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For Release on Delivery

March 20, 2001

INTERCITY RAIL PASSENGER SERVICE IN AMERICA: STATUS, PROBLEMS, AND OPTIONS FOR REFORM

THE SECOND ANNUAL REPORT of the AMTRAK REFORM COUNCIL

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The ARC is an independent federal commission established under the Amtrak Reform and Accountability Act of 1997 (P. L. 105-134)

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March 20, 2001

The Honorable Richard B. Cheney
President of the U.S. Senate
United States Senate
Washington, D.C. 20510

The Honorable J. Dennis Hastert
Speaker of the U.S. House of Representatives
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. President:
Dear Mr. Speaker:

This letter transmits to the Congress the Second Annual Report of the Amtrak Reform Council. A year ago, in its first report, the Council provided a preliminary assessment of Amtrak, its nature, its finances, and its operations. At that time, the Council indicated that it had concerns about Amtrak's performance and its structure. In this year's report, the Council concludes that Amtrak's institutional structure has major flaws that make the task facing Amtrak's Board and management exceedingly difficult.

To help Amtrak reach self-sufficiency, basic changes should be made. Amtrak's commercial functions should be extracted from its governmental functions. Amtrak's core business – a national system of rail passenger, mail, and express services – should be disentangled from major infrastructure cost burdens. It is also essential to provide effective government program administration, policy development, and program oversight, coupled with adequate, predictable funding, for the national passenger rail program. Major reforms, based on this new recommended structure, are needed.

At the same time, the Council sees the prospect of a substantial increase in the demand for intercity rail passenger services. Road and air congestion have spurred transportation departments in at least 14 states to begin investing in rail to provide additional passenger transportation capacity in short- to medium-length intercity corridors. Most of these opportunities fall within the high-speed rail corridors that have been designated in 33 states and the District of Columbia by the US Department of Transportation under provisions of ISTEA and TEA-21. The process of building a bigger and better passenger rail system has gotten underway with the implementation of service improvements in California and the Pacific Northwest. More are planned for Illinois, the Midwest, the Southeast, and Florida. Others will follow.

To capitalize on this opportunity, the Council believes that improvements in the organizational structure for passenger rail activities are urgently needed.

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This report offers the analysis behind the Council's conclusions. It also offers options for organizing and funding train operations, infrastructure, and the governmental responsibilities that the report describes. The Council believes that the report's conclusions, together with the implementation options that it lays out, provide a basis for a much-needed debate. This debate should be particularly important as this 107th Congress moves in the next 18 months toward reauthorization of Amtrak by the end of FY2002, as called for in the Amtrak Reform and Accountability Act of 1997.

The diligent work of the 11-member Council and its staff has produced a strong consensus surrounding all major features of this report. Eight Council members – Ms. Connery and Messrs. Carmichael, Chapman, Coston, Gleason, Kling, Norquist, and Weyrich – have voted to approve the report without qualification. Two of these eight members, Ms. Connery and Mr. Coston, have submitted letters of concurrence, which are appended. A ninth member, Mr. Cox, approves the report's determinations regarding Amtrak's institutional flaws and the recommended business model, but reserves his approval with regard to the need for stable and adequate funding until determinations have been reached on three important issues set forth in his appended letter. Mr. Charles Moneypenny, the representative of Rail Labor on the Council, has voted to disapprove the report for the reasons stated in an appended letter. The eleventh and newest member of the Council, Secretary of Transportation Norman Y. Mineta, has abstained on behalf of the Administration, with reasons provided in an appended letter from the Acting Deputy Administrator of the Federal Railroad Administration. All letters from Council Members are found in Appendix I.

We are pleased to forward this report on behalf of the Council and its staff. Please do not hesitate to contact the Council staff, any member of the Council, or myself, should you need additional information or wish to discuss issues regarding rail passenger service.

FOR THE AMTRAK REFORM COUNCIL

Very truly yours,

Gilbert E. Carmichael
Chairman

Enclosure: Second Annual Report of the Amtrak Reform Council

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EXECUTIVE SUMMARY

The Amtrak Reform Council has concluded that Amtrak's structure should be fundamentally changed. Amtrak is behind in achieving the revenue and expense goals of its own Strategic Business Plan and, according to recent Congressional testimony by the U.S. General Accounting Office (GAO) and the Department of Transportation's Inspector General (DOT IG), will have difficulty achieving operating self-sufficiency. At the same time, there is a resurgence of interest in passenger rail service, particularly higher-speed service to connect inter-urban corridors. Building high-speed corridors, however, will entail a large new federal commitment to rail passenger service and require a predictable long-term source of funding. With re-authorization of Amtrak due in FY2002, now is the time to begin deliberations about these important issues. The Council hopes its report will stimulate debate, culminating in legislation that will establish a sound institutional and financial structure for the long-term improvement of passenger rail service in America.

WHERE AMTRAK STANDS TODAY

Amtrak achieved several important milestones in FY2000: increases in ridership and revenues, the initiation of Acela Express service, and the initiation of a service guarantee program. Nevertheless, Amtrak's performance was $100 million short of its Strategic Business Plan budget result due to delays in the introduction of Acela service, higher than expected operating expenses and, to a lesser degree, the slow growth of Mail and Express. Amtrak was also extremely short on cash last year. To improve its cash position by $25 million and to fund $99 million of equipment capital improvements, Amtrak sold and leased back in four transactions a total of $915 million of passenger equipment. Such transactions, coupled with new equipment and high-speed rail facilities acquisitions, have tripled Amtrak's debt in the past five years to about $3 billion.

FY2000 was the final year in which Amtrak had at its disposal a full year's worth of capital funds provided under the Taxpayer Relief Act of 1997. As of September 30, 2000, Amtrak had committed $1.9 billion of the $2.2 billion in TRA funds made available to it. As required by the Amtrak Reform and Accountability Act of 1997 (the Reform Act), the Council's report also addresses Amtrak's efforts to improve both productivity and the performance of its national system of routes and services.

For FY2001, Amtrak's Plan calls for a 18.3 percent increase from the FY2000 results in revenues and $200 million of bottom line improvements that Amtrak has never before achieved.

GROWING GRASSROOTS SUPPORT FOR PASSENGER RAIL SERVICE

The focus of passenger rail service has changed dramatically in the past ten years. This changing focus is due largely to a groundswell of support at the state and local level for substantial increases in high-speed rail service, characterized by operating speeds of 90 mph or more, in heavily-traveled corridors of about 100 to 500 miles in length. Through ISTEA and TEA-21, eleven corridors in 33 states and the District of Columbia have been designated as candidates for

the development of high-speed ground transportation to complement the highway and aviation systems that serve the particular regions. Preliminary studies suggest that the new corridors could quadruple Amtrak's non-Northeast Corridor ridership (from 10 million to 40 million passengers) by the year 2020.

Ridership on the Northeast Corridor is also expected to rise significantly in the coming years as Amtrak fully implements its Acela service regime. Amtrak projects that ridership (for Acela Express and Acela Regional service, combined with Metroliner and Northeast Direct service) will increase by about two million passengers in 2002 compared to 1999, primarily due to increased ridership between Boston and New York City.

CAPITAL FUNDING NEEDS FOR EXISTING AND EXPANDED SERVICE

Developing new high-speed rail corridors and maintaining the NEC will require significant federal capital investment in partnership with the states and the freight railroads. In its long-term capital needs report released in February 2001, Amtrak estimates that $23.6 billion[1] in combined federal and state funding is needed over the next 20 years to maintain the current passenger rail network. Completing the inventory of all projects that have been advanced for new service, including the emerging high-speed corridors and additional service on long-distance routes, is estimated to cost an additional $73.6 billion. The total cost to maintain and expand the passenger rail network comes to some $97 billion.

Amtrak has not suggested that the entire amount should be spent, primarily because many of the growth projects are only at a conceptual stage and may never be built. Nor does Amtrak pre-judge the institutional structure and funding sources that should be used to implement such a large program. Amtrak's current request is for $30 billion in federal capital funding over the next 20 years, or $1.5 billion annually, of which $16 billion would be used to support current service with the remaining $14 billion to be used for "seed money" for high-speed rail development.

AMTRAK'S INSTITUTIONAL FLAWS AND RECOMMENDATIONS FOR CHANGE

The Council has concluded that Amtrak's poor performance is due to fundamental institutional flaws, and not to Amtrak's Board of Directors, managers, or employees. The Council has identified four major institutional flaws inherent in the Rail Passenger Service Act of 1970, which created Amtrak. If passenger service is to improve, these flaws need to be addressed:

- Amtrak operates in many important respects like a government agency dependent on annual appropriations, and, thus, political considerations heavily influence most major management decisions. At the same time, Amtrak is charged with the decidedly non-governmental function of competing profitably as a commercial business. **The Council believes that the remedy to this problem is to separate Amtrak's commercial functions from its government functions.**

[1] All amounts are in current 2000 dollars.

- Ownership and maintenance of the Northeast Corridor divert Amtrak's attention and resources from its primary mission as a service provider. The Northeast Corridor will require $20 billion in capital funding over the next 20 years for a wide range of capital improvements and to put the southern portion of the Corridor in a state of good repair. The Council believes Amtrak's management should be spending its time on improving passenger operations and customer satisfaction rather than on infrastructure maintenance. Ownership and control of the NEC rail infrastructure is not essential to Amtrak's operations. Of the 1,200 trains operating daily on the corridor, only about 100 are Amtrak trains. **The Council believes that a reasonable remedy to this problem is to appropriately separate Amtrak's train operations from ownership and maintenance of the Northeast Corridor and other infrastructure.**

- Effective government program administration, policy development, and oversight for the national rail passenger system does not exist today. Today, public policy is made in many instances by Amtrak, rather than by an entity whose job it is to protect the public interest. These governmental functions for rail passenger service are fragmented among Amtrak itself, the Federal Railroad Administration (FRA), the DOT IG, OMB, and the GAO. This need for better program administration, policy development, and oversight is even stronger if the states are to compete for billions of dollars to develop high-speed corridors. **The Council's view is that Amtrak's governmental functions, together with those Amtrak program responsibilities of FRA, the DOT IG, and GAO, should be consolidated in a single government entity that would administer and oversee federal funding programs for rail passenger service, be responsible for public policy development, and – in the process – insulate train operations and infrastructure maintenance from direct political pressures.**

- There is presently no secure source of capital funding for passenger rail service. **The Council believes Congress should provide a stable and adequate source of federal funding for the capital needs of the NEC and other rail-passenger infrastructure.**

NEW BUSINESS MODELS FOR AMTRAK

To solve Amtrak's basic problems, a new set of models is needed for train operations, infrastructure management, and government program administration, policy development, and oversight.

Train Operations. The vision for train operations is a customer-focused commercial enterprise shielded from political interference. The organization would have the ability to modify routes, schedules, and prices to improve financial performance, a culture that puts the customer first, the tools to effectively manage the business, and appropriate compensation incentives. The operating company would also be held to new performance standards set by a government oversight entity for measures such as operating income, operating ratio, ridership, and on-time performance. The operating entity would not be expected to operate unprofitable service unless compensated for losses under a service contract with the federal government or the affected states.

Infrastructure Management. The model for infrastructure management is a government-owned corporation responsible for ownership and maintenance of the Northeast Corridor and other Amtrak-owned infrastructure. It would be authorized to buy or sell assets and could, if desirable, transfer all non-NEC Amtrak properties to state and local governments. Funding would come from federal and state capital subsidies, a subsidy for excess mandatory Railroad Retirement taxes, trackage fees on intercity, commuter, and freight carriers for use of the Northeast Corridor, and real estate development revenues from such things as utility and communications easements. The infrastructure corporation would also coordinate operations on the NEC by the various users.

The Role of Government. A primary role of government will continue to be financial support for rail passenger service in the form of capital funding for infrastructure. Beyond this, effective government program administration is needed to develop the emerging high-speed corridors, develop public policy on passenger service issues, and to insulate train operations and the infrastructure company from political interference. The Council is not recommending the creation of a new agency or a new layer of bureaucracy, but rather the consolidation of existing program administration and policy development authority currently exercised variously by Amtrak, the DOT IG, the GAO, and the FRA.

STRUCTURAL OPTIONS

Various approaches are possible for restructuring Amtrak to separate its infrastructure responsibilities, train operations, and government functions. The Council has developed for discussion five such options representing points on a continuum of possible structures, not an exclusive list. These options range from splitting Amtrak into two or three companies, to involving the states more heavily in rail passenger service, to partial or complete privatization of Amtrak. The Council believes that as the debate begins about Amtrak's re-authorization, the entire range of options should be on the table.

In considering various approaches, however, the Council has rejected full privatization along the lines of the British model. The British system is experiencing problems and, in the Council's view, is a "work in progress." The Council also believes that it would first be necessary to implement substantial reforms, including major federally-funded capital improvements and corporate financial reorganizations, if the privatization of either Amtrak's train operations or of Amtrak-owned NEC infrastructure were ever to be realistically considered as a potential option.

In summary form, the five structural options, all of which are predicated on improved funding mechanisms for passenger rail, have these basic characteristics:

1. **Placing Amtrak-owned Northeast Corridor infrastructure into a separate entity, possibly a government corporation**. This option's strength is its simplicity in removing the management and financial burden of infrastructure from the passenger operating company. Its weakness is that it does not consolidate the vital governmental functions (i.e., program administration, policy development, and program oversight).

2. **Separating Amtrak's train operations from its infrastructure and making each a subsidiary corporation of a wholly-government-owned National Railroad Passenger Corporation, which would exercise the government functions**. This option would provide

a coherent structure for passenger rail comprising the governmental functions, which would oversee as subsidiary corporations separate passenger operations and infrastructure companies. It might be regarded as overly complex.

3. **Involving the states much more heavily in the planning, development, operation, and funding of the national rail passenger system, relying for infrastructure improvements on federal matching funding administered by a single federal entity**. Amtrak-owned Northeast Corridor infrastructure would be transferred to the NEC states (under a regional interstate compact). The states would also be responsible for funding passenger operations over the NEC and developing high-speed corridors under service contracts with a selected train operator (including Amtrak). The involvement of the states, which are the primary engines driving the need to increase the capacity of the system, is this option's strongest point. At the same time, while interest among the states is growing, there is substantial disparity between the progress of the states leading passenger rail program expansion and those just beginning to do so.

4. **Partial privatization, in which Amtrak's national train operations would be privatized, with Amtrak-owned NEC infrastructure placed in a separate government entity**. Privatization would help improve the market orientation and efficiency of the passenger rail services. Moving to a private model without major investment up front to restructure the finances of the prospectively private operating company, however, would likely be unworkable.

5. **Full privatization, in which both Amtrak's train operations and its NEC infrastructure would be separately privatized**. A small government entity would be retained to hold the government's franchise for passenger service over the tracks of the freight railroads and administer any residual funding to support services deemed by Congress to be essential and for longer-term infrastructure financing. Adding the challenge of privatizing the NEC infrastructure to the issue of a major financial restructuring of the passenger operating company would likely be financially and programmatically unworkable.

In the coming months, the Council will further evaluate these options and other substantial options that are proposed based on further analysis and on input from federal, state and local officials, the public, the freight railroads, and Amtrak.

FINANCING OPTIONS

In the context of the Council's proposed business models for rail passenger service, it becomes possible to look at a new structure for financing the capital for infrastructure and equipment needed to support passenger services. Since Amtrak's creation, its ability to provide high quality transportation services has been affected by funding that has been unreliable and, some say, inadequate. To create a new network of high-speed corridors and maintain the current Amtrak network will require, over the next 20 to 25 years, an estimated $80 to $100 billion in capital, $30 billion of which Amtrak indicates as the federal share.

The Council feels strongly that funding of this magnitude should not be under the control of Amtrak as it exists today. States developing high-speed rail corridors will be competing for

funds with each other and, if its structure is not changed, with Amtrak. There should be a professional, unbiased, and equitable process for evaluating projects and allocating funds. In addition, in light of the time delays and cost overruns associated with the recent NEC electrification project, there are questions as to Amtrak's ability to manage and transparently account for large capital projects on time and within budget. Effective government oversight is needed to gain the confidence of federal and state governments and the freight railroads.

In addition to identifying a number of possibilities for important types of supplemental funding (for example, highway-rail grade crossing safety), the Council offers for consideration three options as potential principal means for financing capital for infrastructure and equipment:

- Federal appropriations, particularly for demonstration projects and public health and safety problems such as remedial safety work that needs to be done on the tunnels leading into Penn Station, New York.

- A dedicated rail passenger transportation fund, perhaps funded by adding a new penny to the existing federal excise tax on gasoline and requiring a state match of an additional penny per gallon. Since each penny of the federal excise tax on automobile gasoline generates $1.6 billion, a penny at both the state and federal levels could raise about $3.2 billion annually.

- High-Speed Rail Investment Act bonds, which would provide a total of $12 billion in financing over 10 years, principally for the Northeast Corridor and other high-speed corridors. The Council believes that if bonds are to be a possible source of funding for high-speed rail projects, state and regional rail transportation authorities, in addition to Amtrak, should be able to issue the bonds. Moreover, states and regional authorities should have primary responsibility for choosing projects outside the Northeast Corridor, and each project should be evaluated and approved by an impartial government body on its own merits and free from any requirement that Amtrak be the sole provider of the services benefiting from the funding. The bonds should only be used to finance equipment if private sector financing is not available. All bond funds (including state 20 percent matching funds) should be under the control of an independent trustee until paid out for capital projects or to redeem the bonds. Bond proceeds should not be available to Amtrak (or any other operating company) for short term borrowing, nor should they be otherwise co-mingled with any operating company's internal finances.

NEXT STEPS

The Council will hold formal hearings on the issues raised in this report to receive comments and recommendations from federal, state and local officials, freight railroads, the public and other interested parties. Subject to available funding, the Council will also initiate further studies on options for restructuring Amtrak and related issues.

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GLOSSARY

Amtrak	The National Railroad Passenger Corporation
Amtrak Board	Amtrak's Board of Directors (also, "the Amtrak Reform Board")
ARAA	The Amtrak Reform and Accountability Act of 1997
BGL	A consultant specializing in rail industry issues retained by the Amtrak Reform Council to perform an analysis of capital needs of the Northeast Corridor, the emerging high-speed corridors and Amtrak's existing infrastructure
Corporation	Amtrak is sometimes referred to in the text as the Corporation
Council	Amtrak Reform Council
DOT	U.S. Department of Transportation
DOT IG	Office of the Inspector General, U.S. Department of Transportation
FRA	Federal Railroad Administration
FY	Fiscal Year, which, in the federal government, begins October 1
GASB	Government Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	U.S. General Accounting Office
ISTEA	Intermodal Surface Transportation Efficiency Act of 1991
MBNA	Market-Based Network Analysis – a complex system of computerized analytical models that estimate the likely revenues, costs, and profitability for a proposed route or system of routes.
NEC	Northeast Corridor – Rail corridor between Washington, DC, and Boston, MA, of which Amtrak owns about 80 percent of the route
NGS	Network Growth Strategy (Amtrak's February 2000 initiative to modify certain of its routes and services to improve its market penetration for both passengers and mail and express traffic)
Progressive Overhauls	Maintenance of equipment (locomotives, cars, etc) that Amtrak performs on its equipment about every 4 months
Reform Act	The Amtrak Reform and Accountability Act of 1997
RPS	Route Profitability System – Amtrak's historical system for determining route profitability on a fully allocated cost basis, including direct train costs, route costs, and system costs.
RRTA	Railroad Retirement Tax Act
TEA-21	Transportation Equity Act for the 21st Century
TRA	Taxpayer Relief Act of 1997

FOREWORD AND ACKNOWLEDGMENTS

In its report one year ago, the Council stated that ". . . [the Council] would clearly be seen to have ignored its mandate to improve passenger service if it acted as though the only way to make fundamental improvements in the structure of rail passenger service would be to make a financial performance finding against Amtrak, were such a finding called for, with all the difficulties that a finding's complexities and curtailed time-frame might well entail." (The Council's First Annual Report, p. 26). The Amtrak Reform Council[2] (Council) has concluded that Amtrak, as it was created in the Rail Passenger Service Act of 1970, and as it exists today, is – through no fault of its Board or its management or its employees – inherently flawed.[3]

Though this conclusion is unique in the world of Amtrak, it is not unique in railroading. Railroads in many countries have undergone changes similar to those needed in Amtrak to better adapt the railroad mode to changing markets. These principles have been most commonly applied:

- Commercialization of railroads, which requires a separation of the policy and regulatory roles of governments from the commercial responsibilities of railroad managers;

- Implementation of financial compensation arrangements with governments for unprofitable passenger services that governments (national or state) may require the railroad to operate for social reasons;

- Development within railroads of new management structures that are based on different types of business and that focus on market needs;

- The adoption of sound business plans that demonstrate commitment to achieving high productivity of all the factors of production (capital, labor, energy, and materials); and

- The adoption of policies and practices that, where possible and appropriate, encourage competition and participation of the private sector.

The Council believes it is time to begin the debate about the kind of a new structure for rail passenger service that will provide the "fundamental improvements" of which the Council spoke last year.

The Council would like to thank the following people for their assistance and expertise in the preparation and editing of the Second Annual Report.

[2] Biographies of the Council members are found in Appendix II.

[3] Amtrak's formal comments on the Council's Second Annual Report are found in Appendix III.

- The Council's staff – Tom Till, Mike Mates, Ken Kolson, Mary Phillips, Deirdre O'Sullivan, and Dee Gray – for their hard work over several months in preparing this document in response to the not-always-harmonized views of our Council's members.

- The senior management and staff of Amtrak, both for the opportunity to discuss the report and for providing information and analyses during the report's preparation.

- Mort Lowenthal, a retired investment banker with many years of experience advising railroad clients, for his *pro bono* counsel and thoughtful analysis.

- William Watt, for his consistent, seasoned, practical, and unwavering advice during the long process of creating, writing and editing.

- The Office of the Inspector General, U.S. Department of Transportation, especially Inspector General Kenneth Mead and Assistant Inspector General Mark Dayton, for their recurring analyses of Amtrak's Strategic Business Plans and actual performance, which is enormously valuable to the Council and its small staff.

- The staff of the U.S. General Accounting Office, working under Associate Director Phyllis Scheinberg, both for their numerous analyses of topics pertinent to the Council's work.

- The staff of the Federal Railroad Administration, who have provided, both during the last year and in the preparation of this report, consistently thoughtful comments and valuable information.

- Joel Myron of the Brotherhood of Maintenance of Way Employees, standing in for Council member Charlie Moneypenny (who is recovering from major surgery), for his thoughtful commentary and the opportunity he provided for the Council staff to discuss at length issues in the report important to rail labor.

- The Transportation Trades Department of the AFL-CIO for its considered evaluation of the report, and for consolidating the views of the railway labor organizations concerning the report and providing those views to the Council.

- Louis Thompson, Railways Advisor of the World Bank, for his comments on the draft report, including insight into reforms that have been adopted in other countries.

INTERCITY RAIL PASSENGER SERVICE IN AMERICA: STATUS, PROBLEMS, AND OPTIONS FOR REFORM

I. INTRODUCTION

During the year since its first annual report, the Council has moved from a preliminary assessment of Amtrak to a much more complete understanding of the problems and challenges Amtrak faces. Based on this better understanding, the Council presents in this report an analysis of prospects and problems that will provide – in its view – a sound basis for recommending fundamental reforms in the institutional and financial structure of rail passenger service in America. The reforms are called for because the institution currently responsible for our national system of rail passenger services – the National Railroad Passenger Corporation, or Amtrak – is not working as well as it should. The objectives of these reforms are to improve the efficiency and service quality of passenger operations, safeguard federal and state capital investment in track and equipment, and pave the way for successful development of high-speed rail corridors. It is proper for the Council to offer the proposed reforms at this time to open the debate about the reauthorization of Amtrak, a debate which should be completed before FY2003.

Intercity passenger rail service has the prospect – but not the certainty – of becoming an increasingly important form of public transportation in the 21st century. Over the next 10 years, domestic airline travel is expected to grow by over 40 percent, while highway usage is forecast to increase about 2 percent annually,[4] straining roads and airports that are already approaching or exceeding current functional capacity. Rail offers a potentially cost-effective approach for adding capacity in high-density markets if it receives adequate public financial support and can offer comparable overall value in terms of price, time, convenience, and customer service. A number of states are already exploring this option and are working individually or in regional consortiums to design high-speed rail services (generally at speeds between 90 and 110 mph) to connect heavily-traveled inter-urban corridors.[5] These services generally correspond to the intercity corridors designated by the Department of Transportation in 33 states and the District of Columbia for high-speed rail development.

The vision the states and many in Congress have for an improved national system of passenger rail service is far different from the reality of Amtrak. Amtrak has not met its potential as an efficient, modern provider of high-speed, intercity rail passenger service. According to the Bureau of Transportation Statistics, Amtrak accounted for about 0.5 percent of passenger trips of

[4] U.S. Department of Transportation, Forms 41 and 298-C, and Federal Highway Administration, 1999 Status of the Nation's Surface Transportation: Conditions and Performance Report.

[5] The question of what speed is "high-speed" has received a variety of answers over the years. General international practice recognizes 125 miles-per-hour (mph) as "high-speed." Under section 511 of the Railroad Revitalization and Regulatory Reform Act of 1976, 125 mph was also used. ISTEA defined high-speed as 90 mph, while the existing authority to issue bonds for high-speed rail projects (26 USC 142(i)(1)) uses 150 mph. The proposed bond legislation uses the ISTEA definition for high-speed rail.

over 100 miles in 1995, about the same as in 1977.[6] Over the past 10 years, ridership on intercity routes outside of the Northeast Corridor (NEC) has actually declined from 11.1 million passengers in 1991 to 9.6 million passengers in 2000 (while U.S. population growth was about 10 percent over this period).[7] On the NEC, ridership rose 18.5 percent over this period, but fell short of the 28 percent rise in airline ridership growth along the Corridor. Over the past five years, although Amtrak's NEC ridership growth has kept pace with the airlines on a percentage basis, this has not translated into better overall financial performance of Amtrak's core business. Amtrak finished FY2000 with an operating loss of $943 million, $100 million behind its Strategic Business Plan. It is true that potential exists for significant ridership increases in the NEC, where Acela Express service has recently been introduced, and in certain existing and emerging corridor operations in California, the Pacific Northwest, the Southeast, and the Midwest. Unlike the NEC, these latter services are, or are likely to be, organized and subsidized by the states, along with federal investment that will be needed to develop these corridors as well.

The Council believes that the problems behind Amtrak's difficulty in increasing its ridership and improving its financial performance are the same problems that led the DOT IG's Report of September 2000 to conclude that, barring significant corrective measures, Amtrak will be unable to cut costs significantly, make needed minimum capital investments, achieve its revenue targets, or improve its service quality and reliability.[8] Indeed, for most of Amtrak's 30 years of corporate existence, people have asked, "What is Amtrak's problem?" They have asked this precisely because Amtrak has never fully measured up to the expectations, realistic or not, of either its supporters or its critics.

The Council wants to make it clear that it is not Amtrak's Board or Amtrak's managers, and certainly not its employees, that are preventing the needed improvements from being made. The barrier is a flawed institutional structure that hampers effective planning and sound financial management, making it difficult for Amtrak to provide the efficient, reliable service that customers deserve.

A new approach is called for if the potential for rail passenger service in this country is to be realized. Without significant change, should the American people be asked to spend another $24 billion to sustain Amtrak's current operations over the next 20 years, or potentially as much as $80 to $100 billion, the estimated cost to maintain and expand rail passenger service?

The Amtrak Reform Council has spent the past year studying what we believe are the key issues that must be addressed to fulfil a new vision for passenger rail service:

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[6] U.S. Department of Transportation, Bureau of Transportation Statistics, Transportation Statistics Annual Report 1998: Long-Distance Travel and Freight, BTS98-S-01, p. 148. Amtrak indicates that its research finds a market share of about 1.2 percent in FY2000 for trips of 70 miles or greater.

[7] Amtrak notes that during 1994 and 1995 it cut certain routes and frequencies resulting in passenger losses. Most of these route and service reductions were subsequently restored.

[8] U.S. Department of Transportation, Office of the Inspector General, Assessment of Amtrak's Financial Performance and Requirements, September 19, 2000 (hereafter DOT IG Report), at 11-13, 35, 37, 44-45.

- What has kept rail passenger service from thriving over the past 30 years?

- What are the prospects for growth for rail passenger service, and what are the estimated capital and operating costs of the existing and an expanded network?

- Should there be changes in how rail passenger service is organized, planned, and funded?

- Who should control and allocate federal funds relating to intercity passenger rail service?

- How should priorities for high-speed rail investments be determined, and how should the Northeast Corridor (NEC) and the emerging high-speed corridors be managed and funded?

Answering these questions has led the Council to conclude that Amtrak's commercial functions must be appropriately separated from its government agency role. Further, within its commercial functions, its train operations should be appropriately separated from its NEC (and other) infrastructure responsibilities. Chapters IV and V address these issues in detail.

The succeeding chapters of this report address these issues. The Council hopes that its analyses and recommendations for new approaches will contribute to the comprehensive review of the nation's passenger rail institutions and services that the Congress is planning to undertake.

II. ISSUES AND PROSPECTS FOR RAIL PASSENGER SERVICE

Amtrak's performance in FY2000 was approximately $100 million short of its goal. Revenues were lower than expected, costs were higher than planned, and productivity improvements did not produce measurable financial gain. With regard to labor productivity, Amtrak has difficulty in converting tangible gains achieved at the bargaining table into improved financial performance. Yet while Amtrak's performance continues to fall short of its plan, the United States is witnessing a resurgence of interest in passenger rail service. High-speed corridors linking heavily-traveled inter-urban corridors have been designated in 33 states and have the potential to play an important role in meeting the Nation's transportation needs. According to Amtrak, needed federal and state capital investment to support the existing network is estimated at approximately $23.6 billion; for all potential services in an expanded network, the estimates are between $80 and $100 billion over a 20-25 year period. The Council believes there is a need for a strong government entity to plan, fund, and oversee a major program for improvements to our national rail passenger system.

The Amtrak Reform and Accountability Act of 1997 requires that Amtrak achieve operational self-sufficiency. The Act also created the Amtrak Reform Council to monitor Amtrak's progress. Should the Council determine that Amtrak has not achieved or will not achieve operational self-sufficiency, the Council is required by Congress to submit a plan for a restructured and rationalized national intercity rail passenger system. Amtrak would be required to submit a liquidation plan.

The Act also requires the Council to report annually to Congress on several issues important to Amtrak's progress. The Council has been monitoring Amtrak's progress, and Amtrak's progress has been mixed.

A. WHERE AMTRAK STANDS TODAY

1. Amtrak's Fiscal Year 2000 Results

Over the past year, Amtrak has achieved some important milestones: the implementation of a service guarantee program, and the inauguration of Acela Express service. Ridership and ticket revenues were both up in FY2000. Nevertheless, Amtrak's performance continues to fall below its projections.[9] In FY2000, revenues were $84 million below the Strategic Business Plan's goal.

[9] During FY2000, Amtrak's ridership increased approximately 5 percent, to approximately 22.5 million passengers, while its ticket revenues increased by 10 percent, to almost $1.1 billion. Amtrak's annual costs total approximately $2.9 billion. Total operating revenues increased by $212 million from FY1999's $1.8 billion to $2.0 billion in FY2000, but were $84 million below Amtrak's Strategic Business Plan's projection for FY2000, mostly attributable to Mail and Express revenues being $54 million below projections. Amtrak has publicly disclosed (in a February 16, 2001, official statement furnished in connection with the issuance of $110,795,000 of Exempt Facilities Revenue

Expenses excluding depreciation[10] charges of $370 million were $39 million greater than projected and $196 million greater than in FY1999. Amtrak's resulting unaudited FY2000 loss of approximately $943 million was more than $100 million greater than Amtrak's Plan, and it was $26 million worse than the actual loss in FY1999. (Amtrak's actual FY2000 loss excluding depreciation was $15 million better than FY1999's loss excluding depreciation, but the FY2000 loss excluding depreciation was $123 million worse than projected in Amtrak's FY2000 to FY2004 Plan.) Amtrak was also extremely short on cash last year. To improve its cash position by $25 million and to fund $99 million of equipment capital improvements, Amtrak sold and leased back in four transactions a total of $915 million of passenger equipment. Such transactions, coupled with new equipment and high-speed rail facilities acquisitions, have tripled Amtrak's debt in the past five years to about $3 billion.

Based on Amtrak's representations that full year Acela revenues of $300 million would result in a profit contribution of $180 million (a gross profit contribution of 60 percent of revenues), the loss of $150 million of Acela revenues in FY2000 would be anticipated to result in a $90 million net loss, the largest cause of change in actual performance from Plan projections.

The introduction of Acela Express trains was more than a year behind the schedule anticipated in the previous Strategic Business Plan.[11] Amtrak's greater than anticipated loss is attributable to loss of Acela Express revenues, higher operating costs (particularly higher personnel costs due to increasing employment levels), and, to a lesser degree, the slow growth of Mail and Express.

In previous Strategic Business Plans, Amtrak projected the greatest improvements in operating income in FY2001 and FY2002. Acela Express service expansion, however, has been delayed, and Amtrak has continued to demonstrate an inability both to contain its operating costs and to implement effectively and within budget its large projects, such as electrifying the northern portion of the Northeast Corridor and bringing on line a new automated ticketing system. Amtrak also has been unable to grow its Mail and Express business according to its Plan. Reports issued within the past year by both the General Accounting Office (GAO) and the Office

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Bonds) that, "with no high-speed service implemented in Fiscal Year 2000 and only two Acela Regional trains in operation beginning in January 2000, estimated ticket revenues fell short by over $150 million in Fiscal Year 2000." With a net passenger revenue shortfall of $18 million relative to its Strategic Business Plan, non-Acela revenues by logical deduction were $132 million above its Strategic Business Plan for FY2000.

[10] Depreciation is a non-cash charge representing the dollar value of fixed assets consumed, or which become obsolete, during the period of time that revenues were generated. Although depreciation is not a current cash expense, companies are required under GAAP (generally accepted accounting principles) to deduct depreciation charges from revenues in the determination of net income since the consumption of fixed assets will require cash investment in new or rebuilt fixed assets at some future time. Recognition of depreciation on financial statements is not limited to for-profit entities under GAAP. Government Accounting Standards Board (GASB) statement no. 34 requires that government entities account for depreciation of long-term assets in their financial statements.

[11] Over Amtrak's FY2000-FY2004 Plan, only one-third of Amtrak's profit improvement was anticipated from new Acela Express service, with the balance of the profit improvement coming from mail and express and other, unspecified sources. Acela's profit contribution in FY2000 was anticipated to be approximately $90 million based on projected deliveries of Acela train-sets through the fiscal year and projected Acela Express revenues of $150 million.

of the Inspector General of the Department of Transportation (DOT IG)[12] have reached similar conclusions to the Council's research. Both agencies have stated that Amtrak needs to take serious corrective actions immediately to control its costs and increase its revenues if the Corporation is to meet its FY2001 and FY2002 projections and the financial goal of the Reform Act to not require federal operating grants after December 2, 2002. More recently, at a hearing of the Senate Appropriations Subcommittee on Transportation, the GAO testified that "In addition, it is likely that Amtrak will not eliminate its need for federal operating subsidies by the end of 2002, as required by the Congress . . .."[13]

2. Issues The Congress Tasked the Council to Address (Use of TRA Funds, Productivity Issues and Route Closures or Realignments)

The Reform Act requires the Council to Report to Congress on several specific matters. The Council's report and commentary on these issues is set forth below; a full discussion of the Council's statutorily assigned reporting tasks is provided in Appendix IV.

a) Taxpayer Relief Act of 1997 (TRA)

The Council has a statutory responsibility to monitor Amtrak's expenditures funded by special tax refunds of about $2.184 billion[14] authorized by Section 977 of the TRA for defined, qualified expenses. The funds were made available to Amtrak in December 1997 with the signing into law of the Reform Act, a precondition for the release of funds to Amtrak.

Although Amtrak represented that TRA funds would be used primarily for high-return capital expenditures, through December 31, 2000, about $590 million – or 26 percent of total TRA commitments – have in effect been used for expenditures that most companies and Generally Accepted Accounting Principles (GAAP) would treat as ordinary operating expenses, or required capital expenditures.

- $44 million was used for debt service principal payments (which companies other than Amtrak typically fund with cash flow from depreciation charges),

- $229 million went to progressive overhauls of equipment (an operating expense under GAAP),[15]

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[12] The DOT IG Report concluded that "Amtrak's 2000 Strategic Business Plan will not achieve operating self-sufficiency in 2003." [pages vii and 12] The report further concluded that, *"If no corrective action were taken to compensate for them*, Amtrak's cash loss would be about $1.4 billion more than it projects over the 5-year period, 2000 through 2004." (pp. iii, viii)

[13] U.S. General Accounting Office, Statement of John H. Anderson, Jr., Managing Director, Physical Infrastructure before the Subcommittee on Transportation, Committee on Appropriations, U.S. Senate, February 14, 2001, p.2.

[14] Beyond theTRA funds committed to expenditures classified as operating expenses under GAAP, TRA funds implicitly funded a portion of Amtrak's overhead costs (for engineering, procurement and other corporate or Northeast Corridor services) as part of the TRA capital expenditure projects performed with Amtrak personnel. (Appendix IV summarizes TRA commitments by category.)

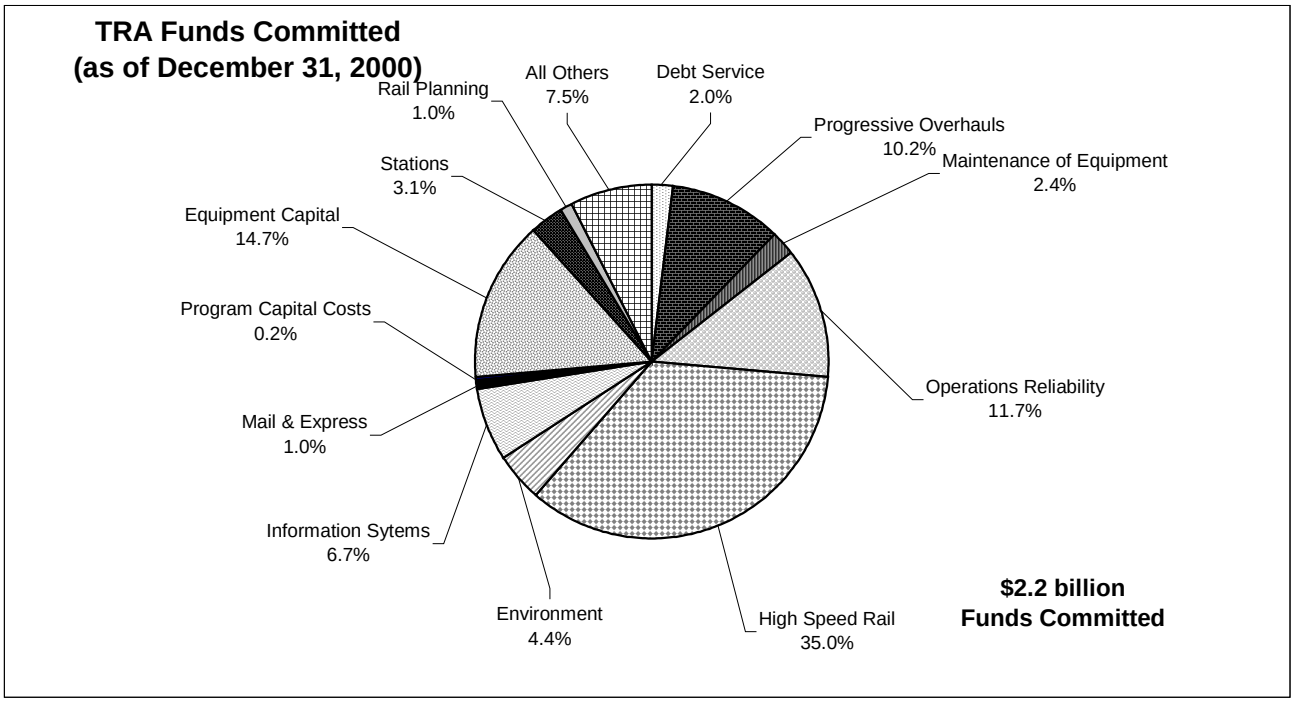
[15] This program of changing out major equipment components has been funded by Congress as an appropriate use of federal capital grants.

- $54 million was used for equipment maintenance (also generally an operating expense unless the economic lives of the equipment are materially increased), and

- $263 million was used for operations reliability projects which are necessary to preserve minimum standards of service reliability.

The figure below summarizes Amtrak outlays of TRA funds and its plans for expending the funds as yet unspent.

	Total Authorized	Percent of Total
Debt Service	$ 44,327,549	2.0%
Progressive Overhauls	$ 228,503,106	10.2%
Maintenance of Equipment	$ 54,307,549	2.4%
Operations Reliability	$ 262,864,898	11.7%
High Speed Rail	$ 785,312,180	35.0%
Environment	$ 99,772,205	4.4%
Information Sytems	$ 149,198,654	6.7%
Mail & Express	$ 23,309,457	1.0%
Program Capital Costs	$ 4,618,909	0.2%
Equipment Capital	$ 330,837,613	14.7%
Stations	$ 69,656,142	3.1%
Rail Planning	$ 22,857,747	1.0%
All Others	$ 168,009,725	7.5%
Grand Total	$ 2,243,575,734	100.0%



b) Productivity Issues

The Reform Act directs the Council to look at a variety of issues related to the productivity of Amtrak's union work force. While the Council understands the importance of labor productivity in any endeavor, it has stated before, and feels compelled to mention once again, that to look at labor productivity in isolation from the productivity of a corporation's use of capital, energy, and materials can be misleading. Against this backdrop, the Council will address three workforce issues.

- Work Rule Savings

  In its last round of labor agreements, Amtrak secured some changes in work rules (described in the Council's January 2000 Report) that have the potential to result in labor costs savings. Notwithstanding these changes, Amtrak's labor costs have grown by approximately 10 percent above the rate of inflation since 1995.[16] Amtrak's stated goal was to offset 20 percent of wage increases from the last round of labor negotiations through labor productivity improvements.

  Amtrak submitted to the Council a set of quarterly numbers stating a total of $21.3 million in "productivity improvements and work rules and cash savings" for FY1999. The report did not show how the savings were allocated and provided no analysis of how the numbers were calculated. For FY2000, Amtrak submitted comparable quarterly and annual reports stating a total of $31.0 million in "productivity improvements, work rule and cash savings" from post-January 1, 1997 labor agreements. Similar to the year - earlier reports, the FY2001 report did not show how the savings were allocated, nor how the numbers were calculated.[17] The Council has not been able to verify these claims.

  In its May 2000 Report, the GAO noted that there is no way to confirm Amtrak's productivity calculations because Amtrak has no methodology in place by which it can measure work rule savings nor does it maintain an audit trail of the information necessary to measure such changes.[18] The GAO report also noted that Amtrak "does not have standard measures of labor productivity for its different lines of business (e.g., intercity passenger service, commuter service)," and that the development of such measures is critical if Amtrak is to control its labor costs (which constitute over 50 percent of its operating costs).[19] The Council concurs in GAO's assessment. Amtrak stated in response to the GAO Report that it agreed to develop such measures.[20]

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[16] See May 2000, GAO Report, "Amtrak Will Continue to Have Difficulty Controlling Its Costs and Meeting Capital Needs" ("GAO Report") at 8.

[17] Amtrak has offered to let the Council's staff review notebooks of field reports received by Amtrak's Labor Relations Department which purportedly substantiate the total quarterly savings amounts reported, but Amtrak does not want this sensitive information copied or taken from Amtrak's offices.

[18] See GAO Report at 27, n.14; see also January 2000 Council Report at 20.

[19] GAO Report at 25-26.

[20] GAO Report at 5.

- Contracting Out
  Under Section 121 of the Reform Act, Amtrak is free to negotiate for the contracting-out of any and all operations effective November 1, 1999, to improve productivity. Section 121 requires that [any] "proposal[s] on the subject matter of contracting-out work…which results in the lay-off of an Amtrak employee…shall be included in negotiations under Section 6 of the Railway Labor Act between Amtrak and an organization representing Amtrak employees…which shall be commenced [no later than] November 1, 1999." Amtrak informed the Council that the Corporation served Section 6 notices, on June 12, 2000, placing the contracting out issue on the bargaining table. Amtrak considers specific contracting out issues to be confidential. (The Reform Act puts no deadline on the collective bargaining process with respect to the issue of contracting out, nor does it require Amtrak and union representatives to reach agreement on the issue of contracting out.)

- Absenteeism
  In its September 19, 2000 report, entitled Report on the 2000 Assessment of Amtrak's Financial Performance and Requirements, the DOT IG noted that "[c]urrently, Amtrak's agreement covered employees are absent an average of 8 to 9 days a year, while the industry average is 5 days" and that "Amtrak has estimated a 1-day decrease in the average will equate to an expense saving of $6 million per year."[21] The Report further noted that Amtrak is engaged in a "presenteeism initiative" to improve the attendance of Amtrak's agreement employees, but that at the time of its assessment, "Amtrak was unable to provide a way of measuring how the presenteeism initiative will translate into [Amtrak's] projected dollar value of expense savings [$30 million over a five-year period]."[22]

  The Council notes that the potential savings to be realized, should Amtrak's presenteeism initiative simply achieve the industry average attendance, are significant – $18-24 million per year.

c) Route Closures or Realignments

The FY2000 Transportation Appropriations Act and the FY1999 Omnibus Appropriations Act require the Council to identify any Amtrak routes that, in the Council's view, might be candidates for closure or realignment. To date, the Council has had a limited opportunity to review the results and data underlying Amtrak's route assessment, which produced a plan for realignments and extensions of its route system called the Network Growth Strategy (NGS). Amtrak conducted the assessment using its Market Based Network Analysis (MBNA) financial model. The MBNA is a complex system of computerized analytical models that estimate likely revenues, expected costs, and potential profitability of a proposed route or system of routes. Completing a thorough evaluation of the MBNA and the plans Amtrak developed using it will be a priority for the Council this year. Until the data underlying Amtrak's MBNA analysis are made available to the Council for analysis, however, the Council will not be in a position to evaluate potential Amtrak route closures or realignments.

[21] DOT IG Report, p. 29.

[22] Ibid

d) Recommendations to Amtrak for Improvement

The Reform Act requires the Council to evaluate Amtrak's operations and to make recommendations for improvement to the Corporation. The Council accordingly approved a number of recommendations and forwarded them, in November 1999, for the Board's consideration.

In response to the November 1999 recommendations, Amtrak has now agreed to prepare separate financial statements, beginning in January 2001, for the NEC infrastructure. Separate statements have been prepared for its mail and express business, which has been made a separate business unit.

The Council is in the process of preparing additional recommendations for Amtrak regarding additional near-term actions that would assist Amtrak in improving its operational and financial performance. Recommendations addressing the following issues have been discussed informally by the Council staff with Amtrak's management and will be formally transmitted to Amtrak's Board and management soon. They are: (1) substantially reducing corporate overhead; (2) acquiring a modern reservations and ticketing system which keeps track of total seat inventories (reserved, occupied, and vacancy) on a real-time basis; (3) undertaking a broad range of marketing initiatives designed to increase load factors and passenger revenues; (4) acquiring modern accounting and management information systems; and (5) considering the restructuring of the crewing arrangements for Amtrak's long-haul intercity trains to provide shorter working lengths of haul, with more rest and more time at home base.

B. A NEW PROSPECT FOR INTERCITY PASSENGER RAIL: REASONABLE EXPECTATIONS FOR SUBSTANTIAL GROWTH

1. The Growing Grassroots Demand for Intercity Rail Passenger Service

The focus of passenger rail service has changed dramatically in the past ten years. This changing focus is due largely to a groundswell of state and local support for substantial increases in high-speed rail service, characterized by operating speeds of 90 mph or more in heavily traveled corridors. Through ISTEA and TEA-21, eleven corridors in 33 states and the District of Columbia have been designated as candidates for the development of high-speed ground transportation to complement the highway and aviation systems that serve the particular regions.

The corridors are generally about 100 to 500 miles in length, a distance over which it is considered feasible for high-speed ground technologies to compete with automobile and airline transportation as depicted on the map on the following page.

Designated High-Speed Rail Corridors

Large increases in ridership have been projected for new high-speed rail passenger corridors. A 1997 analysis of the economics of high-speed rail by the FRA suggests that high-speed operations at 110 miles per hour could quadruple Amtrak's non-Northeast Corridor ridership to approximately 40 million passengers by the year 2020.[23] (Amtrak currently carries approximately 10 million passengers a year outside the NEC.) The FRA analysis was based on a more limited set of high-speed corridors than the current list of designated corridors. The text box on the next page describes how 9 Midwest states are moving toward an effective interstate compact to implement the Midwest Regional Rail Initiative.

Ridership on the NEC is also expected to rise significantly in the coming years as Amtrak completes introduction of Acela service. Amtrak projects that ridership (for Acela Express and Regional service combined with Metroliner and Northeast Direct Service) will increase by about two million passengers in 2002 compared to 1999, primarily due to increased ridership between Boston and New York City.

Recent increases in ridership have been primarily along high-density corridors with average passenger trip lengths of no more than 80-300 miles. In California, for example, ridership on the Capitols between Oakland and Sacramento increased 41 percent in FY2000. Overall, ridership on the Northeast Corridor was up 5 percent last year.

[23] U.S. Department of Transportation, Federal Railroad Administration, High Speed Ground Transportation for America, September 1997, statistical supplement.

A New Approach to Organizing and Funding Rail Passenger Service: The Midwest Regional Rail Initiative (MWRRI)

An interesting and important development in the institutional structure of America's intercity rail passenger system is the approach being pursued by the MWRRI. Working together, and in consultation with Amtrak, nine states have developed a plan for a major system of regional intercity rail passenger services for a region with a population of 60 million. This system would radiate from its hub, Chicago, and, when fully developed, it would increase the size of our national intercity rail passenger system by about 50 percent – from today's 30 million train-miles per annum, to about 45 million. Virtually all of this service would be provided in partnership over the tracks of the private sector freight railroads.

The states designed this major system proposal by constructing a series of scenarios for both train operations and financial performance. Under the plan the states chose, federal funding would be sought for track, structures and equipment on a 80/20, federal/state cost-share basis. To operate the passenger train services, the states have opted to negotiate a franchise with Amtrak to take advantage of Amtrak's statutory right of access to the numerous freight lines that make up the 3,000 mile Midwest system.

The operating contract would compensate Amtrak on a cost per train-mile basis, with rates under discussion significantly lower than Amtrak's current system-wide average train-mile cost. These reductions in cost per train-mile are driven by significant increases in service levels, and thus train-miles, that reduce the impact of fixed costs on the new regional rail system by achieving higher capital productivity.

The consortium of states is likely to operate through an interstate joint powers agreement. Initially, the states will use this agreement to set performance standards for the system, continue implementation and financial planning, provide technical assistance and monitor system performance. Over time a formal joint powers authority may be established that will have the ability to receive state and federal funding, contract for service on a regional basis, and assume revenue risk for the financial performance of the system.

As a developmental model, this approach appears to have a number of important benefits. It defines up front the financial performance goals that must be met. It places the revenue risk with those commissioning the service (much as in the case of a commuter agency), who will also control marketing, reservations and ticketing, and food services -- functions that have a direct and major impact on revenues from operations. It also limits the federal funding role to providing matching capital for initial infrastructure improvements. Amtrak's profit, as the service contractor in this case, will depend on its ability to operate within a negotiated cost-of-service profile. This model could well serve as one model for the modern, economical, and financially responsible development of the high-speed rail corridors that have been designated by the U.S. Department of transportation in 33 states and the District of Columbia.

2. Capital Funding Needs to Support Existing and Expanding Intercity Rail Passenger Service

Developing new high-speed rail corridors and maintaining the NEC will require significant federal capital investment in partnership with the states and the freight railroads. There is a shortage of needed capacity on certain segments of the freight railroad network if it is to accommodate additional passenger and freight traffic. To build new high-speed corridors, it may be necessary to add an additional main line the length of the corridor and install centralized traffic control. The need to build new track, rather than modify existing track, will add significantly to initial project construction costs. The good news, however, is that there is often available right-of-way to add capacity since many routes that are now single track, once had two or more mainline tracks.

Prior to Amtrak's recent release of a long-term capital needs plan, the Council retained BGL Rail Associates, a transportation consulting firm specializing in rail industry issues, to estimate the amount of capital needed to renew and improve the fixed rail infrastructure of the NEC and emerging high-speed rail corridors over the next 25 years. BGL based its estimates on available data developed in studies by the Federal Railroad Administration, the DOT IG, the GAO, and Amtrak.

The BGL analysis concluded that the NEC will need $20 billion in capital through FY2025, including funding to restore the south end of the NEC to a 90 percent on-time performance level and increase track speed for Acela Express service, and about $900 million to bring the Penn Station New York tunnels up to current fire and life safety standards.[24] BGL concluded that the cost of establishing a 90-mph network involving the 11 Department of Transportation-designated high-speed rail corridors would be approximately $12.2 billion over 25 years, while the cost of a 110-mph network would come to about $23.7 billion. BGL's estimates only address fixed rail infrastructure and thus do not include capital needed for passenger equipment and station improvements, nor the additional funds that may be needed for such items as debt service and program management.

Amtrak, in its February, 2001, long-term capital needs report, presents two scenarios, one representing the "minimal investment" needed to support Amtrak's current services and a second plan identifying capital needs to significantly increase service. Amtrak's growth plan includes "all passenger rail services under study and/or development by the states and Amtrak. It contains high-speed corridor projects and some long-distance and point-to-point service."[25] Amtrak's plan also distinguishes between the total capital need and the portion Amtrak envisions being funded by the federal government. The plan covers a 20-year period, rather than the 25-year forecast provided by BGL, and includes capital for stations and equipment, debt service, mail and

[24] U.S. Department of Transportation, Office of the Inspector General, Letter to Hon. Frank Wolf, Chairman, Subcommittee on Transportation and Related Agencies, Committee on Appropriations, U.S. House of Representatives, December 18, 2000, p.2.

[25] National Railroad Passenger Corporation, Investing in the Future of Passenger Rail – Long-Term Capital Plan, February 2, 2001, p. 42.

express, and other items. The Amtrak and BGL projections, therefore, are not directly comparable.

Amtrak estimates that $16 billion in *federal* funding will be needed to support Amtrak's current service and another $14 billion in *federal* funding will be needed to provide "seed money"[26] for expansion of passenger service, including initial high-speed corridor development. This amounts to an annual federal need of $1.5 billion per year, or $30 billion over the next 20 years.

Total funding needs from all sources are significantly higher. According to Amtrak, the total amount needed to maintain current service is $23.6 billion over 20 years, comprising $16 billion in federal funding and $7.6 billion from the states and other funding sources. The total cost for Amtrak's growth scenario would be another $73.6 billion over 20 years, comprising $14 billion in federal funding and about $60 billion from the states and other funding sources, as summarized in the table below. The capital needs associated with the growth scenario, however, should be viewed as an inventory of all projects that have been advanced by the states and/or Amtrak. Many of the projects are at a conceptual stage and may not be funded, if at all, within the 20-year timeframe of the plan. Amtrak notes with respect to the growth scenario that "It is important to reiterate, however, that not all of the corridors and services included in this assessment will end up being fully developed during the plan period. . ." [27]

Amtrak 2001 Long-Term Capital Plan

(billions of 2000 $)

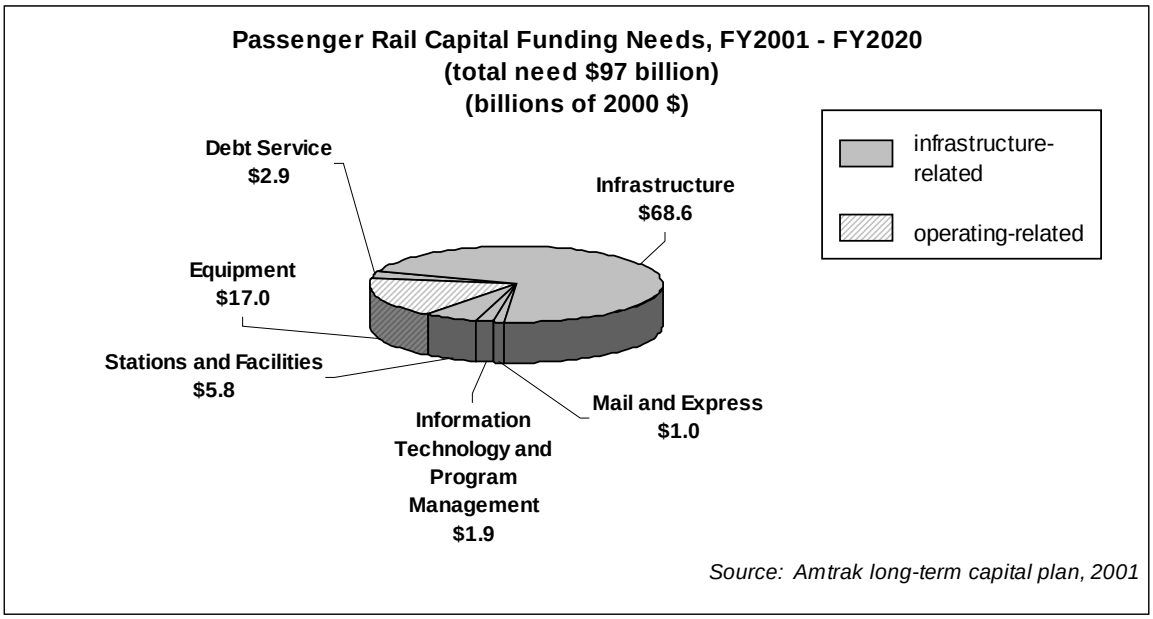
	Total Need	Federal Share
Current Service Needs	$ 23.6	$ 16.0
Growth Service Needs	$ 73.6	$ 14.0
Total	$ 97.2	$ 30.0

The total Amtrak inventory of current service and growth needs sums to about $97 billion over the next 20 years, as depicted in the chart below. It would include $34 billion for infrastructure improvements on high-speed corridors (compared to BGL's $23.7 billion), $22.8 billion on the NEC infrastructure (compared to BGL's $20 billion), and $8.9 billion on infrastructure improvements on long-distance point-to-point routes.[28]

[26] Ibid, p. 44.

[27] Ibid, p. 68.

[28] $2.7 billion would also be spent on non-NEC infrastructure projects under the "current needs" scenario, bringing total spending to the $68.6 billion depicted on the pie chart. While the Amtrak and BGL estimates are not directly comparable, the estimates for infrastructure capital on the NEC and emerging corridors appear consistent. A table comparing the estimates is attached as Appendix V.



The changing nature and increasing importance of passenger rail service to U.S. transportation policy argue strongly for re-evaluating how passenger service is funded and managed. Developing high-speed rail corridors and maintaining existing Amtrak service will require significant federal, state and local funding commitments. A clear understanding is needed of the costs and benefits of proposed projects – and the amount of operating subsidy required. Also essential are a reliable funding source to provide the capital necessary to develop corridors with significant transportation potential and processes that ensure that the funds are efficiently invested.

Using funds efficiently includes combining passenger projects with capital improvements needed by freight railroads. For business reasons, most Class I carriers seem open to joint passenger-freight projects. The sheer size, complexity and cost of the issues related to evolving capital funding needs – both for the freight and the passenger networks – lead to the conclusion that there is a need for an effective institution to plan, fund, implement, and oversee a major program for improvements of our national rail passenger system.

III. WHY AMTRAK DOES NOT PERFORM BETTER: DEALING WITH A CHALLENGED INSTITUTION

An important part of improving any situation is understanding the problems that stand in the way. In Amtrak's case, there are and have been serious misperceptions of the problems that affect Amtrak. The Council believes that fundamental institutional flaws are at the root of Amtrak's problems. In its present incarnation, Amtrak performs both commercial and governmental functions, which the Council believes should be managed separately. Amtrak's train operations – its core business – should also be separated from its responsibilities to own and maintain most of the Northeast Corridor's rail infrastructure. Amtrak's governmental functions, together with program administration and oversight functions currently handled by at least three agencies, should be consolidated in a single government entity separate from Amtrak's commercial functions. The role of this government entity would be to hold the entities performing business functions responsible for developing and implementing sound business plans, to present budgets to the Congress, to keep unfunded mandates from being imposed on the business operations, to manage the expenditure of federal funds, to manage federal investment in the designated high-speed corridors, and to assist in the development of public policy. Finally, the Council believes a secure, long-term source of funding is needed to fund an effectively-structured national rail passenger system.

Why has Amtrak not performed more effectively? The reasons most often cited are not the real reasons that Amtrak has not sufficiently improved. The Council's assessment of both the widely-held perceptions of Amtrak's problems and the more fundamental reasons for Amtrak's chronic difficulties is provided below.

A. GENERALLY-HELD MISPERCEPTIONS OF AMTRAK'S LONG-STANDING PROBLEMS

The problems of Amtrak have been a source of discussion among Amtrak's passengers, the Congress, and both the government and corporate circles of the railroad industry for the 30 years of Amtrak's institutional life. This has been so because Amtrak has never fully measured up to the expectations, realistic or not, of either its supporters or its critics.

Supporters have said that Amtrak should not have been expected to be profitable, and that, thus, it should have been given more money. They also point to the fact that Amtrak does not have a level playing field compared to its highway and aviation competitors, which get billions of dollars each year from federal infrastructure financing programs.[29] In turn, Amtrak's critics have

[29] In fact, the level playing field argument is wrong or at least misleading. Though highways and airports are the recipients of large amounts of federal and state funding, they also pay as much or more in various types of user

said that it should be profitable, that its management is to blame for its poor performance, and that Amtrak has made less than optimal use of the more than $25 billion that Congress has appropriated for its benefit over 30 years. Both critics and supporters have said that there is too much political influence over Amtrak, influence that keeps the railroad from making the sound business decisions it needs to make in order to be efficient, operate a modern fleet for a national system, and provide high quality customer service.

Some say Amtrak cannot make business-like decisions because it is a government agency; others say that it cannot make those decisions – often cast in terms of "pruning" its national route system – because of direct political pressure to keep money-losing trains in its system. Many believe both are true. In frustration, some advocates have even suggested that the Council expose what they term "the Big Lie" about Amtrak, which is the proposition that Amtrak should be able both to run a national system and to do so profitably. They say that no other national passenger railway in the world has ever been able to make a profit; and, though this is not an accurate statement, many believe it to be so.[30]

In surveying this extensive and often conflicting list of problems, the Council offers several observations:

- First – it would be naïve to conclude that political pressure does not adversely affect Amtrak's ability to make sound business decisions. It is true, with minor and financially inconsequential exceptions, that each of Amtrak's individual trains loses money. It is also true that a major pruning of this network of train operations could save money (an exercise of this sort in the Carter Administration cut Amtrak's late-1970s operating deficits from over $900 million per annum to less that $600 million). Unless direct political influence is removed from Amtrak, it can neither make the decisions as to which trains it will run nor insist on getting the funding needed to support the trains it is directed to run.

- Second – it is clear that federal funding for rail passenger service is not provided on the same basis as funding for highways and aviation. Federal aid for roads and aviation is used primarily for infrastructure and is provided on a multi-year basis. Amtrak's federal funding comprises an unclear mix of money for fixed infrastructure, equipment and train operations. In dealing with Amtrak, Congress supports both fixed infrastructure and

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charges or fuel taxes. Overall, automobiles and commercial air passengers pay as much in various charges as is spent on their behalf by the federal government and the states. Amtrak is the recipient of large amounts of federal and state support that it does not significantly offset with taxes or user charges.

[30] After the restructuring of the old Japanese National Railway, the three largest new railways, East Japan, West Japan and Central Japan have been steadily profitable, and a majority of their shares have been sold to private investors. In many countries, profitable companies provide rail passenger services under contracts, franchises or concessions awarded and supported by public agencies. For example: Amtrak reports that it earns profits on the contract commuter services it provides in several U.S. metropolitan areas; long-haul passenger trains in Australia and the franchised passenger operators in the U.K. operate profitably, including contracted-for public support and after paying track access fees; and all suburban passenger services and the Metros in Buenos Aires and Rio de Janeiro are operated by concessionaires who competed for the right to operate trains and receive minimum public support.

passenger operations – and the nature of Amtrak's budget requests provide little indication as to which, if any, of its capital requirements might be suitable for funding by the private sector.

- Third – Amtrak has never really operated as a modern commercial enterprise. Amtrak's basic accounting system is a legacy from the 19th Century Uniform System of Accounts (USOA) promulgated by the Interstate Commerce Commission (ICC) for regulatory, not managerial, purposes. This leaves Amtrak's management effectively in the dark as to the real costs of, and revenue potential from, specific operations. Similarly, Amtrak had not even prepared a long-term capital needs plan until February 2001.

- Fourth – these problems collectively make it very difficult to manage Amtrak effectively as a business enterprise (or even as an efficient government agency). Amtrak's managers must pay excessive and distracting attention to dealing with political requests for additional service, for which sufficient funding is usually not made available. Management must focus on the condition of the vast and expensive Northeast Corridor infrastructure Amtrak is forced to find funds for and maintain. They must provide transportation service without a real idea of the actual costs and profit potential of the services Amtrak provides, for which there is not, in any real sense, a market test. And management must also devote major amounts of time to pursuing federal funding from the Congress and the Executive Branch of the government (as well as state funding for specific projects). Managers of airlines and bus lines need not do any of these things.

The Council also notes that some of the "quick fixes" that are prescribed for Amtrak's perceived problems are largely based on misconceptions:

- There is an unrealistic assumption that, almost everywhere else in the world outside the U.S., nations provide from a bottomless source of public funding whatever public monies it takes to operate and maintain an elaborate national intercity rail passenger system, including its infrastructure. To the contrary, financial pressures have caused governments to implement various programs of reform, restructuring, and privatization to the national railroads of Germany, Sweden, the Netherlands, Italy, and the United Kingdom. The effect of these reforms has been significant. In some cases, higher efficiency and quality have actually permitted a reduction of public support. In other cases, support has increased because the clearer contractual relationships under the new regimes have given governments higher confidence that budgeted funds would be spent effectively and for the purposes intended. Indeed, the European Commission, in its Order 91/440 and subsequent Orders, has imposed increasingly stringent requirements on the E.U. railways to increase efficiency, clarify and restrict subsidies, and introduce competition across borders.

- Another unrealistic expectation is that Amtrak's deficits can be fully offset through internal cross-subsidies. Under this misperception, "profits" from the NEC presumably can cover the losses of its intercity operations. This has not worked in the past – and no one has put forth a convincing case that it could work in the future, especially in light of the billions of dollars of capital required to preserve the NEC at its present performance

levels. Although net income from Mail and Express operations makes an important contribution, it falls far short of Amtrak's own forecasts. Furthermore, cross-subsidies have not materialized in Western Europe's rail operations under conditions that are significantly more favorable – higher passenger density, many large stations conducive to commercial development, and a more extensive, higher-capacity, usually multi-track right-of-way network.

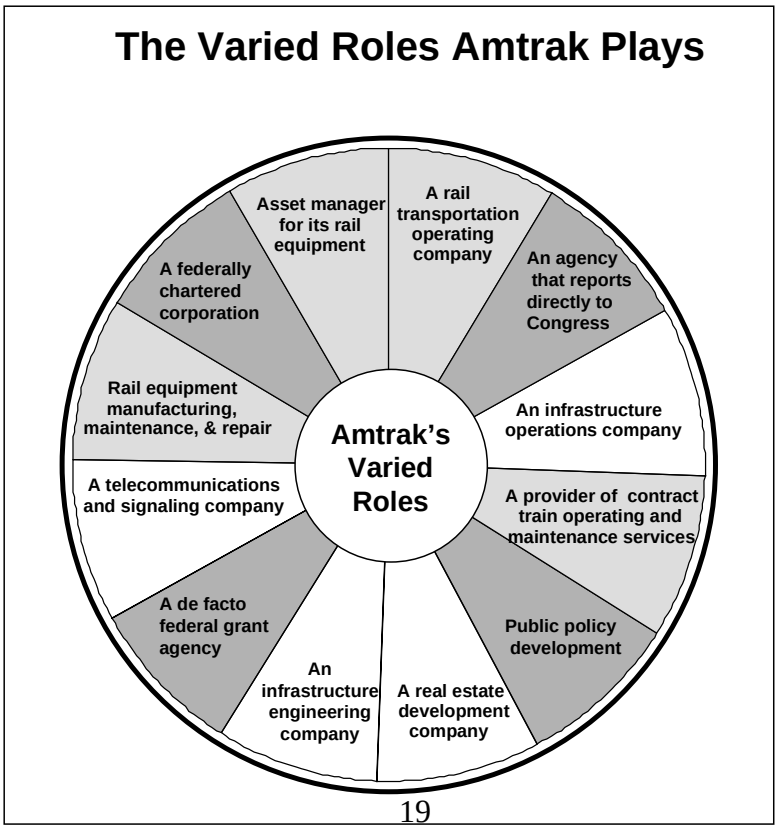
B. THE COUNCIL'S PERSPECTIVE: AMTRAK'S INSTITUTIONAL FLAWS AND RECOMMENDATIONS FOR CHANGE

The Council believes that Amtrak's poor performance since its inception is a symptom of fundamental institutional flaws. Amtrak does not perform like a business because it was not properly designed to perform like a business. Amtrak does not have the tools to perform like a business because it never has been required to develop an organizational structure to compete effectively in the market place. Amtrak does not have a core business objective because it has been asked to do too many things with the resources it has been given. Amtrak does not have the funds to successfully perform all its many functions because Congress, among other reasons, has not seen fit to provide to Amtrak the large amounts of funds that are needed.

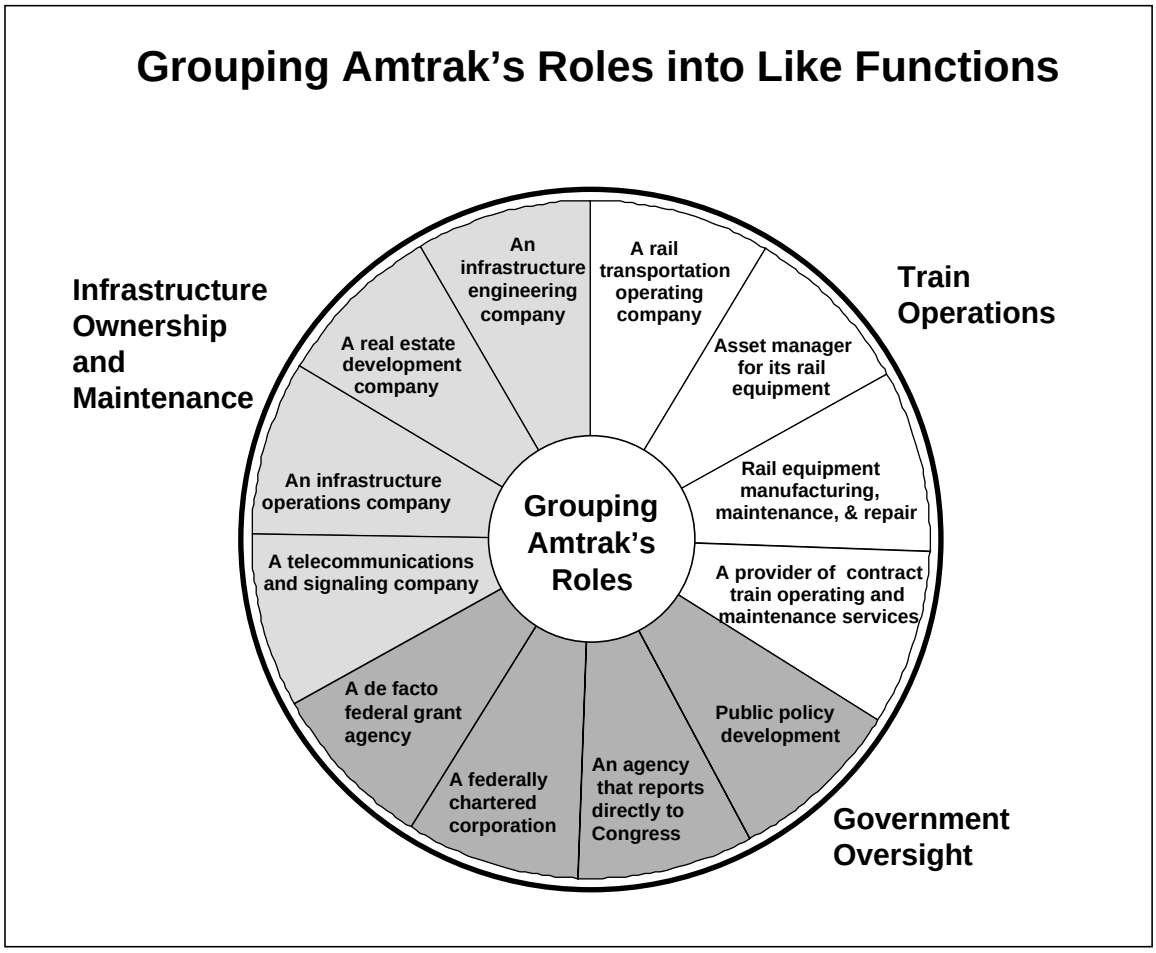
What are the institutional flaws that keep Amtrak from meeting its goals?

1. Amtrak's Many Functions

In its First Annual Report, issued in January of last year, the Council indicated that it thought that Amtrak was performing too many functions, some 12 in all. The graphic below depicts these functions.



These functions impose on Amtrak responsibilities far in excess of those borne by the airline and intercity bus transportation operating companies with which it competes. Not only must Amtrak perform efficiently as an operating company, Amtrak must also carry the additional burden of functions akin to those of a state highway department, in that it must fund and maintain the infrastructure over which it operates, at least in the Northeast Corridor. Further, in respect to a number of important responsibilities, Amtrak must execute the functions of a government agency. The graphic below shows how these 12 functions fall into three basic categories – rail passenger operations, infrastructure funding and maintenance, and governmental or quasi-governmental responsibilities.



2. Amtrak's Unique Structure

The Council also identified the "apples and oranges" problem that afflicts Amtrak. The structure of the intercity rail passenger industry, in contrast to those of its competitor industries, is made up of one big company that provides its own infrastructure, at least in the NEC, which generates more than half of Amtrak's riders. Its competitors are private operating companies that compete with one another over infrastructure funded and provided through government programs. These carriers pay as they go for a portion of their infrastructure costs through user fees, ticket taxes, etc.

3. Amtrak's Fundamental Institutional Flaws

The Council concludes that the Rail Passenger Service Act created the National Railroad Passenger Corporation, or Amtrak, with four fundamental institutional flaws.

The first major flaw is that, because it operates in many important respects like a government agency dependent on annual appropriation of federal funds, Amtrak is both subject to political pressures and to agency-style bureaucratic management methods and patterns of decision making. At the same time, Amtrak is charged with the decidedly non-governmental function of competing profitably as a commercial business. These functions are directly contradictory, and the fact that they are lodged in a single government-chartered entity is the first major cause of Amtrak's chronically lackluster performance.

Amtrak's governmental functions, especially when combined with Amtrak's de facto monopoly and dependence on federal subsidies, constitute both a major distraction from, and a conflict of interest with, Amtrak's core business, which is to operate a modern, efficient, national intercity rail passenger service that can compete and grow in the commercial marketplace as the airlines, bus lines, and trucking companies have.

The Council believes that the remedy to this problem is to separate Amtrak's core business and other commercial functions from its governmental functions.

The second major flaw is that Amtrak's primary responsibility under the law is to run a modern, efficient, intercity rail passenger transportation company, but that it has also been saddled with a massive rail infrastructure responsibility on the Northeast rail corridor between Washington, DC, and Boston. These very large infrastructure responsibilities sap Amtrak's capital and divert its management's attention as it tries to compete in relevant markets with the private automobile, airlines and bus companies. The Council believes that running good rail passenger service (or, for that matter, a good airline, bus company or trucking company) is a sufficient challenge for any company. The Council also believes that the infrastructure funding and management responsibilities for the NEC (as well as the coming wave of passenger- and intermodal-based infrastructure improvements outside the NEC) are so great that they cannot be effectively funded or managed by Amtrak.

The Council believes that a reasonable remedy to this problem is to separate Amtrak's train operations and passenger service functions from its infrastructure-related functions, both in the Northeast Corridor and elsewhere. (A summary of the Council rationale for separating the infrastructure of the Northeast Corridor from Amtrak's national train operations in located in the text box below.)

The third major flaw is that Amtrak is lacking effective federal and state governmental program administration, policy development, and oversight. This flaw is effectively demonstrated by the fact that the major roles in overseeing Amtrak and in informing the Congress concerning Amtrak's performance have been played on an ad hoc basis by the FRA, the DOT IG, and GAO and, more recently, the Amtrak Reform Council, while Amtrak itself, to

an equal or greater measure than the Executive Branch, has been the source of new policy proposals. It is fair to say that efforts to develop policy for intercity rail passenger service have been inconsistent, inadequate, and often at cross purposes.

The Fixed Plant of the Northeast Corridor:
A Unique Asset That Serves Many Masters

In March 2000, the Council's staff, at the direction of the Council's Executive Committee, prepared a working paper addressing the issue of whether the Northeast Corridor (NEC) fixed rail infrastructure should be separated, at least managerially, operationally, and in terms of financial reporting, from Amtrak's national train operating function.

As expressed in the August 2000 working paper issued by the Council staff:

1. ***The Northeast Corridor fixed plant (NECFP) is a large, distracting, and unfair burden on Amtrak. Amtrak should not have to divert scarce resources for planning, raising funds for, and managing massive civil, mechanical and electrical engineering projects****. Amtrak carries this burden while its competitors benefit from the roles undertaken by the federal government, states, regional transportation authorities, metropolitan areas, and special districts that handle all other transport infrastructure. Indeed, trying to shoulder a similar burden for the emerging rail corridors designated under ISTEA and TEA-21 would overwhelm Amtrak's management.*
2. ***The NECFP is a financial millstone around Amtrak's neck.*** *The NECFP is a cost burden on Amtrak of as much as $600 million per year and will require billions of dollars for deferred maintenance and delayed capital expenditures. It is estimated that over the next 25 years, the Northeast Corridor will require a total of $20 billion, or $800 million annually for capital maintenance and improvements to the Corridor.*
3. ***Amtrak's Northeast Corridor serves as a de facto funding conduit from the federal government to the commuter authorities along the NEC.*** *Despite their predominant use of the NEC, commuter trains have benefited from incremental-cost-based user charges since Amtrak acquired the NEC in 1976. The subsidy to the NEC commuter authorities and their riders is substantial, perhaps $100 million annually, and it has to be covered by Amtrak from its overall operating cash flows or from federal capital funding. The present system undermines and obfuscates the profitability of Amtrak train operations on the NEC, hides the subsidies to commuter authorities, and fosters the deferral of maintenance and the delay of capital improvements essential to effective operations and to safety.*
4. ***The NECFP has enormous physical problems that present both barriers to Acela's effective operation and a risk of substantial tort liability.*** *Acela's projected normal operations will be delayed by the wait for major improvements to the NECFP. Amtrak's inability to fund nearly $1 billion in emergency fire and life safety improvements in New York City's Penn Station*

complex could expose Amtrak (as owner) to potentially extensive tort liability even though Amtrak's passengers are less than 15 percent of the passengers using the complex. Separating the NECFP from Amtrak's train operations is essential if the proper capital resources are to be devoted to the NEC fixed plant.

5. ***As long as Amtrak integrates the finances of its train operations and the NECFP, there is an inherent conflict of interest between Amtrak (as owner and operator of the NECFP) and the states and commuter authorities outside of the northeast, which are seeking to raise the capital to develop their own high-speed corridors.*** *States and commuter authorities outside the NEC see Amtrak as favoring the NEC as an investment channel and as charging them for NEC overhead costs in their service contracts with Amtrak. This conflict could limit Amtrak's ability to become the preferred contract operator of passenger, mail and express trains for the emerging high-speed rail corridors and state and regional commuter rail authorities.*
6. ***Amtrak's ownership is not essential to the effective operation of NEC infrastructure.*** *Amtrak is only one of many operators using the NEC. Separating the finances, improvement, maintenance and control of the NECFP from Amtrak's train operations would facilitate adequate funding arrangements for this important infrastructure. It could also facilitate the necessary infrastructure improvements and operating protocols for Acela Express to achieve its full potential at the earliest possible date.*
7. ***While separating the NECFP's finances is not likely to reduce costs, at least not in the short run, it would place Amtrak on a level playing field with its airline and bus company competitors.***
8. ***Separating the NECFP's finances will also broaden and strengthen Amtrak's political base as the emerging high-speed rail corridors in other parts of the country move toward implementation.*** *This will enhance Amtrak's ability to secure adequate capital funding as an effective operating company.*
9. ***The NEC is a unique asset.*** *For much of its 460-mile length the Corridor has four main lines. The entire corridor is a grade-separated, electrified, multiple-user friendly that carries over 1,200 passenger and freight trains daily, including over 100 Amtrak trains. Over one hundred million commuter and intercity passengers travel on the NEC annually.*

The Council's view is that Amtrak's current governmental functions should be consolidated in a single government entity, along with the Amtrak program responsibilities of FRA, the DOT IG, and the GAO. The entity should have regional representation and would have direct responsibility for submitting appropriations requests to the Congress and directing the expenditure of all federal funds for the development of intercity rail passenger service (to include ensuring that unfunded mandates to provide service are not imposed on the operating companies); providing policy guidance and oversight for the train operating and infrastructure companies; and for insulating those companies from political pressure. The government entity would work with states and regional authorities to develop, fund, and implement the designated high-speed rail corridors.

The fourth major flaw, which derives in large part from the first three, is the lack of reliable funding to satisfy market demands for economic transportation services. By contrast, Amtrak's competitors derive great benefit from a dedicated federal funding source for their infrastructure needs. While an effective funding mechanism for Amtrak's capital needs has never been established, it is also true that Amtrak has only recently quantified the capital needs of the NEC and other infrastructure. Historically, Amtrak's capital needs have been presented to Congress on a piecemeal basis. Congress, in turn, has been reluctant to fund Amtrak's capital needs because of Amtrak's continuing operating deficits and its inability to improve its financial performance.

The Council's view is that the remedy to this problem is the provision of a stable and adequate source of federal funding for the capital needs of the NEC and other rail-passenger related infrastructure and to administer this funding through a government entity separate from Amtrak the operating company.

The challenges posed by the major growth issues facing intercity rail passenger service, together with the problems identified by the Council's assessment of Amtrak, point to the need for a new business model for intercity rail passenger service. This new business model calls for a strengthened role for the government entity that administers, funds, and oversees intercity rail passenger services and the infrastructure that supports these services. Finally, this model also must incorporate an effective and adequate set of funding mechanisms for the substantial future needs of the U.S. rail passenger system, both in the NEC and over the nationwide network of the freight railroads.

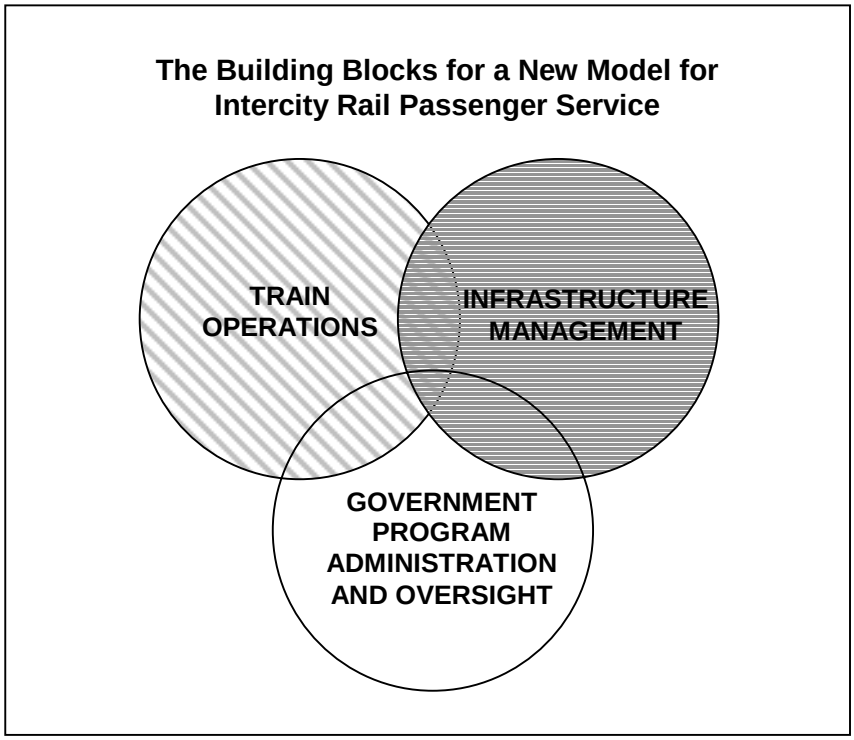
IV. NEW MODELS FOR THE BUSINESS AND GOVERNMENTAL ELEMENTS THAT IMPLEMENT AND SUPPORT AMERICAN RAIL PASSENGER SERVICE

The Council believes that the basic structure of rail passenger service in America must be changed if major improvements in operations, service quality, and efficiency are to be achieved. The business functions for train operations and for infrastructure should each be organized as separate entities, with managements and financial statements that are independent of one another. This separation of operating and infrastructure functions enables boards of directors or government executives (should the infrastructure not be organized in corporate form) to require accountability from top managers. Full accountability does not exist under the existing arrangements, principally due to direct political influence over Amtrak's resource levels and business operations. The problem of political influence can be diminished by separating governmental functions from commercial functions, and by making the government body (that develops policy, administers programs, oversees performance, and funds intercity rail passenger service and its infrastructure needs) a buffer between the commercial functions and political pressure. These changes will free managers of both entities to run the train operating and infrastructure businesses on a commercial basis and enable government to be an informed consumer, an efficient administrator, and an effective overseer of intercity rail passenger service.

The Council has concluded that, for intercity rail passenger service to succeed, we need to implement a strong program of institutional reform. This is based on the Council's perspective that Amtrak, from its statutory inception, was designed with four fundamental flaws. To remedy these flaws, the Council proposes that:

- Amtrak's two business functions should be separated from its governmental functions;
- Within Amtrak's business functions, the responsibilities for maintaining infrastructure should be separated from intercity passenger service, the mail and express business, and Amtrak's contract commuter operations;
- Amtrak's current governmental functions should be structured to provide policy guidance and program administration, oversee Amtrak's passenger and infrastructure businesses, and insulate those businesses from direct political pressure, and;
- Sound, adequate and predictable financing should be provided for the needs of a modern national system of rail passenger service, including separate funding mechanisms for intercity rail passenger operations (where it is essential they be subsidized), and for fixed rail infrastructure improvements across the nationwide passenger-related rail system.

To solve Amtrak's basic problems, it will be necessary to adopt a new set of models for Amtrak's passenger train operations and the management of Amtrak's infrastructure, as well as the role of the federal government. The chart below depicts how Amtrak's responsibilities should be divided.



Following the description of these proposed new institutional models, Chapter V of this report examines a number of structural options available to implement the recommended separation of train operations from infrastructure functions, and, for both of these, to separate political/ governmental functions from commercial functions. Regardless of which organizational or structural option is ultimately selected, the Council believes that the train operating and infrastructure entities should be operated as described below. They also should have accounting and management information systems that transparently, and without bias, provide comprehensive, accurate, and clear management information regarding finances and operations.

A. ORGANIZING FOR SUCCESSFUL BUSINESS OPERATIONS – THE TRANSPORTATION OPERATING COMPANY FOR PASSENGER, MAIL, AND EXPRESS SERVICES

The purpose of creating a separate train operating company is to encourage the long-term self-sufficiency (and profitability) of intercity passenger rail operations. Creating a separate operating company helps make this possible by isolating the commercial, market-driven, for-profit functions of Amtrak from the public-utility-like infrastructure functions associated with passenger rail service. The Council realizes that structural changes alone will not guarantee the self-sufficiency of the new operating company. The new company must also have:

- the ability to modify routes and schedules to improve financial performance;

- the tools to effectively manage the business, including modern accounting and reservations systems;

- incentives for success, including compensation bonuses and profit-sharing;

- cultural changes in how Amtrak, including its rank and file employees, treat customers and the expectations they hold for Amtrak's own performance, and

- freedom, comparable to an airline or bus company, to adjust prices and institute incentive programs to increase ridership and revenues during slack times of the year.

1. Functions of the New Operating Company

The new train operating company would assume responsibility for operating all current Amtrak passenger, mail, and express operations, including commuter contract operations, and for marketing and sales. It would also retain responsibility for acquiring and maintaining equipment for current intercity operations.[31]

All Amtrak-owned track, stations, signal systems and other real estate would be transferred to the new infrastructure company. Both the operating company and the infrastructure company could be subsidiaries of the same company or operate as separate enterprises.

The operating company would access the Northeast Corridor and other properties by paying trackage rights fees to the infrastructure company. These fees, like those currently paid by Amtrak to the freight railroads, would be based on incremental costs. Other than these fees, the operating company would not be responsible for funding property maintenance and improvements.
The only federal support that would be provided long-term to support operations would be funding of excess mandatory Railroad Retirement payments, and contract payments for the operation of any federally-mandated services that would require an operating subsidy. In the short-term, the Council sees a need to help fund new trainsets and possible assistance to acquire or develop improved information systems and other tools needed to operate a business effectively.

2. Organization of the Operating Company

The operating company should be organized to reflect its mission: to provide consistent, quality passenger service on a self-sustaining basis. Its board of directors should be comprised of

[31] Dispatching responsibilities on the NEC would have to be worked out, including the option of retaining existing arrangements under which Amtrak (as an operating company) would control dispatching operations on the NEC except for Pennsylvania Station, where dispatching responsibility would be shared with commuter authorities. Alternatively, the dispatching function could be performed by the infrastructure entity (on a shared basis or otherwise).

business professionals, its managers should be compensated for meeting and exceeding the business plan and all employees should participate in profit-sharing or incentive programs.

The restructuring that will occur in establishing the new company will also provide the best opportunity to pare overhead and streamline the organization, including possibly the consolidation of the strategic business units. Without responsibility for managing the infrastructure, the operating company may need only two business units: one for passenger operations and one for mail and express. Each business unit should keep separate books. Within the passenger rail company, different marketing strategies are called for, but based on the type of service rather than geography:

- Inter-urban corridor, high-density, higher speed operations with average trip lengths of about 150 to 300 miles and a high percentage of business travelers;

- Long distance trains that serve as "hotel" trains for overnight business travelers, as land-cruise trains for vacation travelers, and as practical transportation for short-haul passengers and white knuckle flyers;

- Commuter rail services, generally under contract with state and local commuter authorities. Amtrak competes with other service providers to operate these trains, with the commuter authorities taking revenue, sales and marketing responsibility for the services.

Express service for time-sensitive freight should be provided only where economically viable – generally on long-distance routes that can absorb transloading and trucking costs at origin and destination. Amtrak's ability to provide financially successful mail and express services hinges upon having the right equipment, facilities and trained personnel so that M&E operations do not adversely affect passenger service and schedule reliability.

On the California, Washington State, the Midwest, and the Northeast Corridors, frequent rail passenger corridor services require mail and express equipment that is fast-loading and -unloading to handle high-value, time-sensitive mail and express without requiring excessive dwell times during station stops. Specialized mail and express equipment for this type of high-speed corridor service should be streamlined equipment of similar design to the passenger equipment, but with fast-loading, full-sized side doors on both sides for quick loading and unloading of the same car without increasing dwell times at stations.

While less critical than high-speed corridor trains, mail and express equipment on overnight trains should be designed to complement the passenger equipment to the extent possible, recognizing that Roadrailers and other specialized car types will likely remain on some overnight trains. In each of these cases, Amtrak should carefully evaluate whether it should take on the full scope of M&E operations, or restrict its role to the wholesale function of "hook and haul," letting other, better situated firms carry out the retail functions of marketing, sales, and local transportation.

3. Performance Standards and Competition

The Council foresees the operating company sustaining self-sufficiency and profitability by meeting financial performance and service standards set by a government oversight entity and, over time, through the introduction of competition. The operating company would be expected to prepare an annual business plan (well before the start of the coming business or fiscal year) with goals for operating income, operating ratio, ridership, and on-time performance. The plan should be reviewed and approved by the oversight entity. After the business plan is approved, senior management of the operating company would keep the Board advised of its progress on a regular basis. If the operating company is achieving its minimum business plan objectives, it would be entitled to receive any federal funding included in the business plan. If it is missing its business targets, plans of corrective action would be implemented to offset shortfalls. (The role of the new oversight entity is discussed in detail in section C of this chapter.)

The business plan would also identify service changes that will improve financial performance. Before a service could be reduced or eliminated, the affected states and municipalities would be given the opportunity to preserve the service by providing an operating subsidy equal to the net loss associated with the service. The operating company would not be expected to provide any service at a loss, but would not be prohibited from cross-subsidizing services as long as it at least breaks even on an aggregate basis.

New service, including high-speed rail service, would be put through a cost/benefit analysis to assess overall merit of the project in view of expected revenues, operating expenses, and capital requirements. All new high-speed service would be operated under contract with the involved states. If the states agree to take on this responsibility, they should have the ability to competitively bid the contracts. Since approximately one-third of Amtrak's system-wide route mileage would be encompassed by the designated high-speed corridors, a large portion of Amtrak's current operations would eventually enjoy competition, just as Amtrak today competes for commuter contracts.

Several issues need to be addressed to make competition both effective and fair. The first is that the operating company must not be disadvantaged relative to competitors because of costs associated with Railroad Retirement (it is anticipated that Railroad Retirement would be applicable to providers of any interstate rail passenger service). The second is that other service providers must be able to access the Northeast Corridor and the rights-of-way of the freight railroads on the same basis as the new operating company, i.e., on an incremental cost basis and with operating priority. This could be accomplished by placing Amtrak's statutory right of access with the new government oversight entity, which could authorize selected service providers to operate under the franchise (in a manner comparable to Amtrak contracting out its train operations, which is authorized under existing law). A third area that would need to be addressed is insurance and indemnification. The Council will be looking into this matter in more detail in the coming months.

4. Amtrak's Need to Build on Its Advantages in Operating a Core Rail Passenger Business Augmented by Profitable Mail and Express Operations

Amtrak, the operating company, should concentrate on its core business of providing improved and expanded rail passenger services throughout the United States, augmented by profitable mail and express operations. Amtrak should move away from the model of a municipal transit authority, which, over the last three fiscal years, Amtrak used as the template for its funding requests. Such entities too often provide transportation services based on long-established patterns of routes and services that lag transport demand, are usually subject to substantial political pressure, and operate with publicly-funded financial support provided on what, in the worst cases, can amount to a cost-plus basis. In contrast, Amtrak should move, instead, toward a model based on a private sector, entrepreneurial, market-driven business that actively identifies market demand and responds to it with successful service initiatives.

Two keys to ensuring that the train operating company acts as a private company are: (1) to appoint a paid Board of Directors for the operating company that has private sector business management experience; and (2) to adopt performance-based compensation for management and employees.

B. ORGANIZING FOR SUCCESSFUL BUSINESS OPERATIONS – THE RAIL INFRASTRUCTURE ENTITY FOR THE NORTHEAST CORRIDOR

Having drawn a blueprint for a passenger, mail, and express train operating company separate from Amtrak's responsibilities for fixed plant infrastructure, we can turn to the issue of Amtrak's role in infrastructure.

Since it received the NEC infrastructure in 1976 from the estate of the Penn Central Railroad, as part of the creation of Conrail,[32] Amtrak has been a federal agency that both owns and maintains infrastructure and that operates a passenger transportation services company, which has to compete in the commercial marketplace. Unlike the airlines, intercity bus lines, and trucking companies (for its mail and express traffic), against which it competes, Amtrak cannot limit its concerns to simply finding its optimal passenger market and then tailoring its routes and services to their needs. Today's Amtrak must also act like the Federal Highway Administration (in concert with the state highway departments) and organize the design, improvement, maintenance, and operation of the system of infrastructure over which its trains travel – at least in the Northeast Corridor. (This role would be vastly expanded were the current version of the High Speed Rail Investment Act – S.250 – to be enacted without amendment.)

Lest one think that this is an inconsequential matter, consider two issues. First, the current impact of the NEC on Amtrak's operating losses and, second, the sheer size of the future infrastructure investments for the national intercity rail passenger system.

[32] The United States Railway Association, a special-purpose independent agency created by Congress to reorganize the bankrupt Penn Central railroad, did not want the Penn Central to own the NEC because it was so costly.

From the standpoint of the Corridor's current financial performance, the Council recommended to Amtrak's Board in November 1999 that Amtrak keep track of, in separate financial statements, the financial operations of the Northeast Corridor infrastructure. (Under this approach, Amtrak would treat commuter and freight railroad payments for track use, along with transfer payments from its own train operations on the Corridor, as revenues of the Corridor fixed plant, along with the commercial revenues generated by station leases, utility easements, and the like.) Amtrak has recently agreed to do so, beginning in January 2001, and the Council expects to see the first statements soon. On an unofficial basis, the Council staff has been made aware of two separate and independent rough estimates of the burden of ownership[33] of the NEC fixed infrastructure on Amtrak. One – attributed to an internally-prepared Amtrak analysis in the mid-1990s – estimated Amtrak's burden of ownership of the NEC infrastructure at about $350 million per year. The other – completed within the past 3-4 years by financial analysts providing technical support to the 1997 Working Group on Intercity Rail (more commonly referred to as the "Blue Ribbon Panel") chartered by the House Transportation and Infrastructure Committee in 1997 – estimated that the burden of ownership is from $500 to $600 million per year, depending upon the assumed variability of infrastructure costs and assumptions made regarding capital funds provided by outside parties (i.e., commuter rail authorities). Though Amtrak has this burden for the parts of the Northeast Corridor that Amtrak owns, the growing backlog of maintenance and capital improvements makes it clear that Amtrak is not able to bear this burden. This is a major policy issue that must be addressed as the future disposition and financing of the NEC infrastructure are decided.

As for future capital investments, roughly 70 percent of the estimated future capital requirements to support rail passenger service are likely to be for infrastructure investments, including a large portion for investments in infrastructure that Amtrak does not even own.[34] Separating the infrastructure from operations will provide a clear picture of the true costs of the Northeast Corridor and other Amtrak physical assets.

Establishment of a separate entity to deal with the major issues that face the rail fixed infrastructure of the Northeast Corridor should incorporate the following elements:

1. The Fundamental Operating Premise

This proposed new infrastructure entity, which is to be directed, managed, funded, and operated separately from Amtrak's train operations, would be free from the annual debate over Amtrak's operating losses. Placing the fixed infrastructure within this separate framework would facilitate its financial management and funding. Some capital and maintenance expenses of the new infrastructure entity will likely need federal and state support.

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[33] The burden of ownership is the difference between the full, long term cost of owning and maintaining the Northeast Corridor infrastructure and the fees that Amtrak and other users would pay assuming user fees are based on incremental costs.

[34] And even in the Northeast Corridor, Amtrak is not the sole owner of the infrastructure over which it operates. It shares ownership of the NEC infrastructure with the states of New York, Connecticut, and Massachusetts, and shares the operating environment for its 100 daily trains with more than 1,100 commuter and freight trains.

2. The Basic Functions of the New Company

The new infrastructure entity would carry out the following basic functions:

- Supervise the safe, effective, and fair use of the NEC fixed rail infrastructure by Amtrak's trains as well the commuter and freight carriers
- Maintain and improve the track structure, other civil works, the electric power system, and the communications and signaling systems of the NEC
- Maintain Amtrak-owned passenger stations and terminals or sell them to cities, local transportation authorities, or private owners
- Manage the core business operations of the NEC fixed rail infrastructure in an efficient, equitable, and financially responsible manner
- Coordinate NEC operations and schedules with commuter operators and freight railroads
- Develop and manage commercial revenue sources (i.e., utility and communications facility easements, rental of air rights, etc.)
- Acquire or sell track and other assets in carrying out these functions

3. The Company's Need to Develop New Management Systems and Technologies

a) A New Framework and Accounting and Costing Systems for Managing the Fixed Infrastructure of the NEC.

A new system of accounts is needed for the operation, maintenance, renewal, and improvement of the Corridor infrastructure to support management, costing, and financial analysis. The system on which Amtrak's Corridor infrastructure accounts is based, the Surface Transportation Board's (STB's) Uniform System of Accounts for railroads, is essentially unchanged from that prescribed by it predecessor agency, the Interstate Commerce Commission (ICC), in 1907.[35] That system does not reveal by responsibility cost center the functional operating charges by elements such as labor, materials, and facilities, nor does it identify direct and indirect expenses.

The ability to determine the cost of each separate function of a railroad's operations is essential. Such understandings, and the ability to distinguish between direct and indirect, and fixed and variable costs, is critical to developing a pricing structure (such as the kind that exists for the pipeline industry). This includes the ability to take into account the demands that each class of service places on the system at the time of the rail line's peak operations.

With such new systems, the new NECFP entity, with confidence in its knowledge of its costs, would be in a position, to "sell" track time on the Corridor to the users (including Amtrak's own

[35] A substantial revision was made to the USOA in 1978, but the change did not fundamentally restructure the system of accounts and it made no significant changes in the account structure for fixed plant.

train operations) at an appropriate price that reflects the true costs (including incremental costs) of using the infrastructure. (Amtrak's train operations would be charged on an incremental cost basis for use of the NEC infrastructure; commuter authorities would also continue to be charged incremental costs for operating over the NEC.)[36]

b) Track Capacity: Optimizing Use and Revenues.
Track capacity has two fundamental dimensions: time and force. Only so much time is available for using the track; the fraction of the total available track time that a particular train operation absorbs is one element of capacity. The second element of capacity is force, that is, the physical wear and tear on the track from the movement of trains. The charge to freight traffic using the Northeast Corridor has traditionally been based on car-miles, a measure that takes into account neither time nor force. For example, a particular freight train can stand idle on a stretch of track for hours at a time, absorbing "time" capacity; most likely, with higher average axle loadings, a moving freight train will inflict a high level of wear and tear. Neither of these effects is captured by a car-mile charge. This same dynamic also applies to the commuter and Amtrak trains that use the Corridor. The infrastructure entity should be in a position to devise a more suitable regime of charges that better reflects the costs the various users impose.

As the infrastructure entity evaluates the equipment of the carriers using its track to determine appropriate charges, it is important to ensure that incentives do not lead the infrastructure entity and the train operators to work at cross-purposes. For example, the infrastructure organization may face incentives to put in place testing for new trains that is so onerous that it prevents perfectly acceptable equipment from going into service; this has occurred in some foreign countries where operations were separated from infrastructure. Designing incentives so that trains operators and the infrastructure entity work harmoniously to their mutual benefit must be part of the process of separating the two functions.

4. Potential Risks and Benefits of the New Entity to Operate the Fixed Rail Infrastructure of the Northeast Corridor

There are, of course, certain risks in moving to an infrastructure entity for the Corridor fixed plant. Would the change really promote an improved cost control regime of any significance? Would the expected increase in revenues materialize as operating discipline improves and new rate structure incentives are put in place?

Notwithstanding these potential difficulties, there is a strong case to be made in favor of the move to an infrastructure entity:

- It would lead to improved methods for costing and rate-making.

[36] Amtrak is currently charged incremental costs by freight railroads for use of their tracks as provided under existing law (49 U.S.C. 24308) and a comparable arrangement would be made applicable to Amtrak's use of the NEC. Similarly, existing law is construed as providing for incremental cost reimbursement by commuter railroads over NEC infrastructure, and this arrangement would be continued (49 U.S.C. 24904 (c)). The federal government (with state matching funds) would be largely responsible for covering the capital costs, including costs of ownership, of the NEC.

- It holds potential for substantially improving the revenue-generating use of fixed plant capacity over today's levels.

Moreover, there is the clear promise of substantial additional benefits:

- Undoing the Corridor infrastructure's current integration with Amtrak's train operations will alleviate the substantial financial burden that the fixed rail infrastructure of the NEC imposes on Amtrak's finances, which is a threat to Amtrak's efforts to meet the financial performance goals of the Amtrak Reform Act.

- Separating the infrastructure from Amtrak's train operations will facilitate the development of effective funding mechanisms for the infrastructure capital needs, in large part by clarifying the need and promoting transparency in the implementation of major capital improvement projects.

- Separating the infrastructure will facilitate development and proper application of effective planning, financial, and management information systems for the Corridor infrastructure.

- An infrastructure entity for Corridor fixed plant, properly structured and managed, and insulated organizationally and financially from operations on the Corridor and elsewhere, holds great potential for overcoming many of the most difficult obstacles that both keep the NEC from realizing the better management and improvements it needs, and that hamper the achievement of an efficient and financially successful Amtrak train operating company.

All in all, the likely effects of making the Northeast Corridor fixed plant an infrastructure entity – including the effects upon the efficiency, financial performance, and service quality of all train operations – would appear to be very beneficial, with little or no downside risk.

C. ORGANIZING THE PROPER ROLE FOR GOVERNMENT –PROVIDING EFFECTIVE GOVERNMENT DIRECTION AND OVERSIGHT

A vital role remains for government in the institutional framework to achieve a restructured national rail passenger institution. In order for the operating and infrastructure companies to do their jobs effectively in the public arena, they need an effective institution to administer their program, present their funding requests to the Congress, protect them from unfunded mandates, and exercise oversight of their business operations and financial performance to achieve the same success that we have in providing highway and aviation infrastructure and services. In defining the need for this entity, the Council is not recommending a new layer of bureaucracy but rather the consolidation of existing Amtrak program authority currently exercised variously by Amtrak, FRA, the DOT IG, and GAO into an effective government entity.

The consolidation of these government functions would have a number of practical and programmatic benefits. With functions currently spread over five or so agencies, lower

administrative costs would almost certainly result from an effective consolidation of functions; other, potentially much larger, savings could result from the benefits of ensuring sounder business plans and better execution of those plans in an improved policy framework. A consolidated agency would almost certainly produce improved program administration, including coherent policy development and oversight, compared to today's haphazard assignment of responsibilities. A consolidated agency would offer one-stop shopping for the states at the federal level. Removing from Amtrak's train operating company such governmental functions as allocating federal capital funds will help prevent conflicts of interest. And a single agency could provide a uniform set of benchmarks for all aspects of passenger rail's performance – operational, financial, and customer service.

In rail passenger service, as in any program, the basic design and function is specified by the Congress. The Congress will always have the opportunity to influence the route system and service frequencies. This latitude, however, in the context of Amtrak's current institutional structure, has been peculiarly susceptible to the imposition of unfunded mandates to provide service. Rail passenger service needs the protection from unfunded mandates that a properly-empowered government entity would provide. If plans call for more money than provided, the entity should be empowered to require a pro rata reduction in services provided.

Oversight is also needed, not only to provide controls for a rail passenger company that still might be a monopoly, but also to ensure that performance standards are developed, prescribed, and met. The first requirement of the government entity is for the development of realistic business plans. Accounting tools and other essential management systems must be improved. Aggressive plans for revenue improvements and cost control must be developed and implemented.

New business planning systems would provide the basis for the government entity to provide separate, thoroughly-vetted funding requests to the Congress for the operations and infrastructure companies.

These planning systems would also provide the basis for the assessment of proposals from the regional high-speed rail corridors, evaluating their soundness and, in the light of clear Board-developed criteria, assigning priorities for funding.

1. What The Government Entity Would Do

- Carry out program planning and oversight responsibilities, and administer funding for intercity rail passenger services and infrastructure needs. These program responsibilities would include establishing priorities, in concert with other involved parties, for the federal share of investments in the NEC and the other designated high-speed Corridors.

- Review the annual business and capital plans of the passenger operations company and the infrastructure entity, and, when it has approved these plans, support them before Congress for funding. Currently, before Congressional Appropriations Committees make initial decisions on annual funding for Amtrak, there is not any well-vetted, transparent program request presented to the Congress for rail passenger service.

- Insulate the operations of the passenger transportation company and the infrastructure operations company from direct political interference in or pressure upon their business decisions. The entity would also ensure that the service requirements that the Congress mandates for the national intercity rail passenger operator do not cost more than the funds provided to operate those services (i.e., there should not be any unfunded mandates).

- Develop sound policies and performance measures to foster the effective operation and improvement of the national rail passenger system.

- Administer the federal program for development of high-speed corridors with the states, freight railroads, Amtrak, and other involved parties

- Oversee the operations of the national intercity rail passenger program, including assessing the actual cost and service performance of the operating and infrastructure entities vis-à-vis their plans, and the establishment of benchmarks for gauging reasonable expectations for improvement in the service quality and financial performance of those entities.

- Report annually to the Congress on the performance of the operating company and infrastructure entity and on policy reforms needed to improve the effectiveness of intercity rail passenger service.

2. How the Entity Would Work

This entity, wherever situated, would consist of a governing Board for rail passenger service, supported by a staff. The Board's membership should represent the various regions of the country, and could also include members from the Executive Branch (Transportation and Treasury) and the rail industry (labor and management). The staff (probably of not more than 20-30) would support the operations of the Board in its execution of its four major responsibilities: (1) administering the programs for the operating company and the infrastructure entity, ensuring that they plan and implement effective and economical programs; (2) presenting funding requests to and securing funding from the Congress for the operating and infrastructure companies (including protecting them from unfunded mandates); (3) administering the funding for the development of the high-speed rail corridors, and (4) exercising oversight of the companies' business operations and financial performance.

3. Where the Entity Might Reside

The three likely locations of this entity are as an independent agency, as an independent agency under the umbrella of the DOT, or integrated into the FRA.

V. STRUCTURAL OPTIONS FOR IMPLEMENTING IMPROVED INTERCITY RAIL PASSENGER SERVICE

There are a number of options for restructuring Amtrak to separate its infrastructure responsibilities, train operations, and government functions. This chapter describes five possible options and their strengths and weaknesses. The fifth option – full privatization – is included for purposes of providing a full range of options for discussion, even though there are a number of reasons it could be considered impracticable. This discussion is intended to portray the range of options available for restructuring Amtrak. It is not, however, intended to be an exhaustive set of options, nor is any one option favored by the Council at this time.

In the previous two sections, the Council has identified what it perceives to be Amtrak's significant institutional problems and has proposed new models for the business and governmental elements of a restructured institution to provide intercity rail passenger service that would effectively address those problems. The next task is to determine what structural changes to the existing Amtrak organization would best implement the new models.

The Council believes that any analysis of potential Amtrak structural changes must involve a study of a range of realistic options and an evaluation of whether a particular option, or combination of options, best serves the purpose of the new models.[37] Failure to consider a range of options would limit the Council in its analysis and preclude consideration of sound restructuring proposals that may be recommended by the Council to Amtrak, the Congress, and the states.

In evaluating each option and its components, the Council has attempted to identify how particular features relate to the purpose of the new business and governmental models. How do they improve government policy making relating to planning and funding of rail passenger service? Do they serve to insulate business decision making from political influence? Would they be effective in getting Amtrak to focus on its core rail passenger transportation business and offer a structure in which infrastructure financing – both public and private – could be separated from train operations? Are they likely to impose accountability on each component provider of rail transportation services? Will they promote the development of transparent accounting systems? Do they provide states and regional transportation entities a larger role with respect to planning and funding new state or regional rail passenger service?

In developing structural options, the Council has rejected full privatization on the British model for both Amtrak's train operations and its NEC infrastructure ownership and management functions. The British system is experiencing problems and is a "work in progress." As discussed more fully in Option 5, the Council also believes that it would first be necessary to

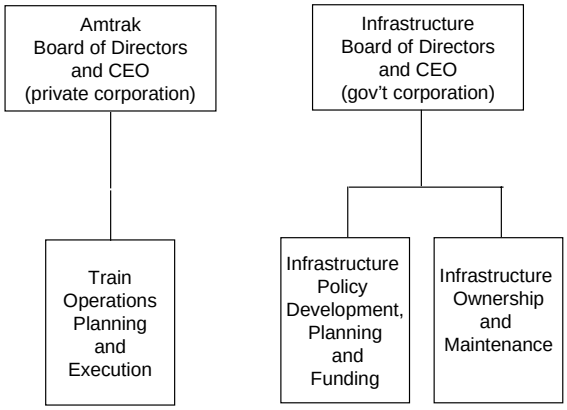
[37] A table comparing the five options described in this chapter is attached as Appendix VI.

implement major reforms if the prospect of NEC infrastructure privatization were ever to be realistically considered as a potential option.

All of the models presented here separate Amtrak's infrastructure from its train operations. The options move from a model that more closely resembles Amtrak today to models that would move toward greater state, regional and private sector participation in rail passenger service to options for partial or full privatization. The Council thought it was important to develop a representative set of options along a continuum to stimulate discussion and further analysis. While no single option is favored by the Council (and other models will no doubt be offered as the debate over Amtrak's future proceeds), it is clear that some options are more likely to be considered seriously for adoption at this time than others.

A. SUMMARY OF OPTIONS

OPTION 1:
SEPARATE OPERATING AND INFRASTRUCTURE ENTITIES



DESCRIPTION

Under this option, Amtrak would continue as the nation's sole provider of intercity passenger rail service. It would operate all intercity passenger trains, including contract commuter operations and high-speed rail corridors, as well as mail and express service, and be responsible for equipment acquisition and maintenance. The composition of the Amtrak Board of Directors would remain the same.

Ownership, maintenance and management of the Northeast Corridor and other Amtrak-owned track, stations and terminals would be placed with a separate entity, possibly a government corporation. The infrastructure entity would also be responsible for managing the design and construction of high-speed rail corridors and for allocating funding for these projects. On the NEC, the infrastructure entity would be authorized to impose track use fees to defray maintenance costs. The entity would also be authorized to transfer or sell Amtrak stations, facilities, track and other infrastructure to the states or others. The infrastructure entity's Board of Directors would be comprised of a representative from each of the NEC states, plus representatives from the other regions of the country. Service would be designed by Amtrak (working with the infrastructure entity with respect to capital needs) in consultation with federal, state and local authorities.

STRENGTHS

Operation and management of the Northeast Corridor is not central to Amtrak's core passenger and mail and express business. Most of Amtrak's operations (about 21,400 miles of Amtrak's 22,000-mile network) take place on infrastructure owned by freight railroads. In addition, of the approximately 1,200 trains per day operating on the Northeast Corridor, only about 100 are Amtrak trains; most others are commuter trains. Divesting ownership of the NEC and other

fixed infrastructure would allow Amtrak to focus on its core business as a service provider and reduce its debt burden substantially.

Divestiture would also remove a huge financial burden from Amtrak. As indicated in previous chapters of this report, the NEC will need $20 billion in new capital over the next 20-25 years to put it in a state of good repair and make improvements. Divestiture would ensure that funds earmarked for capital improvements would be used for the capital improvements and not mingled with operating requirements. Divestiture would further ensure transparency of accounting and a clearer picture of the true costs of the NEC. Today, states outside the NEC providing financial support for Amtrak routes are charged for overhead associated with the NEC. At the same time, Amtrak subsidizes commuter operations on the NEC, since commuter authorities use the NEC on an incremental cost basis.

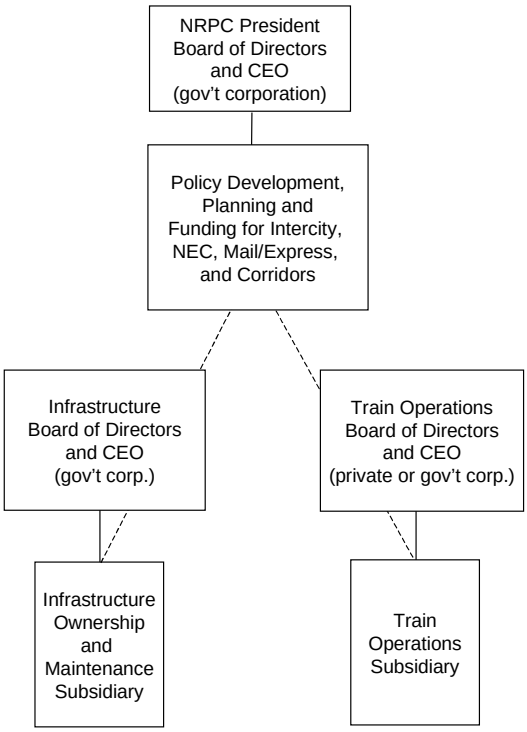
Finally, divestiture of the NEC infrastructure from Amtrak would put all rail passenger corridors on the same footing with respect to Amtrak operations and help reduce or prevent Amtrak favoritism or perceived favoritism toward the NEC in corridor funding and development.

WEAKNESSES

Creating a new infrastructure company may increase total overhead costs. It may also complicate Amtrak's operations over the Northeast Corridor with respect to balancing track maintenance and train operations. There is also the potential that it would be more difficult to obtain a secure, long-term source of funding for the NEC since states outside the NEC may not be willing to help support it financially.

This option gives the role of managing infrastructure funding and development, including development of the emerging high-speed corridors to the infrastructure entity, rather than to a government oversight entity. This may result in the infrastructure entity's suffering from the same shortcomings Amtrak does today since it would not be insulated from political influence and interference. The option, therefore, may not go far enough.

OPTION 2:
MAJOR INSTITUTIONAL AND CORPORATE REFORM



DESCRIPTION

As in option 1, Amtrak operations would be separated from infrastructure ownership and maintenance. In this option, however, the National Railroad Passenger Corporation (NRPC) would be designated under law as a wholly-owned government agency/entity to administer the federal program to provide rail passenger services and associated infrastructure improvements; to review, approve, and submit to Congress for funding the business and capital plans of the train operating company and the NEC infrastructure entity; to manage, in cooperation with the states, freight railroads and other involved parties, the development of the high-speed rail corridors; and to develop policies and performance measures to foster the effective and economical operation and improvement of the national rail passenger system. The Amtrak Passenger Train Operating Company and the NEC infrastructure entity would be subsidiaries of the NRPC.

The NRPC would have a Board of Directors comprised of a representative from each of eight regions in the country plus representatives of rail management and rail labor. The U.S. government would be represented by the Secretaries of Treasury and Transportation; the Amtrak train operating company and the NEC infrastructure entity would each be represented by its president.

The NRPC would hold the national franchise to operate intercity rail passenger services over the tracks of the freight railroads at incremental cost and with operating priority. Initially, Amtrak

would continue to operate all intercity passenger rail service. The NRPC would have the right to determine, however, whether, over time, it might be beneficial to introduce competition for the provision of passenger services through a competitive bidding process for operating franchises.

Both Amtrak and the new infrastructure entity would be organized as for-profit subsidiary corporations of the NRPC. The infrastructure entity would be a government-owned corporation or agency, while the operating company could be organized as either a government or private corporation. Both would be subject to meeting performance standards developed by the NRPC. The Boards of Directors of the operating company and the NEC infrastructure entity would be selected by the Board of Directors of the NRPC and be comprised of business and transportation professionals (in the case of the NEC infrastructure entity, the Board should be made up largely of business and government professionals from the NEC region).

STRENGTHS

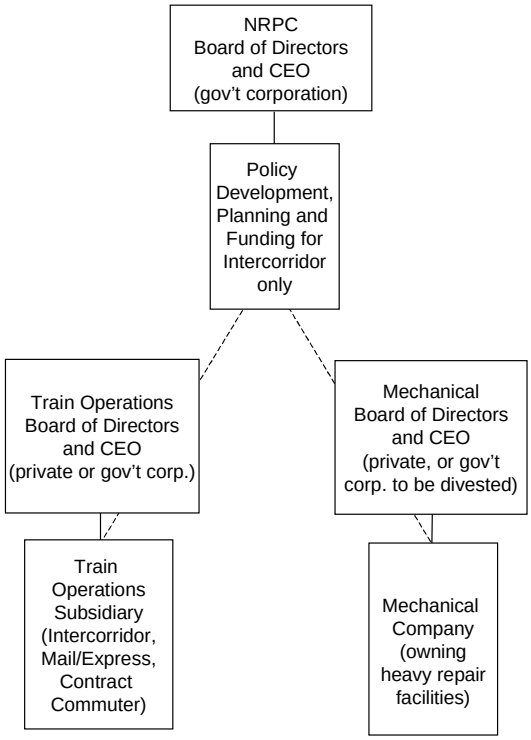
This option shares the strengths of Option 1, since the Amtrak operating company is relieved of obligations to fund and maintain infrastructure and there is a transparency of accounting for infrastructure costs. It also has several other advantages. Charging the NRPC with the statutory roles of program administration and funding, rail passenger policy development, and program oversight for its subsidiary corporations would insulate the operating and infrastructure companies from political pressure and interference. It would also establish a more objective process outside of the political arena for evaluating and funding proposed high-speed rail corridor projects. Performance standards would help protect the federal and state investments in passenger rail service and help foster continuous improvements in efficiency, on-time performance and customer satisfaction. New boards, comprised of paid business professionals, would help the new operating and infrastructure companies operate more as businesses than Amtrak does today.

This option also has the benefit of allowing the operating company to evolve from a monopoly to a competitor over time.

WEAKNESSES

Option 2, like Option 1, could increase total overhead costs. In addition, Option 2 is more complex than existing arrangements and may not go far enough to improve the efficiency of Amtrak and the quality of passenger operations.

OPTION 3:
HYBRID FEDERAL/STATE SYSTEM



(Infrastructure management/ownership and corridor train operations become the responsibility of the states.)

DESCRIPTION

Option 3 gives the states a much enhanced role in intercity passenger rail service. Under this option, ownership and maintenance of Amtrak's Northeast Corridor and other track, stations and facilities would be transferred to the states or local governments. The states, in partnership with the freight railroads, would become responsible for funding operations and maintenance on all corridors, although federal funding would likely be provided for capital to help develop the high-speed corridors and bring the NEC up to a state of good repair. The states would also assume responsibility for purchasing and leasing equipment for corridor operations.

The trade-off to the states for assuming these responsibilities could be a higher level of federal funding, at least during the initial planning and construction phase. In addition, the states would manage their own high-speed rail projects and would be given authority to select the train operator(s) on the NEC and emerging high-speed rail corridors.

Amtrak would continue to operate long-distance, inter-corridor trains, including mail and express trains, to maintain an inter-connected national system. It would also retain responsibility for purchasing and leasing equipment for inter-corridor train operations. Other service by Amtrak, including high-speed corridor service, commuter service, and mail and express service on the

corridors would be operated under contract with the states. After an initial period, competition could be introduced for inter-corridor operations through a competitive bidding process. The Board of Directors of the new inter-corridor train operations company would be selected by the new government program administration, policy development, and oversight entity (NRPC) and comprised of business and transportation professionals.

Another significant difference from previous options is that Amtrak's heavy equipment repair facilities at Wilmington and Bear, Delaware, and Beech Grove, Indiana, would become a separate for-profit private or government company. This new company would perform repairs under contract for passenger rail service providers, commuter authorities and freight carriers. Its Board of Directors would be selected by the new NRPC (discussed below) and comprised of business professionals. It is envisioned that the company could eventually be privatized through a sale or a public stock offering.

Similar to option 2, the NRPC would be chartered as a government program administration, policy development, and oversight entity. Its role would be to manage policy, program, and oversight responsibilities relating to national inter-corridor train operations. The NRPC would also participate in the development of the high-speed corridors, although in a lesser capacity than in option 2, and allocate federal funding for the NEC and high-speed corridors. As in option 2, the NRPC would hold the national franchise to operate over the tracks of the freight railroads at incremental cost and with operating priority and would authorize selected service providers to operate under these rights.

STRENGTHS

Option 3 limits the exposure of the federal government for operating subsidies to inter-corridor routes that preserve a national network and provide connectivity to the new high-speed rail corridors. Responsibility for funding any unprofitable service on the corridors becomes the responsibility of the states. This option also allows the states to manage and develop their own high-speed rail projects and the freedom to choose an operator other than Amtrak. Competition among service providers should increase the efficiency and quality of service.

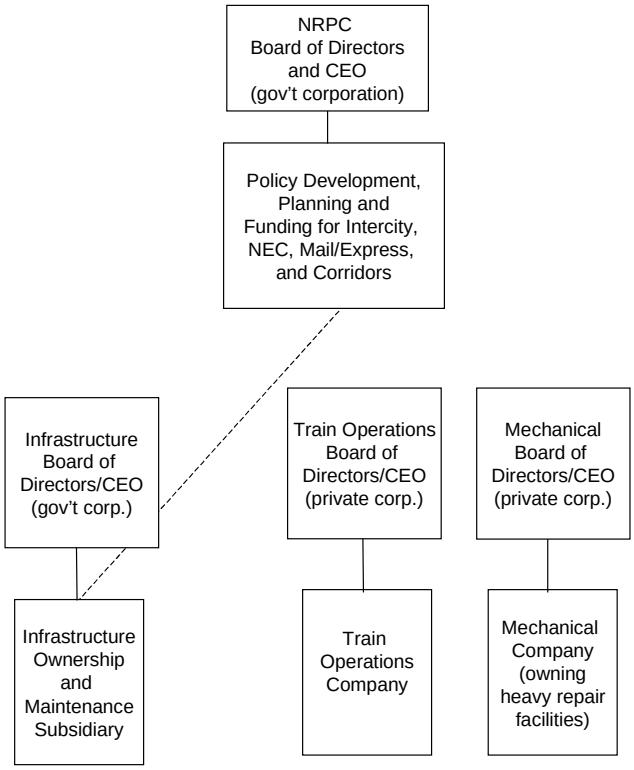
Option 3 shares the strengths of Option 2 relative to the establishment of a new government oversight role, and the strengths of both Options 1 and 2 in terms of the benefits of separating operations from infrastructure ownership and maintenance.

WEAKNESSES

The states may not uniformly wish to take on the responsibilities this scenario envisions, particularly if large new funding requirements come with the infrastructure and/or operations. States may also be unable to fund capital and will turn to the federal government for renewed financial support.

This option creates the possibility of more than one service provider on portions of the same infrastructure since the high-speed corridors and long-distance services will overlap. This may create capacity, service and other concerns on the part of the freight railroads owning the track.

OPTION 4:
PARTIAL PRIVATIZATION



DESCRIPTION

Like the other options, Option 4 would separate train operations from infrastructure ownership and maintenance. This option, however, would privatize train operations and associated mechanical functions (primarily Amtrak's heavy repair shops). For an initial period (e.g., 5 years), the new operating company would retain exclusive authority to provide nationwide passenger service, including service on emerging high-speed corridors, and mail and express service. Thereafter, the new government oversight entity (discussed below) would contract out all service to the train operating company or other service providers pursuant to competitive bids.

Similar to options 1 and 2, the infrastructure entity would be organized as a government corporation that would own and maintain the Northeast Corridor and other Amtrak infrastructure. On the NEC, the infrastructure entity would impose track use fees to defray costs. The entity would also be authorized to transfer or sell Amtrak stations, facilities, track and other infrastructure to the states, cities or others.

Option 4, like options 2 and 3, would create a new government program administration, policy development, and oversight entity known as the National Railroad Passenger Corporation. The role of the NRPC would be to manage public policy issues, the development of high-speed rail corridors, and funding for the NEC and the high speed corridors. NRPC would have authority to contract with one or more operating companies to provide intercity passenger service, including

mail and express. The NRPC would have a Board of Directors comprised of regional planning officials and the Secretaries of the Treasury and Transportation. As in other options, the NRPC would retain Amtrak's national franchise to operate over the tracks of the freight railroads at incremental cost and with operating priority and would authorize selected service providers to operate under these rights.

STRENGTHS

Option 4 shares the strengths of Options 1, 2, and 3 and avoids putting the burden for maintaining infrastructure on the states. This option goes the furthest in encouraging competition for train operations to maximize the benefits of competition for efficiency and quality of operations.

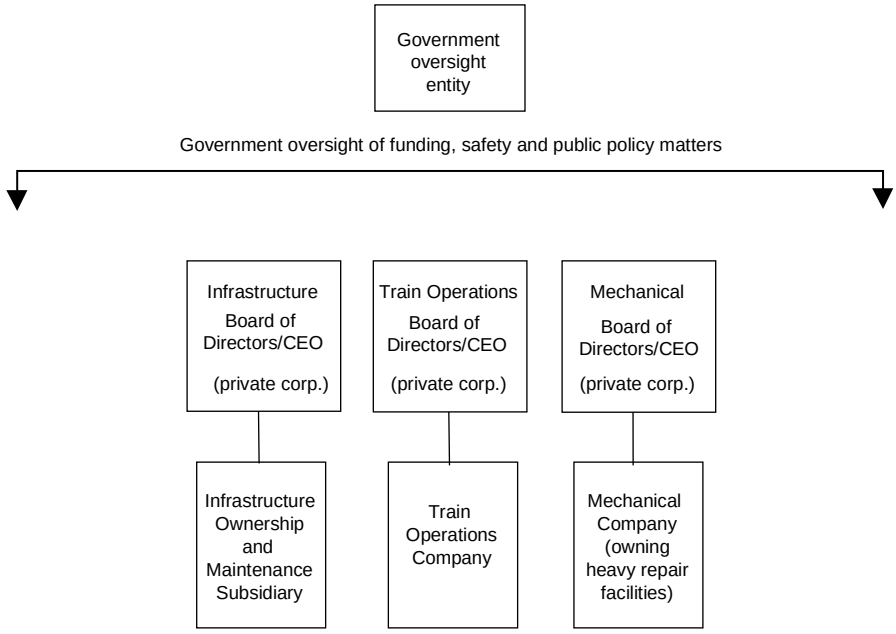
Privatization of services and government control and funding of infrastructure is the typical model in the United States for the provision of other intercity passenger transportation services, including airline and bus services.

WEAKNESSES

Privatizing operations could well be politically and economically impracticable. The federal government would have to restructure Amtrak's operations, outstanding debt, and capital structure in a number of ways that would relieve the newly created, privatized operating company of operating, administrative and financial burdens currently borne by Amtrak.[38] Further, government would have to set and monitor performance standards to ensure the adequacy of service. Opponents would likely argue that privatization of the passenger operating company is too radical because the British system, which has been experiencing well-publicized problems, is still a "work in progress."

[38] The newly-created for-profit, privatized operating company would not be able to raise private sector debt and equity funding for its future capital requirements unless it initially acquires Amtrak's equipment without all of Amtrak's debt and without Amtrak's obligations for liabilities incurred in prior periods for injuries to passengers, employees and others; claims for physical and other damages; mandatory excess Railroad Retirement taxes; and relief from uneconomical agreements to provide train operations that may not be fully funded by passenger revenues and state subsidies.

OPTION 5:
FULL PRIVATIZATION



DESCRIPTION

Option 5 follows the model for Option 4 except that all Amtrak functions, including the ownership and management of infrastructure, are privatized.

STRENGTHS

This option shares the strengths of option 4. In addition, this option would rely to the maximum extent on the private sector for passenger rail operations and maintenance of the infrastructure.

WEAKNESSES

This option shares the weaknesses of Option 4. In addition, privatizing infrastructure and operations could well be politically and economically impracticable. The federal government would likely have to spend billions of dollars to put the NEC in a state of good repair, correct serious bridge, tunnel, and other high cost infrastructure problems, and eliminate life safety deficiencies before the infrastructure could be sold to the private sector. The federal government would have to restructure Amtrak's operations, outstanding debt, and capital structure in a number of ways that would relieve the newly created, privatized entities of operating, administrative and financial burdens currently borne by Amtrak.[39] Further, government would have to set and monitor performance standards to ensure the adequacy of service and levels of infrastructure maintenance. Opponents of full privatization also would likely argue that it is too radical because the British system, which has been experiencing well-publicized problems, is

[39] The newly-created for-profit, privatized operating and infrastructure companies would not be able to raise private sector debt and equity funding for their future capital requirements unless they initially acquire Amtrak's equipment without all of Amtrak's debt and without Amtrak's obligations for prior periods' occurred liabilities for injuries to passengers, employees and others; claims for physical and other damages; mandatory excess Railroad Retirement taxes; and relief from uneconomical agreements to provide train operations which may not be fully funded by passenger revenues and state subsidies.

still a “work in progress.” Moreover, the need for an infrastructure company to earn profits could result in inadequate infrastructure maintenance, unless appropriate financial incentives are in place. For example, all parties agree to implicitly and explicitly provide subsidies to operating companies by setting infrastructure company user fees at levels below fully allocated costs, with the understanding and commitment by the federal and state governments to subsidize the infrastructure company, including an allowance for incentive profits.

VI. FINANCING

Options for structuring rail passenger service differently can only be made to work if appropriate and adequate funding is available, including not only government sources at all levels, but also private capital markets. How our national intercity rail passenger system is structured has a direct impact on how it can be financed. Amtrak relies for some of its needs on funding from private capital markets, but passenger service also has other capital needs that are likely to require funding by federal, state or local governments. A variety of potential approaches is available for providing such funding – both for infrastructure and for operations – and each should be evaluated from the standpoint of whether it would be sufficient for its purpose, realistic, economical, and responsible. No one source of funding is likely to be found to cover all needs. Several sources for different purposes will likely be required.

In the context of the Council's proposed business model (Chapter IV) for rail passenger service, combined with the evolving state and regional approach to organizing, operating and funding rail passenger services (see text box on the Midwest Regional Rail System Initiative, page 12), it becomes possible to look at a new structure for financing the capital for infrastructure and equipment needed to support passenger services, as well as for any funding needed to subsidize the operation of services.

Since Amtrak's creation 30 years ago, its ability to provide reliable transportation services has been affected by unreliable and, some say, inadequate, funding. This unreliability, combined with political pressures to provide non-economic services as a *quid pro quo* for continued funding support, has forced Amtrak not only to defer needed capital improvements, but also to defer expenditures needed to maintain operational reliability. Unreliable funding has resulted in a destructive cycle of investment in fixed assets, followed by the cannibalization of fixed assets through inadequate programs for both maintenance and fixed asset renewal and replacement.

Despite these funding problems, Amtrak has been able to rely for an important element of its capital funding requirements on private capital markets.

A. AMTRAK'S FINANCIAL CONDITION AS VIEWED BY THE FINANCIAL COMMUNITY

Historically, Amtrak has been successful in obtaining equipment financing for much of its new and some of its overhauled and rebuilt locomotives and revenue cars. In December 1999, Amtrak received a Moody's Investors Service rating of A3, making its debt investment grade securities. In January 2000, Standard & Poor's rated Amtrak a Triple-B, also an investment grade.

The Moody's rating was based on the following rationale, which was similar to the basis for the Standard & Poor's rating.

> The rating reflects Moody's assessment of the financial strength of Amtrak in relation to its unique operational and political status as the operator of the nation's national passenger rail system. The rating also reflects Moody's expectation that Amtrak will likely achieve the Congressional mandate of operational self-sufficiency, but that the Federal government will continue to provide financial support for Amtrak's capital programs. Amtrak's status as a private corporation whose preferred stock is entirely owned by the US Department of Transportation (DOT), and the well-established trend of Federal subsidization are additional positive credit factors.
>
> The rating also considers the intense competitive pressures that Amtrak faces from the highly developed highway and air transportation systems in the US. Credit risks include the threat of dissolution should Amtrak fail to meet the Congressional mandate to achieve operational self-sufficiency by year-end FY2002; the continued reliance on Federal subsidies for capital programs; additional delays in the start-up of high-speed Acela rail service on the Northeast Corridor (NEC), and the on-going process of implementing strategic business initiatives.
>
> Additional delays in start-up of full Acela service will place substantial financial strain over the near term, which could jeopardize Amtrak's goal of self-sufficiency and erode political support for Federal funding of capital needs.
>
> **Ratings Outlook**
> The stable outlook is based on Moody's expectation that Amtrak will successfully implement high-speed service and achieve other strategic business initiatives, while continuing to receive Federal subsidies for capital needs.[40]

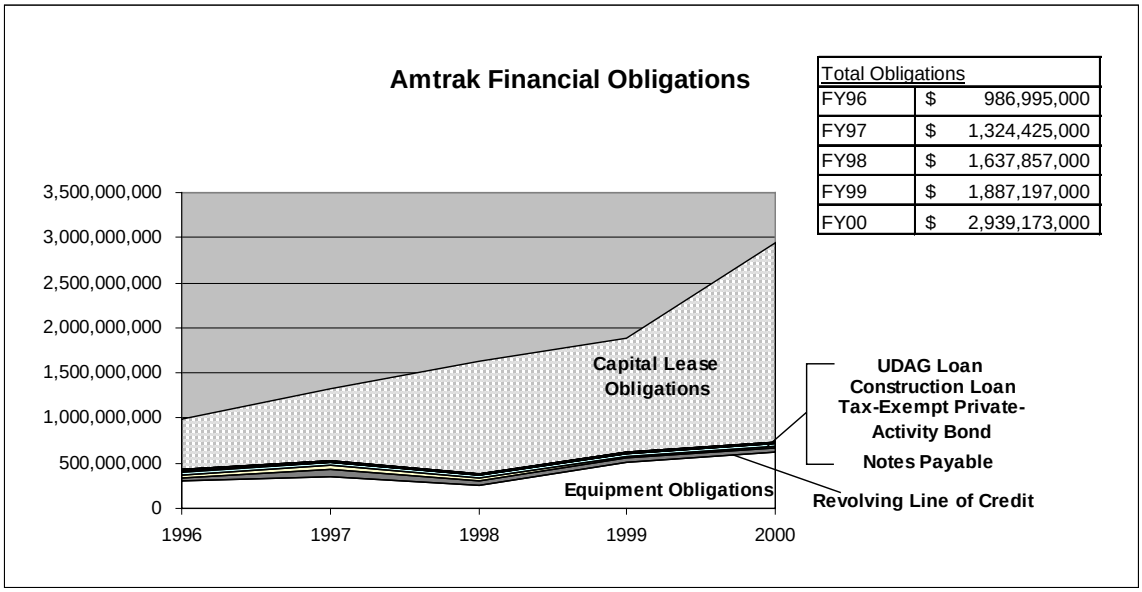
During FY2000, Amtrak took advantage of its investment grade debt ratings to complete four sale-leaseback financing transactions (treated as capital lease obligations on Amtrak's financial statements). In these transactions, 355 Amfleet cars and 270 Superliner cars, with a net, undepreciated book value of $344,690,000, were sold for $915,155,000 and leased back for terms ranging from 23 years to 28 years. The total net present value of the capital lease obligations incurred by Amtrak was $928,686,000. As the result of these four transactions in FY2000, Amtrak received $124,171,000 of net cash proceeds,[41] of which Amtrak represented $99 million was spent in FY2000 on equipment capital projects which would not have been undertaken without the proceeds of the sale-lease back transactions. The $790,984,000 balance

[40] Quoted from Moody's Investors Service, Global Credit Research Analysis of National Railroad Passenger Corp. [Amtrak] dated September 2000.

[41] Before entering into these four sale-leaseback financings, Amtrak had to obtain appropriate releases (or subordination agreements) from the United States (through the FRA) since all rolling stock owned by Amtrak is pledged as collateral to secure a $1.1 billion promissory note payable to the United States of America. The FRA staff indicated that its agreement to release the subject equipment from the lien pool was predicated upon Amtrak using the net capital received from refinancing owned equipment to acquire, rebuild or heavy repair Amtrak's equipment assets.

of the net sale proceeds placed in escrow for the benefit of the capital lease lenders. These deposits are intended to economically defease (i.e., repay), the capital lease obligations. The $580,465,000 gain on the sale-leaseback transaction will be realized by Amtrak over the 23 to 28 year lives of the capital leases. The result of these transactions was to increase cash by $124 million and increase capital lease obligations by $929 million.

Amtrak has significantly increased its financial obligations both through the acquisition of new assets (i.e., high-speed rail investments) and refinancing of existing equipment. The following chart shows that Amtrak has tripled its debt from the end of FY1996 to end of FY2000. By the end of FY2001, Amtrak's debt is likely to approach $3.3 billion.



B. FINANCING REQUIREMENTS

1. Capital Needs

On February 2, 2001, Amtrak released its Strategic Business Plan FY01-05 Financial Plan Update (Strategic Business Plan) which included, for the first time in its history, a comprehensive capital plan projection of funding requirements. Amtrak prepared the capital requirements projections for two scenarios: (a) to maintain Amtrak's existing system of rail passenger, mail and express services (including current contractual commitments for new, state-supported services) and (b) to expand rail passenger services in identified corridors.

In its latest Strategic Business Plan update, Amtrak projects a need for $16 billion in federal support over 20 years (an average of $800 million per year) just to maintain a minimum capital investment in existing services. Alternatively, Amtrak's Plan projects $30 billion in federal support over 20 years (an average of $1.5 billion per year) as Amtrak's assumed share of the capital cost to maintain existing services and develop high-speed corridors. This $30 billion of federal support does not include state, local and private investment requirements. When state,

local and private investment requirements are included, the capital cost for the full inventory of potential projects (including high-speed rail and some additional service improvements on long-distance point-to-point routes) approaches $100 billion over 20 years.

As discussed in Chapter 2, the Council, prior to release of Amtrak's long-term capital plan retained BGL Rail Associates to develop a capital needs estimate for infrastructure only. The BGL analysis produced somewhat lower projections, but makes different assumptions, covers a different time period, and looked at a different set of capital needs. Since the BGL and Amtrak estimates are not directly comparable, and because Amtrak's plan cover all types of capital needs (equipment, stations, infrastructure, etc.), our analysis relies on the Amtrak plan. We recognize that not all of the projects in the plan will be built over the next 20 years.

Funding of the magnitude anticipated over the upcoming 20 or more years should not logically be under the control of Amtrak as it exists today for a number of reasons relating to: (1) the unclear mix of capital and operating funding needs of Amtrak as it is currently organized, and (2) the inherent conflict between the political process of obtaining funding, the need to allocate the funding equitably among competing regional interests, and Amtrak's need to act like a private sector rail transportation operating company. A number of the structural options discussed in Chapter V logically separate the political aspects of Amtrak from the business aspects, and further separate the business aspects into an operating company and an infrastructure company.

The projected $80 to $100 billion of financing for Amtrak and for proposed expanded rail passenger services logically should be separated in the same manner that the structural options separate functions for a number of reasons.

- The states and Amtrak (if it keeps its current structure and retains management and ownership of the NEC) will be competing for capital funds, and there needs to be a fair way to allocate funds and evaluate projects.

- The financing mechanisms for the operating transportation company are different from the mechanisms that would be appropriate for the Northeast Corridor infrastructure company, which, in turn, may be different than the mechanisms that would be appropriate for improvements made to the infrastructure of private freight railroads for other designated high speed rail corridors.

- There needs to be a separate entity that can serve as a buffer between the political pressure to operate uneconomic or under-funded services and the operating and infrastructure entities.

- The amount of investment is very large, and there are significant questions as to Amtrak's ability to manage and transparently account for large capital projects on time and within budget. Accordingly, consolidating Amtrak program administration authority into a single government entity that is responsible for infrastructure investments (both on the NEC and in other high speed corridors on facilities owned by private freight railroads) is likely to be necessary to gain the confidence needed from federal and state governments and private railroads before they make the magnitudes of investments

needed to implement the 20-year, $100 billion investment in rail passenger services inventoried in Amtrak's latest Strategic Business Plan.

New models and structural options to implement improved intercity rail passenger service have been discussed earlier in this report. How funding is provided is a critical determinant of the effectiveness of the proposed new models and structural options. Separation of the governmental functions from Amtrak's business functions is critical if Amtrak's "operating company" is to behave like a private sector company. Likewise, due to the magnitude of the funding requirements, and due to the differences between operating a rail transportation company and managing a company that improves and maintains railroad infrastructure used by many different transportation entities, separating the transportation operating company from the infrastructure company is logical both managerially and financially.

The available financing options for the operating company and infrastructure company depend upon the nature of their funding requirements. Different financing mechanisms are more appropriate for supporting capital investments for passenger operations than for funding long-term fixed-asset capital projects.

C. FINANCING OPERATIONS

The operating company logically will own, lease and/or control the revenue equipment that is not purchased or otherwise owned by the states. Amtrak has been successful in financing equipment with private sector leases and secured equipment obligations. There is no reason why the operating company cannot continue obtaining equipment financing from private sector capital markets. The operating company also can obtain financing by selling assets in sale-leaseback transactions (similar to the four FY2000 transactions described previously), by selling assets such as equipment needed for passenger rail services to states, local governments, and other entities, and by selling surplus assets, such as excess or obsolete equipment to others.

The operating company should also be able to obtain operating grants from or through states and/or commuter rail authorities pursuant to contracts to provide specified levels of rail passenger services. To the extent that the operating company is responsible for excess Railroad Retirement taxes, the operating company should receive federal grants to cover them. For a few years after the operating company begins operations, the operating company may need federal capital and/or operating grants to fund operating cash shortfalls and the costs of restructuring, including funding for the orderly retirement of Amtrak's current debt. If decisions are made to retain certain trains, the federal or state governments also will have to fund the cash deficits of operating such trains.

D. FINANCING INFRASTRUCTURE

The infrastructure entity's operating expenses will be funded by trackage fees charged to the operating entity and other users of the infrastructure (commuter authorities and freight railroads). To the extent that the infrastructure entity is responsible for Excess Railroad Retirement taxes, the infrastructure company should receive federal grants to cover such costs. Likewise, funding

sources need to be identified to fund required "Operational Reliability" expenditures, which are estimated to total $750 million over 15 years ($50 million per year). Additionally, initial working capital of the infrastructure entity (on the magnitude of one month's operating expenditures) may have to be funded by the federal government.

The infrastructure entity also could sell certain of its assets as a one-time source of financing. Specifically, Amtrak currently owns significant real estate interests such as 30th Street Station, Philadelphia and Union Station, Chicago, which could be sold to real estate developers with the operating company leasing back the limited space that it needs for ticketing of passengers and waiting rooms. Additionally, rather than receiving annual payments, the infrastructure entity could raise considerable funds on a one-time basis by selling perpetual easements for fiber optic cables and other utility easements along the rights of way rather than receiving annual rents.

To fund the maintenance and capital improvements both on the Northeast Corridor and on other designated high-speed corridors, there should be predictable, long-term funding from one or more of the potential sources identified in the BGL study. The Council treats these potential sources as suitable to fund the major part of required infrastructure needs (core sources), or as suitable for the less central funding needs (ancillary sources).

1. Core Sources

- Federal appropriations, particularly for demonstration projects and fire and life safety problems such as $900 million in remedial work on the tunnels leading into Penn Station in New York City, and "Operational Reliability" expenditures estimated to be $50 million per year on the South end of the Northeast Corridor for the next 15 years.[42]

- A dedicated rail transportation funding source could be created from the existing fuel tax revenues mechanism by adding a new penny a gallon to the current federal excise tax on gasoline of 18.4 cents per gallon and require a state match of an additional penny a gallon. Since each penny per gallon would generate approximately $1.6 billion, the matching two pennies per gallon would raise approximately $3.2 billion per year for rail passenger funding. While this funding source would provide significant financial support, it would not, by itself, be sufficient to meet projected rail capital funding requirements for the expanded system of passenger trains in designated corridors, which could require approximately $4 billion per year.

- Another possible source of funding is the $12 billion in bonds in the proposed High Speed Rail Investment Act. The new bill provides for $1.2 billion in bonding authority per year for 10 years. Twenty percent of the project costs are to be funded by state matching funds for each project. The states' 20 percent funding match would be invested in escrow accounts for 20 years with the expectation that the states' funds would grow through investment income to equal the par value of the bonds in 20 years. Holders of

[42] Such direct, appropriated sources of funds are limited by TEA-21 and AIR 21 limitations and spending category "firewalls", they are subject to annual authorization and appropriations reviews, and they are by no means assured due to political funding restrictions.

High Speed Rail Investment Act bonds would receive federal income tax credits in lieu of receiving cash interest over the 20-year lives of the bonds.

- There are a number of issues surrounding the bonds that could increase their risk and cost. The analysis by the Joint Committee on Taxation of last year's $10 billion bond bill determined that the "scoring" cost of the bonds would only be approximately $3.5 billion, under rules used by the Committee that look only at the first 10 years that the bond program exists. In fact, the bonds will be outstanding 30 years total (20 year maturity bonds issued over 10 years will result in a portion of these bonds being outstanding for 30 years), and, during that 30 year period, the $10 billion of bonds will likely cost federal taxpayers $16 billion and state taxpayers $2 billion, or a total of $18 billion. Given the $80 billion to $100 billion magnitude of projected rail passenger investment required over the upcoming 20 to 25 years, more expensive financing mechanisms will make it more difficult to implement rail passenger improvements, regardless of how they currently are "scored" for legislative purposes.

- The Council also believes that if bonds are to be a possible source of funding for the development of high-speed rail passenger service projects, federal, state and regional rail transportation authorities, in addition to Amtrak, should be able to issue the bonds. Moreover, states and regional authorities should have primary responsibility for choosing projects outside the Northeast Corridor, and each project should be evaluated and approved by an impartial government body on its own merits and free from any requirement that Amtrak be the sole provider of the services benefiting from the funding. The bond proceeds primarily should be used for infrastructure improvements; proceeds should be used for equipment expenditures only if private sector financing is not available. All funds, including both state contributions and bond proceeds, should be under the control of the Independent Trustee and should not be able to be borrowed by Amtrak (or any other issuer), or otherwise be entangled with the internal finances of Amtrak or any other issuer.

- A much more efficient mechanism for the federal government to raise rail investment funds for designated rail passenger corridors would be for the federal government to (1) borrow the funds, or repay less outstanding federal debt, and (2) provide 80 percent grants to the projects with 20 percent matching grants provided by the states; the funds would go directly into the projects rather than into an escrow fund. The current cost of borrowing funds to the federal government is approximately 6 percent long term versus a likely 8 percent that the federal government would have to pay in tax credits on the proposed bonds. The net present value cost to the federal government of combined federal/state (80 percent/20 percent) grants over the full 20-year lives of the proposed bonds approximates the net present value of the cost of issuing tax credits at a rate equal to 8 percent of the proposed bonds for 20 years. Moreover, there would be no risk that (a) the escrow fund would not grow sufficiently to repay the bond principal in 20 years; (b) that bond proceeds were not used for qualified expenditures in a timely manner and therefore have to be repaid; (c) that Amtrak may not have sufficient losses to shelter interest earnings of the escrow fund; and (d) that the administrative costs of issuing the bonds would be higher than anticipated.

2. Ancillary Sources

- Swift Rail Development Act of 1994 funds could be used to fund a portion[43] of the cost of planning high speed rail corridors in the process of being developed and some limited initial capital expenditures thereafter.[44]

- Other potential sources of rail transportation funding include dedicating (through federal legislation, which is by no means assured) the implicit interest income on the Highway Trust Fund to rail passenger investments. This source would raise approximately $1 billion per year, but the elimination of such interest has already been used to "fund" other federal legislative initiatives. Another possible source of rail infrastructure funds would be the approximately $700 million in estimated additional annual tax revenues that are available as a result of more diligent enforcement.

- Transportation Infrastructure Financing and Innovation Act (TIFIA) funds, a part of TEA 21, authorized the Department of Transportation to provide secured loans, lines of credit and loan guarantees to public and private sponsors of major surface transportation projects. The amount of federal credit may not exceed 33 percent of total project costs. A portion of the Penn Station redevelopment project (the Farley Building in New York City) was funded from this source in FY1999.

- Private activity tax-exempt bonds may be issued by states or local governments (subject to IRS dollar limitations on overall state bond issuance amounts per year and other regulations) under existing legislation to finance certain high-speed intercity rail facilities, but only if these projects are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled station stops. If the IRS Code were modified to lower the speed from 150 miles per hour to 90 or 110 miles per hour, the states could fund a portion of high speed rail projects from this source. The IRS Code currently limits such tax-exempt bonds to the greater of $50 per resident per year or $150 million for all private activity bonds issued by a state in any year. This limitation increases between 2003 and 2007 to $75 per resident per year, or $225 million for all private activity bonds. (A provision of the proposed bond bill (S. 250) would lower the speed to 90 mph and

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[43] The Swift Rail Development Act of 1994 (Public Law 103-440) authorized US Department of Transportation appropriations of $184 million over FY1995-FY1997 to fund (a) a portion of the cost of certain planning activities for establishing high-speed rail service in corridors other than the NEC, and (b) "activities for the improvement, adaptation, and integration of proven technologies for commercial application in high-speed rail service in the United States." Under the funding formula, DOT is authorized to provide up to 50 percent of the publicly financed costs of the activities, provided that at least 20 percent of the costs come from State and local sources that do not include any federal funds. TEA 21 authorized an additional $140 million for FY1998-FY2001, with $10 million per year for planning activities and $25 million per year for technology improvements. This program is coming up for re-authorization.

44 This source is by no means assured, and it is coming up for legislative renewal. Likewise, while arguably Highway Trust Funds and Airport and Airway Trust Funds could be tapped for selected Amtrak projects (such as rail passenger projects which interface directly with intermodal airports or bus facilities), new funding sources need to be developed, or legislation introduced to modify existing mechanisms to allow them to be used on selected high speed rail corridors throughout the country.

would eliminate the state volume caps for state tax exempt bonds used to finance high-speed rail projects.)

- Another possible funding source for rail infrastructure is allocation of Revenue Aligned Budget Authority (RABA) to rail infrastructure projects. RABA is a principal feature of TEA 21 designed to make sure that highway trust fund revenues would be spent. Currently, RABA funding is not shared with the mass transit account, but the fire and life safety infrastructure needs on the commonly used portions of the NEC would be logical uses of such RABA funds (either for the full cost of the fire and life safety infrastructure needs or for the percentage that commuters comprise of the total passengers using the Penn Station New York City tunnels).

- If legislation changed the current restrictions on the use of flexible funding under the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), highway funds (which have been used for a variety of improvements for transit) could be used for intercity rail passenger service funding requirements. Likewise, legislated changes in Congestion Mitigation and Air Quality Improvement Program (CMAQ) could allow such funds to be used in intercity rail passenger projects.

- The freight railroads may also be willing to contribute funding on corridors where they need additional capacity.

E. FUNDING THE GOVERNMENTAL ENTITY

The governmental entity that oversees the operations of the infrastructure and operating entities can itself be funded in ways that range from receiving direct appropriations from the federal government to earning a fee equal to a very small percentage of the funds it raises on behalf of the operating and infrastructure company. To minimize any conflicts of interest, and to keep the governmental entity from perpetuating an ownership and funding structure just to keep its own source of funding, the best funding source would be annual federal appropriations.

F. CONCLUSION

There are a number of funding mechanisms either available or potentially available with minor or major changes in legislation. None other than direct appropriations, possibly with a dedicated funding source such as a new penny on the gasoline tax, and logically with state matching requirements, has the potential to fund the magnitude of financing likely to be needed over the upcoming 20 to 25 years. Most likely, a combination of several financing mechanisms will be used to fund various requirements. However, in order to ensure that equipment financing in the private sector remains available, Amtrak will have to participate in financing packages that do not adversely affect its balance sheet and cash flow available for equipment debt service. As a result of such restrictions, long-term funding to the infrastructure company should be in the form of grants. Funding to the operating company logically should come from fare-box receipts, state operating subsidies, and other income sources, not from bonds that may not be able to be repaid.

VII. CONCLUSIONS, RECOMMENDATIONS, AND NEXT STEPS

A. CONCLUSIONS

At a minimum, the Council has concluded that the following steps need to be taken as the basis for improving our national institutions for intercity rail passenger service:

- Identify or establish an effective, permanent, and possibly independent government organization to provide direction, program administration, fund administration (possibly including issuance of bonds or other securities), and oversight of intercity rail passenger service.

- Separate the management, funding, and financial reporting of Amtrak's passenger train operations from the Northeast Corridor (and other) infrastructure that Amtrak owns.

- Develop a sound financing and financial structure for national intercity rail passenger service that: defines a transparent system for accounting, financial management, and financial reporting; establishes guidelines for business and capital planning, including the separation of capital needs from operating needs and the evaluation and approval of capital investments; and demarcates the roles of federal and state funding and private capital markets.

- Adopt the Council's proposed business model and government institutional framework for rail passenger service as the basis for a reformed legislative and regulatory framework for intercity rail passenger service.

- Construct a set of operational and financial benchmarks to measure the performance of the train operating and infrastructure companies.

B. RECOMMENDATIONS CONCERNING THE COUNCIL'S STRUCTURAL AND FINANCING OPTIONS

The Council believes that the full range of structural and financing options should be presented at formal Council hearings for public comment.

C. NEXT STEPS

Congressional Hearings. The Council understands that various committees and subcommittees in both houses of the Congress may be holding hearings on the proposed High Speed Rail Investment Act (S. 250). The Council believes that such hearings would provide an excellent opportunity for the Congress to evaluate the central views put forth in this report in the context

of ongoing discussions about Amtrak's current performance and its immediate and longer-term financing needs.

Council Hearings. The Council plans to hold formal hearings on the issues raised in this report, with the intent to hold at least one such hearing in each of the eastern, central-mountain, and west coast regions of the country.

Implementation Planning Studies. If funding were made available, the Council believes it would be productive to undertake focused studies and analyses (performed by ARC with the assistance of outside contractors) that would:

- Determine the range and success of new developments throughout the world in the organization, funding, and operational and financial performance of institutions that provide intercity rail passenger services;

- Establish financial, operational, and service quality benchmarks for train operations and for rail infrastructure;

- Determine appropriate accounting practices that would be used to accurately reflect the costs of providing intercity rail passenger service;

- Conduct an analysis of FRA's passenger equipment safety regulations in the light of design specifications, operating regimes, and incidence of fatalities and injuries for rail passenger equipment in Western Europe, Japan, and any other relevant areas; and

- Design and cost a pro forma national intercity rail passenger network for the U.S.