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AMTRAK

Deteriorated Financial and Operating Conditions Threaten Long-Term Viability

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

GAO/T-RCED-95-142

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify at this hearing on Amtrak. Today, we will present the findings from our recently issued report on Amtrak's financial and operating conditions and comment on its recent request for appropriations.[1] For fiscal year 1996, Amtrak is requesting $1.06 billion in federal assistance, a slight increase over its $1.01 billion appropriation for fiscal year 1995. In summary, we found the following:

-- Amtrak's financial condition has always been precarious but has deteriorated steadily since 1990 to the point that its ability to offer service over the current nationwide system is seriously threatened. Since 1971, Amtrak has received over $13 billion in federal funding. However, federal subsidies in recent years have not covered the widening gap between Amtrak's expenses and revenues. To meet its immediate cash needs, Amtrak drew down its working capital from a positive balance of $113 million in 1987 to a negative balance of $227 million in 1994. At the same time, requirements for capital investment have grown; current and future needs now total several billion.

-- Amtrak has attempted to address its financial situation by assuming debt, deferring maintenance, and reducing staffing. Some of these actions, while necessary for day-to-day survival, have simultaneously diminished the quality and reliability of service and contributed to the decline in ridership and revenues. In December 1994, Amtrak announced an aggressive plan to reduce annual expenses by adjusting routes and service frequencies, retiring its oldest cars, reducing

[1]Intercity Passenger Rail: Financial and Operating Conditions Threaten Amtrak's Long-Term Viability (GAO/RCED-95-71, Feb. 6, 1995).

staff, and improving service and productivity. These actions are directed, in part, at closing the gap between the expected operating deficit and the federal grants for 1995. However, even if its plan is completely successful, Amtrak forecasts that it will need an additional $1.3 billion to meet all of its expenses through the year 2000, assuming current levels of federal and state support. If federal support is gradually phased out, as has been suggested, Amtrak forecasts a $2.6 billion shortfall. Moreover, the planned actions will not resolve Amtrak's need for equipment and improved facilities. Finally, the success of Amtrak's plan depends heavily on increases in financial support from state and local governments as well as legislative changes, such as a proposal that would give Amtrak greater flexibility to hire contractors to perform its work.

-- It is unlikely that Amtrak can overcome its problems in financing, capital investments, and service quality--and continue to operate the existing 25,000-mile nationwide system--without significant increases in either passenger revenues or subsidies. Amtrak's ability to overcome these problems is limited by an unfavorable operating environment, including intense fare competition from airlines. In addition, Amtrak estimates that it needs several billion dollars to address its capital needs, including completing improvements to expand high-speed rail services in the Northeast Corridor and bringing its overall equipment and facilities up to a state of good repair. Also, Amtrak must soon negotiate new labor agreements and may confront additional costs for new agreements with freight railroads to use their track.

-- Determining Amtrak's requirement for federal operating and capital grants is complicated by a number of factors. Amtrak is requesting $260 million in operating assistance for fiscal year 1996. However, to cover total expenses, Amtrak forecasts that it will need $311 million in additional revenues and/or state and local contributions to cover total expenses, including depreciation. It is unlikely that Amtrak will be able to generate significant additional revenues, and there is no way to tell whether the states will be willing to make up the difference, nor is it clear what consequences will ensue in the absence of additional support. Amtrak's request for $600 million in capital assistance is $170 million more than Amtrak received in fiscal year 1995. However, the request does not indicate how much of the total capital grant request would be spent on the Northeast Corridor and how much would be spent elsewhere in the Amtrak system.

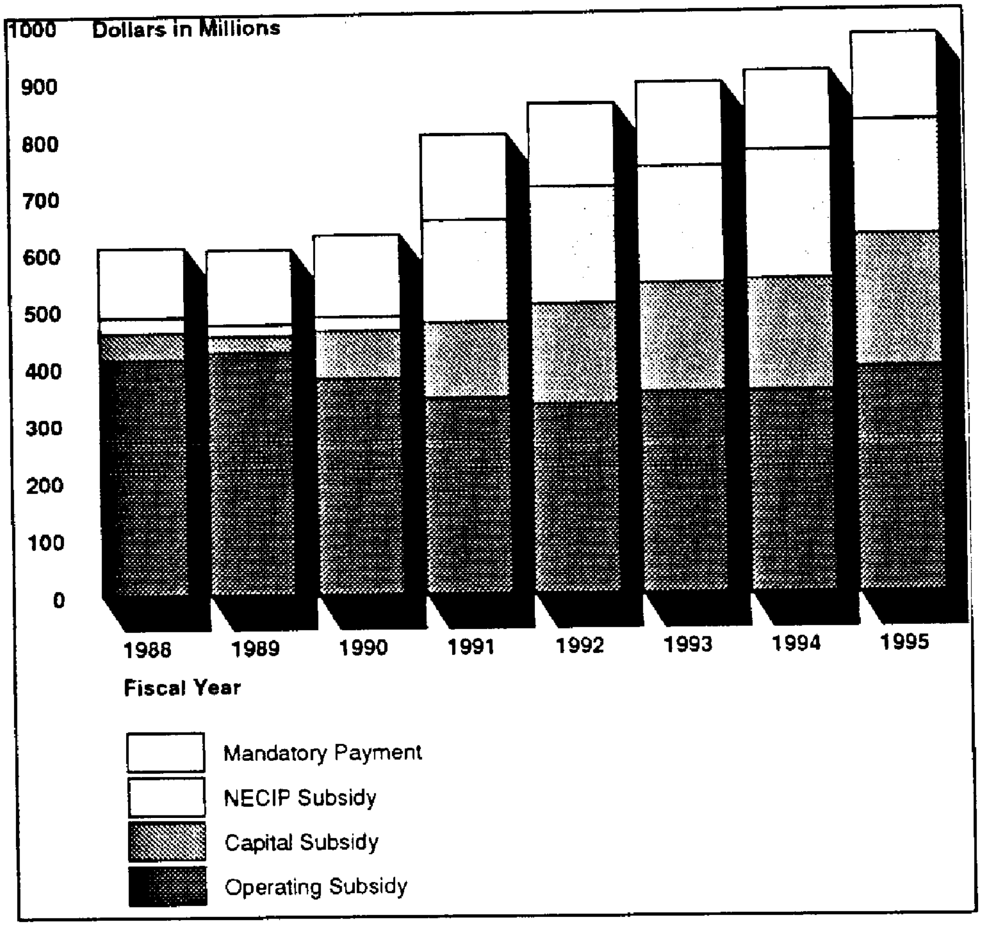
In light of Amtrak's serious financial and operating problems, our 1995 report offers several matters for congressional consideration concerning the scope of Amtrak's mission and basic route network. Our February 6, 1995, report also recommends that Amtrak provide the Congress with cost and related information associated with various legislative proposals that Amtrak believes will further reduce its expenses.

GOVERNMENT SUPPORT FOR PASSENGER RAIL SERVICE IS SUBSTANTIAL

In 1995, out of a total budget of over $2 billion, Amtrak will receive $972 million from operating and capital grants, funds to improve the infrastructure that Amtrak owns in the Northeast, and a payment for retirement and unemployment benefits.[2] (See fig. 1.)

[2] Does not include $40 million appropriated for the Farley Building.

Figure 1: Federal Appropriations for Amtrak, Fiscal Years 1988 Through 1995



Notes: Before fiscal year 1990, the Federal Railroad Administration's (FRA) mandatory payments to the Railroad Retirement Trust Fund were included in Amtrak's operating grant; FRA's payments to the fund for fiscal years 1988 through 1990 are estimated. The fiscal year 1993 appropriation includes $20 million in supplemental funds for operations and $25 million for capital.

Source: Amtrak.

Among the world's passenger railroad systems, Amtrak is not unique in its need for government assistance. In Europe and Japan, where conditions are more conducive to rail travel, intercity passenger service requires substantial public support, including significant investments in the infrastructure. For example, France plans to invest nearly $25 billion in its railroad during the 1990s. This amount includes $6.8 billion for rolling stock, $5.3 billion for investments in infrastructure on high-speed lines, and

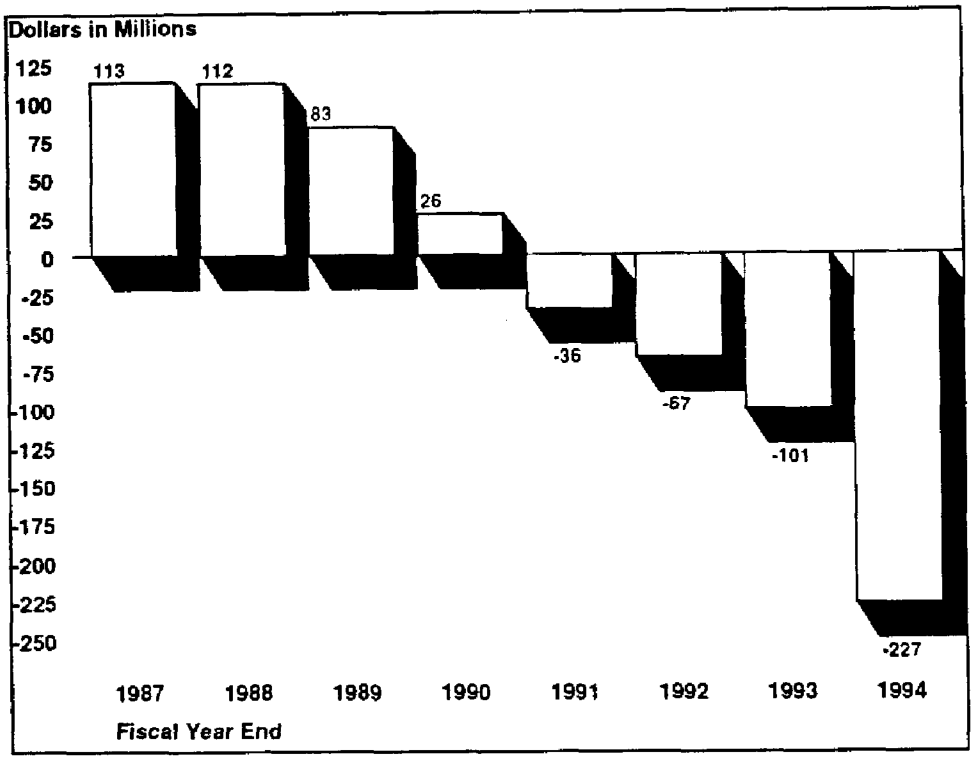
$1.1 billion for other investments in infrastructure. Germany plans to invest over $70 billion in its main railway lines in the 1990s, including $28.8 billion for improvements in infrastructure, $18.5 billion in other upgrades, and $8.2 billion in equipment.

In the United States, other modes of transportation also have benefited to varying degrees from public investment and operating assistance. Some forms of travel, such as general aviation and mass transit, continue to receive substantial public support either in total or on a per-trip basis. In addition, unlike other modes of transportation, intercity rail does not have access to a trust fund to meet its capital investment needs.

AMTRAK'S FINANCIAL CONDITION HAS REACHED A CRITICAL STAGE

Over the years, Amtrak has made numerous attempts to reduce expenses and improve the efficiency of its operations. While these actions have served to hold down the corporation's operating deficit, they have not arrested Amtrak's financial decline. Since 1990, Amtrak's problems have accelerated. From 1991 to 1994, revenues were lower than projected while expenses were higher than planned. Projected revenues did not materialize for a number of reasons, including declines in service quality and competition from airlines. Amtrak overestimated passenger revenues by $600 million from 1991 through 1994. As a result, Amtrak's revenues and federal operating subsidies have not covered the operating deficit. To help cover the gap, Amtrak drew down its cash resources. At the end of 1994, it had a negative working capital balance of $227 million. (See fig. 2.) Amtrak also deferred maintenance on train equipment and reduced staffing levels and some services. Despite these efforts, the 1994 deficit exceeded the federal operating grant by $76 million. Amtrak projected that this gap would increase to almost $200 million in 1995.

Figure 2: Amtrak's Working Capital Surplus/Deficit, Fiscal Years 1987 Through 1994



Notes: Working capital is the difference between current assets and current liabilities.

Amounts are in current-year dollars. In 1994 dollars, working capital declined from $144 million in 1987 to a deficit of $227 million in 1994.

Source: GAO's analysis of Amtrak's data.

AMTRAK ANNOUNCES A PLAN TO ADDRESS FINANCIAL DIFFICULTIES

To address this situation, Amtrak is taking action to reduce its workforce by 5,600 positions (out of 25,000), eliminate 21 percent of the train miles of service it offers, and retire nearly all of its oldest passenger cars. On February 1, 1995, Amtrak reduced the frequency of service on three routes--between Atlanta and New Orleans; between New York and Tampa; and between St. Paul/Minneapolis and Portland Oregon. Amtrak has also announced plans to eliminate 3 routes and segments of 10 others, effective

April 1, 1995.[3] The announced service reductions amount to about 20 percent of Amtrak's total planned reductions for 1995. Amtrak plans to announce additional reductions in early April, 1995. Also, Amtrak plans to achieve significant cost savings by contracting out maintenance work, consolidating crafts, reducing train and engine crews, and taking other actions to reduce costs and improve service.

Amtrak's proposed service cuts are part of Amtrak's Strategic and Business Plan first issued in January 1995. This plan proposes a number of actions to eliminate the gap between losses and federal support for fiscal year 1995 and to eventually reduce annual expenditures by $430 million. If nothing is done, Amtrak expects to lose more than $7.3 billion from 1995 to 2000. If federal subsidies stay constant at 1995 levels, the cumulative net losses after subsidy would be about $3.8 billion, again assuming that no actions are taken. Amtrak clearly had to take some action, and its new plan is an aggressive first step. Yet even if Amtrak could accomplish its entire plan, it still expects its losses to exceed the federal and state subsidies by $1.3 billion from 1996 through 2000, assuming that federal and state support remain constant at their 1995 levels. In February, 1995, Amtrak published a revised Strategic and Business Plan that included a scenario of declining, rather than level, federal support over the next five years. Under this scenario, Amtrak will need a total of $2.6 billion from revenue increases and state and local contributions through 2000 to compensate for the decline in federal operating assistance.

Amtrak also has proposed a number of legislative initiatives that it believes will improve the railroad's long-term financial

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[3]Amtrak has reached interim agreements with the states that would preserve at least some level of service on the Chicago to Milwaukee, St. Louis to Kansas City, and San Jose to Roseville routes. Discussions are ongoing with other states affected by route eliminations.

viability. For example, Amtrak would like to be able to issue tax exempt debt to reduce interest expenses. If Amtrak issues $5.5 billion in tax exempt debt, rather than borrowing that sum in today's market, it projects that the debt service savings could total $2.8 billion over the 25-year term of the borrowing. Amtrak estimates that it could save between $5 million and $7 million annually if it was exempt from paying federal fuel taxes. Finally, if Amtrak received all of its annual operating grant on the first day of the fiscal year, its estimated annual savings in interest payments would be $3 million.

Amtrak believes that its plan will help put the railroad on the road to financial recovery and that by the year 2002 Amtrak might be in a position to eliminate the need for federal operating subsidies while continuing to operate most of its existing service. However, an important underpinning of Amtrak's goal to eliminate the need for operating subsidies are assumptions about changes in the current environment, including: (1) substantially more financial assistance from state and local governments; (2) increased capital assistance to continue to purchase new equipment, improve the Northeast Corridor to support high-speed rail, and rectify the deteriorated condition of its infrastructure; and (3) greater flexibility in dealing with railroad labor. Without these changes, the recently announced cuts will be just the beginning of route abandonments and service cutbacks.

INCREASED REVENUES AND STATE CONTRIBUTIONS NEEDED TO COVER ALL EXPENSES

Table 1 shows Amtrak's federal assistance for fiscal year 1995, its requested funding, and the administration's request for fiscal year 1996.

Table 1: Amtrak's Actual Appropriations for Fiscal Year 1995 and Amtrak's and the Administration's Fiscal Year 1996 Requests

Dollars in Millions

Category	Amtrak's actual appropriations, fiscal year 1995	Amtrak's request, fiscal year 1996	Administration's request, fiscal year 1996
Operating assistance	$392	$260	$300
Mandatory retirement payment	150	0[a]	120
Transition costs	0	150	100
General capital	230	365	230
Northeast Corridor improvement	200	235	235
Farley Building	40	50	50
Total	$1,012	$1,060	$1,035

[a]Amtrak is requesting that the mandatory retirement payment be removed from its operating budget.

Source: Amtrak.

Amtrak's request for operating assistance for 1996 is $132 million lower than its 1995 grant. Assuming Amtrak receives the requested amount, it forecasts that $311 million will need to be generated through revenue increases or increased state support to cover all its expenses, including depreciation. Of the $311 million shortfall, $274 million, or 88 percent, is depreciation--a non-cash expense. According to Amtrak, failure to fund depreciation contributes to poor product quality, declining market competitiveness, and ultimately, reduced revenue.

Amtrak's 1996 general capital request is higher than its 1995 grant. However, in 1996 Amtrak plans to spend $122 million--about 30 percent--of its general capital funds to address a variety of

Northeast Corridor requirements, such as right-of-way maintenance, capital overhauls, and station maintenance.

Increased contributions from state and local governments will be critical to closing Amtrak's projected budget gap because, as we stated in our 1995 report, passenger revenues are not likely to increase enough over the next few years to reverse Amtrak's deteriorating condition. None of Amtrak's routes--including those in the Northeast Corridor--are profitable when capital costs are taken into account. Revenues in the corridor cover about 65 percent of the routes' costs, compared with about 50 percent for routes elsewhere. Furthermore, passenger ticket revenues have declined about 14 percent in real terms--from over $1 billion in 1990 to about $880 million in 1994. The decline resulted from, among other things, a weak economy; intense price competition from airlines in certain markets; Amtrak's old and poorly maintained facilities and equipment; and accidents involving Amtrak trains. While the economy has recovered and the impact of train accidents has begun to abate, the other factors continue to inhibit ridership growth.

Amtrak's fastest growing source of revenues is its contracts to operate local commuter rail systems, which together carry about 7 million more passengers per year than the 22 million intercity passengers carried on Amtrak's intercity trains. These contracts generated over $270 million in 1994 and accounted for 19 percent of Amtrak's operating revenues. Amtrak also believes that new high-speed rail service in selected corridors could increase its ridership and revenues. While high-speed service is now limited to the electrified portion of track between Washington, D.C., and New York City, Amtrak is extending electrification to Boston, improving the tracks, and hopes to purchase new trains that will allow high-speed service from Washington, D.C., to Boston beginning around the year 2000. Between 2000 and 2010, Amtrak expects its market share between New York City and Boston to grow to a level similar to its current 45-percent share between New York City and Washington, D.C.

AMTRAK MUST ADDRESS SIGNIFICANT CAPITAL INVESTMENT NEEDS AND POTENTIAL COST INCREASES

Insufficient investment in capital over the past decade has resulted in critical investment needs to bring infrastructure and rolling stock to a state of good repair. Over a 10-year period, Amtrak's equipment and facilities depreciated at the rate of $200 million per year, while investment has averaged only $140 million. However, most of Amtrak's annual capital grant is already committed to paying off prior purchases and meeting legal mandates such as environmental cleanup.

Capital Needs Total $4.7 Billion Over Next 5 Years

Of Amtrak's $4.7 billion in capital requirements, $3.4 billion--over 70 percent--is needed for infrastructure improvements and equipment purchases to support high-speed rail in the Northeast Corridor, most of which the corporation owns. Outside the corridor, where Amtrak operates at conventional speeds, primarily on track owned by freight railroads, Amtrak's capital needs total about $1.3 billion, mostly for equipment replacement and overhauls and for improvements to maintenance facilities. Table 2 itemizes these capital requirements.

Table 2: Amtrak's Capital Requirements[4]

Dollars in Millions

Element	Estimated cost
Northeast Corridor capital	
Complete electrification, other upgrades, and purchase high-speed trainsets	$900[a]
Infrastructure repairs between Washington and New York	2,500[b]
Non-Northeast Corridor capital	
Equipment replacement and overhaul	1,100[a]
Maintenance facilities improvement	200[b]
Total	$4,700

[a]Amtrak plans to complete these improvements by 1999.

[b]According to Amtrak, these funds are needed as soon as possible to avoid adverse impact on existing service or increased maintenance costs.

Source: Amtrak and FRA.

Amtrak needs $3.4 billion for Northeast Corridor over next 5 years

As table 2 shows, Amtrak estimates that it needs $900 million in further appropriations between now and 1999 to begin offering high-speed service between New York and Boston in 1999 as

[4]In addition to the costs cited in this table, about $1.6 billion in capital will be required to address capacity expansion and infrastructure rehabilitation requirements. Many of these expenditures will be critical to Amtrak's achieving its revenue forecasts by the year 2010.

envisioned in the Northeast Corridor Improvement Project. The remaining improvements--mostly electrification and purchasing high-speed trains--will allow passengers to travel between New York and Boston in just under 3 hours, one hour less than Amtrak's current travel time. Amtrak also estimates that it needs $2.5 billion to bring the south end--the segment between New York and Washington--up to a state of good repair. Much of the track, signals, structures, electrification system, maintenance-of-way equipment, and tunnels have deteriorated and are in need of major repair. These repairs will allow Amtrak to continue its current level of conventional and high-speed service between Washington and New York. According to Amtrak, these repairs should have been made on a regular basis over the years but were given low priority as Amtrak focused Northeast Corridor Improvement Program funds on developing high-speed rail. In the 5-year period between 1990 and 1994, Amtrak used a total of $184 million of its general capital grant to address the most critical needs. In fiscal year 1995, Amtrak plans to use $115 million of its Northeast Corridor grant for repairs.

Equipment for use outside the Northeast Corridor and maintenance facilities require $1.3 billion

Amtrak estimates that about $1.1 billion is needed to meet its needs for equipment replacement and overhauls. Purchasing new equipment (mostly locomotives), will allow Amtrak to retire rather than overhaul old equipment. Assuming Amtrak can purchase the needed equipment, overhaul costs would be $427 million between 1995 and 2002, according to an Amtrak financial management official. If Amtrak cannot replace the equipment, the amount needed for capital overhauls will be substantially higher during those years. Amtrak's recently announced service reductions will allow it to retire much of its "Heritage Equipment," which was inherited from freight railroads when Amtrak was created. This action will improve the age profile for the passenger car fleet and reduce maintenance requirements. Amtrak also projects that existing Amfleet cars will begin to need replacement in 2002 and Viewliner cars in 2007. However, firm cost estimates for this equipment are not yet not available.

In addition, several of Amtrak's 18 maintenance facilities need substantial renovation and/or modernization, which Amtrak estimates will cost about $200 million. The Beech Grove, Indiana, facility, one of Amtrak's largest, is responsible for overhauls of and repairs to 61 percent of Amtrak's total fleet. The facility is nearly 100 years old and deteriorated track causes frequent derailments, buildings are run down, and some buildings cannot accommodate the work for which they are used. Amtrak estimates that renovating and modernizing this facility will cost over $38 million, including $9.8 million budgeted for fiscal year 1995.

Amtrak Faces Additional Costs

Labor costs are also a major factor in Amtrak's finances. Beginning in 1995, Amtrak will be negotiating changes to wages, benefits, and work rules with the 14 unions that represent 90 percent of its employees. Labor costs account for about 52 percent of Amtrak's operating costs. Amtrak has done a good job at improving labor productivity and hopes to achieve further increases in productivity if the Rail Passenger Service Act is amended to allow greater flexibility in negotiating the terms of its labor agreements. However, Amtrak already pays train and engine crews less on average than freight railroads pay for comparable jobs. Continuing to hold down labor costs will present a difficult challenge.

Amtrak could also face increased costs for track leases and liability coverage. Freight railroads own about 97 percent of the track over which Amtrak operates. In 1971, Amtrak entered into 25-

year agreements with the freight railroads to compensate them for the use of their track and for related services. These agreements will expire in April 1996. Freight railroads are likely to seek increases in Amtrak's payments for incremental maintenance and liability coverage.

REASSESSMENT OF AMTRAK'S MISSION AND COMMITMENTS FOR FUNDING IS NEEDED

The Congress faces important decisions about the quality and extent of future intercity passenger rail service, including whether to maintain the current route system. Amtrak's fiscal crisis comes at a time when the federal government is not well positioned to provide the large sums of money required to bring the railroad up to a state of good repair and meet future capital needs. Passenger rail service competes for limited transportation funds, and unlike aviation, highways, and mass transit, it does not have access to a federal trust fund. State and local governments have some flexibility to allocate federal transportation funds among different modes, but their ability to assist intercity passenger rail is very limited.

Increased funding, especially capital investment, would improve service quality and encourage more riders. Doubling Amtrak's general capital grant to $500 million annually--a difficult task in today's fiscal environment--would allow Amtrak to improve maintenance facilities and its rights-of-way and purchase new equipment, primarily locomotives. But even if gains in efficiency and ridership resulted from such improvements, we estimate that Amtrak would continue to need more than $400 million in annual operating subsidies from some source through the year 2000. As described earlier, Amtrak also needs $900 million to commence high-speed operations between New York and Boston by 1999.

If subsidies to Amtrak are eliminated and the railroad is privatized, it is unlikely that a nationwide passenger rail system could be preserved. Under this option, intercity service would be reduced to a few regional corridors, at most, because only a few well-traveled routes could potentially generate sufficient revenues to cover operating costs. Even in these cases, substantial federal investment in the infrastructure would likely be needed before the railroad was privatized.

If funding for Amtrak is reduced or maintained at its current level, we believe that the route network will have to be restructured and reduced beyond the recently announced changes so that quality service can be provided within the available funding. Options could be developed for routes commensurate with various levels of federal, state, and local funding. A basic network could be defined by determining where Amtrak carries the most passengers and has the greatest economic potential. Appendix I shows ridership levels throughout Amtrak's system in fiscal year 1993.

In this regard, we found that 11 of Amtrak's 44 routes earn 68 percent of Amtrak's revenues and account for 61 percent of the expenses. Also, interconnections between routes or the presence of important public benefits as defined by the Congress, such as helping alleviate congestion and pollution, would be relevant in evaluating how best to define the route network. The basic network could be augmented by regional routes supported by those states that were willing to contract with Amtrak to cover shortfalls between revenues and the full cost of operations.

CONCLUSIONS

Amtrak is at a critical juncture. A number of the issues raised by Amtrak's financial and operating condition clearly go beyond the ability of Amtrak and its board of directors to resolve and will require congressional consideration. These issues complicate this year's appropriations decisions. Amtrak's 1996 request for operating assistance does not cover $311 million in anticipated expenses. Amtrak hopes to make up this difference through increased revenues and by obtaining larger state contributions. Although some increases in revenues are possible and some increases in state contributions have occurred, we are not optimistic that Amtrak will be able to cover the $311 million in this manner.

As our February 1995 report stated, the Congress may wish to consider whether Amtrak's original mission of providing nationwide intercity passenger rail service, at the present level, is still appropriate. To facilitate the definition of the scope of Amtrak's mission, the Congress could direct Amtrak or a temporary commission to make recommendations and offer options to the Congress defining and realigning Amtrak's basic route network so that efficient and quality service could be provided within the funding available from all sources. If the outcome of this process is a significantly scaled back Amtrak, Amtrak's capital requirements would be quite different than those needed to maintain the existing nationwide system.

Our report recommended that the President of Amtrak provide the Congress with cost and related information on proposed legislative changes that Amtrak believes could improve its long-term viability and the expected effect of these changes on Amtrak's finances and other affected parties. These include amending the Rail Passenger Service Act to allow greater flexibility in negotiating labor agreements with regard to labor protection and contracting out Amtrak work; removing from Amtrak's budget, its payments under the Railroad Retirement Act for non-Amtrak employees; authorizing Amtrak to issue tax-exempt debt; and exempting Amtrak from federal fuel taxes. Amtrak has provided the estimated cost savings for some of these proposals in its 1996 Legislative Report and Federal Grant Request, submitted to the

President and the Congress on February 15, 1995. This information will provide a vehicle for Congressional deliberation on the merits of each of Amtrak's legislative proposals.

Finally, in terms of this year's budget request, the Subcommittee may find clarification of several aspects of the request helpful. These include the specific timetable of Amtrak capital requirements over the next several years (assuming a given level of regional or nationwide service), clarification of the amount of the general capital request that will be used on the Northeast Corridor, and Amtrak's plan for obtaining additional revenues and state and local support, and the consequences of not obtaining these.

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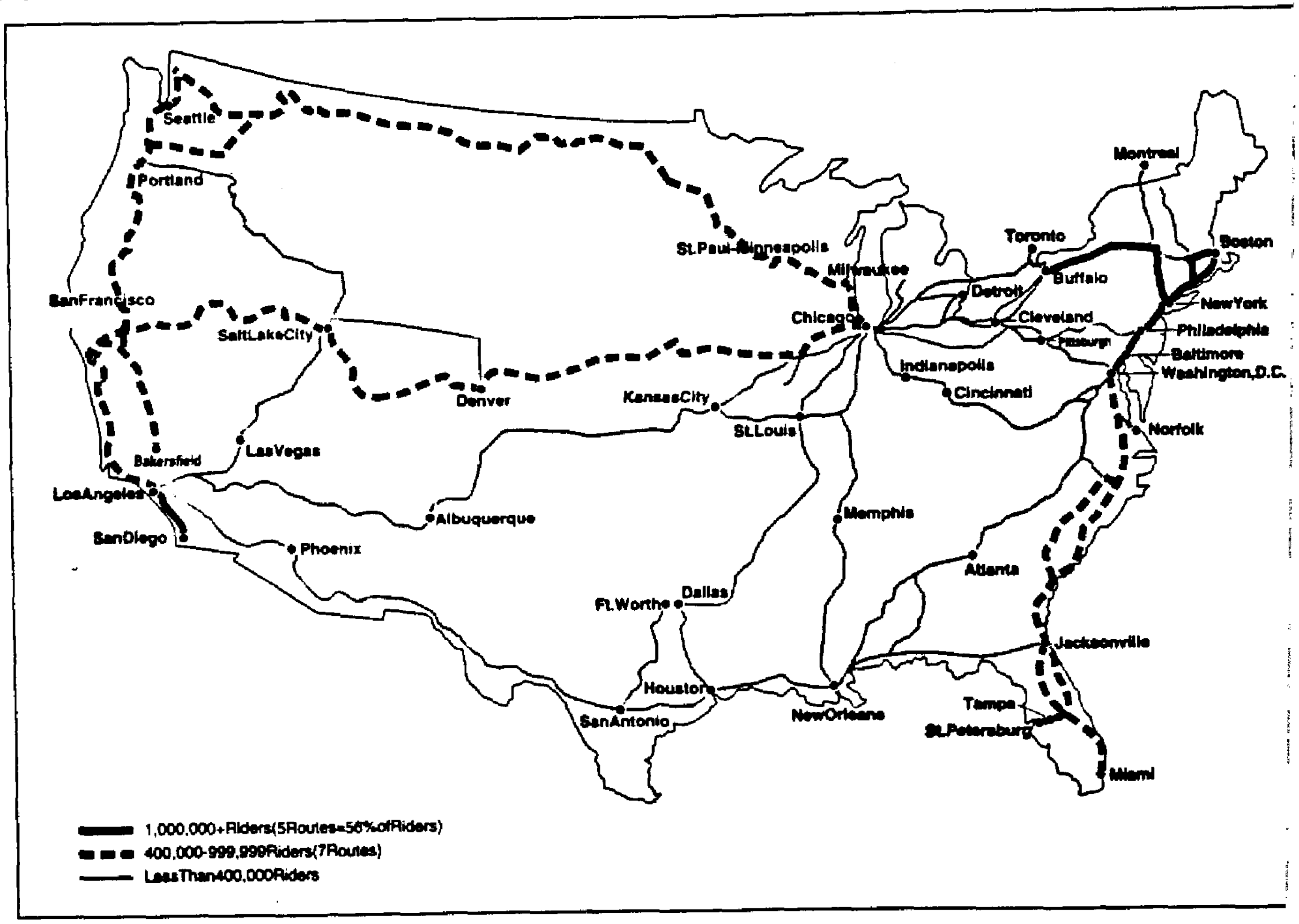
Mr. Chairman, this concludes our testimony. We look forward to working with the Subcommittee in the coming months. We would be happy to respond to any questions that you or members of the Subcommittee may have.

APPENDIX I

Ridership on Amtrak's Rail Passenger System, FY 1993



Source: Amtrak

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