

**STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON RAILROADS
OF THE
HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE
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Chairman Quinn and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss financing the Nation's rail infrastructure, for both passenger and freight service.

In the early days of this country, intercity surface transportation was largely a private enterprise. According to Philip Locklin, the noted authority on transportation economics, the private turnpike movement was flourishing by 1800. Soon thereafter, Pennsylvania alone had chartered 86 private companies to build roads and collect tolls, while New York State had 135. State participation was in the form of stock purchases, or, sometimes, direct subsidy to the company, but not in construction or operation of the road itself.

Rail service, which began in the 1830's, was financed in a similar manner. Private companies offering passenger and freight service built rights-of-way and operated trains. Government assistance was generally in the form of loans, land grants, stock purchases and sometimes outright subsidies, although, in a few cases, states built their own local railroads to aid economic development.

By the 20th century, the picture had changed dramatically for roads – but not for rail. Growing recognition that a sound highway system provided essential social and economic benefits caused the states and localities to take over direct responsibilities for most road and highway construction and maintenance. Recognizing the importance of linking the country together, the Federal Highway Act of 1921 established a system of “federal-aid” roads, at first limited to 7 percent of the rural roads in a state. The system was designed to include the most important highways – those that were critical for commerce and mobility. The system grew, through a series of Congressional mandates, into the network we know today – the Interstate system, the Federal-Aid system and others.

In contrast, the rail system was able to build a transcontinental network linking the country without government ownership or oversight, and has remained essentially in private hands; the passenger network was only transferred to the public sector in 1970.

Because these two networks, while closely linked, require different approaches to financing infrastructure investment, I will discuss them separately and close with a consideration of financing issues for both.

In order to discuss the financing of intercity passenger rail service, the Administration has focused on two questions that first must be answered: what intercity rail passenger service should America have and who decides this type of service? The answers to these questions strongly affect the answer to the question of how to finance intercity passenger rail service in this country.

The present Amtrak route system has changed little over Amtrak's thirty years of existence, seemingly locked in place by history and politics. That is starkly anomalous in America's transportation system. What other transportation company or mode of travel has changed its routes and service so little in the last thirty years? Most transportation providers have changed their systems dramatically over that time span in response to changes in travel patterns driven by economics and demographics. If Amtrak's system were not so ossified, perhaps Amtrak would serve more passengers today than it did thirty years ago. It appears that moving decision-making on routes and service closer to the customers would be a very good thing.

This observation appears to be borne out wherever states have taken a strong role in determining what routes will be operated to serve their citizens, what kind of equipment should be used, what kind of service should be provided, and on what schedule. The states of California, North Carolina, and Washington are all excellent examples of states stepping up to the plate and meeting this challenge, paying for what they want above and beyond what Amtrak would otherwise provide, and getting noticeably better rail service for their citizens as a result. Citizens have responded to those investments: three California state-supported routes have attracted 2.35 million riders in the first seven months of this fiscal year, almost 44% of the total ridership for the same period on the Northeast Corridor Acela, Metroliner and Regional services.

The Administration proposes to build on the examples set by these states to reform and strengthen the Federal role in passenger rail to mirror much more closely the current Federal program supporting mass transit. The Federal government would continue to define rail safety standards and enforce them. The Department of Transportation would provide capital grants directly to states and interstate consortia of states that want passenger rail. State government agencies would determine the level of passenger services needed and the price for such service, and contract with third-party operators to provide long-distance and corridor trains. The same program would apply to legacy long distance routes, current and new corridor services -- at higher speeds or not. To the extent that states' service choices require operating subsidies, state governments would be required to provide that subsidy.

It is possible that in the early part of the authorization cycle, the Federal Government would provide limited subsidies for corridor and long distance trains, and fund the capital backlog for certain passenger rail projects. By the end of the authorization cycle,

however, state governments would be responsible for at least 50 percent of needed capital investment for all intercity passenger rail service— similar to Federal capital investments in the Federal Transit Administration’s “New Starts” program. Similarly, by the end of the authorization period all rail operational costs will be borne by riders or States or State rail consortiums.

We believe this an appropriate division of State and Federal transportation responsibilities. It reflects the way the Federal government handles other transportation programs. After an appropriate transition period, only services States are willing to pay for would be continued.

Like other Federal programs that invest in transportation, intercity passenger rail service would require careful thought and planning up front before either the states or the Federal government make significant investments. Intercity passenger rail service should be part of state transportation plans already required by Federal surface transportation legislation. Careful passenger rail planning should go a long way toward overcoming the long-term problem that our modes of intercity passenger transportation, which were conceived independently for the most part, do not interrelate well. States, however, have a powerful interest in enabling their citizens to navigate our transportation system seamlessly. The states that do so stand to reap considerable economic advantages, such as being more attractive as a location for businesses. A sound planning process should also help make sure that intercity passenger rail service goes where people want to travel, when they want to go, and at an appropriate price.

This may result, for example, in a lot more attention being paid to some of the submarkets along long distance routes, instead of the points of origin and of final destination for these routes. As I understand it, on many long-distance routes few passengers travel the entire length of the route. Instead, most passengers start and stop at intermediate points along the way. It would make sense for a state or two neighboring states having a submarket that attracts a lot of passengers to want more service on that part of the longer route and to invest accordingly. North Carolina is doing that between Charlotte and Raleigh. Oregon and Washington are doing that between Eugene, Portland, Seattle and Vancouver, British Columbia. Those states are reaping significant benefits from doing that and we should help them.

In many places, states may decide that it is more important to have fast, frequent, timely, and reliable service in relatively short corridors that have a lot of business travel. In such corridors, rail can compete effectively with air and highway for business travelers. The Northeast Corridor, where Amtrak is the dominant carrier, is the best illustration of that prospect. Especially where airports and highways are already overcrowded and land is so scarce that it will be hard to build more airports or highways, it is especially important to make full use of existing rail capacity. Since states will be making the key decisions about whether to build additional airports or highways, it makes sense to have them make key decisions about passenger rail service and if it should be expanded, reduced, or eliminated altogether. Then the states can comprehensively plan the best ways to get their citizens from one place to another without needless constraints on modal choice.

Thorough planning also involves thorough discussions and negotiations with the freight railroads, which own the rights-of-way and tracks over which most of the Nation's current and future passenger rail services operate outside the Northeast Corridor. Passenger rail services pose significant operational challenges for freight railroads, and expansions of current services or new service on intercity corridors should not impair the current capacity for carrying freight, lest such investments will lead to increased congestion of our highways by more trucks. Better yet, states considering passenger rail investments should make capacity improvements that benefit both passenger and freight users to maximize the congestion relief afforded by the projects. Policymakers may need to decide whether the current pricing mechanisms of passenger rail access at incremental costs will lead to the most efficient use of public and private infrastructure assets.

Of course, it is also important to provide funding for intercity passenger rail service in a way that best assures that the taxpayers get their money's worth. The standard grant agreement relationship used by the Federal government to provide most financial assistance affords reasonable controls on and accountability by recipients. Properly used, grant agreements make clear what the public will get, when the public will get it, and what it will cost. Reasonable and workable financial controls are used. All aspects of the program are "in the sunshine" and audited. This is a prudent means of seeing that Federal funds are well spent and produce the benefits intended by the Administration and Congress. This kind of thorough financial planning is also mirrored in proposals in the Administration's surface transportation reauthorization, in which states are required to develop financial plans for Title 23 projects over \$100 million.

Let me now turn to freight. The Administration is keenly aware that freight mobility is as important as passenger mobility if we are to keep our economy vibrant. The Department's Freight Analysis Framework estimates that U.S. domestic freight tonnage, for all modes, will increase by 70 percent by 2020, and import/export freight will almost double. International trade now comprises over 25 percent of the U.S. Gross Domestic Product, and is expected to rise to one-third in less than 20 years. Ensuring that the U.S. is an efficient part of the global supply chain is critical, but it will become more and more of a challenge in the years ahead.

This challenge includes addressing the effects of our increased trade. The Federal Highway Administration's "2002 Conditions and Performance Report" finds the number of highway rail grade crossings on the Federal Aid highway system that carry more than 100 trains per day will more than double over the next 20 years, based on the Freight Analysis Framework projections. In particular, crossings near intermodal facilities, ports, major rail yards, and classification and switching areas will experience high train and truck traffic increases.

As a result, crossings will be closed to highway traffic for long periods of time each day. Coupled with expected increases in auto and truck traffic, highway delay is likely to increase significantly. The delay to motorists and pedestrians could reach unacceptable

levels in many communities, blocking emergency vehicles, disrupting local commerce, inconveniencing residents, and creating societal divisions.

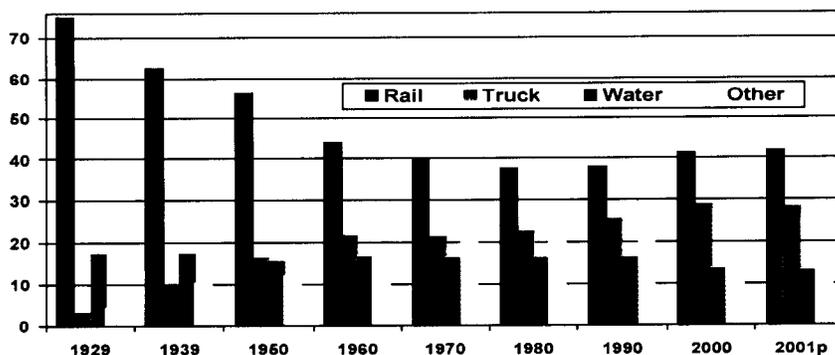
Annual hours of delay for autos could increase by between 35 million and 123 million hours in the next 20 years, depending on whether train traffic coincides with peak highway travel times. Likewise, trucks could spend an additional 4.9 to 6.6 million hours annually behind closed gates by 2022. The cost to highway users in lost time at the most heavily traveled crossings on the Federal-aid system would increase to between \$5.5 and \$7.8 billion over the next 20 years.

All parts of the transportation system – including freight rail – must work together if we are to meet that challenge. But we have to recognize that private companies, such as the railroads, cannot - and should not – be asked to make all the investments that will be necessary.

As this Committee knows full well, the railroad industry is the most capital intensive segment of the private transportation sector, and must put much of its own capital back into plant and equipment to run a safe, efficient and competitive system. In 2001, the Class I railroads spent nearly \$5.5 billion on capital expenditures – 16 percent of total operating revenue; over the last ten years, that figure has averaged \$5.6 billion annually.

The industry is in better financial condition today than in previous decades, having addressed serious structural problems, upgraded plant and facilities and taken advantage of technological improvements. Nevertheless, mode share, which has been declining since the early part of the last century, has been relatively flat in the past decade, as the following charts show:

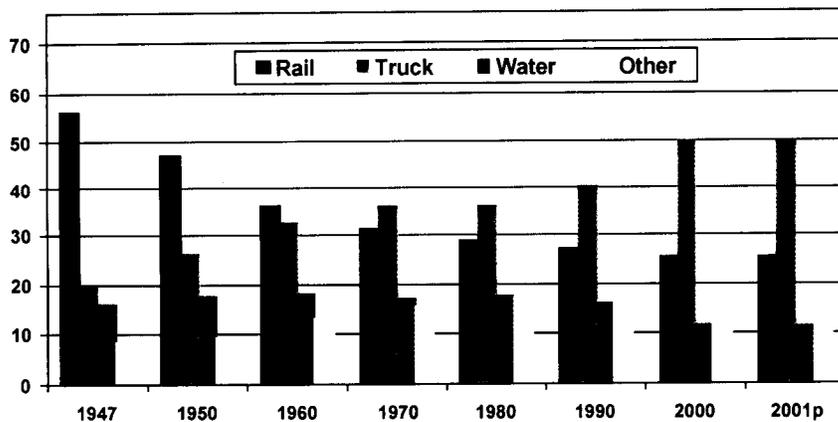
Share of Intercity Ton-Miles (%)



"Other" is predominantly pipelines

Source: Eno Transportation Foundation, "Transportation in America," various editions.

Share of Intercity Tons (%)



"Other" is predominantly pipelines

Source: Eno Transportation Foundation, "Transportation in America," various editions.

Wall Street analysts believe that the industry must proceed cautiously with new investments. According to Scott Flower, a respected railroad industry observer, "... managements within the mature and relatively slow-growth rail sector must carefully manage capital spending and allocation decisions to maximize free cash flow and returns on invested capital in order to maximize the relative performance of their equities.... we believe the rails must take a longer-term view toward improving operations and continuing their drive toward earning their cost of capital, the preeminent "holy grail" of the rail industry, in our opinion." ¹

Like any good business, railroads must be able to fund investments that will make the most sense for their operations and balance sheets, and meet their targets for internal rates of return. There can be significant benefits that accrue to society from rail and rail-related projects. However, neither railroads – nor their shippers, who, after all, provide their revenues - should be expected to pay for infrastructure projects that are driven by public, not private, benefits.

States and localities are recognizing that rail, as well as highways, plays a critical part in providing social and economic benefits². They also recognize that, to realize such benefits, projects to increase capacity and mitigate adverse affects must be undertaken jointly with the private sector if they are to come to fruition. The recently-announced agreement between the City of Chicago, the State of Illinois, the freight rail industry and Metra is a prime example of this type of partnership. When completed, the \$1.5 billion

¹ Citigroup Smith Barney "Industry Note", April 8, 2003.

² Many states realized this long ago with respect to short line rail service. Thirty small railroads in 18 states, with over 1300 miles of track, are government-owned.

project will result in five rail corridors, including one primarily for passenger trains; 25 new grade separations to improve safety and eliminate vehicular delays; and six rail-to-rail “flyovers” to separate freight and passenger trains. Additionally, the city will gain valuable real estate through the purchase of a rail line right-of-way. The agreement, a product of long and hard negotiations, will require the freight railroads and Metra to pay more than \$230 million towards the project. The public benefits are expected to reach \$500 million annually.

Another example of an ambitious public-private partnership is the Mid-Atlantic Rail Operations Study (MAROPS), a joint product of five states (Delaware, Maryland, New Jersey, Pennsylvania, and Virginia), the I-95 Corridor Coalition (representing these five states and eight others in the Northeast Corridor), and three railroads (Amtrak, CSX, and Norfolk Southern) to address rail infrastructure needs along the I-95 corridor.

The study identifies opportunities to better utilize the region’s existing rail assets; formulates a program of system-wide rail investments in all five states; and recommends a public-private partnership to fund and implement the improvements. Specifically, the study calls for a program of 71 infrastructure and information system improvements be implemented across the five states and the District of Columbia over the next 20 years to relieve these choke points. The rail improvements, while providing private benefits, also would help to relieve the pressure on the region’s highway system and meeting the region’s social, economic, and quality-of-life needs. The estimated cost of these improvements is \$6.2 billion.

There are examples of these types of projects, large and small, in all regions of the country. On a more general level, the American Association of State Highway and Transportation Officials (AASHTO), in their “Freight-Rail Bottom Line” report, indicates that public investment in selected rail projects could produce considerable savings, by eliminating the need for more costly investments in the highway system to meet coming demand. The report estimates that significant public investment in rail could produce very favorable benefit to cost ratios for the public sector, from lessened highway congestion, reduced need for maintenance and new construction and other factors.

All these projects have several things in common – they will require close cooperation between freight railroads, commuter railroads and the public to come to fruition; they have the potential to produce significant public benefits; and they all will require significant investment by all parties, commensurate with the benefits realized. Finally, there are no ready funding mechanisms available, although portions of the plans developed to date could be undertaken using existing programs.

This Administration has a strong record of support for innovative financing for surface transportation projects, as the recently introduced Safe, Accountable, Flexible, and Efficient Transportation Equity Act (“SAFETEA”) reauthorization proposal demonstrates. The Transportation Infrastructure Finance and Innovation Act (TIFIA) established a Federal credit assistance program that is already available for intercity rail

projects. SAFETEA proposes to expand the use of TIFIA credit assistance by broadening eligibilities to include private freight rail facilities and reducing the project size threshold for TIFIA projects to \$50 million from \$100 million. States would be allowed to impose user charges on federal-aid highways, including the Interstate System, provided that such charges were part of a program to relieve congestion and/or improve air quality. Transportation projects (highway facilities and surface freight transfer facilities) will be eligible for tax-exempt private activity bonds, exempted from a state's private activity ceilings, encouraging private operation of transportation projects. States will be given more freedom to use innovative project delivery methods such as design/build, which are often a key in setting fixed prices for projects to attract private investment.

One of the common threads in most innovative financing mechanisms for surface modes—state revenue bonds, toll roads, TIFIA, Grant Anticipation Revenue Vehicles—is that most of these financial instruments require repayment. Debt instruments used for transit and road construction either pledge dedicated tax revenues, dependable funding streams from Federal or state programs, or reasonably expected revenues from transportation facility users.

Various kinds of debt instruments are proposed from time to time to fund intercity passenger rail service. The Administration does not think dedicated debt instruments are suitable for this purpose. Unlike most other transportation debt financing mentioned above, intercity passenger rail does not generate adequate cash flows to service significant additional debt, nor is it supported by reasonably anticipated, long-term dedicated funding streams from the Federal government. We believe that there may be corridors in which passenger rail services can cover costs of operations and maintenance, but few corridors will generate revenues sufficient to provide adequate coverage beyond operating and maintenance expenses to repay interest and principal of debt raised for project capital costs.

There are a small number of public/private partnerships for freight rail in which public financing has been issued for the construction of a project that is then paid off with user fees by the railroads using the facilities. Some of these projects were undertaken within state legislative provisions and others have participated in federal innovative financing programs. In some discrete instances, railroads may choose to participate in publicly financed improvements where private sector financial participation makes financial sense. It does not necessarily follow from these limited examples that an across-the-board tax on rail shipments should fund a public investment pool.

There are also limitations on the utility of debt financing instruments for all freight rail companies. Hundreds of regional and short line freight rail companies are facing significant challenges with their infrastructure. Despite improvements already made in the operation of the FRA's Railroad Rehabilitation Improvement Financing ("RRIF") program (and those still to come), there are a number of companies who are not able to take advantage of a loan program, no matter how attractive its terms are. Nevertheless, we are dedicated to improving the operations of this financing program so that railroads interested in obtaining loans can get assistance in preparing high quality applications.

Let me also speak in general terms about tax credit bond financing, even though such matters are not our agency's primary responsibility (and are considered by tax-writing committees in Congress). Let me also say at the outset that this is not an approach that the Administration could support for either passenger or freight improvements. As an example of the concept, you may wish to learn more about Qualified Zone Academy Bonds (<http://www.ed.gov/offices/OESE/SST/qzab.html>), a program that offers limited amounts of tax credit bonds for equipment and rehabilitation of schools in empowerment zones and enterprise communities or schools serving a student population of which at least 35 percent are eligible for free or reduced-cost lunches. These are the only form of tax credit bonds currently allowed. This program, by limiting the total term of the bonds, currently to fifteen years, roughly splits the cost of a qualifying project in half. The federal government pays the interest (through tax credits) and the local school district repays the principal. The total size of the Qualified Zone Academy Bond program is limited to \$400 million per year in new issues, and only certain qualified buyers can purchase these bonds (lending institutions such as banks and insurance companies). These provisions limit the administrative complications and costs to the Treasury of these financial instruments.

If larger amounts of tax credit bonds are issued, the permitted holders of these bonds would likely have to be expanded to include, for example, individuals and mutual funds, thus making them much more complex and increasing the administrative burdens placed on the Internal Revenue Service. If longer terms of maturity are considered for intercity passenger rail purposes, then the overall exposure of the Treasury is increased relative to any matching funds from passenger revenues or state participation. If the tax credit debt is issued in an amount that not only covers capital costs but is also used to create sinking funds from which principal is eventually repaid as interest accrues in the sinking fund then the Treasury is effectively footing the entire bill for the capital costs. Further, because there is very little liquidity in the market for these bonds the market would impose a significant premium, thereby reducing the amount of actual funding and raising the effective costs to the taxpayers of using this funding mechanism compared to more traditional means. For these reasons, the Administration would oppose such a financing mechanism for rail, passenger or freight.

Thank you again for the opportunity to appear before this committee. I will be happy to respond to any questions you may have about my testimony.