Amtrak to operate these services or seek bids from alternative operators. States would also decide on the service attributes such as speed, frequency, and quality.

The NEC is the only corridor that involves more than three states (nine states). Thus, it will be a challenge to develop a workable governance, operating, and funding structure. This is likely to be the case whether this structure is a redefined Amtrak, a Federal/State Compact, or some other form of organization. If the resulting organization separates the control of operations from that of infrastructure, we caution that the recent experience in Great Britain underscores the dangers associated with establishing a commercial, for-profit entity to operate the infrastructure. Allowing an infrastructure company to operate "like a business" may mean relinquishing control over how certain expenses are cut or which capital investments are made. An infrastructure company that is focused on its bottom line may make decisions that are in its best interest financially, but they may affect the safety or efficiency of rail service operations.

States would also take the lead in engaging the freight railroads in the funding and operations of these corridors. The majority of these corridor services will operate over the track of privately owned freight railroads and, therefore, any partnerships must include the freight rail owners. Productive relationships and dispute resolution mechanisms need to be forged that assure cooperation in improving the track infrastructure and timely operation of the improved corridors.

With control comes funding responsibilities and the states should be expected to provide capital funds to match in some proportion the Federal grants. Ultimately, these corridors should be self-sufficient from an operating (not necessarily capital) standpoint, either through farebox collections or through state and local subsidy. Operating losses might initially be shared as they are now between the Federal Government and the states. Currently, states provide about $138 million in operating support to Amtrak for corridor trains and provide capital funds on a project-by-project basis.

Secure Federal Funding Sources. The Federal quid pro quo to a stepped-up state funding role in passenger rail services should be the elimination of the "Perils of Pauline" approach to Federal funding. Investments in corridor development can proceed most efficiently where long-term decisions and multi-year investments can be made without the threat of a shut-down in Federal funding. A secure Federal funding source will likely be needed to cement this new Federal-State partnership.

Redesign Long-Distance Trains to Complement Corridor Services and Minimize Operating Losses. The current long-distance services should transition to a role of complementing corridor services. This restructuring can take a number of forms, from the combination of parallel or overlapping services to the elimination of endpoint service on routes. For example, on some long-distance trains today, significantly fewer than half of the passengers travel the entire route from endpoint to endpoint. These trains could be redesigned as feeder services that would connect on a once-a-day or more frequent basis to the endpoints of corridors. By operating in the gaps between corridors, but not overlapping them, these feeder services could continue to provide services to coach passengers currently served by the long-distance trains and do so on more convenient, daytime schedules. This restructuring can be accomplished over a period of years that would minimize transition costs and would allow for the growth of the complementary corridor services.

The alternative of simply shifting the responsibility for subsidizing the operating losses on long-distance routes to the states could encounter problems from states in the middle of the route that choose not to contribute. Restructuring long-distance trains into a feeder service that connects to the higher speed/higher frequency corridor services would solve this problem. Because most of the feeder routes would lie in either one or two states, any decision by the states not to subsidize and, therefore, not to operate the service would reflect the perceived lack of benefits to their citizens.

Freeze and Amortize Amtrak's Long-term Debt. Because Amtrak requires both operating and capital subsidies greater than its debt principal and interest payments, these obligations are, in effect, funded by Federal subsidies. This creates the incongruous situation in which a government that can borrow at 4 percent for 10 years is paying 7 percent or more on Amtrak debt of the same or lesser duration.[3] Because all current and future (if it were permitted) Amtrak debt would likely be paid by the Federal Government, Amtrak's ability to incur long-term debt should be permanently frozen, and all debt that can be economically amortized immediately should be funded in a one-time appropriation. This will minimize the cost to the taxpayers of these outstanding liabilities.

Direct Appropriation to the Railroad Retirement Board of Excess RRTA. To simplify and clarify future funding of passenger rail services, any portion of future retirement tax payments for passenger rail providers that would qualify today as excess Railroad Retirement Tax Act payments should be funded through a direct appropriation to the Railroad Retirement Board. This will establish and maintain a level playing field for all competitors to provide corridor services.

Amtrak's Operating and Financial Performance Since 1997

Today, Amtrak provides intercity passenger rail service over a network of more than 22,000 route miles and serves more than 500 stations in 46 states. It owns about 730 route miles between Boston, Massachusetts, and Washington, D.C., and in the state of Michigan. In other parts of the country, Amtrak operates over track owned by freight railroads. Many of Amtrak's routes are corridor operations that run through a maximum of three states[4] and are generally about 100 to 500 miles in length. Amtrak also operates 17 long-distance trains that traverse multiple states, include sleeper and dining car service, and travel more than 750 miles.

Operating Needs. Since receiving in December 1997[5] its mandate to achieve operating self-sufficiency by December 2002, Amtrak has improved passenger revenues and ridership, up about 39 percent and 16 percent, respectively. However, expense growth has more than kept pace. Consequently, Amtrak's operating and cash losses have increased and Amtrak is farther from operating self-sufficiency now than it was in 1997. Amtrak recorded an operating loss of \$1.15 billion for 2002,[6] \$352 million more than in 1997. Amtrak's cash loss for 2002 was \$631 million, \$82 million more than in 1997. (See Figures 2 and 3.)

To cover the gap between its operating losses and Federal and state funding, thereby creating the appearance of meeting its "glidepath," Amtrak incurred debt and sold assets. For example, in 2000, Amtrak entered into four separate sale and leaseback transactions for which it received \$124 million in cash and \$791 million

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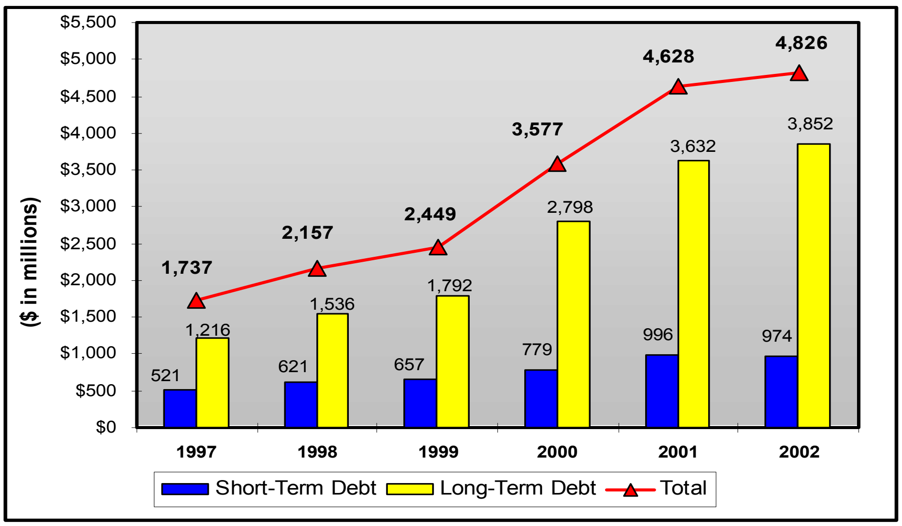
[3] Amtrak pays more for its debt because its default risk is greater than that of the Federal Government.
[4] The Acela Express/Metroliner and Acela Regional are the only routes characterized as corridors that have stops in more than three states. Acela Express/Metroliner stops in nine states and the Regional stops in six states.
[5] Amtrak Reform and Accountability Act (ARAA).
[6] Based on Amtrak's Audited FY 2002 Consolidated Financial Statements.

in interest-earning set-aside deposits to be applied against the lease obligations. In June 2001, Amtrak mortgaged a substantial portion of improvements located at Penn Station in New York for cash proceeds of nearly $300 million. In 2002, Amtrak received a $100 million loan for general capital purposes from the Department of Transportation as well as $205 million through supplemental appropriations.

As a consequence of Amtrak's external financing of its cash losses as well as new train equipment and related maintenance facilities, total debt and capital lease obligations increased by $3.1 billion, from $1.7 billion in 1997 to $4.8 billion in 2002, representing an overall increase of 178 percent (see Figure 4).

Figure 4. Growth in Amtrak's Short- and Long-Term Debt and Capital Lease Obligations, 1997 Through 2002



Note: Amtrak's Consolidated Balance Sheet also lists Other Liabilities and Deferred Credits such as casualty and environmental reserves, as well as post-retirement employee benefits obligations, totaling an additional $1.2 billion.

Amtrak's annual debt service during this same period grew from $111 million to $233 million. For FY 2004, Amtrak projects its debt service payments will increase to $278 million. It is also important to note that Amtrak's heavy debt load was acquired during a period when Amtrak received Federal operating and capital grants, as well as other Federal assistance totaling $5.27 billion, or more than $1 billion annually (see Table 1).

Table 1. Sources and Amounts of Federal Support to Amtrak 1998 Through 2002 ($ in millions)

Sources	1998	1999	2000	2001	2002	Total
Taxpayer Relief Act	$1,092	$1,092	$0	$0	$0	$2,184
NECIP[1]	250	0	0	0	0	250
General Capital	0	609	571	521	521	2,222
Operating	202	0	0	0	0	202
Other[2]	0	0	0	0	410	410
Total Funding	**$1,544**	**$1,701**	**$571**	**$521**	**$931**	**$5,268**

[1] Northeast Corridor Investment Program.

[2] This category is made up of $100 million for Life Safety projects and $5 million for security costs included in the Department of Defense appropriation, which was signed into law on January 10, 2002; $205 million provided through Public Law No. 107-206, Making Supplemental Appropriations for the Fiscal Year Ending September 30, 2002; and $100 million for the Railroad Rehabilitation and Infrastructure Financing Program (RRIF) loan provided by DOT, June 28, 2002.

Capital Needs. The $1 billion in annual Federal assistance during the past 5 years was insufficient for Amtrak to maintain its system in a steady state. While improvements were made to the north end (New Haven to Boston) for the introduction of high-speed rail service, and new high-speed rail equipment and facilities were acquired, the general state of Amtrak's infrastructure and rolling stock continued to deteriorate.

The continual deferral of investments needed to renew and replace infrastructure and equipment has created a huge backlog of capital projects that threatens current and future service reliability. In the Northeast Corridor, Amtrak provides service over bridges, through tunnels, and on electric traction systems that are well past their useful lives and consequently more expensive to maintain. The high-speed, high-density, and mix of diverse users (Amtrak, commuter, and freight) in this operating environment magnifies all types of problems, especially those related to infrastructure. Amtrak expects that these problems will continue to grow and eventually require reductions in service and speed if not soon addressed.

Based on our assessments of Amtrak's financial performance and requirements over the past 5 years, Amtrak needs approximately $750 million annually for a basic capital program that will maintain its assets in the current state. However, this amount will not address the deferred capital investment needs. If the decision were made to keep the current structure, we estimate Amtrak would need to spend about $500 million annually for an extended period (perhaps as long as 15 years) on infrastructure and rolling stock to eliminate the backlog of capital investment.

The length of time and, therefore, total investment are somewhat indefinite because key decisions need to be made on whether major assets will be refurbished, overhauled, or completely replaced. For example, do we completely rebuild or replace bridges and tunnels, such as the Baltimore tunnels, or do we merely refurbish components and perform moderate upgrades to extend their useful lives for several more years? Should we repair selected components of the catenary system from Washington to New York or should it be replaced in its entirety?

The total magnitude of capital needs will be in the billions of dollars depending on the future vision regarding desired capacity, reliability, and trip times in the corridor. One thing we know for sure is that without major reinvestment, Amtrak or an alternative operator will experience significant negative effects on its operations, although neither we nor they can predict with any certainty the timing or severity of the breakdown.

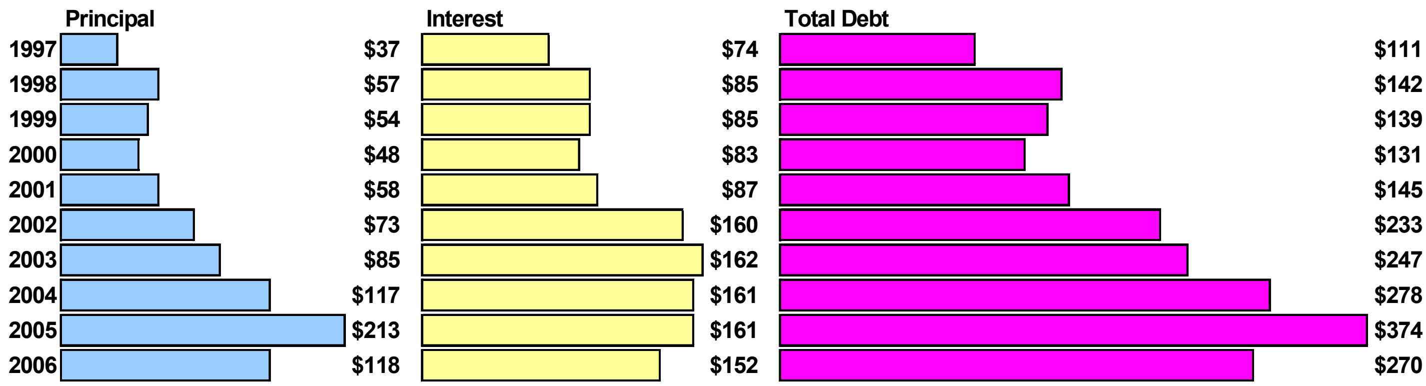
Amtrak's Financial Performance in 2003. We are encouraged by improvements David Gunn has made since his appointment as President and Chief Executive Officer of Amtrak, such as management streamlining and workforce reductions in the hundreds, and a willingness to provide more comprehensive operating and financial information to DOT and Congress. However, positive operating and financial results for 2003 remain elusive in a difficult travel environment due to the war in Iraq and heightened terrorism alerts at home. Systemwide ridership decreased a little less than one percent during the first 6 months of 2003 from 11.5 million to 11.4 million. Some of the additional contributing factors were a slower than expected economic recovery and poor on-time performance.

Amtrak's overall operating revenues decreased $117 million while expenses remained flat for the first 6 months of 2003 compared to the first 6 months of 2002. This resulted in an operating loss of $666 million, an increase of $120 million over the 2002 operating loss of $546 million for the same time period. Amtrak's cash loss for the first 6 months of 2003 was nearly $374 million, an increase of about $64 million over its cash loss of $309 million in 2002. We note that Amtrak's 2003 approved budget included a forecast cash loss of about $355 million, which means it is off budget by about $19 million. Thus, despite the fact that events outside Amtrak's control, such as the war in Iraq and the slump in business travel, negatively affected passenger revenues, strong oversight by the Department and Amtrak's close control of operating expenditures this year has enabled it to stay relatively close to its budget.

Amtrak's current authorization has expired and many questions remain about the future of intercity passenger rail in the United States. The question of what kind of system is best for the country is inextricably intertwined with the question of how much the country is willing to pay for such a system.

Mr. Chairman, this concludes our statement. I would be pleased to answer any questions.

Figure 1. Amtrak's Actual and Forecast Cash Principal and Interest Payments, 1997 through 2006



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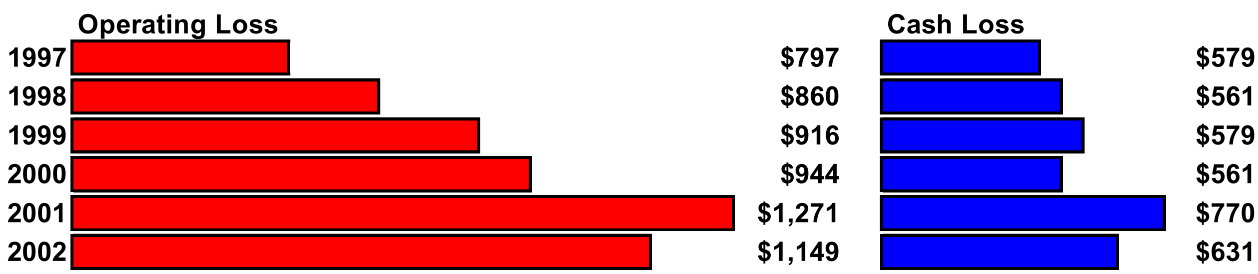

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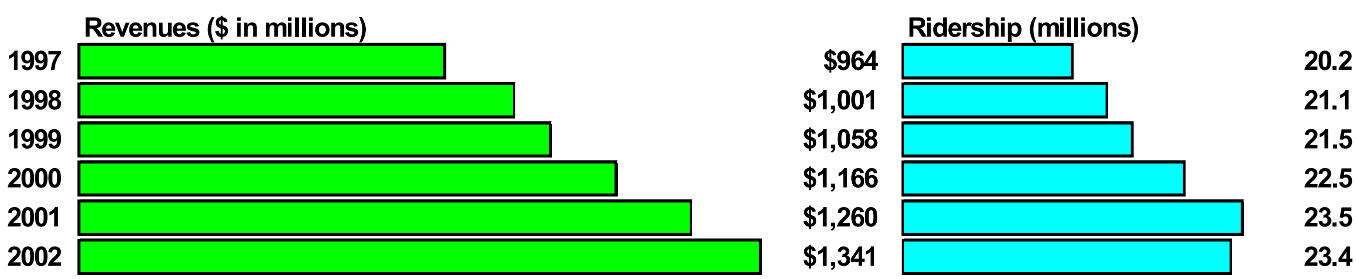

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