I. WHY AMERICA'S PASSENGER RAIL PROGRAM DOES NOT WORK AND WHAT IT NEEDS TO BECOME SUCCESSFUL

A. INTRODUCTION

When, on November 9, 2001, the Amtrak Reform Council approved a resolution finding that Amtrak would not achieve operational self-sufficiency by December 2, 2002, as required by the Amtrak Reform and Accountability Act of 1997 (Reform Act), it marked a beginning, not an end.[6] The Council's finding reflected the majority's view that –

- Amtrak's financial performance since enactment of the Reform Act has deteriorated and will fall far short of that required by the Reform Act;

- Our nation's transportation system needs an effective program for the development and operation of intercity rail passenger service and that passenger rail can and should have a bright future in America;

- The current federally-chartered organization for providing intercity rail passenger service, Amtrak, needs major structural improvement; and

- The Council should propose a new program for intercity passenger rail in the Action Plan the Reform Act requires the Council to submit to the Congress.

The Council's view is based on its investigations of Amtrak's institutional structure and performance. This work led the Council to conclude that Amtrak, as it is currently structured, funded, and operated, is not capable of delivering the improvements in passenger rail service that America needs. In the almost four years since enactment of the Reform Act, Amtrak has not made any significant progress toward operational self-sufficiency.

The Council is confident that the recommendations for reform proposed in this report, if enacted, will improve the national passenger rail program.

Building on the Council's Second Annual Report, issued in March 2001, the Action Plan proposes a new policy framework for passenger rail as well as specific proposals for the implementation of the business model that the Council approved in its Second Annual Report. To ensure that these options are implemented effectively, the Council's plans include provisions for a careful transition from the current corporate and operational structure of Amtrak to the new structure proposed for the National Railroad Passenger Corporation.

---

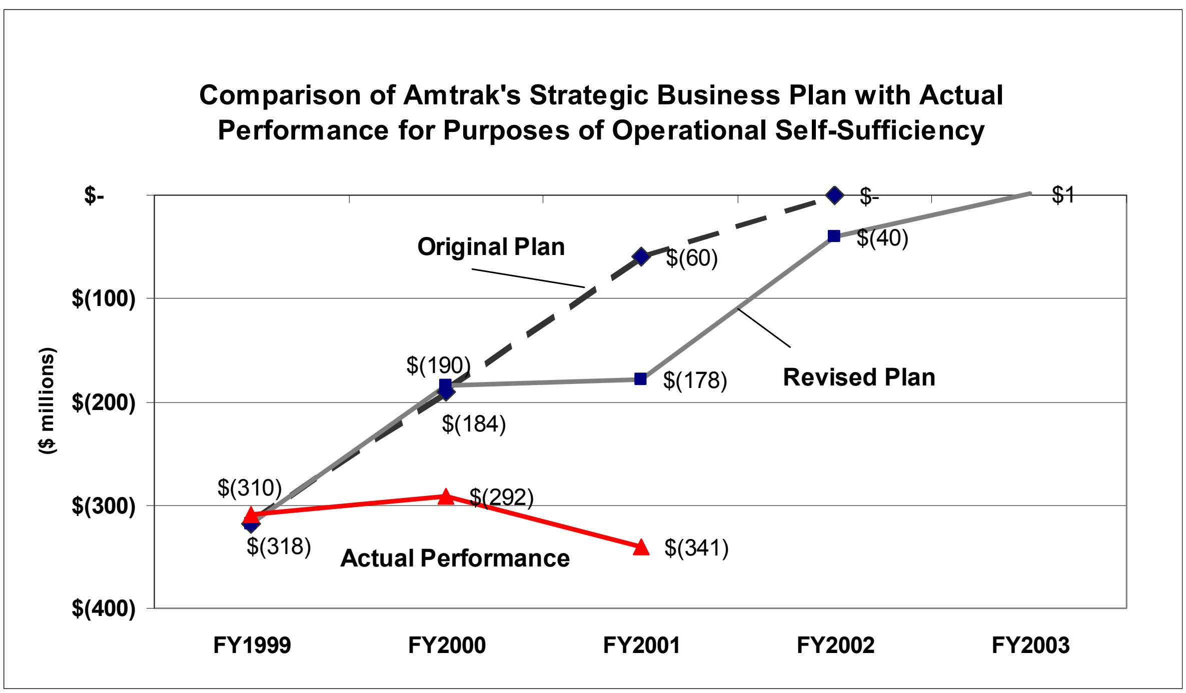
[6] The Council's finding document is attached as Appendix II.

B. PROBLEMS OF A FLAWED INSTITUTION

The vision of improved passenger rail operations bears no resemblance to the performance of Amtrak over its 30-year history. The Council previously determined, as reported in its Second Annual Report, that the roots of Amtrak's flaws lie in its institutional structure. While one may criticize the management, the board of directors, and even the employees or the unions, the institutional structure is the root cause of Amtrak's problems. Effective reform will ensure that these same flaws do not undermine a new passenger rail program.

Some outstanding examples of Amtrak's problems under its existing organizational structure include:

- Failure to develop and execute sound business plans has prevented Amtrak from meeting its goals for revenue growth and cost containment.
  - Amtrak's original Strategic Business Plan for FY1999 – FY2002 projected that Amtrak would achieve self-sufficiency in fiscal year 2002. With the delays in the introduction of Acela Express service and rising costs, Amtrak had to revise its Business Plan, pushing back the date for achieving operational self-sufficiency a full year to fiscal year 2003. Amtrak finished fiscal year 2000 $100 million behind its revised Plan. Amtrak finished fiscal year 2001 more than $150 million behind its revised Plan and about $280 million behind its original plan. Its operating loss for purposes of operational self-sufficiency – as that test is defined by Amtrak – increased in FY2001 to $341 million[7], up from $292 million in FY2000.

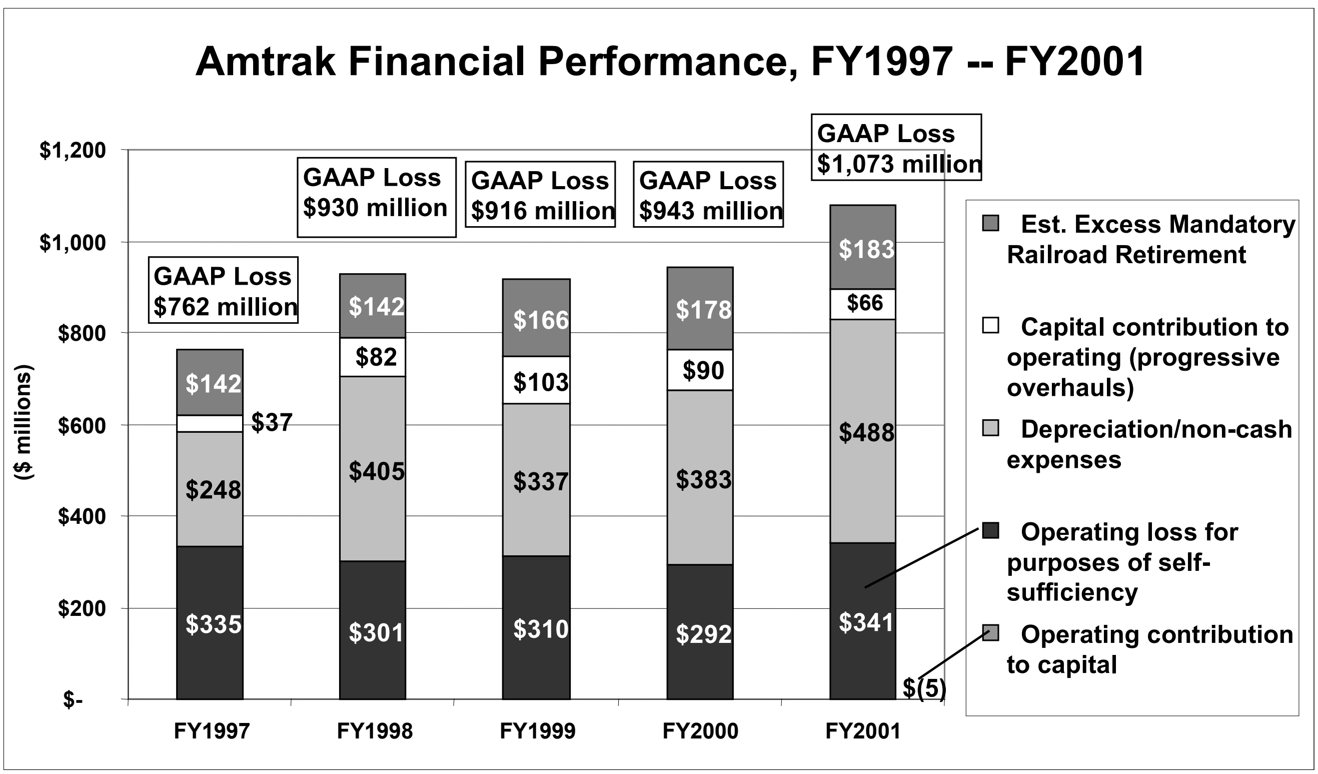


[7] Based on Amtrak's unaudited financial statements for fiscal year 2001. Amtrak concurs with the Amtrak Reform Council's calculations for purposes of the self-sufficiency test.

- Amtrak's costs continue to grow faster than its revenues. Amtrak has projected significant overall cost reductions in its strategic business plans since 1999, but Amtrak did not define specific cost reduction initiatives until FY2001, and those proposals total only $75 million annually, exclusive of any savings from Amtrak's planned reduction in force. These cost reductions are clearly inadequate to meet Amtrak's strategic business plan projections.

- In five years, Amtrak has made no progress toward achieving self-sufficiency and is in a weaker financial condition today than in 1997. While Amtrak made modest improvements towards self-sufficiency in FY1998 and FY2000, its FY2001 loss was its highest ever.

- On January 25, 2002, the US Department of Transportation's Office of the Inspector General (DOT/IG) released its report on Amtrak's FY2001 performance. The Inspector General reached the same conclusions as the Amtrak Reform Council about Amtrak's performance, stating "Amtrak's cash losses have not decreased and Amtrak is no closer to operating self-sufficiency now than it was in 1997. With less than a year remaining in its mandate, there is not sufficient time for Amtrak to implement the kinds of sustainable improvements necessary to meet its deadline for self-sufficiency. At this point in time, Amtrak will face a formidable challenge in 2002 just managing its cash resources – be they from operating revenues or Federal subsidies – to make ends meet without further borrowing."



- Amtrak's contentions to the contrary, simply meeting an annual target for reduced federal operating funding does not mean Amtrak is making meaningful strides toward self-sufficiency. Amtrak has been able to continue operations with more limited federal operating funds only by using Taxpayer Relief Act (TRA) capital funds for operating purposes and by engaging in counterproductive practices and transactions that have weakened the overall financial and physical condition of the company.[8] Federal operating grants for Amtrak may be declining, but Amtrak's losses for purposes of operational self-sufficiency are increasing. The statutory deadline of December 2, 2002, for operational self-sufficiency is not a finish line. It is instead the starting point from which Amtrak must sustain operations over the long run without federal operating assistance.

- Despite receiving appropriated federal funds and TRA funds totaling approximately $5 billion for Fiscal Years 1998 through 2002, Amtrak's assets are in worse physical condition now than when the ARAA was passed.

- Amtrak's inability to follow its business plans have led to imprudent borrowing, most notably the mortgaging of a portion of Penn Station New York to obtain a $300 million loan that was used to avoid running out of cash in the last quarter of FY2001. In FY2000, Amtrak also engaged in the sale-leaseback of substantially all unencumbered Amtrak equipment, which raised $124 million that had not been projected as a cash source in its strategic business plan for that year.

- The Penn Station loan and other borrowings, including sale-leaseback transactions, have tripled[9] Amtrak's debt since 1995, increasing its costs for debt service to about $200 million annually.

- Amtrak lacks a transparent accounting system for its operations and infrastructure, an effective reservations system that will identify seats available on Amtrak trains on a real-time basis (including reservation no-shows), and a system to measure the productivity of its use of capital, labor, energy, and materials.

- Amtrak has not made any use of the reforms enacted under the Reform Act. Amtrak has not used its Reform Act authority to restructure or eliminate unprofitable routes. It has not used its Reform Act authority to contract out elements of its operations to achieve cost savings.[10]

- Amtrak has resisted all requests that it separate the financial statements for the Northeast Corridor rail infrastructure that it owns and maintains from the financial statements of its train operations. This makes management of both elements more difficult.

---

[8] The sale leaseback of equipment in FY2000 raised approximately $124 million, and the $300 million Penn Station loan in FY2001 provided additional funds that were not in Amtrak's strategic business plans, but which helped fund cash shortfalls from business plan projections. Such additional debt and asset liens will limit future years' options and sources of cash flow.

[9] Amtrak notes that its debt only doubled since 1995 if cash escrow deposits of approximately $1 billion set aside to defease (i.e., repay outstanding debt from a dedicated escrow fund) the sale-leaseback obligations are deducted from the approximately $3 billion of Amtrak debt outstanding at September 30, 2000.

[10] The Reform Act eliminated previous statutory prohibitions concerning contracting out work where the loss of a job would result, and made contracting out a collective bargaining issue. Amtrak and its unions have been in collective bargaining on the issue of contracting out since June 2000.

- Amtrak lacks a strong policy to improve the intermodal connections of its system. A case in point is that Greyhound, which serves about 3,500 cities, has secured access to only 55 of Amtrak's 500 stations in the 30 years that Amtrak has been in business, and at only 35 of those 55 stations do all Greyhound buses serving that city come to the train station.

These flaws make it clear that Amtrak will not achieve operational self-sufficiency because, as an institution, it has not been able to use the past four years to get its house in order by better managing revenues, costs, and productivity. The events of September 11th are simply irrelevant to the reasons why Amtrak's financial situation has not improved over this period, and why Amtrak will fail to pass the operational self-sufficiency test.

C. ROOT CAUSES OF THESE PROBLEMS

Amtrak's poor performance is the result of institutional flaws:

- Direct susceptibility to political pressures on major and minor management decisions, which provides strong incentives to make decisions that are politically expedient in the short run, but financially crippling in the long run.

- A monopoly structure, that exhibits inherent resistance to innovation and lacks motivation to improve efficiency.

- Lack of transparency and accountability in Amtrak's management structure, accounting system, and financial reporting

- Lack of effective program administration and oversight.

- A business model based on the faulty premises of large-scale cross-subsidization and the availability of federal funding as needed.

- Lack of Congressional confidence in Amtrak as an institution, making it virtually impossible for Amtrak to secure stable and adequate funding.

Both historically and currently, the administration and oversight of the passenger rail program are ineffective. Without reform, there will be continued reliance on deficit financing with no incentives for efficiency in the conduct of operations or the use of capital. These practices will continue to fuel the debate about the efficacy of the institution, making it difficult – if not impossible – to secure adequate funding. Inadequate funding will continue the cycle of deterioration of assets, both equipment and infrastructure. This particularly will be true for the passenger equipment on the long-haul trains and for the NEC infrastructure. The operational reliability of the NEC will continue to degrade, introducing further train delays that will – if unchecked – act as a drag on the competitiveness of the regional economy of the Northeastern US (New England and Middle Atlantic). Impediments to the ability of states outside the NEC to develop their emerging high-speed rail corridors will continue.

Improvement will not come without institutional reform.

D. The Council's Vision

The Council view is that there should be a bright future for intercity rail passenger service in America. But the Council also believes that passenger rail service will never achieve its potential as currently organized and managed by Amtrak. A new and different program is needed to move forward.

The basis for reform should be the design of a new program that will support passenger train operations and infrastructure improvements and that will provide for planning and development of improved intercity passenger rail services. The program's basis would be a business model in which strong federal program administration and oversight works with states and the freight railroads to provide the high-quality rail infrastructure needed to support a passenger rail program. This would be so both in the Northeast Corridor and on the track network of the freight railroad industry. Concomitantly, any needed operating support for passenger rail services would be provided on the basis of contracts involving performance incentives to lower costs, raise revenues, and improve the quality of service.

This program, which would work with states and regions to support the development of passenger service, would be modeled on the programs for infrastructure development that have been so successful for highways and airports. The states have been the leaders in the expansion and improvement of passenger rail service over the past decade, and this program would provide them with the federal-state partnership to do that job more effectively.

Amtrak's primary mission is the transportation of people and mail/express. As presently constituted, however, Amtrak also administers governmental policy and program authority on rail passenger issues and is responsible for owning and maintaining much of the Northeast Corridor (NEC) rail infrastructure, an asset shared with rail commuter authorities and freight railroads and having a significance that clearly transcends Amtrak's operations. To correct these institutional failings, the Council recommends:

- Restructuring the National Railroad Passenger Corporation (NRPC) as a small federal program agency to administer and oversee the intercity passenger rail program. Under current law, no federal oversight entity exists to review Amtrak's operations and performance. *Ex post facto* audits of Amtrak's performance by the DOT/IG and GAO provide analyses and reports, but are not a substitute for hands-on oversight. Amtrak's current train operating and infrastructure functions, under the Council's plan, would be provided by strong companies, with independent boards. The NRPC would actively oversee the new train and infrastructure companies with respect to budget matters and approval of their business plans. The NRPC would also be responsible for managing the federal program for development of high-speed rail corridors and would have the discretion to introduce competition in some or all Amtrak markets.

- Organizing Amtrak's responsibilities for train operations and infrastructure as separate companies. This will allow Amtrak as a train operator to focus on its mission as a service provider and free it from the burden of ownership for much of the NEC. A separate infrastructure company will better represent and balance the needs of all Corridor users and stakeholders. The NRPC would insulate both new companies from political interference. Finally, separation will highlight the Northeast Corridor's capital needs, estimated by Amtrak to be nearly $28 billion over the next 20 years.

- The option of introducing competition, through a competitive bidding process, of both intercity passenger rail services and the operation, maintenance, and improvement of the NEC. The Council believes that, as is the case throughout our free-market economy, competition would drive down costs and drive up revenues, service quality, and customer satisfaction. The Council does not stand alone in making this recommendation. The introduction of competition has been an effective hallmark of reform of state-owned railroads world-wide in recent years. And franchising is realistic. Experience shows that a variety of other interests, both public and private, would be interested in operating Amtrak services. Under the right circumstances, even some of America's freight railroads might be interested in participating.

- The Council strongly supports protecting the existing rights of Amtrak employees under the Railway Labor Act, FELA and the Railroad Retirement System.

- The Council also believes that long-term sources of funding are needed to meet the operating and capital needs of the intercity passenger rail program.

This report describes in detail the Council's Action Plan for implementing its vision.