

GAO

Testimony

Before the Subcommittee on Transportation,
Committee on Appropriations,
House of Representatives

For Release on Delivery
Expected at
10:00 a.m. EST
Thursday
March 17, 1994

AMTRAK

**Financial Condition Has
Deteriorated and Future Costs
Make Recovery Difficult**

Statement of Kenneth M. Mead,
Director, Transportation Issues,
Resources, Community, and Economic Development Division



059384/15690

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify at today's appropriation hearing on Amtrak. As you know, Amtrak was created in 1970 and charged with revitalizing intercity rail passenger service. The inherited rail equipment was in a state of disrepair, and most travelers had abandoned rail for air and auto travel. Today, Amtrak is at a crossroads, and we believe that important decisions need to be made that will affect Amtrak in both the short and the long run. The House Committee on Appropriations and four other Committees asked us to comprehensively review Amtrak's operations. As agreed with the Subcommittee, my statement today will present our preliminary findings on Amtrak's financial condition and on the challenges facing the corporation. We will issue our final report later this year. Our overall points follow:

- Amtrak has always relied heavily on federal subsidies but has been under increasing pressure since about 1982 to reduce its dependence on its federal operating subsidy. Since that time, Amtrak has attempted to have its revenues cover a greater portion of its operating expenses. Amtrak has reported that its revenues for 1993 covered about 80 percent of its operations. Yet this performance measurement does not include all operating expenses. Also, although Amtrak has improved its revenue-to-expense ratio and received an average of \$360.3 million annually in federal operating subsidies since 1989, its total needs for federal subsidies (operating and capital) have steadily increased.
- Several indicators show that Amtrak's current financial condition has deteriorated in recent years. Since 1990, Amtrak's federal subsidy has not covered the gap between operating expenses and revenues. During this period, total cumulative operating deficits exceeded federal operating subsidies by \$102 million in current year dollars (\$110 million in 1994 dollars). This occurred because Amtrak's revenues have been less than projected while its expenses have been higher than projected. To cover this deficit, Amtrak has steadily reduced its working capital over the last 7 years by \$217 million in current year dollars. In 1994 dollars, this amounts to a \$252 million reduction. If this financial deterioration continues, Amtrak may not be able to pay all its debts and provide quality nationwide service.
- Amtrak has dealt with its passenger revenue shortfall by increasing other revenues and cutting back planned expenses. For example, on the revenue side, Amtrak has increased its commuter rail business and transport of U.S. mail. On the expense side, Amtrak has since 1991 lowered planned expenses by \$120 million in current year dollars by

reducing staff, deferring maintenance, and cutting service on some routes. However, these self-help initiatives will not solve Amtrak's financial problems because they involve relatively few dollars. In fact, certain actions, such as deferring maintenance, may aggravate an already serious problem.

- Over the next few years, Amtrak will face difficult and costly challenges that must be met if Amtrak is to operate a viable intercity network. These challenges include the need to (1) modernize its locomotive and passenger car fleet, acquire high-speed trains, and continue rail improvements in the Northeast Corridor; (2) maintain its aging passenger cars; (3) modernize the Beech Grove, Indiana, overhaul facility, which services all equipment used outside the Northeast Corridor; (4) negotiate, by 1996, new operating agreements with the freight railroads, which own about 97 percent of the track over which Amtrak operates; and (5) negotiate labor issues and work rules for Amtrak's union employees.

The President's proposed fiscal year 1995 budget for Amtrak of \$987.6 million, which represents a nine percent increase over 1994, should help Amtrak address its growing operating deficit. However, it will not resolve the short- and long-term cost challenges facing Amtrak. If Amtrak is to continue to provide nationwide intercity passenger service at its present level, to offer quality and reliable service, and to improve its overall financial condition, it can do so only if it receives substantial operating and capital funding. Only a handful of routes in Amtrak's system may ever generate sufficient revenues to cover all operating costs. Even in European countries where competitive conditions are more conducive to rail travel, intercity passenger service has required substantial public support. Amtrak and the federal and state governments must decide whether Amtrak is to continue its present course, expand into new areas such as high speed rail service, or truncate the network to a few relatively well-traveled corridors where losses can be minimized. Under any scenario, federal and state support will need to be commensurate with the assigned task.

GOVERNMENT SUPPORT FOR PASSENGER RAIL

In 1970, the Congress created Amtrak to revitalize intercity passenger rail transportation. Before that time, individual railroads provided both passenger and freight rail service. Both passengers and the rail business suffered under this arrangement. Passengers lacked smooth connections between railroads, and the rail industry was losing money operating unprofitable passenger service. The combined losses of the railroads operating during 1970 totaled more than \$1.7 billion in today's dollars. In comparison, Amtrak in 1993 received federal support totaling \$891.5 million. In 1971, most railroads willingly gave up their passenger

service and provided the personnel, equipment, and infrastructure that became Amtrak.

Recognizing the need for national passenger rail service, the Congress has provided significant funding for Amtrak since 1971. As figure I.2 in appendix I shows, Amtrak receives federal funds through an operating and capital grant, the Northeast Corridor Improvement Project (NECIP) grant, and a mandatory payment by the Federal Railroad Administration to the Railroad Retirement trust fund and for the Railroad Unemployment Repayment Tax. In fiscal year 1994, Amtrak will receive over \$900 million in federal subsidies. The chart in appendix II shows the federal funds that Amtrak has received over the last 8 years.

Operating and capital subsidies enable Amtrak to fund its operating deficits and make capital purchases and improvements. The NECIP grant is for improvements--such as bridge replacements, signal upgrades, station and yard repairs, and track electrification--to the railway between Washington, D.C., and Boston. Finally, the Federal Railroad Administration (FRA) makes mandatory payments on Amtrak's behalf to the Railroad Retirement Trust Account. These payments are for amounts that Amtrak is required by law to contribute for benefits to retirees and for railroad unemployment insurance.

AMTRAK'S FINANCIAL CONDITION HAS DETERIORATED

Amtrak's financial condition has deteriorated in recent years. Since 1990, Amtrak's federal subsidy has not covered the gap between operating expenses and revenues because actual revenues have been lower than projected while expenses have been higher than projected. At the same time, the federal government has faced a very difficult budget environment.

Operating revenues have been lower than projected since 1991 because ridership and yield have not been as high as expected. This situation has been the result of, among other things: (1) the poor economy and recent recession; (2) increased price and service competition by airlines; and (3) old, unattractive, and poorly maintained facilities and equipment. In total, Amtrak overestimated its passenger revenues by \$440 million for 1991 through 1993 in current year dollars (which is \$468 million in 1994 dollars). For the first 4 months of fiscal year 1994, passenger revenues are 6 percent below the actual revenues for the same period in fiscal year 1993 and total revenues are 3 percent below the projections for fiscal year 1994. According to Amtrak officials, the corporations optimistic revenue projections resulted from underestimating the length and severity of the recent recession. Also, Amtrak was under increasing pressure to show progress in achieving its goal of having a greater portion of its revenues cover operating expenses. As a result, Amtrak requested

substantially less funding from the Congress than it needed to cover these expenses. This funding shortfall, in turn, has contributed to Amtrak's current financial condition. At the same time, the former Administration proposed much less funding for Amtrak. In addition, Amtrak has incurred additional expenses, including start-up costs for new services, such as extending the Sunset Limited route, and for wage increases. As the chart in appendix III shows, Amtrak's system route miles have remained relatively stable since 1980.

Although Amtrak undertook activities to bring its expenses in line with projected revenues, its total operating deficits have exceeded federal operating subsidies by \$102 million since 1990 in current year dollars (\$110 million in 1994 dollars). In fiscal year 1993, Amtrak requested \$58 million and received \$45 million in additional grants. As illustrated in the chart in appendix IV, Amtrak has drawn down its working capital from \$113 million at the end of fiscal year 1987 to a negative \$105 million by the end of fiscal year 1993 in order to cover its operating deficit.¹ In 1994 dollars, this represents a draw down of \$252 million.

If Amtrak's financial condition continues to deteriorate, it will be more difficult for Amtrak to cover future deficits and disasters--such as the effects of last year's flood in the Midwest--without additional federal funds. Not only would Amtrak have to cut routes, reduce the frequency of service, and cut amenities, but it would also be unable to restore services that were eliminated to deal with the recent operating deficits.

Each year, Amtrak computes a "revenue-to-expense" ratio as a measure of its annual performance. Amtrak uses this ratio to show its progress in generating operating revenues to cover a larger portion of its expenses. Amtrak's revenue-to-expense ratio for fiscal year 1993 indicated that revenues were covering about 80 percent of operating expenses. However, the calculation of this ratio excluded certain expenses; including, (1) depreciation; (2) the FRA mandatory retirement payment; (3) various taxes paid to the federal or state governments; (4) user fees assessed by FRA; (5) other miscellaneous expenses relating to accident claims; and (6) losses incurred in providing 403(b) service to the states² and

¹Working capital is the difference between current assets and current liabilities. As such, it is an indicator of a firm's ability to pay current liabilities from current assets.

²Under section 403(b) of the Rail Passenger Service Act, Amtrak may initiate new service that is financially supported, in part, by a non-Amtrak source. Known as "403(b) service," this service may be requested by a state, group of states, any regional or local agency, or any other person with adequate financial backing.

disbursements for labor protection, which according to an Amtrak official are excluded at the direction of the Congress. If these expenses for fiscal year 1993, which totaled about \$370 million, had been included in the calculation, the ratio would only have been 66 percent, or 14 percentage points lower than reported by Amtrak. We believe all relevant costs, both capital and operating, should be included in any performance measurement. Because it excludes certain relevant expenses, Amtrak's ratio does not reflect the ability of the corporation's revenues to cover all costs of operating Amtrak. Yet despite the overall deterioration of its working capital position, as the chart in appendix V shows, Amtrak has covered an increasing percentage of its operating expenses with operating revenues--but not as much as 80 percent.

Performance ratios seldom tell the full story. For example, emphasis on improving the ratio could actually cause Amtrak to take actions that would adversely affect operations. As discussed in appendix VI, Amtrak could actually increase its total operating losses but still show improvements in its revenue-to-expense ratio. The true test of whether new business is beneficial to Amtrak is whether the additional business contributes more to revenues than expenses over both the short and long term.

RECENT ACTIVITIES BY AMTRAK HAVE HELPED IN THE SHORT TERM

Amtrak's efforts to generate additional revenue and reduce operating costs have helped in the short term but may not be the answer to long-term financial problems. From fiscal year 1991 through fiscal year 1994, Amtrak cut or plans to reduce operating expenses by \$120 million in current year dollars by decreasing staff, marketing activities, and maintenance. In addition, Amtrak improved its cash position by reducing inventories, requiring advance payments from contractors, and stretching out payments on bills.

Amtrak has also increased revenues from commuter services, mail and baggage express, real estate development efforts, and other activities. Revenues from these activities have grown from \$378 million in 1990 to \$460 million in 1993 in current year dollars and now account for 33 percent of Amtrak's revenues. The chart in appendix VII compares the growth in passenger and other revenues since fiscal year 1987.

Revenues from commuter rail operations represent Amtrak's second largest source of operating revenue. In fiscal year 1993, they accounted for \$245 million, or 17.5 percent of Amtrak's total operating revenues. Amtrak provides commuter services under contracts with regional transit agencies operating in Boston, Massachusetts; Metropolitan Washington, D.C.; Los Angeles, California; and New Haven, Connecticut areas. During years when the number of Amtrak's intercity passengers remained steady or

declined, the number of commuter passengers carried by Amtrak has steadily increased. By 1993, Amtrak was carrying 29.3 million commuters compared with 22.1 million intercity riders. Three of Amtrak's seven commuter contracts, which accounted for about 84 percent of the fiscal year 1993 total commuter passengers, will be up for renewal in 1995. Whether Amtrak is able to retain the present level of revenue from its commuter rail operations will depend upon its ability to retain its current contracts, and any increases in revenue will depend upon its ability to win additional contracts.

AMTRAK FACES INCREASED CHALLENGES OVER THE NEXT FEW YEARS

In the next few years, Amtrak will face difficult and costly challenges that must be met if it is to operate a viable intercity network. These challenges include the need to (1) modernize its locomotive and passenger car fleet, acquire high-speed trains, and continue rail improvements in the Northeast Corridor; (2) maintain its passenger cars and locomotives; (3) modernize the Beech Grove, Indiana, overhaul facility, which services all equipment used outside the Northeast Corridor; (4) renegotiate by 1996 its operating agreements with the freight railroads; and (5) renegotiate labor compensation and work rules with the various unions representing Amtrak's employees.

Future Federal Capital Subsidies Have Already Been Committed to Purchase New Equipment

Amtrak already commits a sizable portion of its federal capital subsidy to pay for previous purchases, mandated equipment modifications, and capital overhauls. As a result, Amtrak may have much less funding available for new purchases and capital improvements than the Congress may realize. From fiscal year 1991 to 1993, Amtrak made commitments to purchase 245 Superliner and Viewliner cars and 72 new locomotives. This equipment will give Amtrak added revenue-generating capacity and will be much easier to repair and overhaul than the so-called "Heritage" equipment that Amtrak inherited from its predecessors. Unlike the Heritage cars, for which replacement parts have to be specially manufactured, the new cars have standardized parts and modular components to allow for easier replacement. As these cars begin to replace Heritage cars--as Amtrak intends, although it has made no firm decisions yet about retiring the Heritage fleet--the need for manufacturing parts to supply the Heritage overhauls should diminish. Amtrak would then have more resources available to overhaul more cars. Amtrak has agreed to pay \$924 million for both the cars and locomotives. Between 1994 and 2017, projected interest expense will amount to at least another \$765 million.

Amtrak Is Developing High-Speed Rail

Amtrak believes that it can increase its ridership by offering a high-quality travel alternative that is time- and price-competitive with other modes. To that end, Amtrak has been upgrading the Northeast Corridor, which traverses the nation's most densely populated and heavily traveled region. Since 1976, federal appropriations for this project have totaled \$3.1 billion (in current year dollars), allowing Metroliner trains to reach 125-mph service between Washington and New York and continue with improvements to permit 150-mph speeds and 3-hour trip times between New York and Boston around the turn of the century. Amtrak has estimated that it will need about \$800 million to complete the project.

However, FRA believes that, in addition to the remaining \$800 million (current year dollars) estimated by Amtrak, additional funds will be needed to sustain high-speed operations between New York and Boston. FRA's draft Master Plan for High-Speed Rail Service in the Boston-New York Corridor states that, in the coming decades, about \$1 billion (in constant 1993 dollars) will be required to rehabilitate or replace aging bridges, tunnels, or other key facilities. The master plan also states that an additional \$582 million (in constant 1993 dollars) will be needed to expand capacity to accommodate anticipated growth in commuter and freight traffic around the turn of the century.³

Amtrak agrees that after completing its formal Northeast Corridor Improvement Project towards the end of the century, continued investment will be required--on the order of \$100 million to \$200 million per year--to rehabilitate and maintain the infrastructure and allow for growth. However, Amtrak also believes that some of the projected costs should be paid by the commuter and freight operators or by the right-of-way owners.⁴

The immediate appropriations decision concerns Amtrak's \$270 million request for its Northeast Corridor Improvement Project. Included is \$54.3 million for high-speed trains, which represents the second installment towards the estimated \$500 million total cost to purchase 26 high-speed trains for the corridor. In fiscal year 1994, Amtrak allocated \$51.6 million of its appropriation

³Additionally, the administration's fiscal year 1995 budget request includes a \$90 million grant to Amtrak to redevelop intercity and commuter station facilities in New York. FRA plans to include this project in its final report.

⁴Several segments of the right-of-way between New York and Boston, totaling about 95 miles, are owned by entities other than Amtrak.

toward high-speed trains. These trains comprise a critical component of Amtrak's overall plans for the Northeast Corridor and capitalize on the significant federal investment in the corridor since 1976. The federal government needs to determine whether Amtrak should finance all or part of the remaining cost. To the extent that Amtrak finances the procurement, interest expenses will increase the required federal operating subsidy.

The traveling public has responded well to high-speed rail between Washington and New York. Since the late 1970s, annual ridership between these cities has increased from 600,000 to 1.6 million, capturing about 45 percent of the air/rail market. Amtrak expects similar results on the New York-to-Boston segment by the year 2010--a considerable improvement over Amtrak's current 15 percent air/rail market share on this segment. Taken as a whole, the Northeast Corridor recovers more of Amtrak's expenses than any other routes in Amtrak's system.

However, the vision for the New York to Boston segment hinges on two major considerations. First, capacity and coordination need to be assured, since Amtrak's plans call for more than doubling the number of trains per day along many segments of the route, while commuter and freight operations that share the route also expect growth. FRA makes the point in its draft that if three-hour service is to be reliably maintained, increased capacity will be required to avoid adverse impact on future freight and commuter operations. FRA also states that increased coordination of plans and schedules among Amtrak, the freight and commuter operators, and the right-of-way owners will be important to avoid delays.

Second, projected ridership must materialize. The planned increase in ridership between New York and Boston assume that, annually, 1.4 million airline passengers will switch to high-speed rail, between New York and Boston and between intermediate city pairs. A key variable underlying this assumption is the extent to which airlines will reduce their fares to retain passengers. Amtrak could respond with lower fares, but fare reductions could adversely affect Amtrak's recovery of costs on the New York-to-Boston route.

To encourage the development of high-speed rail outside the Northeast Corridor, the Congress is considering a proposed High-Speed Rail Development Act. This act would authorize about \$1 billion to develop high-speed rail corridors, which the administration envisioned allocating over 5 years. However, to date, the administration's appropriation requests have been modest--\$140 million for fiscal year 1994 and \$37.1 million for fiscal year 1995. FRA views the \$1 billion as seed money to be used by the states, rather than by FRA or Amtrak, to develop high-speed rail systems. States would be required, at a minimum, to match federal funds.

In November 1993, we recommended that because of the high costs involved, any funds appropriated for high-speed rail be strategically focused on a small number of meritorious projects.⁵ If these funds were spread over the dozen or so proposed high-speed rail projects, the \$1 billion would quickly be exhausted before any project reached completion. Even if the \$1 billion were spread over as few as five projects, each would receive just \$200 million--a small portion of the \$2 billion cost of upgrading a single 200-mile corridor to provide 125-mph service. To complete such a project, \$1.8 billion in combined state and private sector funding would be required. State planning officials and private investment analysts we spoke with were generally not optimistic that the states and the private sector could provide such funding.

Amtrak's Aging Fleet Will Be More
Costly to Operate and Maintain

Amtrak inherited much of its fleet of passenger and baggage cars from other railroads when it was formed. As illustrated in the chart in appendix VIII, these "Heritage" cars are, on average 34 years old (passenger cars alone are, on average, 40 years old) and comprise about 43 percent of Amtrak's 1,959-car fleet. The cars and their components are not standardized, and Amtrak must often manufacture parts to repair them--a very expensive requirement. The remaining passenger cars are newer but, except for the 20 Superliners that have been delivered since July 1993, all have been in service long enough and are old enough to require heavy overhauls. Since it began operating its own equipment in 1976, Amtrak has maintained its cars through a program of periodic, preventive maintenance. In 1979, Amtrak established a policy of overhauling its cars every 3 to 4 years. These overhauls (during which a car is stripped bare and is completely rebuilt) can cost about \$300,000 for each car. In comparison, a new car costs about \$2 million.

To cope with its deteriorating financial condition, Amtrak cut back on maintenance, and starting in 1989 it began falling behind in overhauling its passenger cars. The overhaul backlog grew to nearly 40 percent of the fleet by the end of fiscal year 1993. Additionally, Amtrak must (1) replace refrigeration units in 168 food service cars to ensure food safety, (2) install by October 1996 retention-type toilets on 544 passenger cars, at a cost of \$27,500 to \$95,000 per car, and (3) fumigate cars more frequently for rodent control. Funds for these projects had to come from the Amtrak capital subsidy or from already stretched operating funds.

Amtrak's Chief Mechanical Officer recognized that the relatively few overhauled passenger cars were in pristine condition

⁵High-Speed Ground Transportation: Issues Affecting Development in the United States (GAO/RCED-94-29, Nov. 17, 1993).

while a significant number, which were awaiting overhaul, were looking shabby and breaking down with increasing regularity. To address this situation, Amtrak adopted a new "progressive" maintenance and overhaul program in 1993. Under the new program, no cars will be upgraded to the condition resulting from the previous heavy overhaul procedures, but many more are expected to be maintained in better condition than cars now awaiting overhaul. With progressive maintenance/overhaul, cars will be inspected and will receive a limited overhaul each year. Basic safety components, such as brakes and wheel sets, will be serviced annually, while other components and furnishings will be replaced only as necessary. Every third year the overhaul will be more comprehensive.

The progressive program, however, places a much greater burden on Amtrak's overhaul facilities, exceeding the plants' current capabilities. For example, Amtrak's largest overhaul facility at Beech Grove, Indiana, overhauled 117 cars and 50 diesel locomotives in fiscal year 1993. Beech Grove will now be responsible for overhauling 527 cars annually.⁶ However, Beech Grove officials stated that the facility has the capacity to handle only 241 cars per year (or one per work day)--less than half the annual requirement. A similar situation exists at the Bear, Delaware, facility. Bear will be responsible for overhauling 629 cars each year. In fiscal year 1994, however, Bear received funding to overhaul only about 200 cars.⁷ Amtrak officials said that Bear must increase its workforce by about 90 people and operate with 3 shifts 7 days per week to overhaul the 629 cars. Bear will need to increase its production from three cars per week to three cars per day to meet its goal. It is clear that greater resources and efficiencies will be needed for the new program to succeed.

⁶Beech Grove will be responsible for 1-year overhauls on 350 Horizon, Superliner, and Viewliner cars and for traditional overhauls on 177 Heritage cars. The 788 Heritage cars, which are operated outside Amtrak's Northeast corridor, are Beech Grove's responsibility but will not be maintained under the progressive program. They will continue to receive traditional overhauls until a decision is made to either retire the cars or place them in the progressive program.

⁷Under the progressive program, Bear will perform 1-year and 3-year overhauls on all active Amfleet I and II cars---a total annual responsibility of 629. In fiscal year 1994, however, Bear received funding for heavy overhauls on 43 cars and for 1-year or 3-year overhauls on 148 cars.

Beech Grove Maintenance Facility Needs Renovation and Modernization

Poor conditions at Beech Grove have reduced the plant's ability to overhaul and maintain cars. Much of the on-site rail track was installed in the early 1900s and has deteriorated, resulting in frequent derailments. In fiscal year 1993, 37 derailments resulted in an estimated 76 lost production shifts--- about 4 percent of the total available production time. Engineers estimated in 1992 that rehabilitating Beech Grove's track would cost \$2.6 million. The conditions at other parts of the facility also interrupt or delay work; for example, leaking roofs force shutdowns in the paint shop whenever it rains. The nearly 100-year-old facility also was not designed for production line overhauls of both locomotives and cars. According to Amtrak's Chief Mechanical Officer, changes to Beech Grove's infrastructure would improve the facility's efficiency and productivity.

In 1990, Beech Grove engineers prepared a 5-phase modernization plan to increase efficiency as well as upgrade plant conditions. Improvements costing about \$12 million have already been initiated. The remaining improvements, estimated to cost about \$35 million, have not been funded.

Our observations at the Bear facility gave us another perspective on the gains in efficiency and productivity that Amtrak might achieve by renovating the Beech Grove facility. Bear is a relatively new plant, built in 1979 for constructing specialized freight cars. Amtrak purchased the facility in 1985. It can currently handle 17 cars on 3 production tracks at a time and operates more efficiently as a production line than other Amtrak facilities. Cars are brought in at one end of the plant and move through a logical series of steps until they are released, completely overhauled, at the other end. Tasks have been defined at each step along the track, and the parts necessary for those tasks are generally stored nearby. This concept is not currently possible at Beech Grove, where cars must be moved from building to building during the overhaul process, traveling around or through the intervening locomotive shop. The cars traverse the entire Beech Grove complex, moving over old and deteriorated tracks. Derailments occur frequently--interrupting the workflow and contributing to Beech Grove's inefficiency. The Bear facility shows that this lack of efficiency can be overcome and the rewards in productivity can be significant.

Contracts With Freight Railroads and Labor Unions Expire Over the Next 2 Years

Amtrak depends heavily on freight railroads in operating its passenger trains. Freight railroads own about 97 percent of the track over which Amtrak operates, and they provide essential

services, such as dispatching trains, making emergency repairs to Amtrak trains, and maintaining stations. Some freight railroads also provide police and communications services and pay injury claims for Amtrak. When Amtrak was formed, it entered into 25-year agreements with freight railroads to compensate them for the incremental cost of providing Amtrak with these services. Under these agreements, Amtrak has paid freight railroads an average of about \$80 million annually for the last five years. These agreements expire on April 30, 1996.

Freight railroad officials told us that compensation and liability are two key issues that will be negotiated when Amtrak's operating agreements with freight railroads expire. Freight railroads do not believe that they are adequately compensated for their services and may ask to change the methodology used to calculate costs. They may also seek higher payments from Amtrak for using their facilities and equipment--payments that more closely reflect commercial rates and consider the opportunity cost of property being used by Amtrak. For example, Amtrak pays as little as \$1 per year to lease some stations owned by one freight railroad. Freight railroads are also concerned about their liability in settling high-cost claims from passenger train accidents occurring on their tracks and may seek to reduce their risk exposure and/or increase the amount of risk assumed by Amtrak.

In addition, Amtrak will be negotiating new agreements with 14 labor unions between 1994 and 1996. About 90 percent of Amtrak's approximately 25,520 employees are union members. Since labor costs represent a large portion--about 54 percent--of Amtrak's operating costs, these negotiations could lead to substantial changes in future operating costs.

AMTRAK'S MANAGEMENT OF ITS FEDERAL SUBSIDIES IS REASONABLE

One of our review objectives was to determine whether Amtrak properly accounts for the federal funding it receives and has a reasonable system for allocating costs. We found that Amtrak accounts for its federal subsidies in accordance with federal requirements and agreements and with generally accepted accounting principles. While Amtrak accounts for operating and capital funds separately, it manages cash as a fungible resource by combining cash from all sources, such as ticket revenues and federal grants. Amtrak uses its cash to pay the corporation's next immediate expenditure. By pooling its cash resources, Amtrak exercises prudent "cash management," minimizing interest expense and maximizing interest earnings, and thereby ultimately reducing its need for federal operating subsidies. Also, Amtrak's cash management is consistent with private industry practices.

Amtrak has two principal automated cost accounting systems: the Route Profitability System and the Train Information System.

The route profitability system collects and allocates expenses to Amtrak's individual routes in two categories, avoidable and fixed. Avoidable costs, for things such as fuel and labor, vary with the operations of a route, and would cease if the route were eliminated. Fixed costs, for such things as maintenance facilities and administrative expenses would remain relatively constant if a single route were discontinued. The system's fully allocated cost reports provide a reasonable basis for showing a route's profitability and for measuring one route's performance against that of other Amtrak routes. These reports show that no Amtrak route is profitable and that the amount of loss can vary considerably. Amtrak's train information system, on the other hand, takes the cost data from the route profitability system and produces avoidable cost reports on routes. These reports approximate the incremental cost gained or lost from adding or eliminating a route or service and are one source of information used in decisions about adding or deleting routes or service. This system also provides a relative measure of a route's performance within a specific grouping, such as the Northeast Corridor, long-distance routes, and short-distance routes.

Arthur Andersen & Company annually audits Amtrak's consolidated financial statements. These audits are conducted in accordance with private sector and government auditing standards. On the basis of its audits, Andersen issues opinions on the fairness of Amtrak's financial statements and on the adequacy of Amtrak's internal controls and compliance with key laws and regulations. Andersen issued an unqualified opinion on Amtrak's 1993 financial statements, indicating that the financial statements were fairly presented in all material respects. In addition, Andersen's assessment of Amtrak's internal controls revealed no material weaknesses. It also concluded that Amtrak was in compliance with laws and regulations that could have a material impact on Amtrak's financial statements. This opinion on Amtrak's financial statements does not extend to the calculation of performance measures, such as the revenue-to-expense ratio discussed earlier.

CONCLUSIONS

The President's proposed fiscal year 1995 budget for Amtrak of \$987.6 million, which represents a nine percent increase over 1994, should help Amtrak address its growing operating deficit. However, it will not resolve the short- and long-term costly challenges facing Amtrak. If Amtrak is to continue nationwide intercity passenger service at its present level, to offer quality and reliable service, and to improve its overall financial condition, it can only do so with substantial operating and capital funding. Only a handful of routes in Amtrak's system may ever generate sufficient revenues to cover all operating costs. Even in European countries where competitive conditions are more conducive to rail travel, intercity passenger service has required substantial public

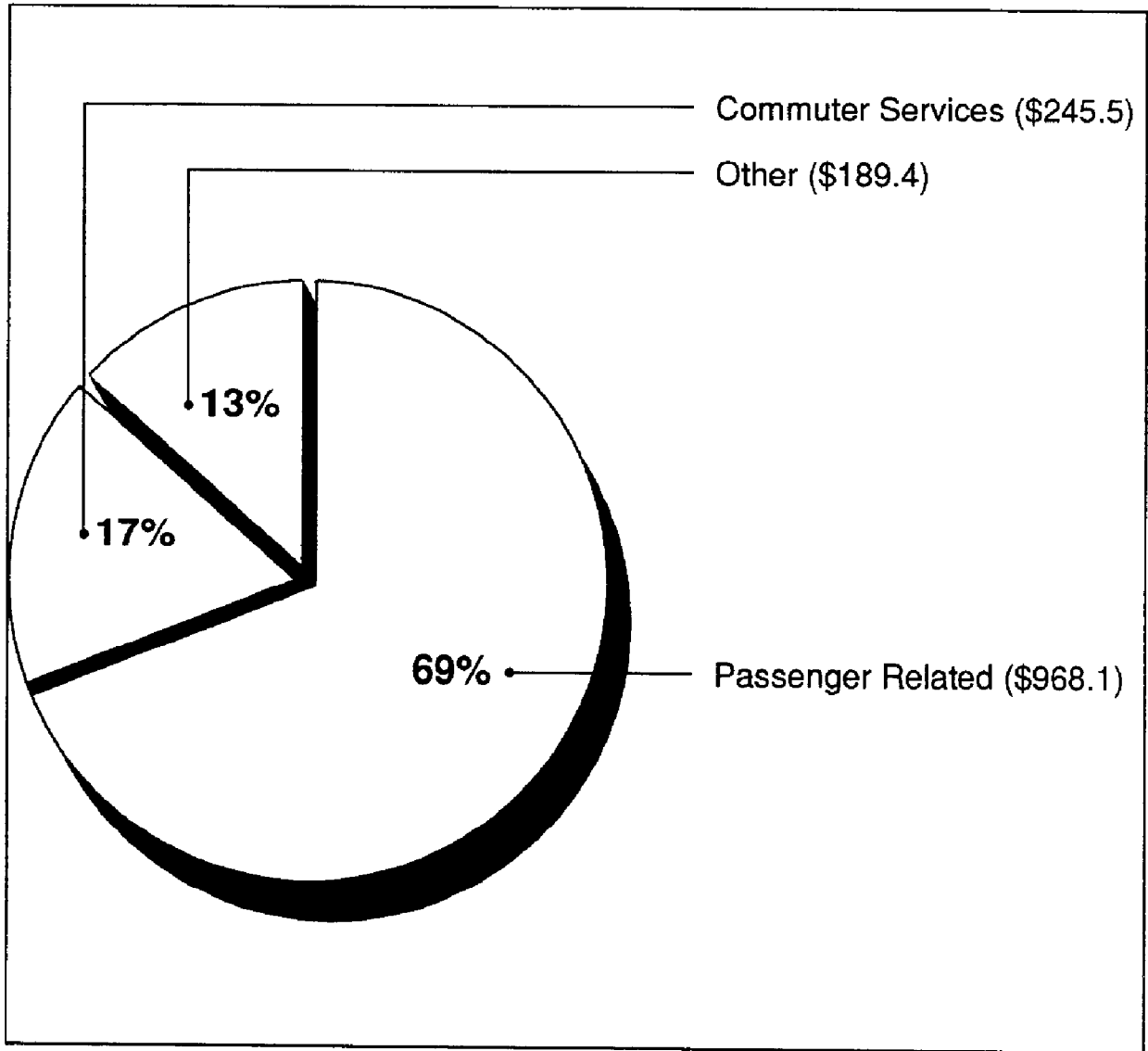
support. Amtrak and the federal and state governments must decide whether Amtrak is to continue its present course, expand into new areas such as high-speed rail service, or limit its operations to a few relatively well-traveled corridors where losses can be minimized. Under any scenario, federal and state support will need to be commensurate with the assigned task. We will report later this year on Amtrak's longer-term challenges.

- - - - -

Mr. Chairman, that concludes our testimony. We would be happy to respond to any questions you or Members of the Subcommittee may have.

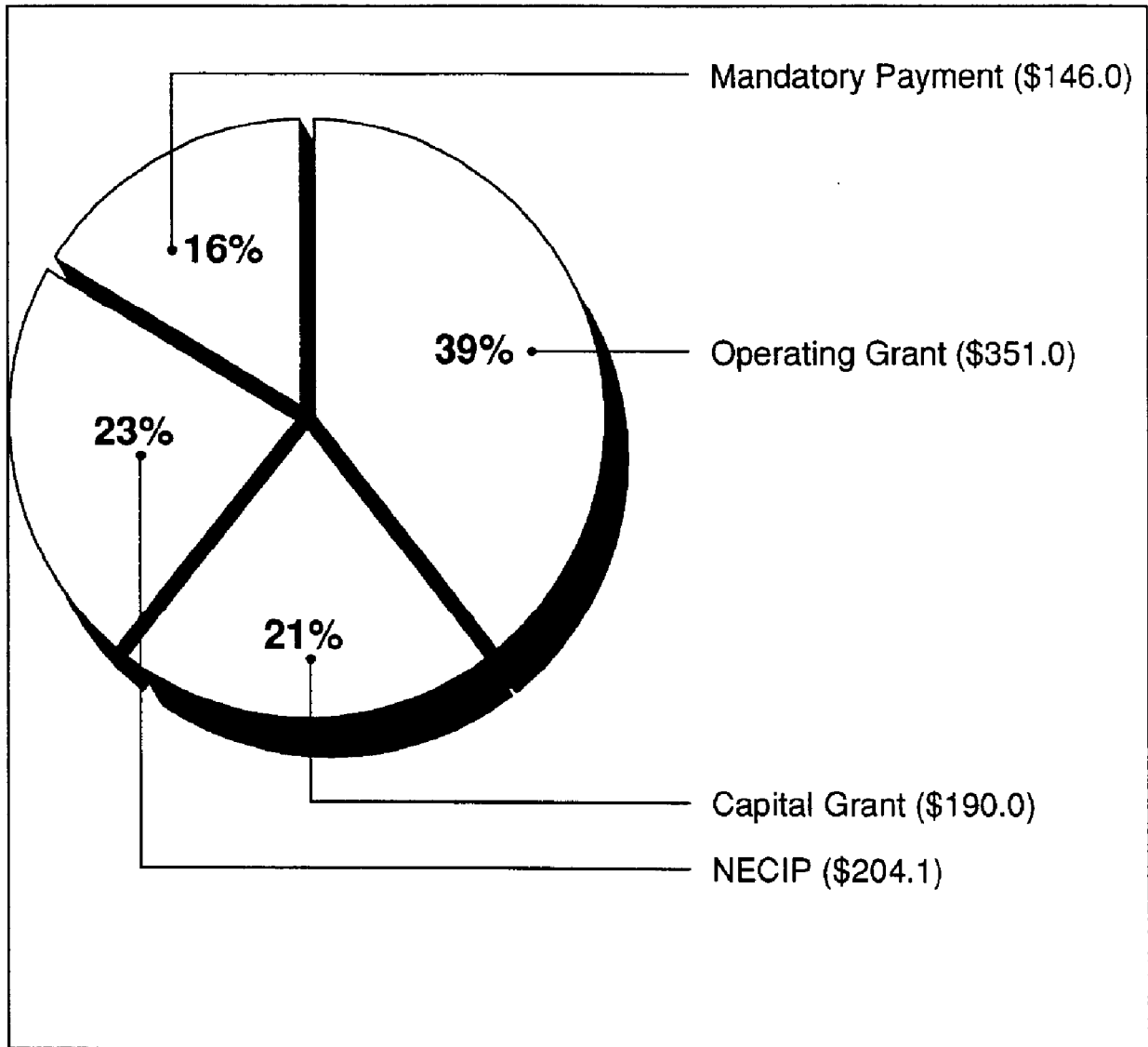
AMTRAK'S OPERATING REVENUES, FEDERAL FUNDING,
AND OPERATING EXPENSES FOR FISCAL YEAR 1993

Figure I.1: Amtrak's Operating Revenues for Fiscal Year 1993
(Dollars in millions)



Source: GAO analysis of Amtrak data.

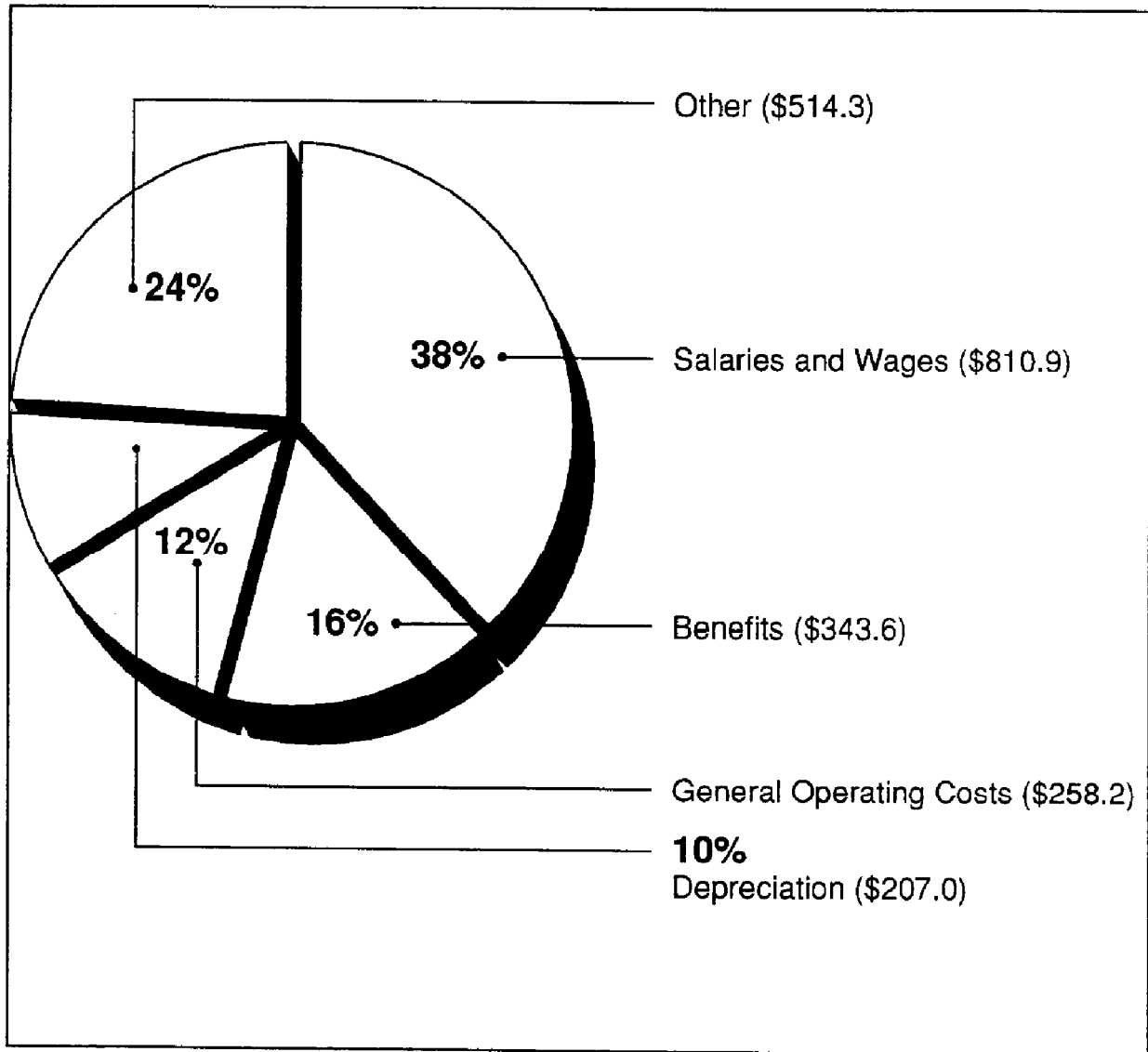
Figure I.2: Amtrak's Federal Funding for Fiscal Year 1993
(Dollars in millions)



Note: The operating grant includes the original appropriation of \$331 million plus a supplemental appropriation of \$20 million and the capital grant includes the original appropriation of \$165 million plus a supplemental appropriation of \$25 million.

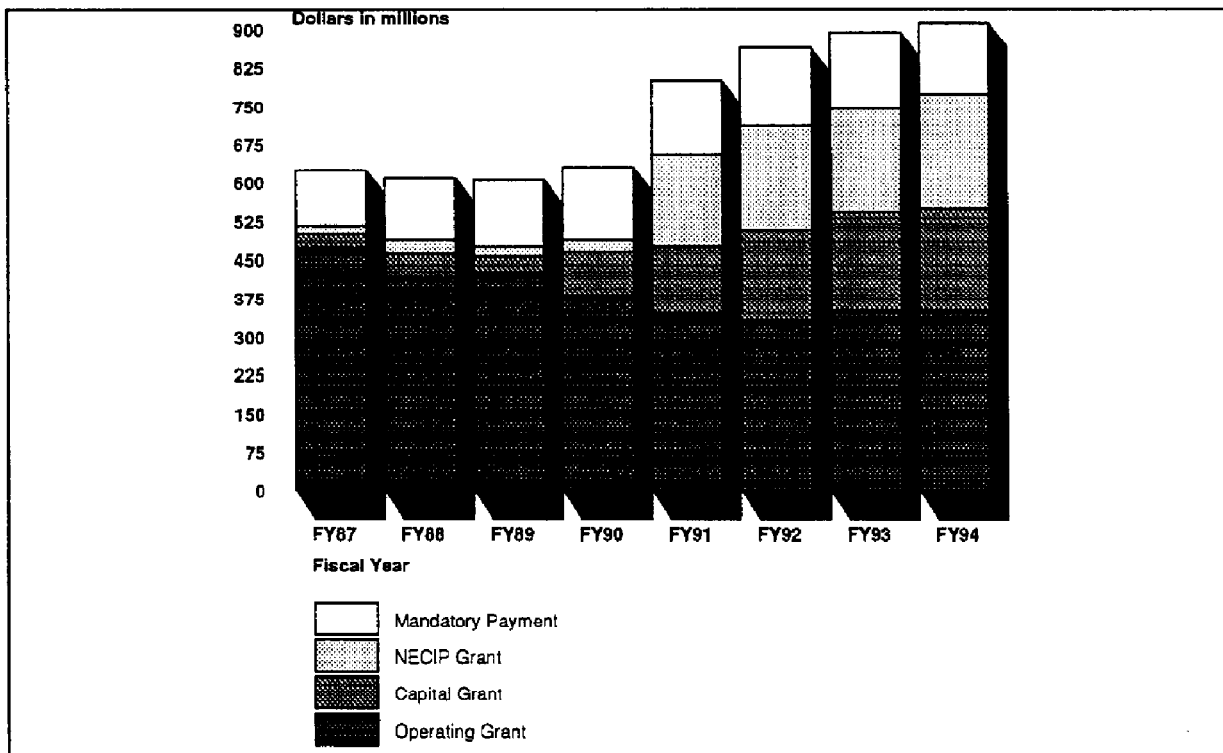
Source: GAO analysis of Amtrak data.

Figure I.3: Amtrak's Operating Expenses for Fiscal Year 1993
(Dollars in millions)



Source: GAO analysis of Amtrak data.

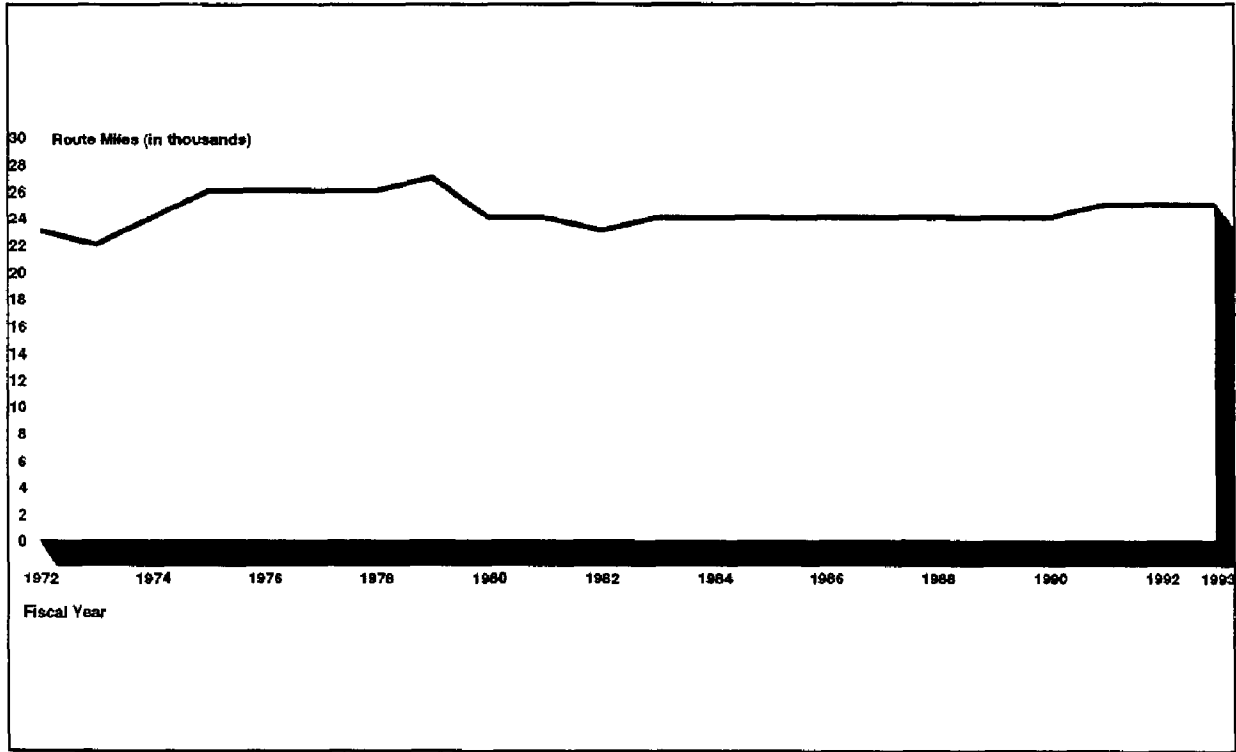
AMTRAK'S FEDERAL FUNDING, FISCAL YEARS 1987-94



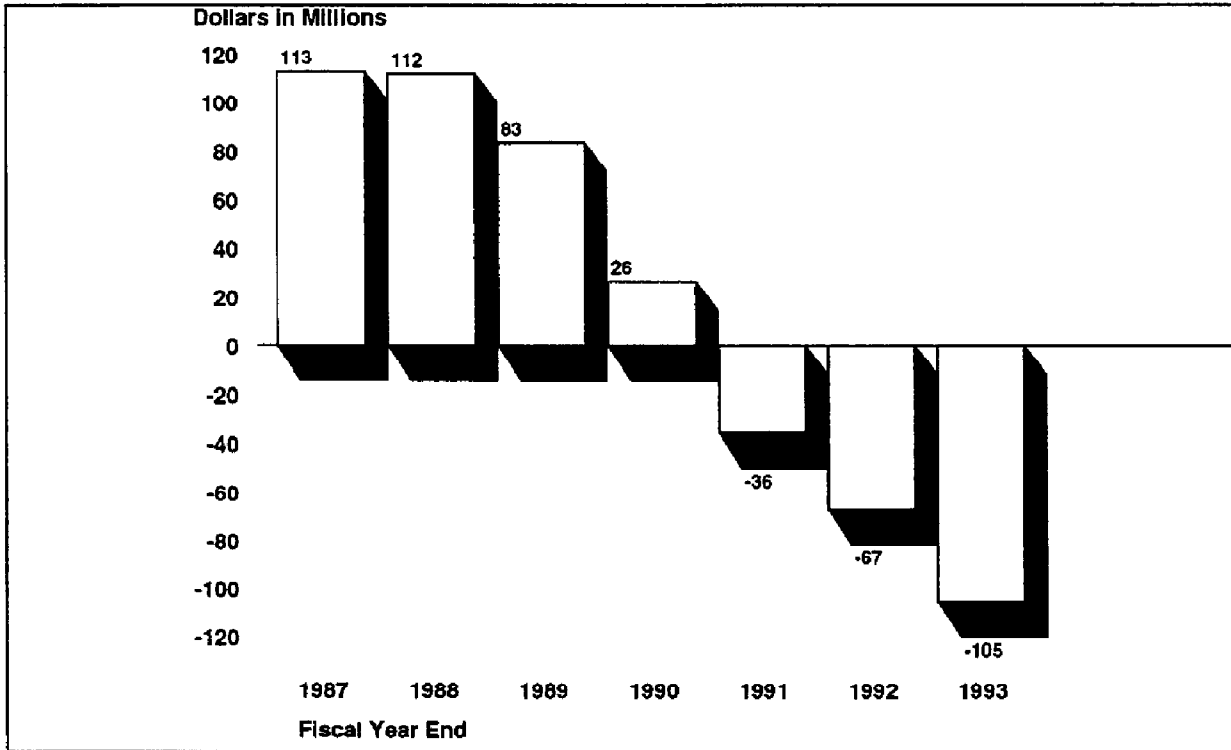
Notes:

1. Capital grants for fiscal years 1987 through 1989 are estimated.
2. Mandatory payments made to the Railroad Retirement Trust Account and the Railroad Unemployment Insurance Account for fiscal years 1987 through 1990 are estimated.
3. All amounts are in current year dollars.

AMTRAK'S SYSTEM ROUTE MILES,
FISCAL YEARS 1972-93



AMTRAK'S WORKING CAPITAL SURPLUS/DEFICIT
FOR FISCAL YEARS 1987-93

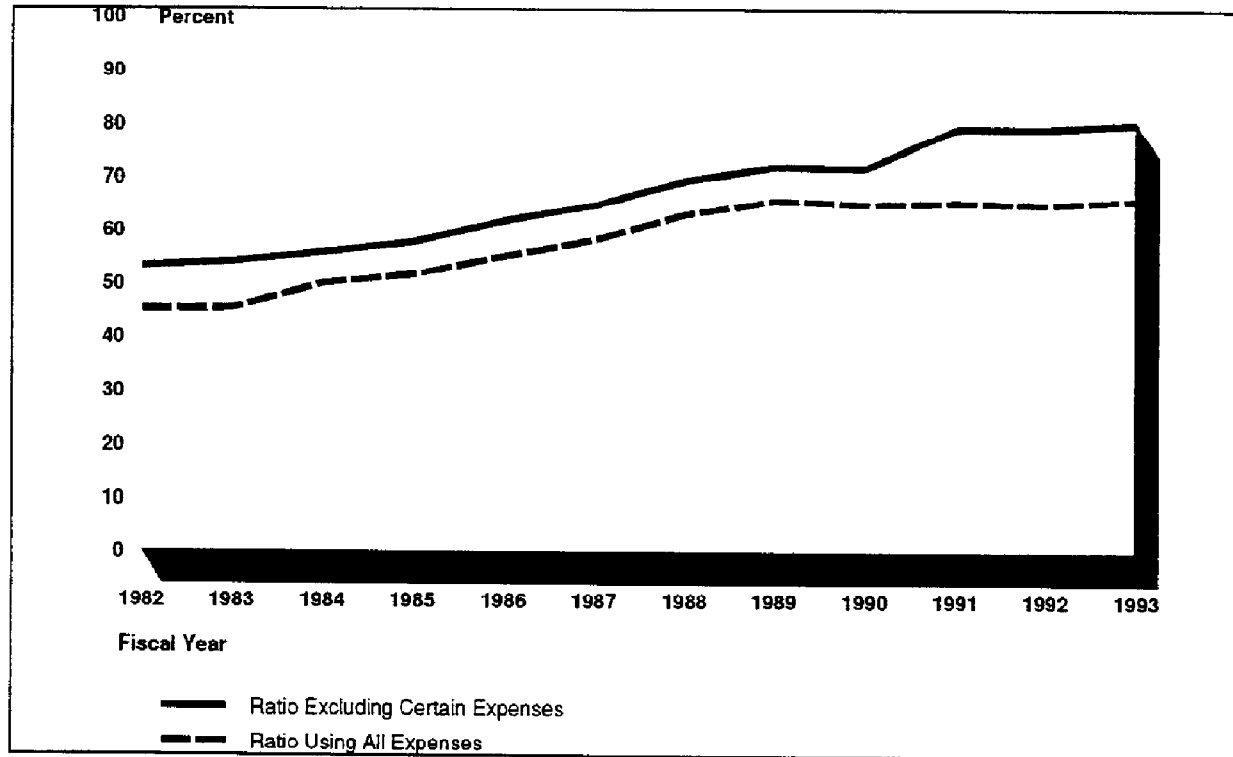


Notes:

1. Working capital is the difference between current assets and current liabilities. As such, it is an indicator of a firm's ability to pay current liabilities from current assets.
2. Amounts are in current year dollars. In 1994 dollars, the working capital has declined from \$144 million in 1987 to a deficit of \$108 million in 1993.

Source: GAO analysis of Amtrak data.

AMTRAK'S REVENUE-TO-EXPENSE RATIO,
FISCAL YEARS 1982-93



Notes:

1. The revenue-to-expense ratio as calculated by Amtrak excludes expenses for depreciation, labor protection payments, federal and state taxes, user fees to the Federal Railroad Administration, and losses on state 403(b) service.
2. The revenue-to-expense ratios as calculated by Amtrak for fiscal years 1991 to 1993 exclude the mandatory payment to the Federal Railroad Administration for the Railroad Retirement Trust Account and the Railroad Unemployment Insurance Account.
3. The revenue-to-expense ratio as calculated by Amtrak for fiscal year 1993 excludes \$10 million in expenses accrued for the recent accident in Saraland, Alabama.

Source: GAO analysis of Amtrak data.

AMTRAK'S REVENUE-TO-EXPENSE RATIO

Each year, Amtrak computes a "revenue-to-expense" ratio as a measure of its annual performance. Amtrak's emphasis on improving this ratio could actually cause it to take actions that have an adverse effect on operations. For example:

- An improving ratio does not necessarily indicate that the need for federal support is decreasing. The ratio can improve and expenses could actually go up by a greater dollar amount than revenues. For example, the ratio increased from 65 to 66 percent between fiscal years 1992 and 1993; however, the net loss actually increased from \$712 to \$731 million. In addition, the operating grant went from \$331 to \$351 million.

- When expenses exceed revenues, if revenues increase and the ratio remains the same from one year to the next, expenses would have to have increased by a greater dollar amount than revenues. For example, between fiscal years 1989 and 1993, the ratio remained constant at around 65 percent; however, the gap between revenues and expenses increased from \$665 million in fiscal year 1989 to \$731 million in fiscal year 1993, in current year dollars.

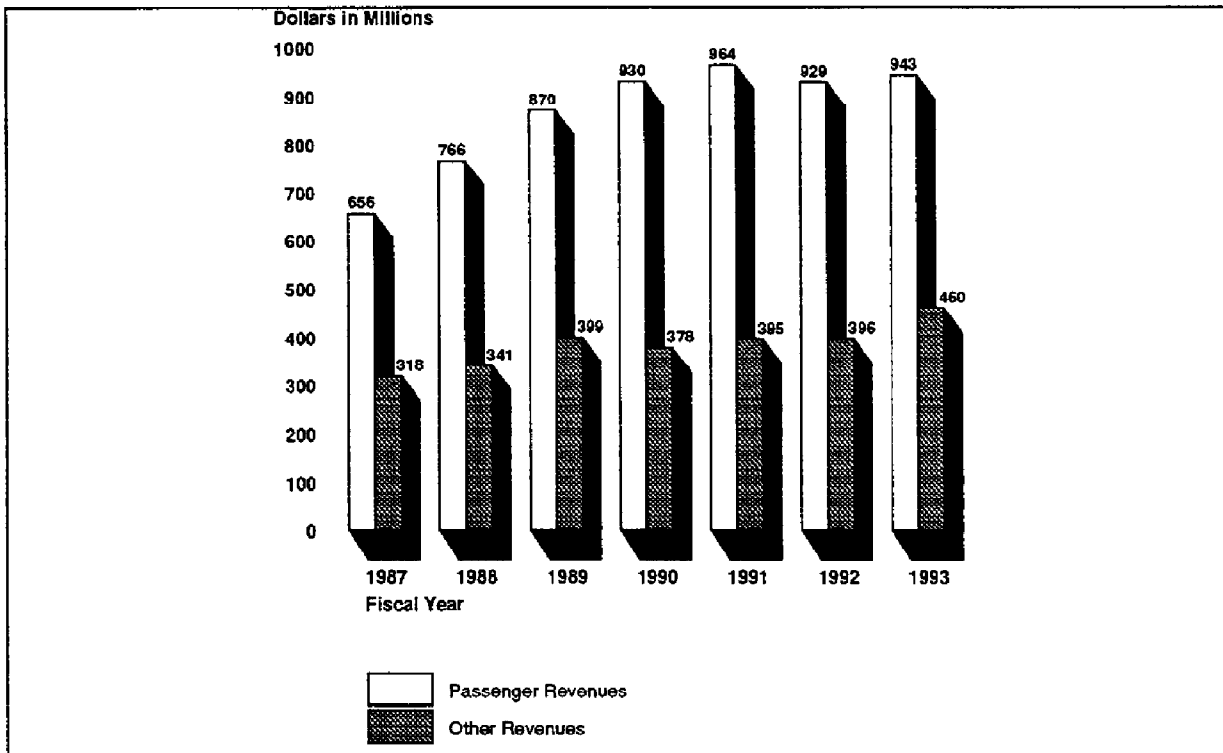
-- The true test of whether new business benefits Amtrak is whether the new business contributes more to revenue than expenses in the short and long term. Table VI.1 shows what the impact would have been on the fiscal year 1993 ratio if Amtrak had added business that brought in \$100 million in revenues that actually cost \$125 million to provide.

Table VI.1: Effect of Additional Business on Revenue-to-Expense Ratio (Dollars in Millions)

	<u>Fiscal year 1993 actual</u>	<u>With additional business</u>
Revenues	\$1403.0	\$1503.0
Expenses	\$2134.0	\$2259.0
Net Loss	(\$731.0)	(\$756.0)
Ratio	65.7 %	66.5 %

As the above example illustrates, Amtrak would have been able to improve the ratio by taking on new business that actually increased its net loss by \$25 million.

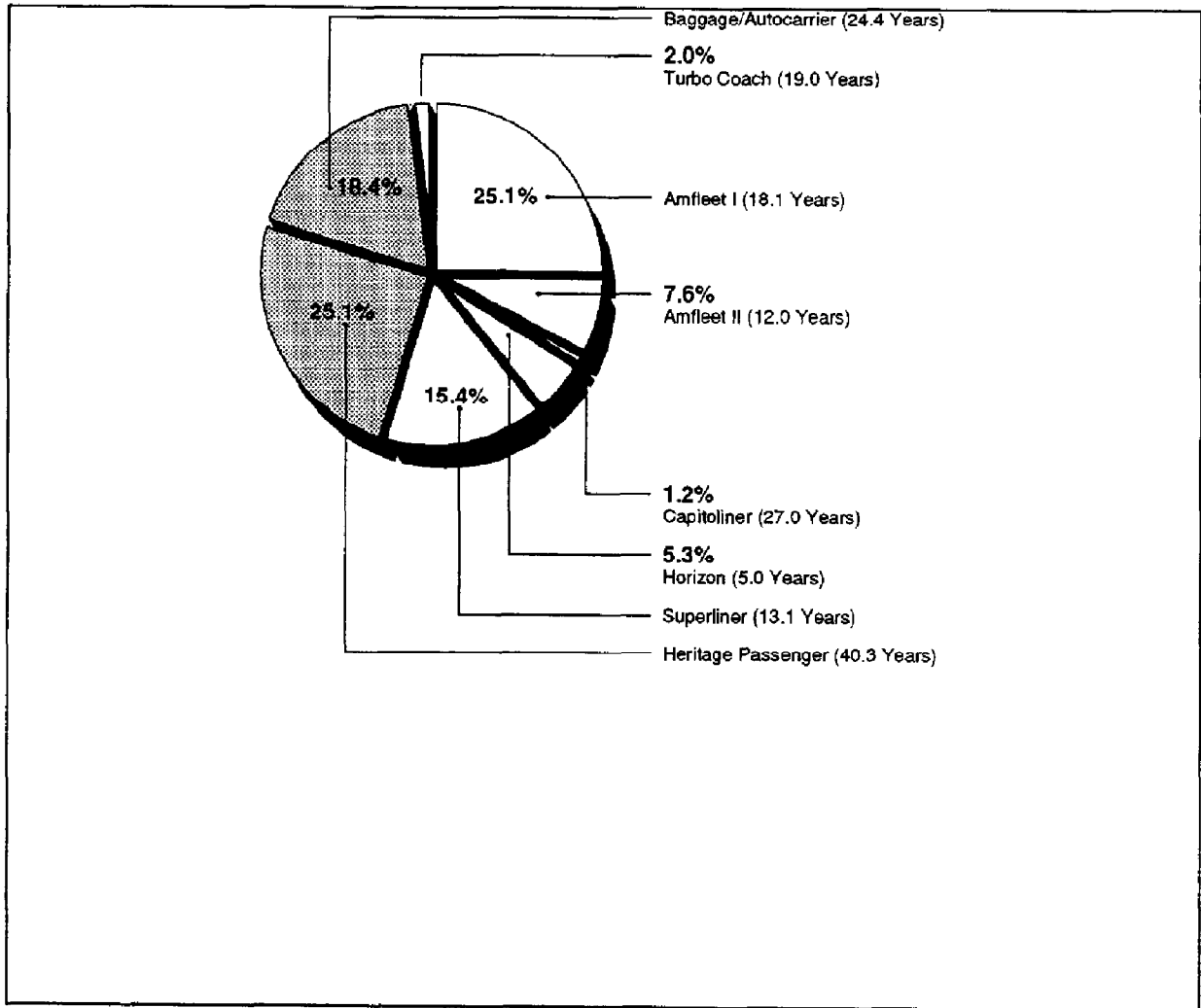
AMTRAK'S PASSENGER AND OTHER REVENUES,
FISCAL YEARS 1987-93



Note: Amounts are in current year dollars.

Source: GAO analysis of Amtrak data.

PROFILE OF AMTRAK'S CAR FLEET

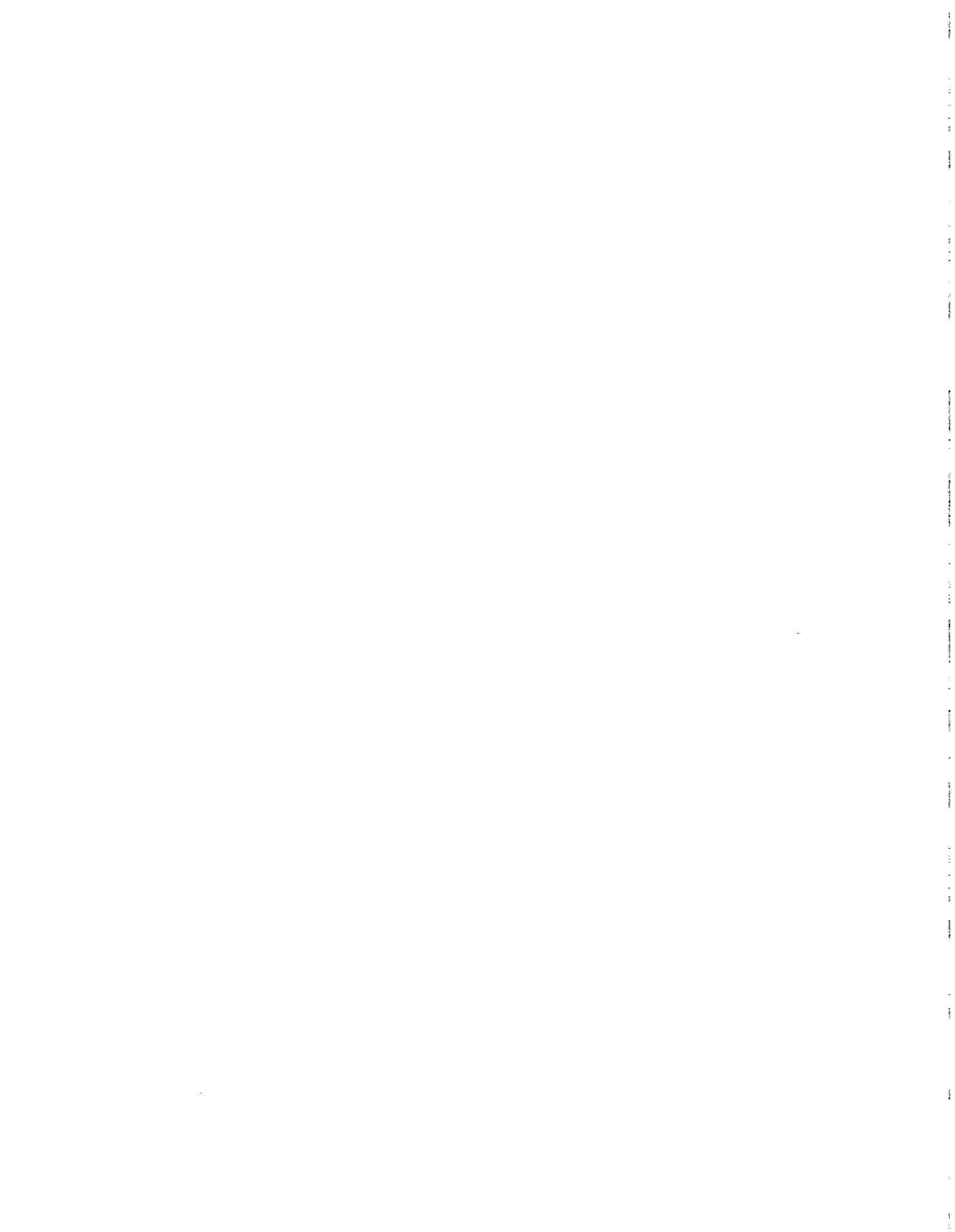


Notes:

1. Heritage cars are shaded.
2. Average age is noted in parenthesis.
3. Capitoliners are no longer actively used by Amtrak.

Source: GAO analysis of Amtrak data.

(343853)



Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

**U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015**

or visit:

**Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC**

**Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066.**

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested
