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Amtrak's Financial Outlook

Statement of

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on Amtrak's financial outlook. Last March, we provided our views in statements to the House and Senate Appropriations Subcommittees. Our overall assessment at that time was that with strong leadership, intense management, and favorable economic conditions, it would be possible, albeit difficult, for Amtrak to become operationally self-sufficient by 2003.

Based on our assessment of Amtrak's 1999 Strategic Business Plan (Plan),[1] we still believe that it is possible for Amtrak to achieve operating self-sufficiency. However, this will depend greatly on Amtrak filling the $692 million gap in its 1999 Strategic Business Plan. Furthermore, high-speed rail service in the Northeast Corridor must begin as soon as prudently possible so that the expected revenue benefits can accrue in 2001 with the full ramp up of high-speed service, and the service can achieve its full revenue potential in 2003, the first year of operating self-sufficiency.

Amtrak must finalize and provide its long-promised, long-term strategic capital plan to Congress. The Amtrak Reform and Accountability Act of 1997 (ARAA) makes it clear that operating assistance will disappear after 2002,[2] but it is silent on the issue of continued capital assistance. Amtrak's capital needs beyond 2002, particularly on the Southend of the Northeast Corridor, will be in the billions of dollars, and without a clear accounting of these needs, Congress and the Administration cannot begin to determine how to address this issue.

This capital bill will grow between now and 2002 if Amtrak is unable to deliver the revenue promised from high-speed rail and other business plan actions. Increased losses will have to be covered with funds that could otherwise be used on capital projects. Every dollar spent on operating losses is a dollar taken away from capital investment.

Today, we would like to present our views on Amtrak's Fiscal Year 1999 operating results, the outlook for Amtrak's future financial performance, the financial impact of delays in the high-speed rail program, and Amtrak's long-term capital funding needs.

First, 1999 Operating Results. Amtrak's operating results, while positive in some areas, still indicate the need for significant improvements in order to reach operating self-sufficiency by 2003.

[1] Report No. CE-1999-116, July 21, 1999. *Report on the 1999 Assessment of Amtrak's Financial Needs Through Fiscal Year 2002,* Office of Inspector General, U.S. Department of Transportation.
[2] Except for excess RRTA expenses.

On the positive side, Amtrak's systemwide passenger revenue grew by almost 6 percent in 1999, although this was short of Amtrak's goals. Systemwide ridership increased by 2 percent from 1998 levels, led by growth of better than 3 percent in both the Northeast Corridor and Amtrak West business units. Intercity ridership decreased by 1.6 percent, due in part to fare increases, reservation system glitches, and residual effects from the Bourbonnais accident last March. Nevertheless, all three business units posted increases in passenger revenues ranging from 2 to 11 percent.

Amtrak's 1999 operating loss of $907 million, including depreciation, was $47 million more than its 1998 loss and the largest in Amtrak's history.[3] Amtrak's test for self-sufficiency, however, pivots on its cash losses rather than its operating losses. In 1999, the cash loss was $569 million, nearly equal to the $578 million loss in 1994, Amtrak's largest cash loss. This was $44 million higher than the 1998 cash loss and $9 million worse than Amtrak projected for 1999.

Amtrak, however, is reporting a budget result $8 million *better* than its Plan. The $17 million difference reflects two charges that Generally Accepted Accounting Principles define as operating expenses. These expenses are netted out of Amtrak's budget result because they are fully funded through Amtrak's capital program. Our calculation of Amtrak's cash loss is consistent with how the loss will be calculated in *2003* when the ARAA mandates that all operating expenses, except excess RRTA[4] payments, must be funded from non-Federal sources. If Amtrak intends to continue to use its Federal capital funding for some operating expenses (e.g., progressive overhauls of equipment) beyond 2002, that issue will need to be resolved between Amtrak, the Administration, and Congress.

Second, Risks to Self-Sufficiency. Amtrak is entering a critical year in its path to achieving self-sufficiency. We have identified $692 million in projected revenue increases and cost reductions that we believe are at risk of not being achieved between 2000 and 2002, and $192 million of this amount is in 2000. Over half of the $692 million represents placeholders for the intended benefits from several key initiatives – Amtrak's Market-Based Network Analysis, Service Standards initiatives, and other management actions that had not been identified in 1999. In 2000, these initiatives are projected to result in a combined bottom-line impact of about $52 million.

[3] Amtrak's reported operating loss for 1998 was $930 million, which included the full amount of retroactive labor payments attributable to the years 1996 through 1998 (per newly settled labor agreements). After allocating these costs to the years in which they were incurred, the 1998 operating loss totals $860 million.

[4] Railroad Retirement Tax Act

Amtrak's 2000 Strategic Business Plan must translate these initiatives into measurable, concrete actions that will significantly increase revenues and reduce expenses. Amtrak's nearly completed Market-Based Network Analysis will document where opportunities exist for Amtrak to improve the operating results of its intercity rail service. It will also make clear the costs of maintaining service where market demand—in spite of frequency, fare, and schedule adjustments—is insufficient to cover operating costs.

If the plans Amtrak develops fail to yield the required revenue increases and cost reductions represented by the placeholders, it will be forced to use scarce capital funds to cover higher-than-projected operating losses. As a result, Amtrak will be unable to invest in the capital projects it has identified as the means of eliminating future losses, thereby threatening Amtrak's ability to achieve and maintain operating self-sufficiency. Along with beginning high-speed rail, *filling* and then successfully *ful*filling the 1999 Plan placeholders will be Amtrak's most critical challenges in 2000.

Third, Delays in High-Speed Rail. The delays in high-speed trainset deliveries will affect Amtrak's financial results for 2000 and 2001. Amtrak must find additional sources of revenue, other than those projected in its 1999 Strategic Business Plan, to replace the approximately $41 million in net revenue that Amtrak estimates it will not realize in 2000 because of the delays in the high-speed rail program. Amtrak has identified means to compensate for this expected revenue shortfall, but we have not had an opportunity to analyze the plans and their projected financial impacts. Unfortunately, had high-speed rail services started as planned, these newly identified revenues could have supplied additional funds that could have been used to close Amtrak's capital funding gap through 2002, which we estimated as $244 million.

The currently expected 6-month delay in the delivery of the new Acela Express high-speed trainsets to Amtrak is not likely to increase the risk to self-sufficiency in 2003. The delay reflects problems that surfaced during testing of the new trainsets and locomotives. Revenues from high-speed rail will play a significant role in Amtrak's plans to become self-sufficient, and it is imperative that Amtrak achieve the projected results, *once the service is fully operational.* The $41 million in net revenue foregone in 2000 because of the delay is comparatively minor; the far more significant challenge in 2000 and beyond will be addressing the $692 million at risk in the 1999 Strategic Business Plan including the successful definition and implementation of the placeholders in that Plan.

Amtrak plans to begin a limited Acela Regional service in January 2000 using existing equipment to offer electrified service between Boston and New York. This service will start despite the electrification system being only partially

complete. Construction and testing are expected to continue concurrently with the operation of this service through June 2000. Furthermore, Amtrak currently plans to begin Acela Express service immediately after the first high-speed trainsets are ready for service in May 2000.

Although Amtrak faces significant pressures to start the electrified and high-speed services as quickly as possible, much more important to Amtrak's long-term viability is the quality and reliability of those services. Amtrak must be prudent and not respond to such pressure by introducing services that it may not be able to operate with consistent reliability. If this happens, Amtrak may risk long-term damage to its ability to attract and retain riders.

Fourth, Long-Term Capital Funding. Amtrak's long-term capital funding needs must be addressed if Amtrak is to maintain operating self-sufficiency beyond 2003. It is important to recognize a distinction between operating self-sufficiency and Amtrak's long-term capital investment requirements. Operating self-sufficiency, as defined in ARAA, requires Amtrak to cover all of its operating expenses, except excess RRTA payments, with funds from non-Federal sources after 2002. ARAA is silent on whether Federal capital grants to Amtrak would continue beyond 2002.

If Amtrak reaches operating self-sufficiency in 2003, substantial capital investment in the Northeast Corridor must be made over the next 15 years to sustain that self-sufficiency. Amtrak has a multi-billion dollar backlog of deferred investment on the Northeast Corridor south of New Haven that must be addressed soon after 2003. This includes replacement of the catenary and power supply systems, rebuilding of switches and high-speed turnouts, and track and bridge improvements. If these infrastructure improvements are not made, the quality of high-speed service on the Northeast Corridor will start to deteriorate, threatening the ridership and revenue that are essential for Amtrak to maintain operating self-sufficiency.

In 1995, Amtrak and the Federal Railroad Administration promised to provide Congress a detailed, 20-year capital plan the following year. The plan would identify all these capital investment needs and their timing, cost, and funding sources. Four years later, that promise has still not been kept. It is imperative that this plan be completed in early 2000. Without this critical input, Amtrak cannot complete the development of a credible capital investment strategy nor can the Administration and Congress determine how to fund such requirements.

In the short term, Amtrak's projected Federal funding through 2002 will not be enough to cover its minimum capital needs – the level of investment needed to continue operations in a steady state through 2002. We project that the shortfall

will total $244 million, primarily in 2001 and 2002, when Taxpayer Relief Act funds have been largely expended. In the long term, Amtrak will require annual capital funding substantially greater than it currently receives. These funds are needed to rebuild the Northeast Corridor, maintain the capital assets in the rest of the system, and invest in new corridor development and other business growth opportunities.

We believe that, after Amtrak has produced its capital plan, Congress, the Administration, and Amtrak should proceed to determine an appropriate level of long-term capital funding necessary to sustain a commercially viable railroad and to identify the means by which this funding will be provided. This effort, in essence, will define the future national passenger rail system.

Operating Results

Amtrak's unaudited 1999 operating loss of $907 million,[5] while on target with Amtrak's projections, was $47 million more than its 1998 loss and the largest in Amtrak's history. The increase in operating losses primarily reflects slower than targeted growth in passenger revenues and increases in depreciation expenses resulting from Amtrak's recent investments in equipment and other large capital projects. These factors were partially offset by better-than-projected performance in Amtrak's commuter and commercial business activities.

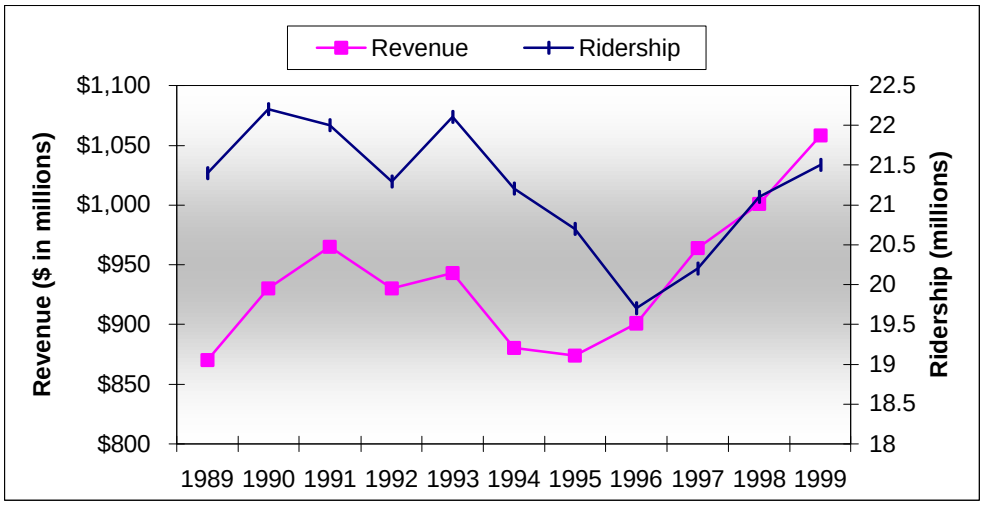
Amtrak's test for self-sufficiency pivots on its cash losses rather than its operating losses. In 1999, Amtrak's cash loss was $569 million. This represents an increase of $44 million from the 1998 cash loss of $525 million and was $9 million worse than Amtrak's goal. Amtrak is reporting a budget result $8 million better than its Plan. The $17 million difference reflects two charges that Generally Accepted Accounting Principles define as operating expenses, but they do not add to Amtrak's unfunded loss, or budget result, because they are fully funded through Amtrak's capital program. Our calculation of Amtrak's cash loss is consistent with how the loss will be calculated in 2003 when ARAA mandates that all operating expenses, except excess RRTA payments, must be funded from non-Federal sources. If Amtrak intends to continue to use its Federal capital funding for some operating expenses (e.g., progressive overhauls of equipment) beyond 2002, that issue will need to be resolved between Amtrak, the Administration, and Congress.

We note, however, that Amtrak's plans for improving revenues and reducing expenses include a number of initiatives with significant up-front costs, including Service Standards training, the Market-Based Network Analysis, the express

[5] Includes depreciation and other non-cash expenses.

shipment business, and contracting-out of the food service. If these efforts are successful, they will start to repay Amtrak with increased revenues and expense savings over the long term. For example, Amtrak's contract earlier this year with Dobbs Food Services to take over commissary functions resulted in employee buyouts. These buyouts are one-time cash payments that more than offset the first-year contract savings. We expect that in 2000 and in each year thereafter, Amtrak's net result from this action will be positive.

Figure 1. Systemwide Passenger Revenue & Ridership Trends, 1989 through 1999

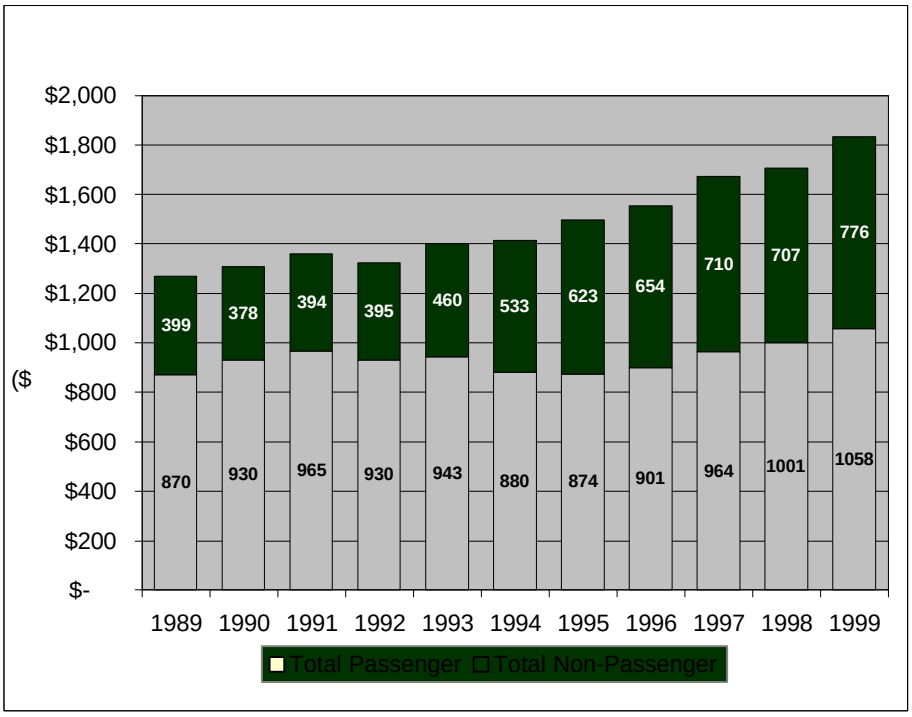


On the positive side, Amtrak's systemwide passenger revenue grew by almost 6 percent in 1999; however, this was short of Amtrak's goals. Systemwide ridership increased by 2 percent from 1998 levels. Figure 1 illustrates the overall trends in revenue and ridership between 1989 and 1999. The largest ridership growth was in the Northeast Corridor, with 3.3 percent more riders than last year, followed by Amtrak West ridership growth of 3.1 percent. Intercity ridership decreased 1.6 percent, due in part to fare increases, reservation system glitches, and residual effects from the Bourbonnais accident last March. Nevertheless, all

business units posted increases in passenger revenues: nearly 2 percent in Intercity, 8 percent in the Northeast Corridor, and over 11 percent in Amtrak West.

Non-passenger revenues have become increasingly important for improving Amtrak's bottom line. These revenues are generated from activities such as commuter operations, mail and express services, and right-of-way access fees. In 1999, non-passenger revenues topped $775 million, an increase of $68 million from 1998. Non-passenger activities now account for over 42 percent of Amtrak's total operating revenues. Figure 2 illustrates the changes in the make-up of Amtrak's revenues between 1989 and 1999.

Figure 2. Composition of Total Revenues, 1989 through 1999



In 1999, Amtrak's commuter and commercial operations generated an operating profit that exceeded its Plan by $28 million. These exceptional results were offset, in part, by lower-than-projected performance in reimbursable and express business

activity. Also noteworthy, in 1999, State support payments approached $100 million, $17 million (21 percent) higher than in 1998. While continued increases in operating support payments from the States are expected, it is not likely that Amtrak can sustain yearly increases of this magnitude.

On a cautionary note, Amtrak's year-end 1999 financial results were on target with its Plan, but it was only able to meet the overall 1999 projections because of exceptionally strong commercial revenues from the Northeast Corridor business unit. These revenues included the one-time sale of property in Rhode Island that yielded about $15 million in revenues. Such actions and their associated financial benefits help close the gap in the near term. However, stopgap measures such as these are not a long-term solution – expendable assets like the Rhode Island property are scarce. Other assets, such as parking garages and stations owned by Amtrak, could be sold, but the short-term cash infusion will come at the expense of sustained long-term commercial income. Even so, it will become increasingly more difficult to close budget gaps as the performance bar is raised higher and the window for improvements continues to close.

Ability to Reach Operating Self-Sufficiency

Along with beginning high-speed train service, filling and then successfully fulfilling the 1999 Strategic Business Plan placeholders will be Amtrak's most critical challenge in 2000.

Amtrak's 1999 Strategic Business Plan projected a nearly $300 million improvement in its annual cash losses during the period 1999 through 2002, and projected reaching operating self-sufficiency in 2002. Based on our assessment of Amtrak's 1999 Plan, we are somewhat less optimistic. We identified $695 million in Amtrak's projections that we believe are at risk of not being achieved;

$692 million of this is at risk in the period 2000 to 2002. We restated the total projected cash loss between 1999 and 2002 from $1.6 billion to $2.3 billion.

We are concerned that a large component of the $692 million at risk represents plans that have not yet been identified or translated into concrete actions with measurable results. Of the $692 million, $379 million includes placeholders representing the intended benefits from several key initiatives – Amtrak's Market-Based Network Analysis, Service Standards initiatives, and other management actions that had not been identified in 1999. In 2000, these initiatives are projected to result in a combined bottom-line impact of about $52 million.

The Market-Based Network Analysis is a year-long effort undertaken by Amtrak with the goal of identifying ways to maximize revenues by better meeting customer demand. Amtrak has used extensive market research, travel demand models, and operating and engineering analyses to identify the potential cost and revenue effects of any adjustments to its current service profile. Amtrak is also exploring ways to improve integration of passenger service and commercial ventures such as mail and express service as a way to increase revenues where passenger revenues alone fall short of operating costs. The ultimate goal of this effort is for Amtrak to define a commercially viable national network consistent with the goal of operating self-sufficiency by the end of 2002.

In the next year, the Market-Based Network Analysis and the other undefined business actions must be translated into concrete actions – for example, service adjustments, cost-sharing agreements with States, or employee policy changes – that can be implemented with measurable outcomes. If Amtrak is unable to identify actions that will result in significant benefits, or if the actions themselves fail to yield the projected revenue increases or cost savings, Amtrak will find itself in a very difficult situation. Amtrak will then be forced to use scarce capital funds

to cover higher-than-projected operating losses and thereby be constrained from investing in the capital projects aimed at eliminating future losses. Were this to occur, Amtrak would face a mounting barrier to achieving and then sustaining operating self-sufficiency.

Amtrak is likely to face resistance to implementing unpopular service adjustments, and as such it will be difficult to realize the maximum benefits from the Market-Based Network Analysis. Amtrak is committed to maintaining a national system of passenger rail service, but for almost 30 years, Amtrak has contended with two often-conflicting objectives: operating as a private business and serving the public interest. The results of the Market-Based Network Analysis will indicate where opportunities exist to improve the operating results of its Intercity service. It will also make clear the costs of maintaining service where market demand—in spite of frequency, fare, and schedule adjustments—is insufficient to cover operating costs. This information is critical for Amtrak to operate in a businesslike manner. In addition, acknowledging the actual cost to Amtrak and the Federal budget of maintaining desired but unprofitable parts of the national passenger rail system will better enable Congress and the Administration to make decisions on whether and how losses associated with these services should be covered.

Delays in Electrified and High-Speed Rail Services

Amtrak's recently announced delay in the delivery of the high-speed trainsets will affect Amtrak's start-up of service and reduce the revenues realized from this service in 2000 and 2001. While this will force Amtrak to identify other sources of revenue to compensate for these revenue losses, we do not believe at this point that these delays will affect Amtrak's financial results in 2003 – the first year of mandated operating self-sufficiency. The critical factor in terms of Amtrak's

ability to reach self-sufficiency will be the success of the project once it is fully implemented – Amtrak's ability to fully realize, and sustain, projected high-speed rail revenues.

Although Amtrak has delayed the start-up of its Acela Express service until the trainsets are ready for revenue service, it plans to go ahead with a limited Acela Regional service starting in January 2000. This service will include two roundtrips daily between Boston and New York at travel times of just under 4 hours. Current travel times range from 4 hours 30 minutes to over 6 hours. (When the high-speed trainsets begin service, the fastest time will drop to 3 hours.) These plans, however, depend on the electrification contractor completing a sufficient amount of work to allow Amtrak to run continuous electrified service on at least one track between New Haven and Boston. The plan is a patchwork approach that establishes one dedicated route by electrifying only selected sections of track, requiring trains to shift from eastbound to westbound tracks several times. Amtrak and the contractor have agreed to defer noncritical work in some areas until after service starts to allow the contractor to target resources to establishing this route.

Amtrak still must overcome three potential barriers to starting its service in January. In the Boston Terminal Area, Amtrak's contractor faces a difficult working environment because of the extensive work being done on the Central Artery/Tunnel Project and the large volume of Amtrak and commuter traffic operating through the area daily. Although no Central Artery construction remains on the railroad right-of-way, highway construction equipment in the surrounding areas complicates the timely movement and staging of the electrification contractor's equipment. Heavy commuter traffic also makes it difficult to schedule time when the tracks can be taken out of service to allow the contractor uninterrupted access for construction. The electrification of five

movable bridges between Old Saybrook and Mystic, Connecticut, also poses challenges for Amtrak because of electrification design and construction complexities. Additionally, testing on four of the eight electrical sections is already behind schedule, and problems related to voltage transformer failures that emerged during testing of the first electrified section threaten further delays if a solution is not identified quickly.

In addition to the concerns we have about Amtrak's ability to begin this service as planned, we are also concerned that the operation of electrified service during construction and testing of the electrical system will affect service reliability. Persistent track outages could interrupt planned service, and track work that requires enforcement of slow orders will affect speed.

The revenues from high-speed rail will play a significant role in Amtrak's plans to become self-sufficient, and it is imperative that Amtrak achieve the projected results *once the service is fully operational*. When fully operational, Amtrak is projecting over $180 million in annual net revenues from the Northeast Corridor. But the projected loss of revenues from the trainset delay in 2000 and 2001, in and of itself, is unlikely to compromise Amtrak's ability to reach its self-sufficiency goal. In FY 2000, Amtrak can compensate for the trainset delays by identifying $41 million in revenues to replace foregone high-speed rail revenues. This will be minor compared to Amtrak's challenge in 2000 and beyond of finding ways to address the $692 million we found at risk from other actions in the 1999 Plan. The critical element in this effort will be successfully defining and implementing the $379 million representing the Market-Based Network Analysis, the Service Standards initiative, and the undefined business initiatives in the last Plan. In fact, the temporary loss of high-speed rail revenues makes it that much more critical that Amtrak vigorously work to identify, implement, and pursue benefits that fulfill the projections related to these actions.

Despite the fact that the electrification project will not be complete, Amtrak is planning to start electrified service in January 2000. Amtrak also plans to begin Acela Express service immediately after the first high-speed trainsets are ready for service, optimistically within 6 months. Although Amtrak faces significant pressures to start the electrified and high-speed services as quickly as possible, much more important to Amtrak's long-term viability is the quality and reliability of those services. It is our concern that if Amtrak rushes to compensate for delays by introducing services that it is unable to operate with consistent reliability, it may risk damaging its long-term ability to attract and retain riders. The deferment of initial revenues is more easily overcome than the losses that could result – and be sustained – if Amtrak's initial services fall short of their promises.

Every day that high-speed service is delayed means a loss of valuable revenues to Amtrak, and Amtrak should strive vigorously to minimize delays and begin revenue service as quickly as possible. At the same time, if Amtrak feels compelled to begin prematurely a service that is unreliable and does not live up to its promises, the cost to Amtrak in long-term sustained revenue losses could be far greater.

Capital Needs

If Amtrak reaches operating self-sufficiency in 2003, substantial capital investment in the Northeast Corridor and the rest of Amtrak's system must be made over the next 15 years to sustain that self-sufficiency. Amtrak has a multi-billion dollar backlog of deferred investment on the Northeast Corridor south of New Haven that must be addressed soon after 2003. This includes replacement of the catenary and power supply systems, rebuilding of switches and

high-speed turnouts, and track and bridge improvements.[6] If these infrastructure improvements are not made, the quality of high-speed service on the Northeast Corridor will start to deteriorate, threatening the ridership and revenue that are essential for Amtrak to maintain operating self-sufficiency.

In 1995, Amtrak and the Federal Railroad Administration promised Congress a detailed, 20-year capital plan that would be provided the following year. The plan would identify all these capital investment needs and their timing, cost, and funding sources. Four years later, that promise has still not been kept. It is imperative that this plan be completed as soon as possible. Without this critical input, Amtrak cannot complete the development of a credible capital investment strategy nor can the Administration and Congress determine how to fund such requirements. With the growing capital funding gap, we believe Congress, the Administration, and Amtrak should proceed to determine an appropriate level of long-term capital funding necessary to sustain a commercially viable railroad and to identify the means by which this funding will be provided. This effort, in essence, will define the future national passenger rail system.

In the short term, even with the Taxpayer Relief Act (TRA) funds of $2.2 billion provided to Amtrak in 1998 and 1999, Amtrak's projected Federal funding through 2002 will not be enough to cover its minimum capital needs – the level of investment needed to continue operations in a steady state through 2002. Our 1999 assessment projected that the shortfall would total $244 million, primarily in 2001 and 2002, when TRA funds have been largely expended.

We would like to mention one final point on the subject of capital funding. In addition to direct Federal capital support, the States have become an increasingly

[6] Catenary is the system of overhead wires and supporting structures that supply electric power to the trains. A turnout connects two parallel tracks permitting a train to move between the tracks.

important source of capital funds for Amtrak, particularly in California, Oregon, and Washington. We believe that States have the potential to mitigate even more of Amtrak's capital funding shortfalls by sharing more of the costs of purchasing, improving, and maintaining equipment and facilities. Amtrak and the States support Senate Bill S-1144, which would give States flexibility to use highway funds provided in the Transportation Equity Act for the 21st Century (TEA-21) on passenger rail service, a spending option currently prohibited. If this bill were to pass, States could use TEA-21 funds to invest in and retain service that might otherwise be eliminated.

Mr. Chairman, the successful implementation of the Northeast Corridor high-speed rail program and service improvements resulting from the Market-Based Network Analysis will play a crucial role in shaping Amtrak's remaining glidepath to operating self-sufficiency. I can assure you we will look closely at these initiatives, along with other proposed actions in Amtrak's new Strategic Business Plan, and keep you and your staff fully informed. We expect to have our assessment report on Amtrak's 2000 Strategic Business Plan available next spring. This concludes our statement. I would be pleased to answer any questions.