

**Before the Subcommittee on Transportation, Treasury, the Judiciary,
Housing and Urban Development, and Related Agencies
Committee on Appropriations
United States Senate**

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Intercity Passenger Rail and Amtrak

**Statement of
Mark R. Dayton, Senior Economist
U.S. Department of Transportation, Office
of Inspector General**



Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to present the views of the Office of Inspector General on Federal funding for Amtrak in Fiscal Year (FY) 2007.

Once again, as with last year, the key to maintaining fiscal discipline at Amtrak will be the work of this Subcommittee and your colleagues in the House. We can report today that the provisions the Committee put in place for this fiscal year are having an impact: the Amtrak Board of Directors and current management seem committed to reform, efficiency improvements are beginning to be implemented, and some reductions in required operating subsidies are being realized. But the heavy lifting has just begun and current reform efforts will require many years of sustained commitment. Indeed, much of the financial benefits in the form of significant operating loss savings will not occur for several years.

Absent a fundamental restructuring of the company through reauthorization, it will fall to the Appropriations Committees to continue the pressure for reform, specifically by limiting the funds made available to subsidize operating losses and by making Federal support conditional upon further operational restructuring.

The Bottom Line. To maintain the currently configured system in a steady state of repair and after accounting for the reform efforts already underway, the FY 2007 appropriation for Amtrak would need to be about \$1.4 billion. This includes \$485 million for cash operating losses, \$600 million for capital spending, and \$295 million for debt service. The operating subsidy amount would continue the pressure on Amtrak for reform put in place by Congress last year, the capital amount would simply keep the system from falling into further disrepair, and the debt service amount is Amtrak's fixed costs for repayment of principal and interest.

Despite this being almost a 7 percent increase over the FY 2006 enacted level, it is a tight budget that would leave little or no margin for error in neither operations nor investment. If an operating problem arose that affected revenue or expenses, such as the Acela brake problem, or if an unexpected capital expense arose, such as a bridge failure on the Northeast Corridor (NEC), Amtrak could face insolvency, particularly if the problem were to occur late in the fiscal year after the majority of funds had been spent or committed. Private companies of Amtrak's size often have access to lines of credit to reduce the risk associated with these unforeseeable events or maintain cash reserves in an order of magnitude larger than that typically held by Amtrak.

Working capital of \$125 million would help address the risks Amtrak faces from these unforeseeable events. To ensure these funds are used to cover fluctuations in operations and not for ordinary course expenditures, appropriate controls should be established. One approach for dealing with this problem is to impose the same constraints on use of these funds as those in this year's Efficiency Incentive Grants whereby approval of the Secretary would be required before the year-end level of working capital could fall below \$125 million. Alternatively, a unanimous vote of the Board of Directors could be required in the same event. In either case, if Congress were to provide these funds, additional funds would not be needed for this purpose in future years.

These funding requirements illustrate the fundamental dysfunction that we face with Amtrak: just to maintain the current state of repair—not to address the backlog of infrastructure needs, not to invest in short-distance corridors around the country, not to recapitalize the equipment fleet—requires an \$86 million increase in Amtrak funding in FY 2007 and an increase of over \$200 million to avoid increased risks of insolvency, should Congress decide to provide \$125 million for working capital.

How Did We Get Here? Amtrak's funding requirements actually have not changed appreciably over the past 9 years – only the source of those funds has changed. External funding to Amtrak (in addition to revenue and state support) totaled \$11.6 billion from 1998 through 2006 or almost \$1.3 billion per year.¹ Therefore, the current \$1.4 billion estimate of requirements is in line with past years. It differs, however, in that now all of it must come from direct appropriations, whereas in past years some came from borrowing and some from the Taxpayer Relief Act of 1997. Because debt service increased significantly during this same time period, the \$1.4 billion actually provides less funding for operations and investment than prior year average subsidies.

What are the Solutions? As we testified previously, the current system needs to be fundamentally restructured. Such a restructuring requires new authorizing language for Amtrak programs and funding support. We have enumerated three key goals for successful reform of intercity passenger rail service: (1) continuous improvements in the cost-effectiveness of services provided, (2) devolution of the power to determine those services to the states, and (3) adequate and stable sources of Federal and state funding.

¹ This consists of \$7.7 billion in Federal appropriations; \$2.2 billion in capital funds from the Taxpayer Relief Act of 1997; and \$1.7 billion in net, non-defeased (that is, not pre-funded) borrowing.

These goals can be achieved through six programmatic changes: formula grants to states for capital and operating costs of intercity passenger services, restoration of the forward-going system to a state of good repair, capital matching grants to states for corridor development, establishment of adequate Federal and state funding, resolution of the legacy debt issues, and resolution of NEC ownership and control.

Until a reauthorization is forthcoming, there is much that Amtrak management and its Board can do to achieve these goals and program changes, assisted by this Committee. The company has made strides in reforming its food service provision and may have in place process that will achieve break-even or marginally profitable provision of food service on its trains in the next 4 to 5 years, if it follows through on these initial steps.

Much work remains, however, to eliminate the losses on first class sleeper service. We continue to find unacceptable any Federal subsidy for first class passengers and have yet to see plans for pilot programs to restructure these services. Outsourcing of reservation and maintenance services has become widespread in the transportation sector, but Amtrak has only begun to scratch the surface on assessing its potential. As a condition to taxpayer support in any FY 2007 appropriation, particularly at levels approaching \$1.5 billion, accelerated efforts in these areas should be mandated. Such requirements for fiscal discipline from this Committee and the Congress will keep Amtrak moving in the right direction so that when a reauthorization is finally enacted, the company will be poised to provide better, more efficient services for the country.

I will now discuss these issues in greater detail.

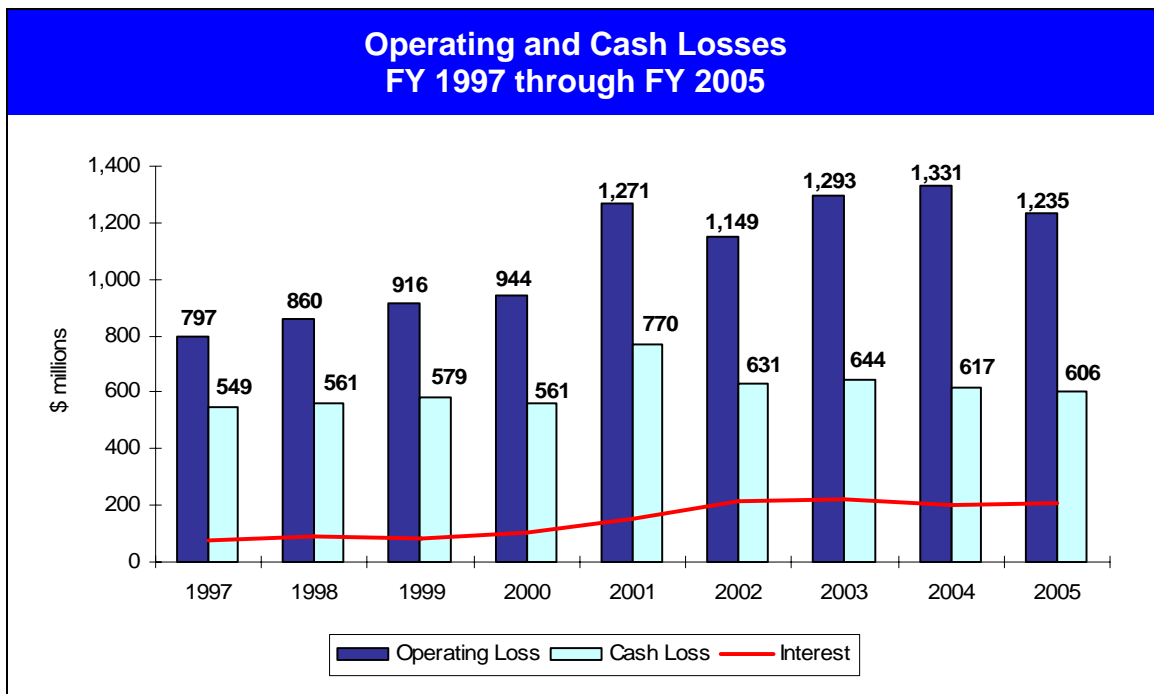
Amtrak's Financial Condition Remains Precarious Because it Has Not Structured Its Services to Match Available Funding

The current model for providing intercity passenger service continues to produce financial instability and poor service quality. Despite multiple efforts over the years to change Amtrak's structure and funding, we have a system that limps along, is never in a state-of-good-repair, awash in debt, and perpetually on the edge of collapse. In the end, Amtrak has been tasked to be all things to all people, but the model under which it operates leaves many unsatisfied.

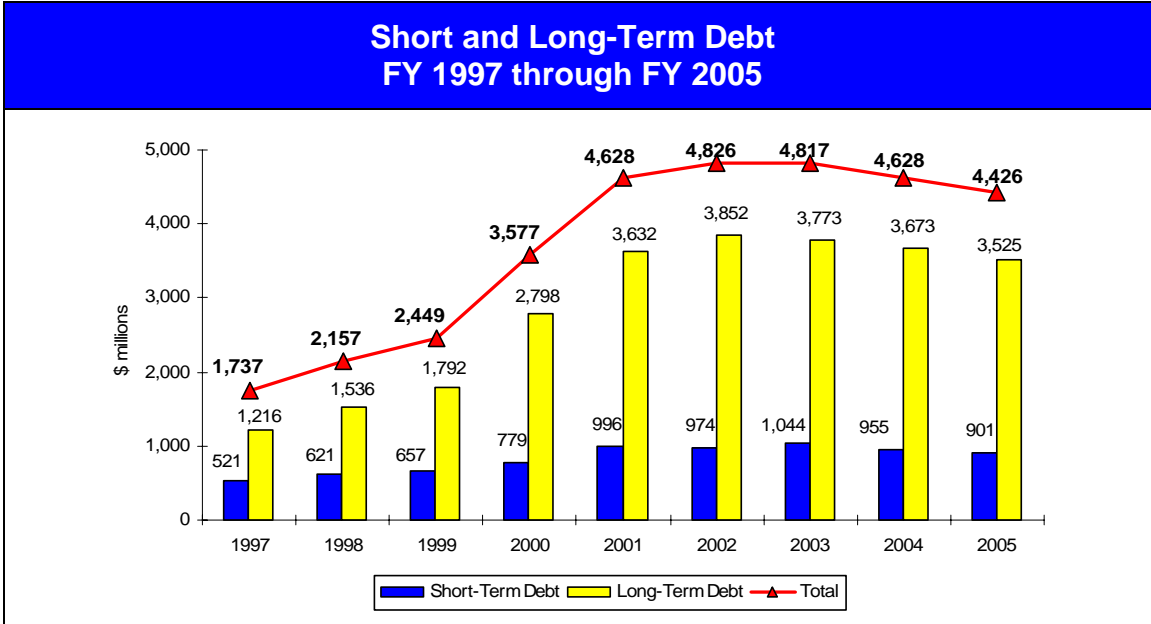
Operating Losses. Amtrak continues to incur substantial operating losses. It ended FY 2005 with an operating loss of \$1.235 billion. On the positive side, during the first 4 months of FY 2006, Amtrak’s net operating loss was \$49 million less than last year and its cash operating loss, excluding interest

and depreciation, was \$74 million less than the same period last year. It remains to be seen if these improved financial results can be sustained for all of FY 2006. In fact, Amtrak has indicated that operating within the \$485 million operating subsidy for this year will likely require some one-time actions in spite of its performance to date.

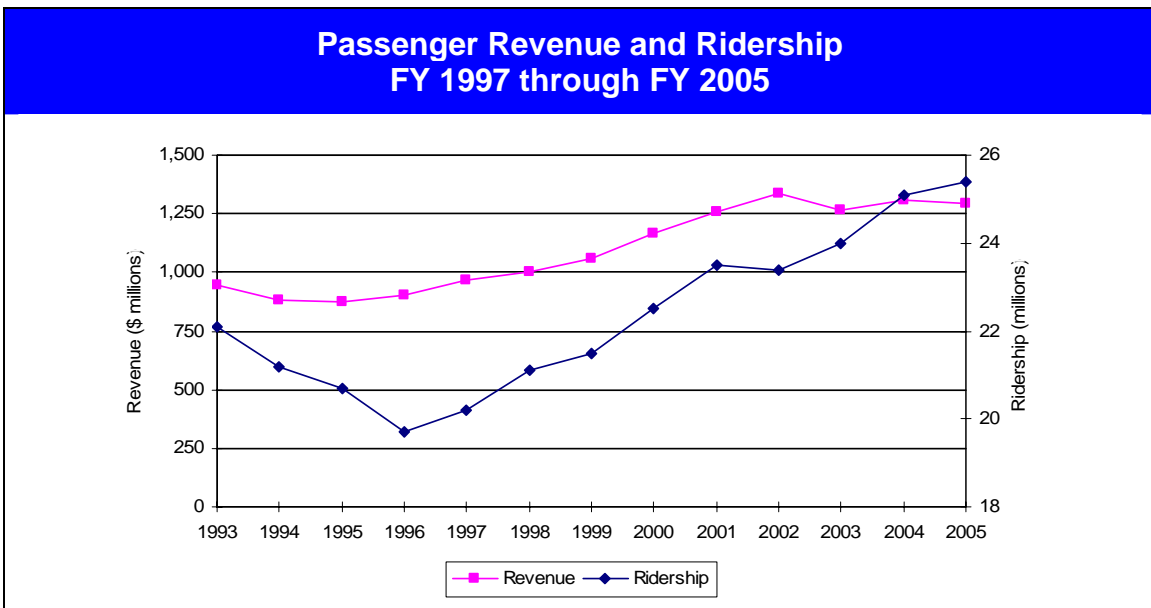
Putting these results in perspective, the system continues to suffer operating losses on all but a handful of routes. Operating losses on long-distance trains, excluding interest and depreciation, were \$529 million in FY 2005. Losses on some long-distance trains (excluding depreciation and interest) exceed \$400 per passenger. For the last 5 years, annual cash losses have exceeded \$600 million, though their persistence at this level primarily is attributable to increased interest expense. Amtrak has made some progress in controlling its cash operating loss, excluding interest.



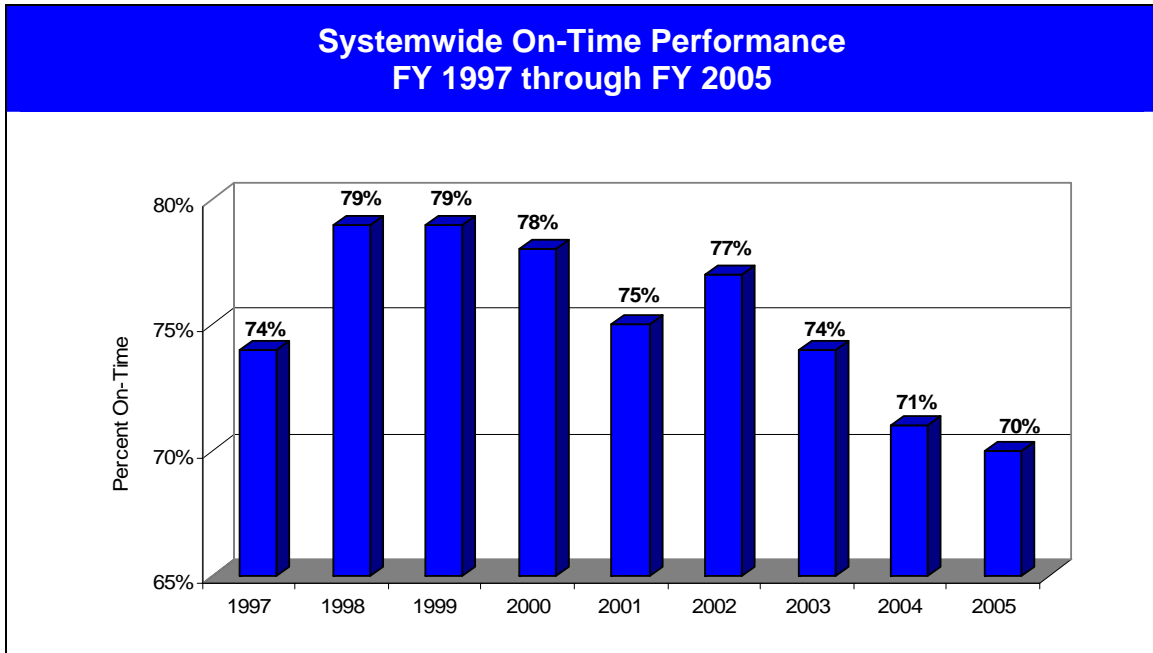
Debt Burden. Amtrak is carrying a large debt burden. Its total debt peaked at \$4.8 billion in FY 2002 and has declined only slightly in the past 2 years. For the foreseeable future, Amtrak’s annual debt service will approach \$300 million.



Revenue and Ridership. While ridership increased to 25.4 million in FY 2005, passenger revenues declined to \$1.292 billion, and remain below the \$1.340 billion achieved in 2002. For the first 4 months of FY 2006, passenger revenues were \$31 million higher than the same period in FY 2005, mainly due to fare increases. Ridership growth during this period was less than 1 percent.



On-Time Performance. On-time performance fell from 74 percent in FY 2003 to 70 percent in FY 2005, with even Amtrak’s premier service—Acela Express—achieving on-time performance of only 76 percent. On-time performance for long-distance trains averaged 41.4 percent last year, with the poorest performing train, the Sunset Limited, having an on-time performance of only 7 percent. Systemwide on-time performance through January 2006 was 66 percent, compared to 72 percent for the first 4 months of FY 2005.



Absent Reauthorization, the Appropriations Process Can Provide Needed Fiscal Discipline Over Amtrak’s Operating Losses

The system needs to be fundamentally restructured through a reauthorization. In the absence of a reauthorization last year, the Appropriations Committee established a process in FY 2006 to achieve meaningful, but incremental, operational reforms. We believe this process is not a substitute for reauthorization, but it is of considerable value nonetheless; and we strongly encourage Congress to continue it in FY 2007.

The FY 2006 Appropriations bill specifically directs Amtrak to achieve savings through operating efficiencies, including, but not limited to, modifications to food and beverage service and first-class service. The bill also exerts pressure on Amtrak to reform by reducing Amtrak’s operating subsidy from the FY 2005 level of \$570 million to \$495 million. (A 1-percent recision, \$4.95 million, and a

designation of \$5 million for the development of a managerial cost accounting system, combined to reduce the funds available to subsidize ongoing operations to \$485 million.) In addition, \$31.7 million was made available for an efficiency grant program aimed at providing additional capital investments if Amtrak reduces operating costs to live within its FY 2006 Federal operating subsidy.

The FY 2006 Appropriation bill also requires our office to report quarterly to this Committee and its counterpart in the House on whether or not and to what extent Amtrak has achieved savings as a result of operational reforms. We must certify whether or not Amtrak has achieved such savings by July 1, 2006 if Amtrak is to continue its use of FY 2006 appropriated funds to subsidize the net losses from food, beverage, and sleeper car service on any Amtrak route.

In our January 5, 2006 report to this Committee, we set Amtrak's overall operating subsidy baseline at \$586 million. This baseline represents Amtrak's FY 2006 projected operating loss after accounting for anticipated costs and revenue adjustments. It also reflects the savings resulting from initiatives implemented in FY 2005 and FY 2006 prior to our issuing the report.

This fiscal year, Amtrak will need to achieve \$101 million in savings from the \$586 million operating loss baseline to operate within its Federal subsidy. In addition to sustainable operational reforms, Amtrak plans to rely on one-time actions, and revenue increases to meet its end of year budget goals. One-time actions will not be considered as part of our July certification process. It is our opinion that Congress intended us to consider only those savings from sustainable, structural reforms when we decide in July whether or not Amtrak has achieved enough savings from operational reforms to warrant certification.

Amtrak Needs to Respond Aggressively to the Appropriations Bill Requirements and See These Initiatives Through to Completion

To address needed savings from operational reform, Amtrak has developed an implementation plan for 15 new initiatives. These include a plan for restructuring its food and beverage service and dining and lounge car operations over several years; adopting a reliability-centered maintenance approach to increase fleet maintenance efficiencies; consolidating maintenance facilities and reducing maintenance overtime; outsourcing and reducing staff at stations; improving fuel efficiency; renegotiating labor agreements to eliminate outsourcing and work rule restrictions; and reducing outside legal fees. Other initiatives such as restructuring long-distance train services, improving financial management systems, and

improving service reliability on the Northeast Corridor are only in the beginning planning stage. Our Quarterly Reports will examine Amtrak's reform efforts to determine whether Amtrak is fully addressing potential reform opportunities and whether planned initiatives are meeting their stated goals and are sustainable over the long-term.

The initial focus of Amtrak's reform efforts is its food and beverage service. The company has made strides in reforming its food service provision and may have in place a process that will achieve break-even or marginally profitable provision of food service on its trains. Amtrak plans to implement its strategic initiatives, including food and beverage service, over a 6-year period, with some not fully implemented until FY 2012. Once fully implemented, Amtrak projects savings of \$190 million a year from these initiatives.

Our preliminary analysis of Amtrak's operating savings for the first 4-months of FY 2006 indicate that only about \$20 million in such savings can be expected this fiscal year. These savings amount to only 20 percent of the savings Amtrak must achieve to live within its FY 2006 Federal operating subsidy. Amtrak plans to close the remaining gap with one-time actions and budget adjustments, spending the remaining FY 2005 year-end cash reserves, and better-than-projected revenue performance.

These short-term gap-closing actions will not reduce Amtrak's need for subsidies in FY 2007 or beyond. In addition, Amtrak initially planned to rely on the \$31.7 million Efficiency Incentive Grant to make ends meet in FY 2006 and reduce the need for further operational savings. As we stated in our January Quarterly Report, we do not believe it would be appropriate to anticipatorily count these discretionary grants toward achieving the required savings. Congress should require a business plan from Amtrak that does not rely on these savings and specifically identifies all the savings required to operate within its FY 2006 resources. Congress should also continue the pressure on Amtrak to be expansive and aggressive in the scope and pace of implementing long-term, structural operating reforms.

As mentioned earlier, Amtrak needs to address the cost of providing long-distance service, and, in particular, first-class sleeper service. In July 2005, we reported that Amtrak could save between \$75 million and \$158 million in annual operating costs by eliminating sleeper car service, outsourcing food and beverage service, and eliminating other amenities on long-distance trains. The plan Amtrak is preparing on how to improve the operational and financial performance of these trains needs to fully address these areas for potential significant savings.

Reauthorization is a Better Course for Reforming Intercity Passenger Rail Service

Incremental operating savings over the next 5 or 6 years will not be sufficient to fund the significant increases in capital investment required to return the system to a state-of-good-repair and promote corridor development. This mismatch of funding sources and needs requires a long-term solution that can be achieved only by changing the model for intercity passenger rail.

To create a new model for intercity passenger rail, a comprehensive reauthorization that provides new direction and adequate funding is needed. The problem with the current model extends beyond funding—there are inadequate incentives for Amtrak to provide cost-effective service; state-of-good-repair needs are not being adequately addressed; and states have insufficient leverage in determining service delivery options, in part because Amtrak receives Federal rail funds, not the states.

Reauthorization should establish meaningful reforms that ensure greater cost-effectiveness, responsiveness, and reliability in the delivery of passenger rail transportation. Three central themes will drive successful reform.

- **Improvements in Cost-Effectiveness.** Amtrak, as the sole provider of intercity passenger rail service has few incentives, other than the threat of budget cuts or elimination, for cost control or delivery of services in a cost-effective way. Amtrak has not achieved significant costs savings since its last reauthorization.
- **States Need a Larger Voice in Determining Service Requirements.** The current model for providing intercity passenger service does not put states in a position to decide upon the best mix of service for their needs—what cities are served, schedules and frequency of service, and what amenities should be provided. Those decisions are made by Amtrak, and they are not always in the best interests of the states served. Intercity passenger rail would be better served with state-led initiatives as to where and how intercity passenger rail service is developed. States are best able to determine the level of passenger rail service required to meet their strategic transportation needs and state sponsorship will become increasingly important as they will be asked to provide increased operating and investment support. Capital funding decisions, as with mass transit, should ultimately reside with the Department of Transportation, based on congressional direction and in partnership with the states.

- **Adequate and Stable Federal Funding is Essential.** None of the corridors around the country, including the Northeast Corridor, can provide the type of mobility needed without significant capital investment. In the NEC, this means bringing the existing facilities to a state-of-good-repair with no match requirement. In other corridors around the country, it means creating the infrastructure for high-frequency services in partnership with freight railroads and commuter authorities. A robust Federal program of capital matching grants will be essential if these corridors are to be developed. In addition, long-distance services that provide connections between corridors require recapitalization if they are to be run efficiently and are to provide the high quality services their passengers deserve. None of this, however, implies giving more money directly to Amtrak, especially under the current model.

In our view, a framework for reauthorization requires the incorporation of six core elements.

1. **Formula Grants to States for Capital and Operating Costs.** This program would address the needs of areas served by long-distance routes that have little corridor development potential, while simultaneously creating incentives for states to encourage operating efficiencies from the service operator. Formula funds can be used for operating expenses, capital maintenance, and/or capital improvements at the discretion of the states and have no match requirement.
2. **Restoration of the Forward-Going System to a State-of-Good-Repair.** This program would provide Federal funds, with no match required, to address the accumulated backlog of deferred investment and maintenance on the NEC and in fleet and facilities outside the NEC. After a state-of-good-repair has been achieved, capital funds with a reasonable state match would be available for capital maintenance.
3. **Capital Matching Grants to States for Development of Corridor Services.** This program would give states the ability to improve and expand routes and service on their supported corridor routes through a Federal capital funding program with a reasonable state match requirement.
4. **Setting Federal and State Funding of These Programs at Adequate Levels.** Federal funding levels, along with state contributions have not been sufficient to subsidize operations, address deferred capital needs, and significantly improve service along the existing rail network. It will require

minimum Federal funding of \$2.0 billion a year to restore the system to a state-of-good-repair and provide funding for new corridor development.

5. **Resolution of the Legacy Debt Issue.** This element would give the Secretary the authority to evaluate Amtrak's debt and to take action in the best interest of intercity passenger rail that is economically advantageous to the United States Government.

6. **Resolution of Northeast Corridor Ownership.** The NEC is of considerable interest in reauthorization. Unlike the rest of the passenger rail system, Amtrak owns the infrastructure between Boston and Washington, D.C. The Federal Government may decide to take on the responsibility of restoring the NEC to a state-of-good-repair, and its debt—if it is determined to be in the public's interest to do so. Once the NEC is returned to a state-of-good-repair, the states can take a larger responsibility in directing and managing ongoing operations and maintenance. In return for fully funding the corridor, the Federal Government may decide to take title to Amtrak's assets. Although Amtrak may very likely remain the operator for NEC, we will be in a better position to decide what is the best use and ownership structure of NEC assets by the end of the reauthorization period.

This framework would require cost efficiencies as Federal funds available to cover operating losses would decline over the 5-year reauthorization period. Specifically, it would give states greater responsibility for passenger rail investments with oversight of capital investment vested in the Department. Additionally, it would focus Federal funding on stable and robust capital investment programs that would bring the system to a state-of-good-repair, maintain it in that condition, and provide for the development of corridors throughout the country.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions at this time.