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AMTRAK

Deteriorated Financial and
Operating Conditions

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



Mr. Chairman and Members of the Committee:

We appreciate the opportunity to testify at today's hearing on Amtrak. In April 1994, we testified before the Subcommittee on Surface Transportation and reported on the deteriorated state of Amtrak's finances. Our statement today updates our earlier assessment of Amtrak's operations and finances and offers some observations about the corporation's recently announced strategic business plan. In summary:

- Amtrak's financial condition has always been precarious, but it has declined steadily since 1990, to the point that its ability to offer service over a national route system of the current size is seriously threatened. Since our earlier testimony, the situation has grown worse. Amtrak's federal support has grown to almost \$1 billion annually of which about \$390 million is for operating assistance. In recent years, this assistance has not covered the widening gap between expenses and revenues. Requirements for capital investment also have grown. Unmet needs for new equipment and improvements to facilities and track now total several billion dollars.
- It is unlikely that Amtrak can overcome its problems in financing, capital investments, and service quality--and continue to operate the current 25,000-mile nationwide system--without significant increases in passenger revenues and/or funding, particularly for capital investment, from federal, state, and local governments. Amtrak's ability to overcome these problems or to greatly increase its passenger revenues is exacerbated by an unfavorable operating environment, including intense fare competition from airlines. In addition, Amtrak estimates that it needs over \$4 billion to bring its equipment, facilities, and track into a state of good repair. Also, Amtrak must soon negotiate labor agreements and may confront substantial additional costs for continued access to the rights-of-way owned by the freight railroads.
- Over the past several years, Amtrak has reacted to its deteriorating operating and financial conditions by assuming debt, deferring maintenance, and reducing staffing. Some of these actions, while necessary for day-to-day survival, have simultaneously diminished the quality and reliability of Amtrak's service. Most recently, on December 14, 1994, Amtrak announced an aggressive plan to reduce annual expenses by \$430 million by reducing routes and service, retiring its oldest cars, reducing staff, and improving service and productivity. Amtrak expects these actions should close the gap between the expected operating deficit and federal grants for 1995. However, the gap will begin growing again in 1996, and the announced actions do

not resolve Amtrak's need for capital and improved facilities. Amtrak's plan is an aggressive first step, but it will not solve the railroad's longer-term problems.

- The Congress faces important decisions about the future of intercity rail passenger service in the United States and will need to consider the nation's expectations for intercity rail passenger service and the scope of Amtrak's mission to provide that service. The Congress will also need to decide the appropriate roles of the federal government in funding the operating losses and capital investments.

BACKGROUND

In 1970, the Congress created Amtrak as a "for-profit corporation" to provide nationwide intercity passenger rail service. Until 1970, private railroads had provided both freight and passenger service, but by that year their combined annual losses for passenger services had increased to about \$1.7 billion in today's dollars. Because of these losses, most railroads provided personnel and equipment to Amtrak, and it began operations in 1971. Like all major national intercity rail services in the world, including those in Europe and Japan where the competitive environments are much more favorable to passenger trains, Amtrak operates at a loss, and it has always needed government funding. Since it began operations, Amtrak has received \$13 billion in federal support. In 1995, out of a total budget of \$2.4 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.

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 be subsidized. 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. These actions have served to hold down the corporation's operating deficit, but 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 the 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 operating costs.

To help cover this gap, Amtrak drew down its cash resources. At the end of 1994, it had a negative balance in working capital of \$227 million. Amtrak also deferred maintenance on train equipment and reduced its staffing levels and some services. Despite these efforts, the 1994 deficit exceeded the federal operating grant by \$76 million, and Amtrak had projected that this gap would increase to almost \$200 million in 1995. In December 1994, Amtrak announced a new strategic business plan that included a number of service reductions along with other changes that Amtrak believes will ultimately reduce costs by \$430 million annually.¹ These actions are directed at closing the gap between losses and the federal operating grant in 1995, but the gap will reemerge in 1996 and will cumulatively total \$1.3 billion through the year 2000.

AMTRAK'S REVENUES WILL NOT KEEP PACE WITH CAPITAL INVESTMENT NEEDS

The cost of replacing and modernizing Amtrak's physical assets--maintenance facilities, train equipment, and support assets--is a greater challenge to the viability of the railroad than resolving the current shortfall in operating funds. To cope with funding shortages in the past, Amtrak reduced car maintenance. By the end of 1993, overhauls were overdue for 40 percent of its nearly 1,900 cars. Amtrak also deferred modernizing its outdated maintenance facilities, and this delay 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 allow Amtrak to retire its oldest and most-costly-to-maintain passenger cars, but Amtrak estimates that it still needs about \$1.5 billion for equipment overhauls and new equipment, primarily locomotives. Over the past 10 years, Amtrak's equipment and facilities have depreciated at the rate of \$200 million per year, while investment has averaged only \$140 million. Yet most of Amtrak's annual capital grant is already committed to paying off prior purchases and meeting legal mandates such as environmental cleanup.

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

¹Amtrak expects that the cutbacks will also cause revenues to fall by \$66 million so that the net annual savings are \$364 million.

of Amtrak's operating costs. Amtrak has done a good job at improving labor productivity and plans to achieve further increases in productivity. Amtrak already pays train and engine crews less on average than freight railroads pay for comparable jobs. However, 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 agreements with the freight railroads to compensate them for the use of their track and for related services, such as dispatching trains. 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.

NONE OF AMTRAK'S ROUTES IS PROFITABLE
AND REVENUE GROWTH POTENTIAL IS LIMITED

Revenues from passenger services 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--is 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 revenues have declined about 14 percent in real terms--from over \$1 billion in 1990 to about \$880 million in 1994. This decline resulted from, among other things, a weak economy; intense price competition from airlines in certain markets; Amtrak's old, unattractive, 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 growth in ridership.

Contracts to operate local commuter rail systems provide Amtrak with its fastest growing source of revenue. These contracts generated over \$270 million in 1994 and accounted for about 20 percent of Amtrak's revenues. 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 purchasing 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 substantial funds to expand rights-of-way, rehabilitate track and facilities, and purchase new train equipment. In addition, 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.

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

Amtrak's recently announced strategic business plan is designed 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. 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 and most-costly-to-maintain passenger cars. In addition, 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. Actions requiring changes in legislation or collective bargaining agreements account for about 26 percent of the savings. 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 to 2000, assuming that federal and state support remain constant at their 1995 levels. Moreover, these losses do not include any additional costs for using freight rail rights-of-way, acquiring high-speed train sets for the Northeast Corridor, or undertaking any other new initiatives (such as the Penn Station/Farley Building project in New York.)

Based on its analysis and the work done by its consultant, Mercer Management, Amtrak believes that it has gone as far as it can in cutting and reducing service and eliminating routes and that any further reductions would compromise its ability to offer service over a national system. Amtrak believes that the reductions it plans in service frequency for most of its long-distance trains will have relatively little impact on revenues because most of the passengers riding those trains are discretionary travelers who are not time-sensitive--that is, they do not care whether the service is daily or triweekly, they will adjust their schedules in order to take the train. Amtrak has limited empirical evidence for its position, but this view is consistent with what others have observed about the nature of long-distance train travel today.

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 several changes in the current environment including: (1) substantially more support from state and local governments, (2) greater flexibility in dealing with railroad labor, and (3) increased capital assistance to rectify the current deteriorated condition of its infrastructure and equipment. Without these changes in its operating environment, the recently announced cuts will be just the beginning of route abandonments and service cutbacks.

It is clear, Mr. Chairman, that Amtrak is at a critical juncture. A number of the issues raised by Amtrak's financial and operating condition 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 remaining deficits might be covered. In addition, Amtrak's Board of Directors has concluded that the corporation's future lies in densely populated corridors, commercially oriented service between specific pairs of cities, and essential rail service corridors. A related issue that will need resolution is whether all these corridors need to be connected in a national route network.

Mr. Chairman, as you know, we have just completed a comprehensive review of Amtrak's financial and operating conditions and expect to issue our report within the next 2 weeks. We look forward to working with the Committee and the Subcommittee on Surface Transportation in the coming months. Mr. Chairman, this concludes our testimony. We would be happy to respond to any questions that you or Members of the Committee may have.

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