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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. Our overall assessment is that with strong leadership, intense management, and favorable economic conditions, it will be possible, albeit difficult, for Amtrak to become operationally self-sufficient by 2003. Nevertheless, even if Amtrak reaches operating self-sufficiency, it will require substantial and continuing capital funding to support the system as it currently exists. Today our testimony addresses 5 areas related to Amtrak's financial outlook. They are:

- Amtrak's 1998 operating results,
- Amtrak's ability to achieve operating self-sufficiency by 2003,
- Cost and schedule for the Northeast Corridor High-Speed Rail Project,
- Amtrak's funding needs for capital improvements, and
- Amtrak's request for funding flexibility.

First, Amtrak's operating results were better than the $845 million operating loss (including depreciation) projected for 1998, but the loss still totaled $823 million. This loss *did not* include a $107 million cost adjustment related to Amtrak's labor settlements. Amtrak had expected to record these costs in 1999.

Amtrak's ridership and passenger revenue increased in 1998, but not as much as Amtrak had projected. Non-passenger revenues from activities such as commuter operations, mail and express service, and freight access fees have become increasingly important to Amtrak. In 1998, these sources accounted for 37 percent of *all* Amtrak revenue.

Second, our review of Amtrak's March 1998 Strategic Business Plan showed that Amtrak would sustain an additional $823 million in operating losses between 1999 and 2003, and that it would have an unfunded cash loss of $304 million in 2003, which is $167 million more than it forecast. Amtrak management is aware of our concerns and has indicated that it has taken actions to increase revenues and cut costs. Amtrak has been responsive to the recommendations we made in the Independent Assessment.

To reach operating self-sufficiency by FY 2003, first and foremost, Amtrak must provide good timely service to its customers. It must also implement a robust high-speed rail service in the Northeast Corridor and greatly expand mail and express service, an area that offers considerable opportunity for non-passenger revenue. Amtrak must also improve ridership and revenue on Intercity and

Amtrak West trains, and enhance partnerships with State, regional, and local governments.

Third, the cost of the high-speed rail program in the Northeast Corridor has grown as a result of increasing the number and scope of the projects included in the high-speed rail budget and cost overruns on the electrification project. All project reserves have been depleted and any further cost increases will need to be funded by diverting funds from other system-wide capital needs. The electrification project has experienced repeated delays and is on a very tight schedule for implementation in October 1999.

Fourth, Amtrak's capital funding needs range from a minimum of $2.7 billion to keep the railroad infrastructure in good operating condition through 2003 to $4.0 billion for expansion and business opportunity development. Amtrak's funding will fall short of even the minimum needs by at least $500 million. The amount could be more if Amtrak's operating losses are higher than Amtrak projects.

Finally, Amtrak received congressional approval to spend its 1999 Federal capital appropriation for maintenance of equipment. Amtrak has now requested approval to spend its Federal funding for maintenance of way as well. Without this authority, Amtrak will not be able to cover its operating losses and could be forced to default on current obligations. This could occur even though Amtrak is likely to have $1 billion in Taxpayer Relief Act (TRA) funds in the bank.

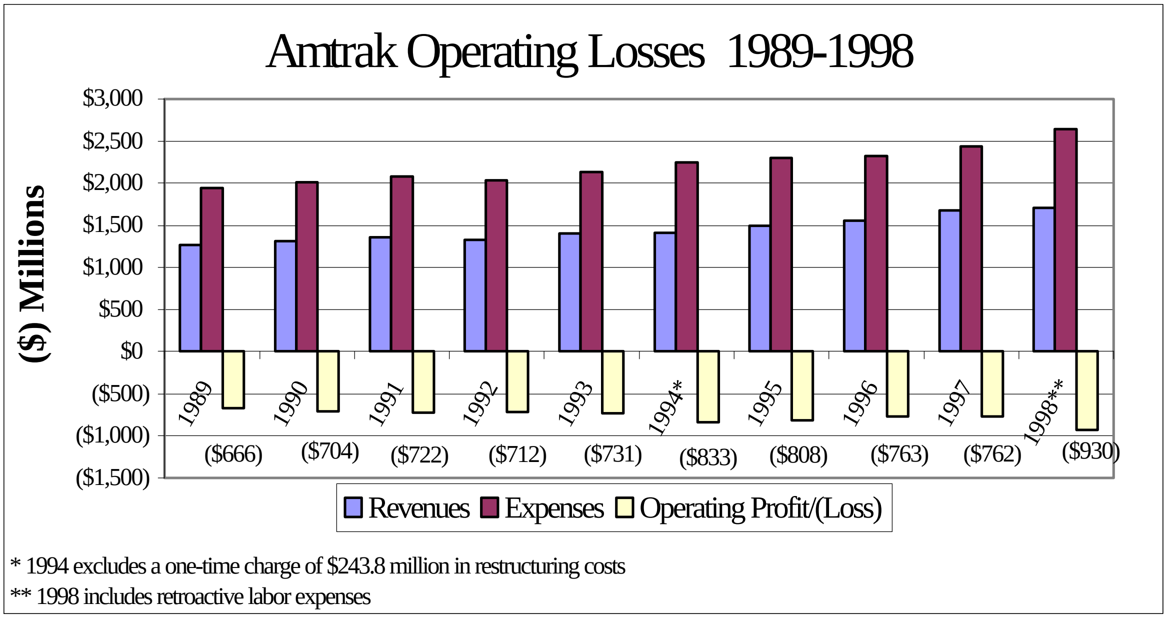
A Perspective on Amtrak's Financial Goals

Since Amtrak was created in 1971 to provide national intercity passenger service, it has been the goal of Congress for Amtrak to become self-sufficient. For Amtrak, this means covering its operating expenses with revenues generated from the services it provides. Despite this long-standing goal, Amtrak has continued to sustain significant operating losses, and has remained dependent on Congress to provide assistance for both operating and capital needs.

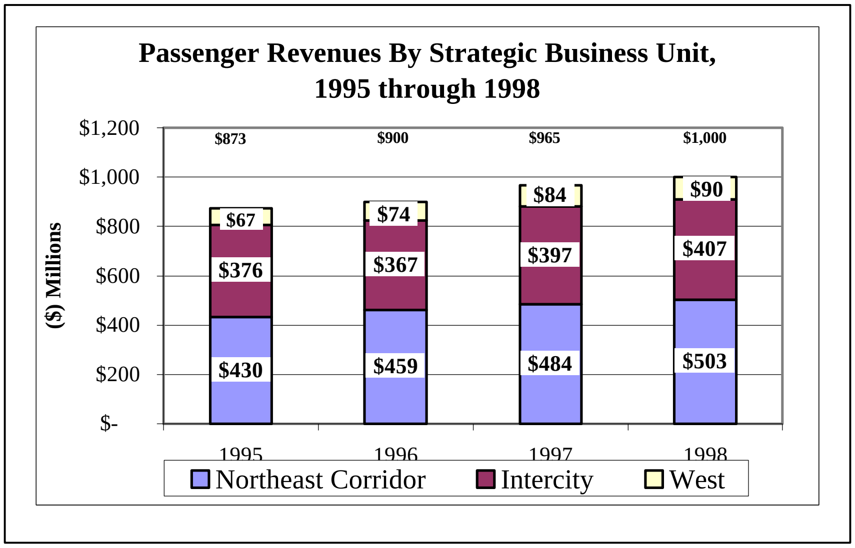
In the 1997 Amtrak Reform and Accountability Act (ARAA), however, Congress mandated that Amtrak develop a plan to eliminate its need for operating support after FY 2002. Thereafter, Amtrak is prohibited from using Federal funds for any operating expenses other than for excess contributions under the Railroad Retirement Tax Act (RRTA). Amtrak has never defined self-sufficiency as generating enough revenues to cover capital needs, and anticipates needing Federal capital support indefinitely. Amtrak *does* believe it can achieve the Congressional mandate of *operating* self-sufficiency.

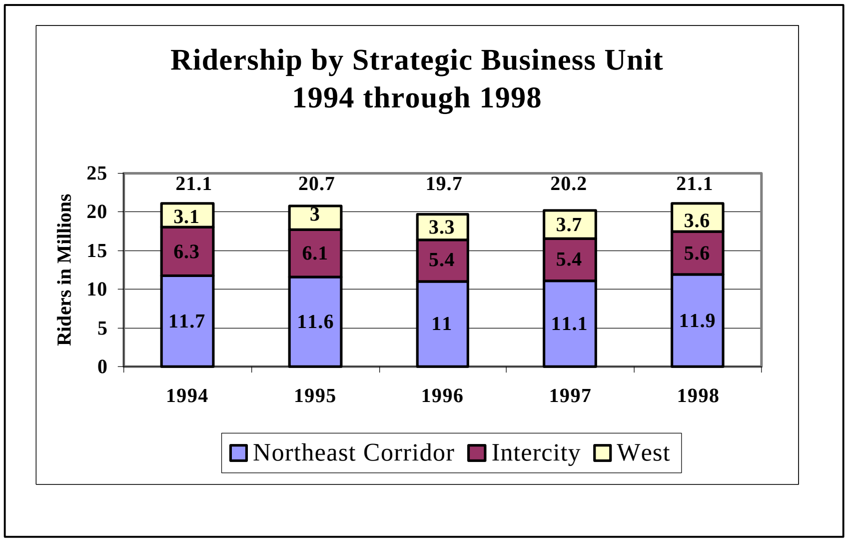
Operating Results

- **Amtrak's 1998 Operating Loss Was Less Than Projected.** Amtrak's 1998 operating loss was $823 million. This was $22 million better than Amtrak's projection. Amtrak recorded an additional $107 million loss as a post-audit adjustment for its labor settlements. The lump sum adjustment for the settlements was for labor expenses for unions that settled their contracts in 1998 or were expected to settle in 1999, and included retroactive payments as far back as 1995. Amtrak had planned to record the costs in 1999, so the additional loss in 1998 is basically an offset between years. The following chart shows the history of Amtrak's operating losses.

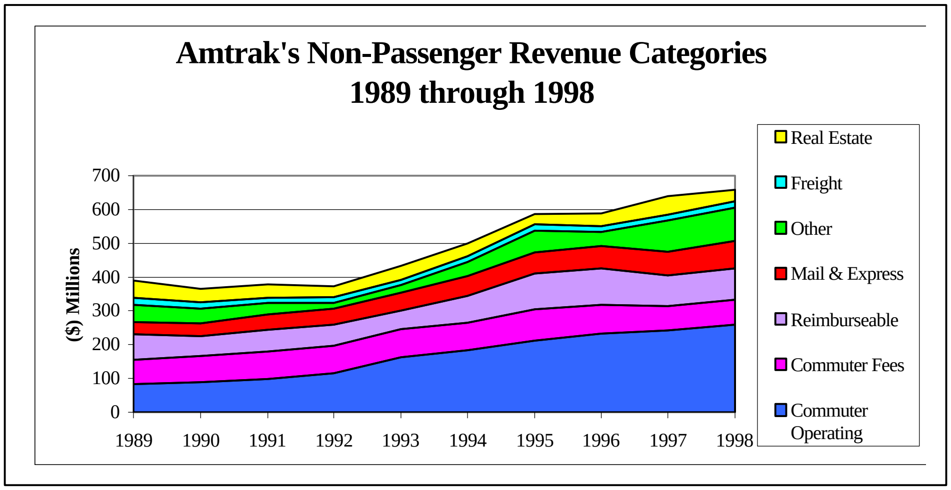


Ridership and Passenger Revenue Have Increased But Not As Much As Projected. Amtrak's system-wide ridership and passenger revenues increased in 1998 by 4 percent over 1997 but both fell short of projected growth by about 3 percentage points. The charts on the following page illustrate the overall growth trends in Amtrak's ridership and passenger revenue.

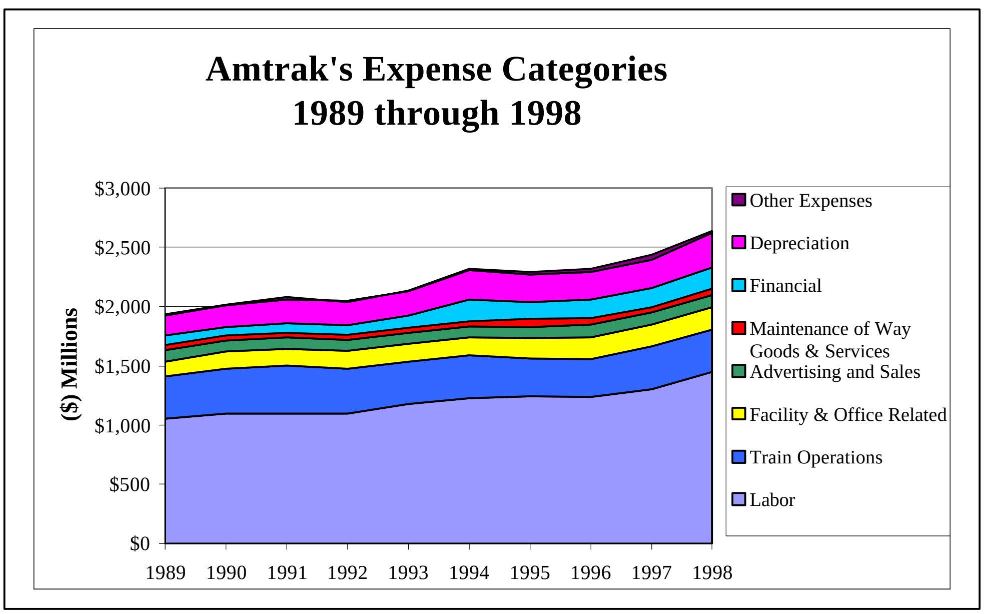




- **Non-Passenger Revenue Has Increased and Is Now A Critical Part of Revenue.** Amtrak's non-passenger revenues, such as those it receives from operating commuter rail services, carrying mail, providing express package service, and allowing freight railroads to access Amtrak's system have increased 60 percent in the past 10 years, from $391 million in 1989 to $626 million in 1998. Commuter operations alone have tripled since 1989. Amtrak has significant opportunities for growth in the non-passenger revenue market, especially in its mail and express package business. The growth of Amtrak's non-passenger revenue is expected to continue, and indeed, will be a critical factor in Amtrak's ability to meet its financial goals. The chart on the following page illustrates the growth of non-passenger revenues since 1989.



- **1998 Expenses Were Less Than Projected.** Amtrak projected a 7 percent increase in expenses between 1997 and 1998. Due to favorable fuel prices and other savings, the actual increase – excluding the post-audit adjustment for the labor settlements – was 4 percent. The following chart depicts Amtrak's expenses since 1989.



Ability to Reach Self-Sufficiency

Our review of Amtrak's March 1998 Strategic Business Plan showed that Amtrak expected to reach operating self-sufficiency by FY 2003. We estimated, however, that if Amtrak were to follow its 1998 plan without any adjustments, Amtrak would sustain an additional $823 million in operating losses between 1999 and 2003, and that it would have an unfunded cash loss of $304 million in 2003, $167 million more than it forecast. (The cash loss does not include depreciation.) Amtrak management is aware of our concerns and has indicated that it has taken actions to increase revenue and cut costs.

A key determinant of Amtrak's future is its ability to increase revenue and reduce costs throughout its system. Revenue improvements will require robust implementation of high-speed rail in the Northeast Corridor, greatly expanded mail and express service, and improved ridership and revenue on Intercity and Amtrak West trains. Amtrak must also develop enhanced partnerships with State, regional, and local governments. Cost reductions will require close attention to actions contained in the Strategic Business Plan and achievement of the productivity increases that are part of the newly negotiated labor agreements.

- **High-speed rail in the Northeast Corridor is vitally important to Amtrak's future.** Amtrak's projected passenger revenues of $3.72 billion between 1999 and 2003 on the Northeast Corridor exceeded what we believe could reasonably be expected, given Amtrak's projected fares, frequencies, and trip times in the Corridor. Our projection of revenues is $3.50 billion during this time period, a difference of $219 million. Our extended projections, however, indicate that the revenues are likely to exceed Amtrak's projections by 2006.

- **Expanded Mail and Express revenues are key to improving the performance of Intercity routes.** In our 1998 assessment, we reduced Amtrak's projected net revenue from Express package service from $104 million to $67 million cumulative in 1999 and 2000. We did not restate Amtrak's projections in the years 2000 through 2003, reflecting our belief that Amtrak could become a competitive player in this market despite the slow start-up in performance. Although Amtrak has recently established several additional partnerships with shippers, Amtrak must vigorously pursue its marketing plans and meet the operating expectations of its shippers if it is realistically to capture more of this traffic.

- **Business Plan Actions must be achieved to produce cost savings.** Amtrak's 1998 Strategic Business Plan contained 296 actions that cumulatively accounted for $1.1 billion in net bottom line impact between 1999 and 2003. We identified 94 actions that required impact adjustments totaling $440 million. The restatements resulted in $153 million in reduced non-passenger revenue projections and a $287 million reduction in expense savings. For 35 of the 94 actions, totaling $372 of the $440 million, Amtrak recognized the fact that the action would not achieve the intended result. For example, a decision by the Federal Energy Regulatory Commission foiled Amtrak's plans to purchase power wholesale for its own use and to resell to other Northeast Corridor users. Amtrak withdrew the action from its business plan, thereby eliminating a projected $212 million in cost savings between 1999 and 2003.

Amtrak's 1999 Strategic Business Plan contains new plans to reduce costs whose financial impact will be important to the success of the 1999 Strategic Business Plan. Amtrak management and the Reform Board must pursue forcefully the actions contained in the 1999 plan and must monitor carefully their implementation. In this year's assessment, we will also be monitoring these proposed expense reductions and will consider the likelihood of their achievement.

- **Labor productivity agreements reached as part of Amtrak's recently settled labor agreements must be fulfilled to offset part of the settlement costs**. Amtrak's labor settlements included plans to offset 20 percent of the incremental cost of the agreements with $53 million in productivity increases. We believe that these productivity targets are achievable. The onus is squarely on management and labor to see that the cost-saving targets are met. In this year's assessment, we are reviewing the specific work-rule changes geared to achieving the cost savings and will assess the likelihood that they will be implemented as required.

Northeast Corridor Improvements

- **Amtrak projects that, by 2002, over $180 million in *net* revenues will result from high-speed rail service in the Northeast Corridor**. These revenues are a critical element of Amtrak's plans to become self-sufficient.
  - **High-speed rail is on schedule to begin at the end of 1999 but the schedule is extremely tight – there is no room for slippage**. Testing of the trainsets is progressing as planned and we have no reason to believe that they will not be delivered on schedule. The electrification project has experienced repeated delays, however, and is on a very tight schedule for completion and full system testing. The original schedule called for completion of all system testing by July 1999, the current schedule is for

October 1999, the same month service is set to begin. A further complicating factor, partially outside of Amtrak's control, is the intersection of the Northeast Corridor with the Central Artery project. Central Artery bridge and tunneling work must be completed on schedule in order for Amtrak to implement high-speed rail as planned. We are not aware of any problems that are likely to adversely impact the scheduled completion of this work.

- **The high-speed rail program has had cost overruns.** The current high-speed rail budget is $2.47 billion, an increase of almost $500 million from project initiation. However, most of this increase stems from an expansion of the project size and scope. For example, Amtrak's addition of 15 high-horsepower locomotives to the high-speed rail program added $120 million to the total project budget. But 40 percent of the budget growth reflects a cost overrun in the electrification project between New Haven and Boston. Because of Amtrak's projected capital funding shortfall between now and 2003, any further cost overruns will need to be funded by diverting funds from other system-wide capital needs.

Capital Needs

- Amtrak has significant capital investment needs, including improvements to keep the railroad infrastructure in good operating condition and investments to generate new business opportunities. We identified needs ranging from $2.7 billion to $4.0 billion. The $2.7 billion is lower than Amtrak's estimate of minimum needs, but even at the lower amount, Amtrak's projected Federal funding will fall short by at least $500 million between 1999 and 2003. If operating losses are higher than Amtrak projected, Amtrak will have to spend more of its scarce capital funds to cover operating losses, and the gap between available funding and capital investment needs will increase.

    - **Amtrak will need $125 million more per year in capital appropriations between 2000 and 2003 than the Administration's request in order for it to attain its minimum needs level of capital investment.** The $2.7 billion minimum level of capital investment we estimated would be enough to keep Amtrak operating in a steady state through the end of 2003, but would make Amtrak vulnerable to equipment problems after that date. *We want to be very clear that this level of funding would make Amtrak susceptible to equipment and schedule reliability problems beyond 2003, thereby threatening its operational self-sufficiency. We do not recommend this level if Amtrak is to remain as currently structured.*

- **Amtrak would require an additional $200 million each year through 2003 to sustain operations at its current level beyond 2003.** With this level of additional funding, projects in progress could be completed and equipment overhauls continued, but no new investments could be made, most notably in new corridor development, one of Amtrak's highest long-term priorities.
- **Amtrak would require an additional $450 million each year in Federal appropriations in order to invest in the types of new corridor services and other business that it projects will result in improved operating results and will be the key to Amtrak's long-term financial stability**.

Spending Flexibility

Funding Amtrak with an annual capital grant should not obscure the fact that Amtrak still requires operating assistance through FY 2002. Amtrak's plans to achieve operating self-sufficiency depend on continued operating assistance, and without this help, Amtrak cannot survive until 2003.

- **Amtrak requests flexibility in spending its Federal funding.** Amtrak was given some flexibility to spend this year's appropriation on maintenance of equipment (an operating expense). In 2000, Amtrak is also requesting flexibility to use its Federal appropriation for maintenance of way expenses. Amtrak's request is consistent with the 'transit' definition of capital applied by the Federal Transit Administration. There are strong economic arguments for making all maintenance expenses eligible for funding through Amtrak's capital grant. Amtrak needs the ability to decide whether refurbishing its existing capital assets makes better economic sense than investing in new replacements. Such decisions should be based on the economic merits of each expenditure and not on the relative availability of maintenance and investment funds.
- **Expanding eligible expenses in next year's Federal appropriation is financially imperative.** If the same funding restrictions as in the FY 1999 appropriation are applied next year, Amtrak will not be able to cover its operating losses and could be forced to default on current obligations, in spite of the fact that Amtrak will likely have about $1 billion in Taxpayer Relief Act funds in the bank.
- **Amtrak has strong incentives to economize on operating losses.** Amtrak's current strategic business plan, and thus its long-term viability, is grounded on the revenues that are expected to flow from critical capital

projects. Every dollar spent unnecessarily on operating losses is a dollar taken from these capital investments.

- **How Amtrak is funded will have no effect on determining whether it can meet its congressional mandate.** Amtrak abides by generally accepted accounting principles (GAAP) and must adhere to the requirements of its external auditors in determining whether an expense is classified as operating or capital. Therefore, regardless of the type of Federal grants Amtrak receives or how Amtrak is permitted to spend them, Amtrak will have to cover all of its operating expenses (except for excess payments for RRTA) in FY 2003 from non-Federal sources. In other words, maintenance of equipment and maintenance of way expenses would, under current law, no longer be eligible for Federal funding in 2003. That is the mandate from ARAA, and it is the standard we are using to gauge Amtrak's financial viability in our assessments.

Mr. Chairman, this concludes our statement. I would be pleased to answer any questions.