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AMTRAK

Deteriorated Financial and Operating Conditions Threaten Long-Term Viability

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

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Madam Chairwoman and Members of the Subcommittee:

We appreciate the opportunity to testify at this hearing on Amtrak. Today, we will present the findings from our recently issued report on Amtrak's financial and operating conditions.[1] In summary, we found that:

-- Amtrak's financial and operating conditions have always been precarious but have deteriorated steadily since 1990 to the point where its ability to offer service over the current nationwide system is seriously threatened. Since 1971, Amtrak has received over $13 billion in federal funding. This support has increased from $640 million in 1990 to almost $1 billion in 1995, but the increase has not covered the widening gap between Amtrak's expenses and revenues. Requirements for capital investment have grown, with unmet needs for equipment and improvements in facility and track now totaling several billion dollars.

-- Over the past several years, Amtrak has taken actions to address this situation by assuming debt, deferring maintenance, and reducing staffing. These actions, while necessary for day-to-day survival, have simultaneously diminished the quality and reliability of service and contributed to the decline in ridership and revenues. Most recently, on December 14, 1994, Amtrak announced an aggressive plan to reduce annual expenses by $430 million by adjusting routes and service frequencies, retiring its oldest cars, reducing staff, and improving service and productivity. These actions are directed at closing the gap between the expected operating deficit and federal grants for 1995. However, the gap will begin growing again in 1996, totalling over $1 billion by 2001, and the announced actions do not resolve Amtrak's need for equipment and improved facilities. Finally, the success of Amtrak's plan is very dependent on financial support from state and local governments as well as other legislative changes, such as providing Amtrak with greater flexibility to contract out its work.

-- It is unlikely that Amtrak can overcome its problems in financing, capital investments, and service quality--and continue to operate the existing 25,000-mile nationwide system--without significant increases in either passenger revenues or subsidies. Amtrak's ability to overcome these problems is limited by an unfavorable operating environment, including intense fare competition from

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

airlines. In addition, Amtrak estimates that it needs over $4 billion to bring its equipment and facilities systemwide, and track in the Northeast Corridor, up to a state of good repair. Also, Amtrak must soon negotiate new labor agreements and may confront additional costs for new agreements with freight railroads to use their track.

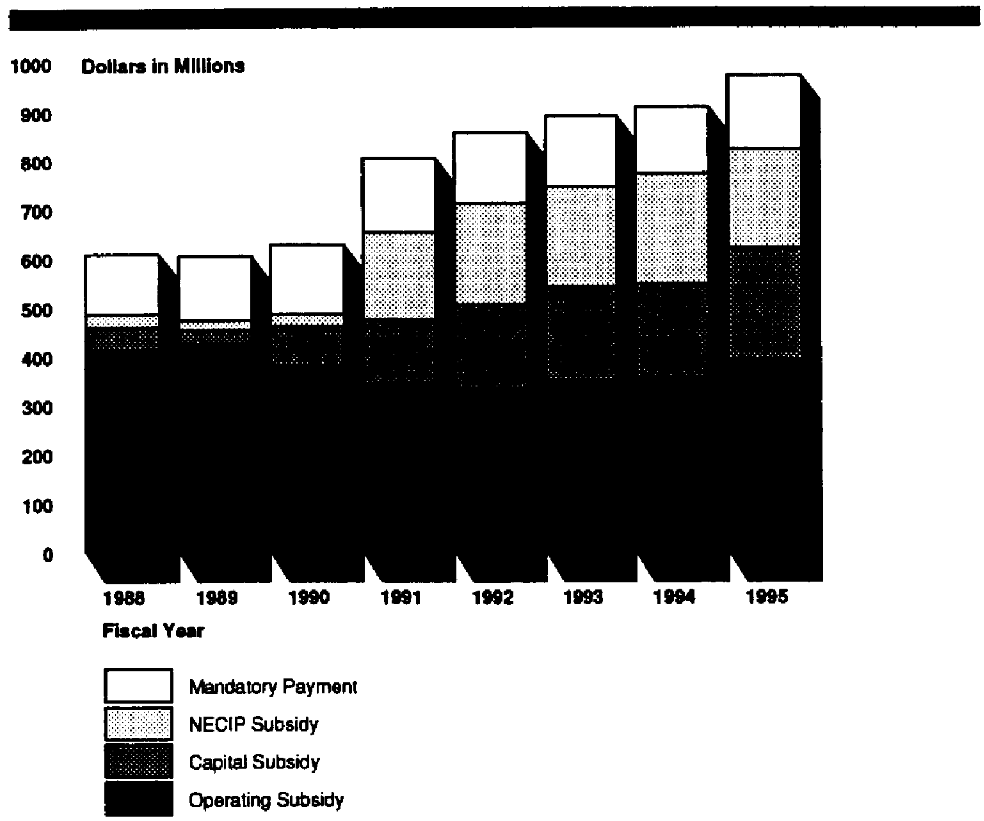
-- The Congress faces important decisions about the quality and extent of future intercity passenger rail services. We believe that continuing the present course--maintaining the same funding level and route system, even with Amtrak's recently proposed service cuts--is neither feasible nor realistic because Amtrak will continue to deteriorate. Substantially increasing funding, which would permit Amtrak to make capital investments and improve service quality, might be difficult to achieve given current budget constraints. At the other extreme, eliminating subsidies and privatizing Amtrak would be difficult to achieve because few private firms would be willing to assume the risks of providing intercity passenger service, considering that no Amtrak route earns sufficient revenues to cover all its costs. One option would be to refocus Amtrak's efforts and realign or reduce the current route system, retaining service in locations where Amtrak can carry the largest number of passengers in the most cost-efficient manner consistent with available funding. This option does not preclude retaining relatively unprofitable routes or operating high-speed service outside the Northeast Corridor, if the states or other entities are willing to make the necessary investments and cover any operating deficits.

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

GOVERNMENT SUPPORT FOR PASSENGER RAIL SERVICE

In 1970, the Congress created Amtrak as a "for-profit corporation" to provide nationwide intercity passenger rail service. Until 1970, private railroads were required to provide both freight and passenger service, but by that year their combined annual losses for passenger services had increased to over $1.7 billion in today's dollars. Because of these losses, most railroads, in return for being allowed to drop their passenger service, provided personnel and equipment to Amtrak, which then began operations in 1971. Amtrak was expected to help alleviate the overcrowding of airports and highways and offer the public a convenient and efficient transportation alternative. Like all major national intercity rail services in the world, including those in Europe and Japan where the competitive environments are more favorable to passenger trains, Amtrak operates at a loss, and has always needed government funding. In 1995, out of a total budget of over $2 billion, Amtrak will receive $972 million from operating and capital grants, funds to improve the infrastructure that Amtrak owns in the Northeast, and a payment for retirement and unemployment benefits (see fig. 1).

Figure 1: Federal Appropriations for Amtrak, FY 1988-95



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

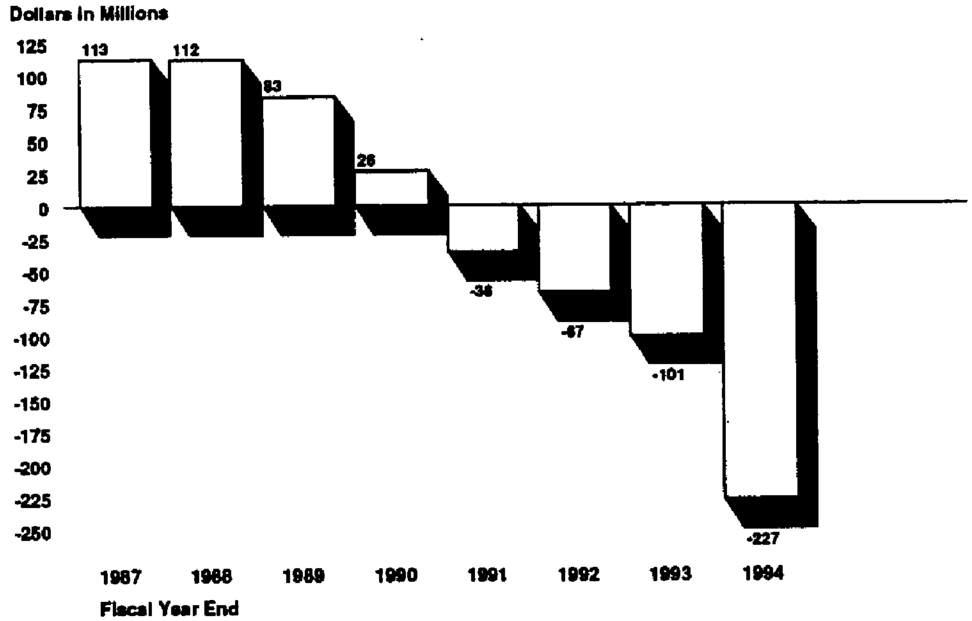
Source: Amtrak.

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

AMTRAK'S FINANCIAL CONDITION HAS REACHED A CRITICAL STAGE

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

Figure 2: Amtrak's Working Capital Surplus/Deficit, Fiscal Years 1987-94



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

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

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

To address this situation, Amtrak plans to reduce its workforce by 5,600 positions (out of 25,000), eliminate 21 percent of the train miles of service it offers, and retire nearly all of its oldest passenger cars. Amtrak plans to eliminate 3 routes and segments of 10 others and reduce service frequencies. Also, Amtrak plans to achieve significant cost savings by contracting out maintenance work, consolidating crafts, reducing train and engine crews, and taking other actions to reduce costs and improve service.

AMTRAK MUST ADDRESS SIGNIFICANT CAPITAL INVESTMENT NEEDS AND POTENTIAL COST INCREASES

Replacing and modernizing Amtrak's physical assets--maintenance facilities, train equipment, and track--is more critical to the corporation's financial well-being than resolving the current shortfall in operating funds. To cope with funding shortages, Amtrak in 1989 started reducing car maintenance. By 1993, 40 percent of its nearly 1,900 cars were overdue for costly heavy overhauls. Amtrak also deferred renovating and modernizing its outdated maintenance facilities, which has contributed to costly and inefficient operations.

Focusing exclusively on the shortfall in operating funds masks the critical problem of Amtrak's capital needs. Today, the average age of Amtrak's cars is about 22 years, which is similar to what it was when Amtrak first began operating. The recently-announced service reductions will, if implemented, ease the car problem by allowing Amtrak to retire many of its oldest passenger cars. Nevertheless, Amtrak currently estimates that it needs to invest about $1.5 billion for equipment overhauls and new equipment, primarily locomotives. Over a 10-year period, Amtrak's equipment and facilities depreciated at the rate of $200 million per year, while investment has averaged only $140 million. However, most of Amtrak's annual capital grant is already committed to paying off prior purchases and meeting legal mandates such as environmental cleanup. Also, because capital grants are subject to the annual appropriations process, it is difficult for Amtrak to formulate and implement long-term investment projects.

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

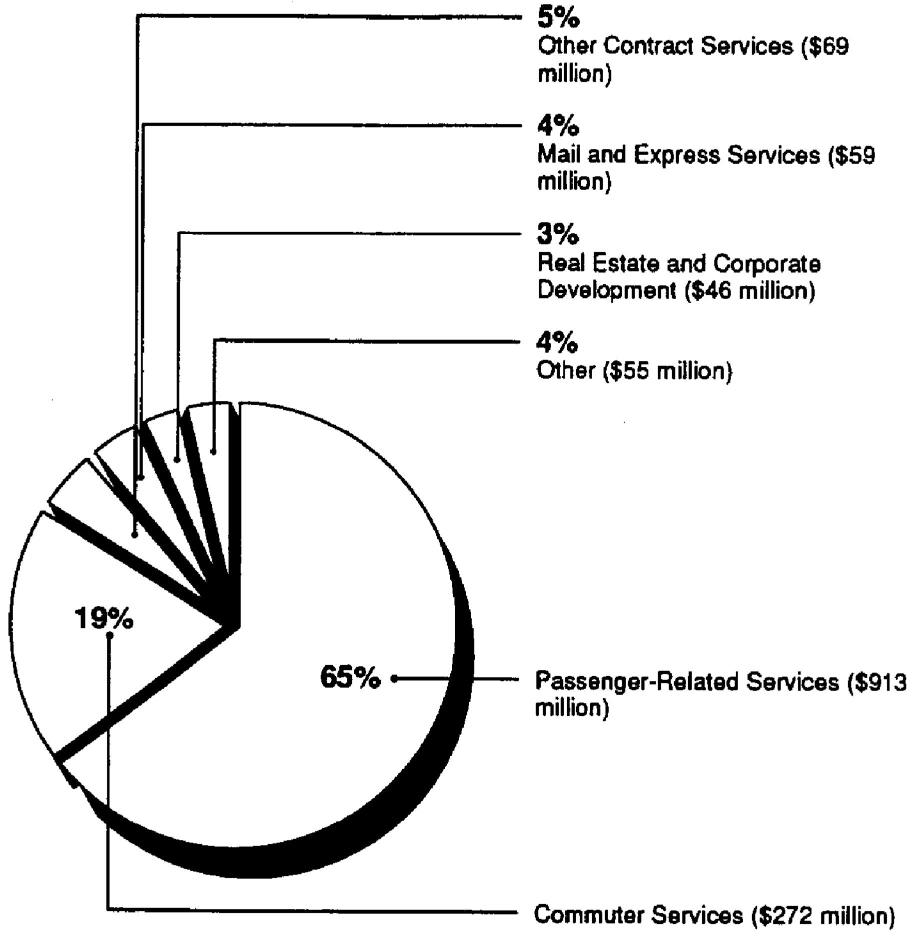
Amtrak could also face increased costs for track leases and liability coverage. Freight railroads own about 97 percent of the track over which Amtrak operates. In 1971, Amtrak entered into 25-year agreements with the freight railroads to compensate them for the use of their track and for related services. These agreements expire in April 1996. The freight railroads do not believe that Amtrak's payments, which total about $90 million annually, are adequate compensation for their services, and they will seek higher payments. Freight railroads are also concerned about their liability in accidents involving passenger trains and will likely seek reductions in their own exposure or increases in the amount of risk assumed by Amtrak. Amtrak has stated that its costs could be significantly minimized if the Congress limited or capped the amount of punitive damages for which Amtrak would be liable.

INCREASED REVENUES ARE NOT A LIKELY SOLUTION TO AMTRAK'S PROBLEMS

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

Amtrak's fastest growing source of revenues is its contracts to operate local commuter rail systems, which together carry about 7 million more passengers per year than the 22 million intercity passengers carried on Amtrak's intercity trains. These contracts generated over $270 million in 1994 and accounted for 19 percent of Amtrak's operating revenues. (See fig. 3.) Amtrak also believes that new high-speed rail service in selected corridors could increase its ridership and revenues. While high-speed service is now limited to the electrified portion of track between Washington, D.C., and New York City, Amtrak is extending electrification to Boston, improving the tracks, and hopes to purchase new trains that will allow high-speed service from Washington, D.C., to Boston. Amtrak expects its market share between New York City and Boston to be similar to its 45-percent share between New York City and Washington, D.C. To realize these expectations, however, Amtrak will continue to need funds to expand rights-of-way, rehabilitate track and facilities, and purchase new train equipment. High-speed service beyond the Northeast Corridor is unlikely without greatly increased federal and state funding. Private-sector efforts to sponsor high-speed rail without substantial governmental funding have been unsuccessful.

Figure 3: Amtrak's Operating Revenues for Fiscal Year 1994



Source: GAO analysis of Amtrak data.

AMTRAK'S NEW PLAN IS AN AGGRESSIVE FIRST STEP BUT LONG-TERM SOLUTIONS DEPEND ON EVEN MORE SUBSTANTIAL CHANGES

In January 1995, Amtrak finalized a strategic business plan that proposes a number of actions to eliminate the gap between losses and federal support for fiscal year 1995 and eventually lead to reduced annual expenditures of $430 million. If nothing is done, Amtrak expects to lose more than $7.3 billion from 1995 to 2000. If federal subsidies stay constant at 1995 levels, the cumulative net losses after subsidy would be about $3.8 billion, again assuming that no actions are taken. Amtrak clearly had to take some action, and its new plan is an aggressive first step.

Yet even if Amtrak could accomplish its entire plan, it still expects its losses to exceed the federal and state subsidies by $1.3 billion from 1996 through 2000, assuming that federal and state support remain constant at their 1995 levels. Amtrak estimates that about 26 percent of the anticipated savings might require collective bargaining and/or legislative changes before they can be achieved. Also, the plan does not account for implementation costs, such as pay protection to employees whose jobs are eliminated as a result of route closures. Amtrak also estimates it will need to make over $4 billion in capital investments to bring its systemwide equipment and facilities, and track in the Northeast Corridor, up to a good state of repair. This does not include any additional costs for using freight rail rights-of-way, acquiring high-speed train sets for the Northeast Corridor, or undertaking other new initiatives (such as the Penn Station/Farley Building project in New York).

Amtrak believes that its plan will help put the railroad on the road to financial recovery and that by the year 2002 Amtrak might be in a position to eliminate the need for federal operating subsidies and maintain the current level of service. However, an important underpinning of Amtrak's plan are assumptions about changes in the current environment including: (1) substantially more financial assistance from state and local governments, (2) greater flexibility in dealing with railroad labor, and (3) increased capital assistance to rectify the deteriorated condition of its infrastructure. Without these changes, the recently announced cuts will be just the beginning of route abandonments and service cutbacks.

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

The Congress faces important decisions about the quality and extent of future intercity passenger rail service, including whether to maintain the current route system. Maintaining the present nationwide route network will require increased funding from federal, state, and/or local governments. Passenger rail service, however, competes for limited transportation funds, and unlike aviation, highways, and mass transit, it does not have access to a federal trust fund. State and local governments have some flexibility to allocate federal transportation funds among different modes, but their ability to assist intercity passenger rail is very limited.

Increased funding, especially capital investment, would improve service quality and encourage more riders. Doubling Amtrak's capital grant to $500 million annually--a difficult task in today's fiscal environment--would allow Amtrak to improve maintenance facilities and its rights-of-way and purchase new equipment, primarily locomotives. But even if gains in efficiency and ridership resulted from such improvements, we estimate that

Amtrak would continue to need more than $400 million in annual operating subsidies from some source through the year 2000.

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

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

In this regard, we found that 11 of Amtrak's 44 routes earn 68 percent of Amtrak's revenues and account for 61 percent of the expenses. Also, interconnections between routes or the presence of important public benefits as defined by the Congress, such as helping alleviate congestion and pollution, would be relevant in evaluating how best to define the route network. The basic network could be augmented by regional routes supported by those states that were willing to contract with Amtrak to cover shortfalls between revenues and the full cost of operations. Amtrak has identified other legislative changes that it believes would also reduce expenses, such as eliminating the corporation's obligation to pay federal fuel taxes, obtaining authority to issue tax-exempt debt, providing statutory limitations on punitive damages against Amtrak, and providing Amtrak with greater flexibility to contract out for its work.

CONCLUSIONS

Amtrak is at a critical juncture. A number of the issues raised by Amtrak's financial and operating condition clearly go beyond the ability of Amtrak and its Board of Directors to resolve and will require congressional consideration. These issues include the amount of resources the Congress wants to commit to rail passenger service and how any remaining deficits and capital investment requirements might be covered. A related issue that will need resolution is whether all these corridors need to be connected in a national route network.

In light of Amtrak's financial and operating problems, the Congress may wish to consider whether Amtrak's original mission of providing nationwide intercity passenger rail service, at the present level, is still appropriate. To facilitate the definition of the scope of Amtrak's mission, the Congress could direct Amtrak or a temporary commission, to make recommendations and offer options to the Congress defining and realigning Amtrak's basic route network so that efficient and quality service could be provided within the funding available from all sources.

Additionally, our report recommended that the President of Amtrak provide the Congress with cost and related information on proposed legislative changes that Amtrak believes could improve its long-term viability and the expected effect of these changes on Amtrak's finances and other affected parties. These include amending the Rail Passenger Service Act to allow greater flexibility in negotiating labor agreements with regard to labor protection and contracting out Amtrak work, removing payments under the Railroad Retirement Act for non-Amtrak employees from Amtrak's budget, authority to issue tax-exempt debt, and exempting Amtrak from federal fuel taxes. This information will provide a vehicle for Congressional deliberation on the merits of each of Amtrak's legislative proposals.

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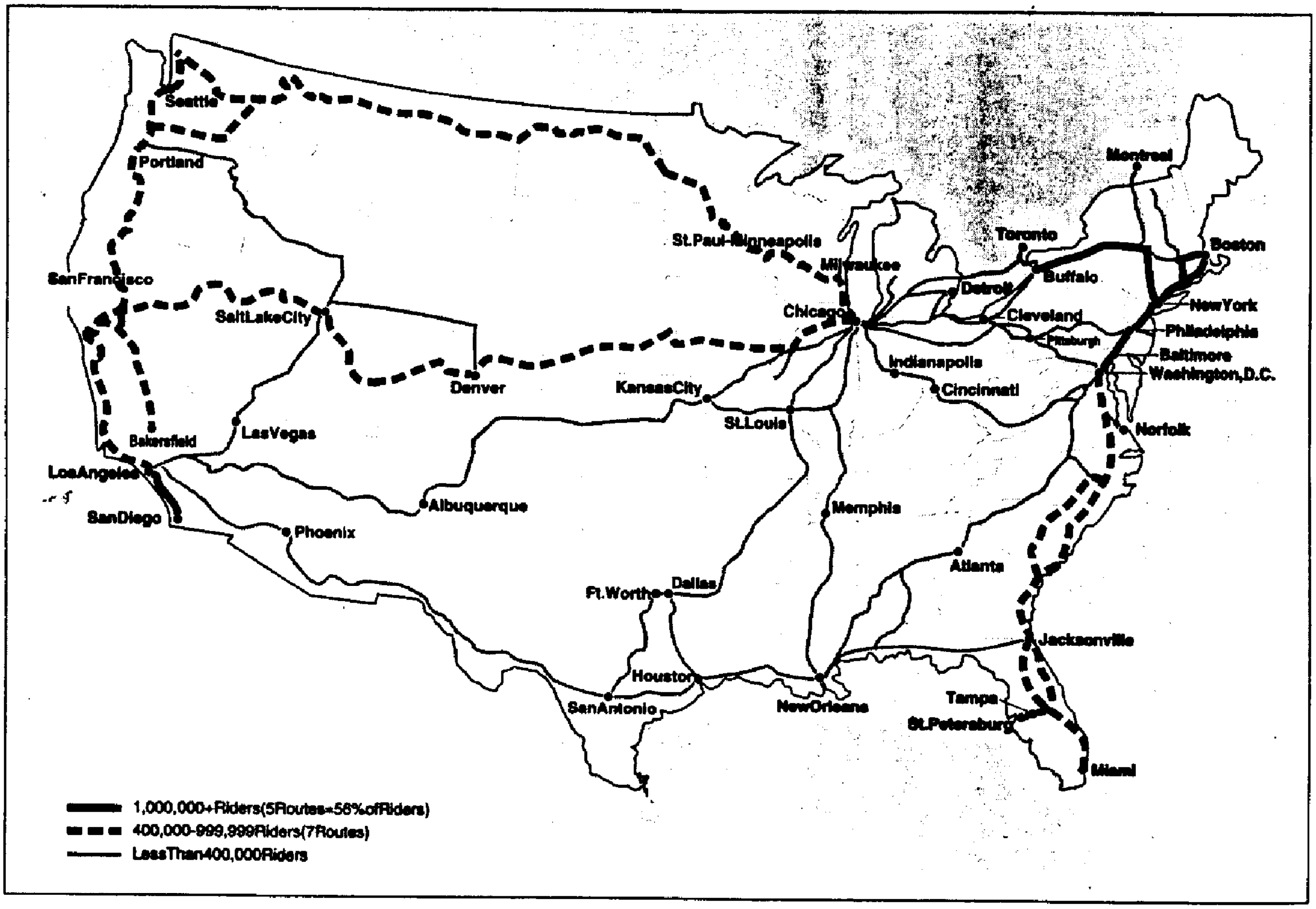
Madam Chairwoman, this concludes our testimony. We look forward to working with the Subcommittee on Railroads in the coming months. We would be happy to respond to any questions that you or Members of the Subcommittee may have.

Ridership on Amtrak's Rail Passenger System, FY 1993



Source: Amtrak

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