

**Before the Committee on Commerce, Science, and Transportation  
Subcommittee on Surface Transportation and Merchant Marine  
United States Senate**

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# **Reauthorization of Intercity Passenger Rail and Amtrak**

**Statement of  
The Honorable Kenneth M. Mead  
Inspector General  
U.S. Department of Transportation**



Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on reauthorization of intercity passenger rail and Amtrak. Intercity passenger rail is an important component of a balanced transportation system. Amtrak's authorization expired in 2002. In the interim, Congress has provided direction in piecemeal fashion in the appropriations process. We have testified several times since then on Amtrak's unsustainably large operating losses, poor on-time performance, and increasing levels of deferred infrastructure and fleet investment. We find ourselves testifying again today on these same subjects, but with greater urgency. As time goes on, the current limp-along status quo system comes closer to a major failure, but no one knows where or when such a failure may occur.

We reported in November 2004, that the current model for intercity passenger rail is broken. And the reason it is broken goes beyond persistent budgetary shortfalls and extends to matters like who decides on the type and amount of service, who provides service, and who selects the providers. Other than budget cuts or the threat of budget cuts, the current model provides few incentives for cost control or delivery of services in a cost-effective way.

Amtrak is quite literally coming to the end of its rope and, for several reasons, the bankruptcy option would be an extraordinarily complex and risky undertaking—in our opinion, one not to be relied upon if the objective is to promote a more rational and reliable national passenger rail system. In short, a comprehensive reauthorization that provides new direction and adequate funding is needed and needed this year.

The reauthorization, in our opinion, should focus on improving mobility in short distance corridors around the country—not just in the Northeast Corridor—and in restructuring long-distance services to complement corridor services. This will require new relationships or partnerships between the Federal Government and the states and among the states, Amtrak, and the freight railroads, and give the states much greater authority and control over intercity passenger rail decisions. But, in order for this to work, a considerably more robust Federal funding program for capital, with a reasonable state match, will be required along with additional state contributions.

The Administration's proposal recognizes that the current model is broken and confronts several key issues in a straightforward way, while leaving others less clear or unanswered. We concur with the emphasis on corridor development within and outside the Northeast Corridor—these are the places where the demand is—and we concur as well with the greater decision-making powers given the states.

Also, reauthorization should leave open the door to competition. Amtrak is currently the sole provider of intercity passenger rail service and, as such, has few incentives, other than the threat of funding cuts, to operate more efficiently. While we are not in a position to say how many, if any, potential competitors there might be, there needs to be a level playing field to promote competition, and consideration must be given as well to the legitimate interests of the freight railroads who own the rail infrastructure outside the Northeast Corridor.

Left unanswered by the Administration's proposal, however, is a central issue, most notably the approximate level of funding it supports. This has fostered a perception that while the states would be given more authority, the funding burden for operating losses would fall largely on them, with no corresponding commitment to significantly expand Federal capital funding. The debate on reauthorization would be much better informed if the Administration's bill spelled out Federal funding levels with greater clarity. We fully recognize that the problems of the current model extend beyond matters of money, but funding levels are an integral part of any solution and in reaching consensus.

Our own take on the funding issue is as follows. In Fiscal Year (FY) 2005 Amtrak received a Federal appropriation of \$1.2 billion. In addition, Amtrak anticipates \$140 million in state contributions for operating costs and \$200 million for capital projects. In effect, Amtrak had access to funds of about \$1.5 billion. This level of funding is not sufficient to make progress toward achieving a state of good repair.

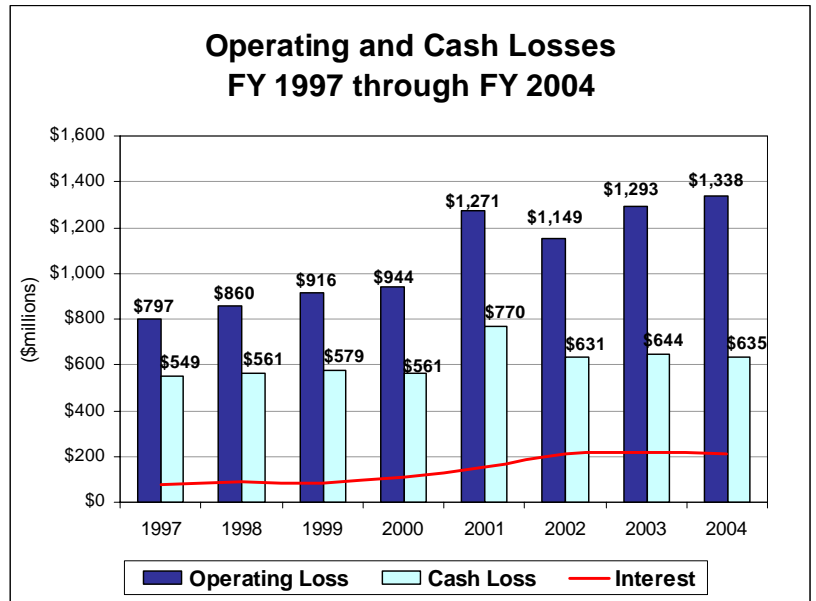
If Amtrak receives only \$1.2 billion in Federal funding in FY 2006, even combined with expected state operating and capital contributions, they will likely continue to defer needed capital investment and may need to cut services. Amtrak needs Federal funding between \$1.4 billion and \$1.5 billion, plus existing state contributions, in order to maintain the status quo as we know it today. However, this level of funding would not be sufficient to move the system to a state-of-good-repair, let alone permit investment in new corridor development.

For 2007 and beyond, Federal funding levels between \$1.7 billion and \$2.0 billion would put us on the road to bringing the existing infrastructure and fleet to a state-of-good-repair and better position states to use Federal funds plus their own revenues to invest in rail corridors. This assumes that states would provide a reasonable match of 15 to 30 percent for capital grants and would cover a larger portion of operating subsidies and that Amtrak would implement cost saving measures in such areas as food and beverage service.

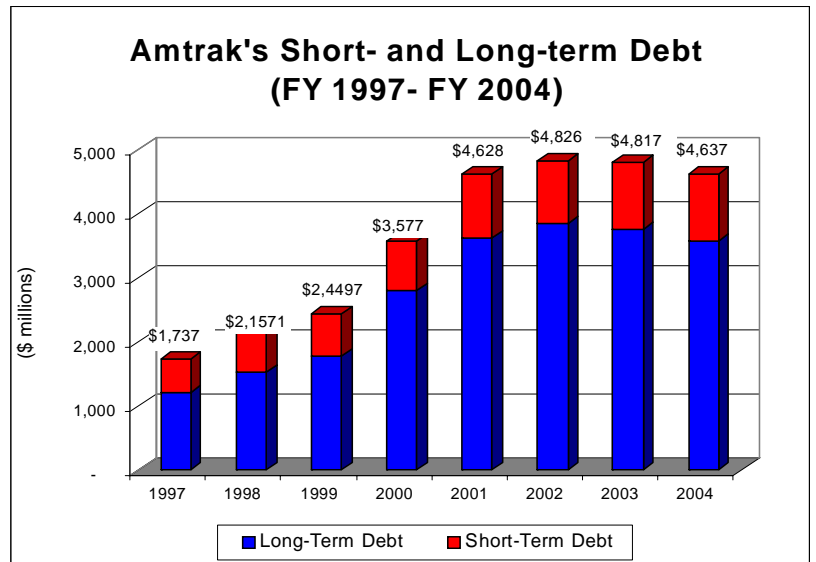
## Current Model Is Broken, Resulting in Severe Financial Instability and Declining Service Quality

Despite multiple efforts over the years to change Amtrak's structure and funding, we have a system that limps along, 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. Consider the following:

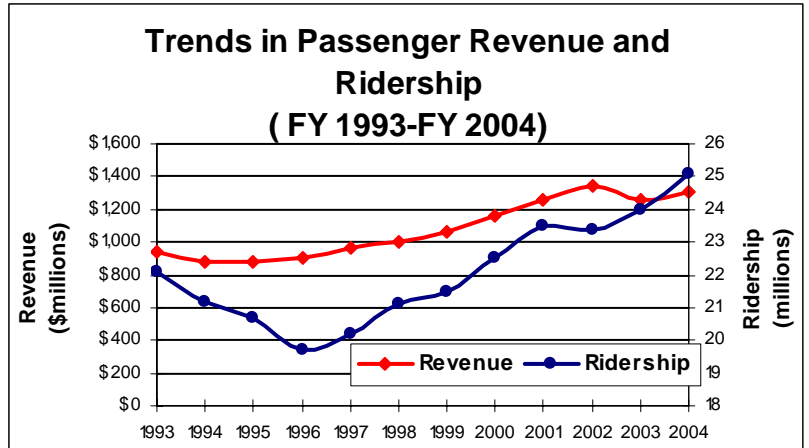
- Amtrak is in a precarious financial condition. Its system continues to suffer operating losses on all but a handful of routes. Losses on some long-distance trains (excluding depreciation and interest) exceed \$400 per passenger. For the last 6 years the average annual cash losses have exceeded \$600 million. The growth in cash losses since FY 2000 is primarily attributable to rising interest expense.



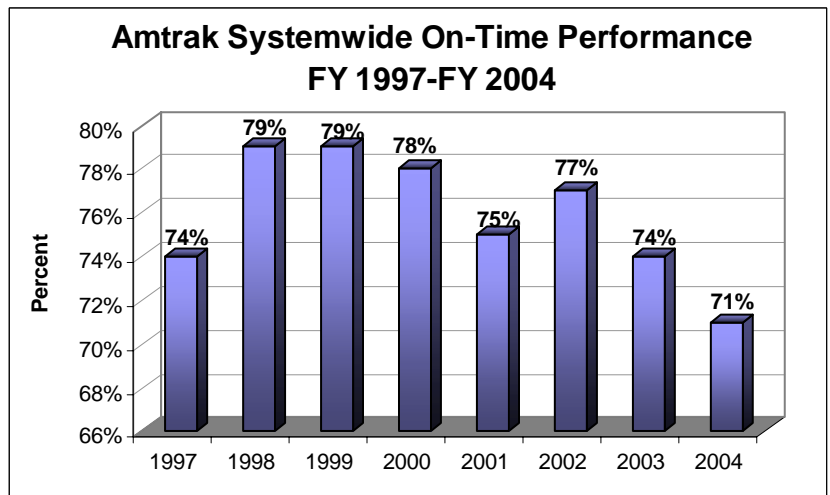
- Amtrak is carrying a large debt burden. Its total debt grew 178 percent between FY 1997 and FY 2002, although it has declined slightly in the past 2 years. For the foreseeable future, Amtrak's annual debt service payments will approach \$300 million.



- While ridership increased to 25.1 million in FY 2004, passenger revenues were \$1,304 million, below the \$1,341 million achieved in 2002, due primarily to fare pressures. For the first 5 months of FY 2005, passenger revenues were \$3 million lower than the same period in FY 2004.



- Amtrak has an estimated \$5 billion backlog of state-of-good-repair investments, and underinvestment is becoming increasingly visible in its effects on service quality and reliability. Deferred capital investment has led to several system failures in recent years, including a failure of a key 12-kilovolt electric cable during the August 2003 northeast power blackout; fallen overhead power lines (catenary) on the line between New York and New Rochelle; and broken bolts on the Thames River bridge in Connecticut. No one knows where or when a critical failure will occur, but continued deferral of needed investment increases the risk that it may not be too far away.
- Further, on-time performance fell from 74 percent in FY 2003 to 71 percent in FY 2004, with even Amtrak’s premier service – Acela Express – achieving on-time performance of only 74 percent. On-time performance for long-distance trains averaged less than 50 percent. Last year, the poorest performing train, in this regard, was the Sunset Limited, with an on-time performance of only 4 percent.



Today, Amtrak’s corridor trains outside the Northeast Corridor, based on current schedules, average 48-mph speeds and long-distance trains average only 46-mph. These speeds reflect scheduled time and overstate the lower

actual speeds due to delays. Deteriorating infrastructure and increasing freight and commuter rail congestion will continue to impact on-time performance.

## **Bankruptcy Is No Substitute for Reauthorization**

A rail bankruptcy is an extraordinarily complex and risky procedure, and we cannot predict how the passenger rail system would emerge from bankruptcy. An Amtrak bankruptcy is no substitute for reauthorization. In our opinion, this is not an option to be relied upon if the objective is to promote a more rational and reliable national passenger rail system.

- **Labor Costs.** Labor negotiations are outside the bankruptcy process. In a non-railroad bankruptcy, the bankruptcy court can cancel or change collective bargaining agreements, which some airlines successfully used as leverage when renegotiating with their unions. In a rail bankruptcy, the Trustee would have to negotiate with Amtrak's unions under the Railway Labor Act.
- **Cash Crunch and Infrastructure Needs.** Amtrak's cash crunch would be exacerbated in bankruptcy. Once in bankruptcy, vendors often demand cash or provide credit under stringent terms. As a result, absent a Federal cash infusion, there is a possibility that major assets such as Penn Station and the Northeast Corridor would need to be sold or remortgaged to raise cash to sustain operations. Meanwhile, the value of the Federal Government's mortgages on these properties would be diluted, and the infrastructure would continue to deteriorate.
- **Public Interest.** Once in bankruptcy, a federally appointed Trustee would direct and manage Amtrak. The trustee must consider the "public interest," which has generally been broadly interpreted as continued operations of the railroad, but in what fashion would clearly be left up to the Trustee and it might not be the best solution or a solution that the reauthorizers would prefer (or what the states would prefer). For example, in order to continue operations, the Trustee may need to shut down various state corridors or long-distance service to stop the bleeding of cash and operating losses.

## **Eliminating Long-Distance Service Will Not Solve the Funding Problem**

Long-distance service has sparked widespread controversy, in part, because of its heavy subsidies. In 2004, long-distance trains cumulatively incurred operating losses of more than \$600 million (excluding interest and depreciation). In fact, the loss per passenger exceeded \$400 on two of these trains—Sunset Limited and Southwest Chief. Eliminating long-distance service reduces operating losses associated with long-distance trains by about half (or \$300 million) but will not make Amtrak profitable.

Because long-distance trains share stations and facilities with corridor trains, eliminating the long-distance trains would not eliminate the shared costs. In addition, Amtrak allocates a share of overhead and infrastructure maintenance to the long-distance trains – some of these costs will be reallocated to all remaining trains. For example, we estimate that \$300 million or more in shared and system costs would be shifted to other corridor trains. Thus, the expected net savings are only about \$300 million. However, these savings would not be immediate – in fact, in the first year, it may cost Amtrak *more* to eliminate the service than to operate it because of its labor severance payouts (commonly called C-2).

Long-distance trains represent about 15 percent of total intercity rail ridership. However, many of long-distance riders do not really travel long distances. In fact, long-distance trains carry only a small number of end-to-end riders. Of the 3.9 million long-distance riders in FY 2004, only 527,000 rode the entire length of the route and another 403,000 rode between city pairs also served by existing corridor service. The remaining 3 million riders traveled along portions of the route. These trips mostly ranged from 500 miles to 700 miles – slightly longer trip lengths than corridor riders.

While eliminating long-distance service may seem appealing from a Federal budgetary standpoint, especially with the large deficits, it ignores the mobility needs of rural areas of the country and the benefits passenger rail provides. Amtrak provides long-distance service in 41 states and is the only intercity passenger rail service in 23 of those states. The questions of whether to provide long-distance service, who makes those decisions, and who funds the losses are critical policy decisions that will need to be made.

## **Where Do We Go From Here? Reauthorization Guidance Is Essential**

The “limp along” approach is costly and leaves many unsatisfied. The current model for providing intercity passenger service does not leave the 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 service amenities. The model provides little balance between the national goals of an integrated network and regional and state transportation needs. How much funding and who provides the funding—Federal, state, or a combination—are also critical questions that need to be addressed. In providing reauthorization guidance, some core elements need to be considered in determining how passenger rail is funded and delivered. Specifically, deciding the levels and mix of Federal and state funding, achieving a state-of-good repair in the Northeast Corridor, determining the appropriate framework to integrate competing demands of infrastructure and operations in the Northeast Corridor, and paying off Amtrak’s legacy debt.

In our opinion, a new model for intercity passenger rail should also include several important aspects. The first is that funding and governance build in incentives for cost cutting. Specifically, eliminating direct subsidies to Amtrak, or any other operator, and channeling funds through the states will likely promote more cost control because an operator will need to better justify costs in order to retain an operating contract. In addition, it will encourage states to maximize efficiency by keeping their own costs to a minimum. Second, the introduction of private competition into the management and operation of intercity passenger rail services will exert additional market pressures on operators to provide cost-effective, higher quality service.

### **Adequate Federal and State Funding Should Be Provided in Order To Restore the Intercity Passenger Rail System and Invest Meaningfully in Corridor Development**

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. In the last 2 years, Amtrak has received annual Federal funding of \$1.2 billion. These amounts were supplemented by operating and capital contributions from state and local sources—in FY 2004 these were \$135 million and \$114 million, respectively. In effect, Amtrak received about \$1.45 billion in public funds.



It will require at least \$2 billion in funding from all sources to begin any meaningful corridor development. The policy challenge is determining who pays for what portions of the system. Federal funding of \$1.4 billion to \$1.5 billion would not provide sufficient funding to maintain a 5-year program toward restoring the system to a state-of-good-repair. Projects in both the Northeast Corridor and in the corridors and long-distance routes outside the Northeast Corridor would continue to be deferred. This simply maintains the limp-along status quo.

One approach to promote adequate Federal and state funding could be to use a variety of grant programs similar to those used in aviation, transit, and highways that place funds in the hands of states. These programs are based on a combination of Federal/state matches and formula grants. More specifically,

- **Capital Grants With a Reasonable Match.** Like the Administration's proposal, this approach would provide capital grants on a competitively determined basis and would be administered by the Department of Transportation (DOT). States that desire to improve existing intercity rail service and/or develop new corridor services would apply to DOT for a matching grant, similar to the Federal Transit Administration's New Starts Capital Program. The Administration's proposal also suggests such a program but provides a 50/50 capital match rate by the end of the reauthorization period. Our view is that a lower state match rate requirement would provide incentives for states to take an "ownership" role in developing rail corridors on a more competitive basis with other transportation modes (historically, highways and transit have used an 80/20 match rate).

To accommodate the need for different types of capital investments, two types of capital matches could be established. For investments that qualify as traditional capital investment, such as track or purchases of passenger equipment, the Federal share could go up to 80 to 85 percent. On the other hand, for investments that qualify as capital maintenance (for example, those under the transit definition) the Federal share might be 70 to 75 percent.

- **Formula Grants With No Match Required.** This approach provides funds to states outside the Northeast Corridor that do not have corridor development potential and that rely on long-distance trains for substantially all intercity passenger rail service. By discussing this approach, we are not taking a position on the ultimate policy of whether long-distance service should be retained or eliminated but merely presenting it as an approach for

funding states that do not have the population densities to support corridor development.

This approach could initially include sufficient funds to subsidize existing long-distance and corridor services. Over the reauthorization period the funds associated with corridor services would be reduced and then eliminated at the end of the period. Further, we expect the level of Federal funds subsidizing the long-distance services would be reduced to reflect greater operating efficiencies resulting from capital investments as well as other savings resulting from food and beverage service changes, improved labor productivity, and efficiencies that may be introduced by competitive service providers.

As determined by the states, funds could be used to defray the cost of operating subsidies, capital investment, or both, with no match required. The amount of the formula grant could be calculated on the basis of Amtrak's Fiscal Year 2005 operating loss allocable per embarking/disembarking passengers in the affected state or some other formula that provides an equitable allocation.

- **Restore Northeast Corridor to a State of Good-Repair.** The Northeast Corridor presents a difficult challenge. The funding priority for the Northeast Corridor reflects the accumulated deferral of investments which has resulted in an estimated \$5 billion backlog of capital projects, threatening current and future service reliability. The effects of the deteriorating infrastructure are readily evident. For example, Amtrak's reported on-time performance in the Northeast Corridor as a whole between 1994 and 2002 ranged from 82 to 89 percent. In FY 2003, it dropped to about 80 percent. For FY 2004, even Amtrak's premiere Acela service posted an on-time performance of only 74 percent, far short of Amtrak's stated goal of 94 percent. If the decision were made to keep the current Northeast Corridor intact, we estimate Amtrak would need to spend about \$575 million annually for an extended period on infrastructure and rolling stock to eliminate the backlog of capital investment in the Northeast Corridor.

However, bringing the eight Northeast Corridor states and the District of Columbia together in a short period of time to direct and manage this effort is incredibly complex but may be achievable by the end of the reauthorization period. Recognizing this challenge, one option during the reauthorization period could be for the Federal Government to fully fund the Northeast Corridor's capital requirements until a state-of-good-repair is achieved. This would also address states' reluctance to inherit a legacy

system they did not create. We suggest that the DOT distribute funds directly to the Northeast Corridor infrastructure manager separately from the competitive grant process.

**Construct for 5-Year Reauthorization Funding.** Congress and the Administration have a difficult decision to make in determining the appropriate level of funding for intercity passenger rail. The level of funding can obviously vary. We have been giving this some thought and would like to present a construct for consideration. We recognize that many assumptions need to be made about who pays for what and how to balance national, regional, and state transportation needs. Those are decisions for Congress and the Administration to make.

In building this construct, we made several assumptions for purposes of illustration. These include:

- Formula grants will not fully cover train operating losses. Amtrak’s forecast net cash operating needs (excluding interest) were used as the starting point. The levels of funding represent imputed cost savings of 10 percent per year from a combination of revenue growth and operating cost savings.
- Over the 5-year reauthorization period, Federal subsidies decline for long-distance trains and corridor operating subsidies shift to the states. We expect states to place higher performance and efficiency demands on the service provider to lower operating costs to more affordable levels.
- Debt service is based on Amtrak’s projected debt service payments through FY 2009, adjusted for installment payments on their RRIF loan and possible early buyout options on leased equipment.
- Capital requirements to restore the system to a state of good repair are based on Amtrak’s Strategic Plan for FY 2005-FY 2009 and on assumptions we made on allocating capital needs between the Northeast Corridor and the rest of the system. The funding allocation assumes a capital need of \$575 million for infrastructure and fleet in the Northeast Corridor and \$250 million for infrastructure and fleet outside the Northeast Corridor.
- Funds available for capital match represent funds remaining after state-of-good-repair funding requirements are met.

**Construct for 5-Year Reauthorization Funding**  
(\$ in Millions)

<b>Federal Contributions</b>	<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>	<b>FY 2009</b>	<b>FY 2010</b>	<b>After State-of-Good Repair</b>
Formula Grants (Capital and/or Operating Subsidy)	\$570	\$513	\$462	\$416	\$374	\$337
Debt Service	276	361	314	298	298	298
Capital to Restore System State-of-Good Repair	754	776	825	825	825	
NEC Infrastructure+Fleet	575	575	575	575	575	
Non-NEC Infrastructure+Fleet	179	201	250	250	250	
Available Capital for Match			97	261	503	1,365
<b>Total Federal Contribution</b>	<b>\$1,600</b>	<b>\$1,650</b>	<b>\$1,700</b>	<b>\$1,800</b>	<b>\$2,000</b>	<b>\$2,000</b>

NEC: Northeast Corridor

New Federal capital available for state match does not become available until annual Federal funding levels reach \$1.7 billion. This construct highlights the policy choice that needs to be made between restoring the system to a state-of-good repair and investment in new corridor development. At \$2 billion, we would expect about \$500 million to be available to states to match for use in new and/or improved corridor development, and after a state-of-good-repair has been achieved this Federal funding level would provide over \$1.3 billion for state capital matches.

**Too Premature to Separate Management of Northeast Corridor Infrastructure From Operations**

Proposals to separate the Northeast Corridor infrastructure management and operations into two independent companies present a level of complexity and risk that needs a more thorough examination. At some point down the road, this split might be feasible and may prove a better way of controlling costs. However, at this juncture, not enough is known about the benefits and risks of this proposal. As we witnessed in Great Britain’s experience, there are risks associated with establishing a commercial, for-profit entity to operate the infrastructure. Allowing an infrastructure company to operate “like a business” may mean relinquishing control over how certain expenses are cut or which capital investments are made. An infrastructure company focused on its bottom line has incentives to make decisions that are in its *financial* best interest but may not be in the best interest from a safety or efficiency perspective for the operator. The result could be, at best, disruption to service and a decline in on-time performance and, at worst, compromised safety conditions.

Aside from the risks of separating the infrastructure from operations in the Northeast Corridor, there are benefits to the integration. In particular, an integrated Northeast Corridor provider of track maintenance, capital programs, operations, and dispatching is likely to be more efficient and less costly than two providers, each having a separate organizational support structure. In addition, a bifurcated approach would require a fully functional oversight and control organization at the outset lodged in the Northeast Corridor compact or the DOT to coordinate between operations and infrastructure. If formation of the Northeast Corridor compact is delayed, there could be disruptions to the operation of the corridor.

It may be possible at some point down the road to develop a model where all interests are best served, but a more thorough review and understanding of lessons learned from other similar attempts would be a valuable precursor to such a division in the Northeast Corridor.

### **Pay Off Legacy Debt and Restrict Future Borrowings**

As of September 30, 2004, Amtrak had long-term debt and lease obligations of about \$3.8 billion with amortization periods extending beyond 20 years. Under the current model, these obligations are paid for with Federal appropriations. Because portions of Amtrak's debt were financed at higher interest rates than what the Federal Government can borrow, Congress and the Administration should consider a one-time appropriation for the specific purpose of discharging any debt that can benefit from the Federal Government's borrowing power, producing long-term Federal savings. For example, Amtrak pays 9.5 percent interest on its mortgage obligation for Penn Station, New York, whereas recent 10-year Treasury notes issued by the Federal Government are yielding a little over 4 percent. In addition, Amtrak's ability to incur long-term debt should be restricted, except for refinancing opportunities that lower interest expense and do not increase the outstanding principal, and no commitments should be made without advance approval by the Secretary of Transportation.

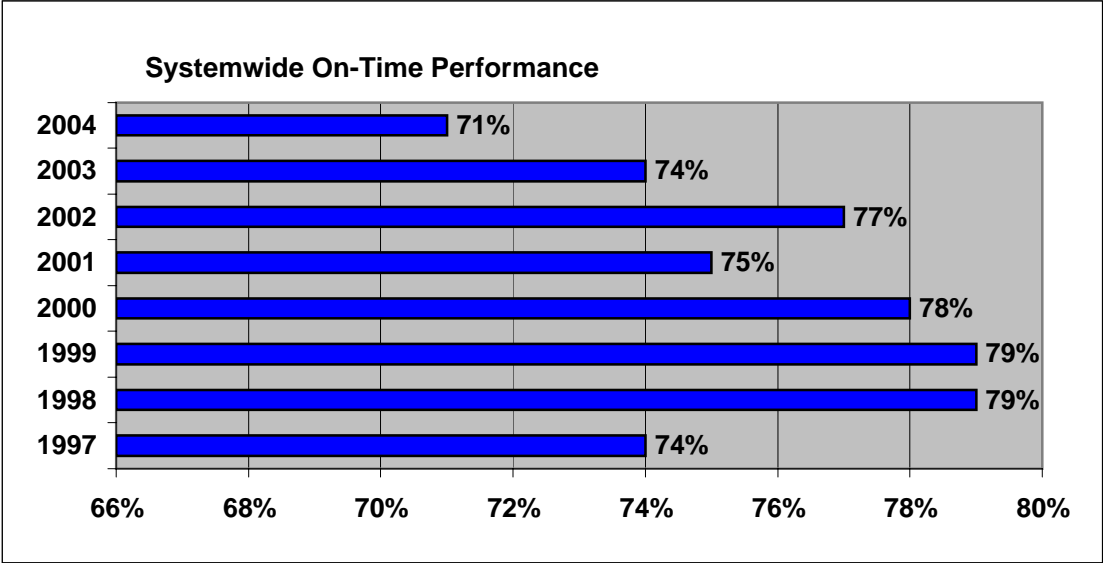
Mr. Chairman, that concludes my statement. I would be happy to answer any questions at this time.

The following pages contain textual versions of the graphs and charts found in the preceding document. These pages were not in the original document but have been added here to accommodate screenreaders and other assistive technology.

**Construct for 5-Year Reauthorization Funding (\$ in millions)**

<b>Federal Contributions</b>	<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>	<b>FY 2009</b>	<b>FY 2010</b>	<b>FY 2011</b>
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	1997	1998	1999	2000	2001	2002	2003	2004
Systemwid	74%	79%	79%	78%	75%	77%	74%	71%





**Figure 6. Amtrak's Short-Term and Long-Term Debt 1997-2004**

	1997	1998	1999	2000	2001	2002	2003
Long-Term Debt	\$ 1,216	\$ 1,536	\$ 1,792	\$ 2,798	\$ 3,632	\$ 3,852	\$ 3,773
Short-Term Debt	\$ 521	\$ 621	\$ 657	\$ 779	\$ 996	\$ 974	\$ 1,044
Total	\$ 1,737	\$ 2,157	\$ 2,449	\$ 3,577	\$ 4,628	\$ 4,826	\$ 4,817

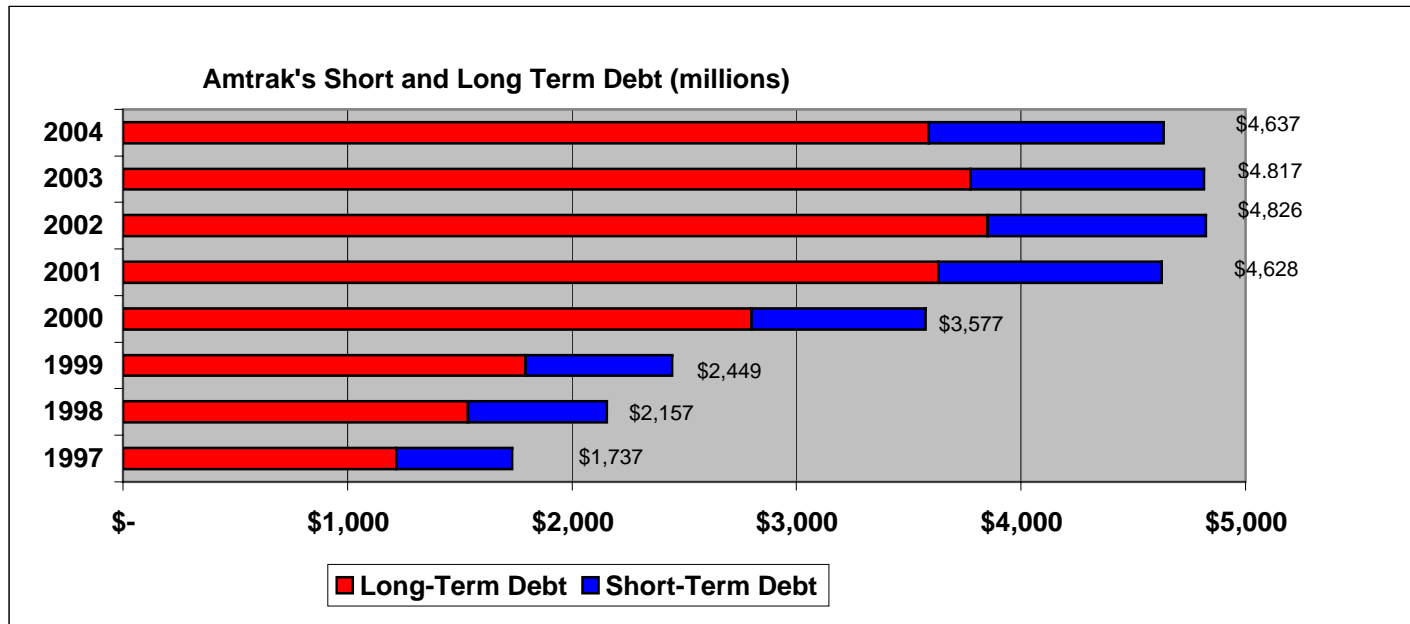


Figure 2. Systemwide Ridership Trends, 1994 Through 2004 (in millions)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Ridership	21.2	20.7	19.7	20.2	21.1	21.5	22.5	23.5	23.4	24.0	25.1

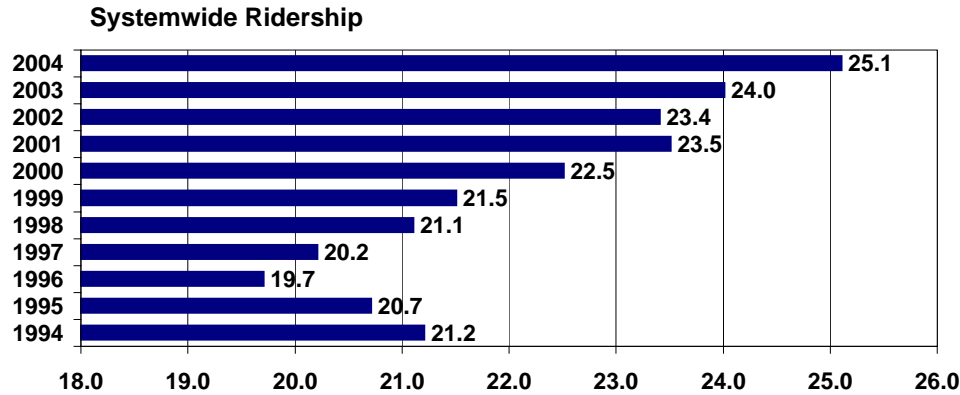
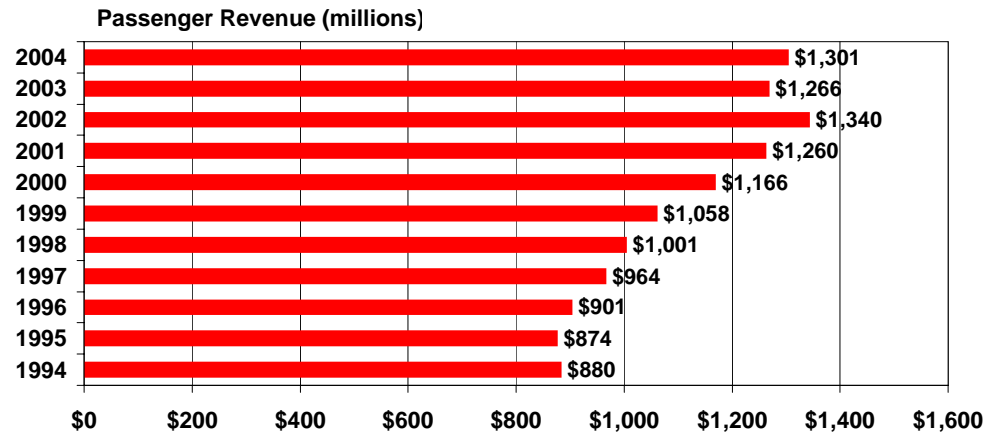


Figure 3. Systemwide Passenger Revenue Trends, 1994 Through 2004 (in millions)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Revenue	880	874	901	964	1,001	1,058	1,166	1,260	1,340	1,266	1,301



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Figure 1a. Operating and Cash Losses, 1994 through 2004 - \$ in millions

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 pre - audited figures
Operating Loss	833	808	798	797	860	916	944	1,271	1,149	1,293	1,338
Cash Loss	578	554	558	549	561	579	561	770	631	644	635

