Statement of John H Winner
President, Harral Winner Thompson Sharp Klein, Inc.

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Good day Mr. Chairman and members of the Committee. Thank you for inviting me to address the Committee regarding the future of Amtrak and of intercity rail passenger services in the United States. My name is John H Winner. I am president of Harral Winner Thompson Sharp Klein, Inc., a management consulting firm specializing in the rail industry. We have worked worldwide with commercial railways, transit authorities, transport industry investors, industry suppliers, financial institutions, and governments on strategic, financial, and operational issues related to rail transportation. I have over 30 years experience in the rail industry and have managed rail passenger and freight assignments all over the world. My work has taken me to many countries in Western, Central and Eastern Europe, South America, the Asia-Pacific region, the former Soviet Union, the United Kingdom, Canada, and, of course, the United States.

I want to state at the start of my testimony that I believe that both freight and passenger rail transportation are vital to the US economy. I use Amtrak's northeast corridor services regularly. It has been my experience, as a passenger, that Amtrak's Acela service is excellent. It provides what an intercity rail passenger service should—comfort, speedy service, reduced congestion and air pollution, safety, convenient mobility. Such services have the potential to reduce the need for more public investment in highways and airports.

The Committee has asked me whether there are alternatives to the existing structure of intercity passenger services in the United States and whether there are private companies willing and able to operate such services. The short answer to these questions is "yes." One need not even look outside the United States to see some of these alternatives: state and local governments have pursued many different ways to provide commuter services using a wide range of public and private service providers. Beyond the United States, we find a variety of approaches to providing intercity passenger rail services—some relying on private companies and some using state entities. In Europe, in particular, governments are facing the increasing costs of rail passenger transport by adopting new methods and structures to provide rail passenger services through private enterprise in a competitive framework.

Many private companies have the experience and skill needed to operate intercity passenger trains.

- In North America, all major railroads (CSX, BNSF, UP, NS, KCS, CN, CP), multi-billion-dollar enterprises operating thousands of trains each day, are more than qualified private sector operators. Some of them already operate commuter services.
- Connex, a subsidiary of Vivendi, is one of the largest private passenger transport groups in the world with some 30,000 employees and annual revenue of some $2.5 billion. Connex-US is part of a consortium that has recently won a bid to operate commuter services in Boston.
- VIA GTI is the largest urban passenger transport supplier in France and provides urban and suburban rail passenger services throughout Europe.

- National Express Group, which employs about 30,000 and has annual revenue of more than $2 billion, operates part of the EuroStar TGV service, intercity passenger services in the UK, urban and commuter services in Australia, and has bus operations in the US.
- FirstGroup, with some 45,000 employees and $2 billion in revenue, operates intercity, urban and suburban services internationally.
- Ariva, with 15,000 staff and revenue of about $2 billion, provides intercity and suburban services in the UK and The Netherlands.
- Stagecoach, with 32,000 employees and more than $2 billion in revenue, operates intercity services in the UK and has rail equipment leasing operations.
- Throughout the world, many other private companies provide intercity train services.

Together these companies operate thousands of trains each day. I am certain that many of them, given an opportunity to operate profitably, would be willing and able to provide intercity train services in the United States.

This does not imply that all, or even *any*, US intercity passenger trains can be operated without government support. Indeed, very few intercity rail passenger services are privately operated and financed. But, public support of *privately provided* goods and services is common in market economies. Many public services are provided by private companies operating at a profit, including garbage collection, highway maintenance, sewer and water services, toll roads, air traffic control, and commuter-rail services. Private companies provide security services, build F-16s, build and operate mass-transit systems, and provide a wide range of other products and services that are often not profitable without the government as a customer. Public funding and private operation of intercity rail passenger services should not be considered unusual.

Americans commonly ask: "Why can't the United States have the kinds of trains they have in Europe?" They are often surprised to find that many European train services are provided by private companies. They would probably be surprised to find that European governments are working desperately to introduce private sector participation in intercity rail and freight services as a means to control costs, increase rail market share, and increase the use of private capital in financing intercity rail services. They might also be surprised to find out how much European taxpayers pay to subsidize intercity rail services and the infrastructure over which they operate.

One would think that in the United States, the home of free-enterprise and the largest market economy in the world, private enterprise would be the preferred method for providing public services where economically feasible.

Private Operation of Intercity Passenger Trains

Intercity rail passenger services require a number of different activities—developing schedules, determining the price of a ticket, marketing and advertising the service, taking reservations, providing equipment, operating stations, providing on-board staff, driving the train, cleaning and repairing stations and rolling stock, etc. Private train services can separate and group these activities many different ways. Private participation is often improperly lumped under the term "privatization," but should generally be categorized across a range encompassing contracting, franchising, and privatization. The differences between categories may be defined by how many activities are performed by the private sector. Here is how I would define the activities within these categories.

Contracting

In contracting, a private company is hired to perform some of the activities associated with providing public services, such as providing drivers, on-board staff, and perhaps station staff. Typically, scheduling, reservations, marketing, advertising, and most asset ownership remain with the government agency.

Usually, the service has an image which is separate from that of the operator and managed by the government agency. A contractor typically operates the train, provides and manages on-board and station staff, and may be responsible for cleaning stations and rolling stock, servicing equipment, collecting ticket revenue, and, perhaps managing some customer service functions (lost and found, help, complaints, etc). An operating contract covering these kinds of functions is typically short term—say two to four years. The length of the contract depends on startup costs such as employee recruitment, training, and any equipment or facilities needed. Contracts with larger startup costs are typically let for longer periods.

Contracts are competitively bid and the government agency pays the contractor for providing the specified services, so a low bid generally wins. A contractor generally takes on only limited ridership and transportation revenue risk. It is not being asked to build the service, just to operate it properly. Examples of contracting include Herzog's operation of the Trinity Railway Express in Dallas, and the operation of MBTA commuter services by Connex in Boston.

Franchising

Franchising usually means that a private company provides operating services like a contractor, but also provides and manages more of the soft aspects of train service—scheduling (though a minimum schedule may be specified in the franchise agreement), marketing and branding, advertising, additional customer service functions, station appearance, perhaps reservations, and the condition of rolling stock. The government agency retains overall ownership of the "right" to provide rail passenger services. In many cases, a franchise operator has some ability to set prices, if only for premium services. In some cases, the franchise will include a requirement to make some capital investment—rehabilitating stations, modernizing rolling stock, maybe even provide new rolling stock. A private franchise operator takes not only the risks associated with operating the service, as does a contractor, but also takes ridership and revenue risks, and the risks associated with investments.

Franchising usually has higher startup costs, more investments, and involves greater risks than contracting, so the length of franchise is likely to be longer. Generally, the greater the investment required, the longer the franchise term. In the UK, franchises are typically for seven years, with options for negotiated two-to four-year extensions. In some cases, where the capital investment requirements were high, the franchise term has been longer—15 to 50 years. Some franchises have been sold; companies have actually paid governments for franchise rights. But often the franchise bid is negative—the franchise operator is paid to develop and operate the franchise.

UK train services, commuter and long-distance train services in Argentina are examples of franchising of train services.

Privatization

Privatization usually means that all or most aspects of an intercity passenger service are sold, including the "right" to define and provide the service and to determine the prices charged. The private operator has all the rights, obligations, and risks of any other private business,

including the ability to fail or to make a lot of money. A private company usually must buy (or lease) the rolling stock necessary to provide services and has to arrange for access to, or ownership of stations, and all the other infrastructure needed. There is usually no guaranteed government payment for privatized intercity passenger service although private companies do contract with government entities to provide some services that are not commercially viable.

Examples of privatization of long-distance passenger trains include the sale of intercity passenger services in Australia; The Ghan, and Indian Pacific trains are the most notable. In this case, only the services and equipment were sold, not the infrastructure. The Japanese National Railway was privatized in three vertically-integrated passenger services. The privatization process was quite complex and involved settlements with excess staff and transfer of prior debt. The three Japanese private rail passenger companies currently operate profitably.

There is room for a lot of overlap between these categories. In the case of Amtrak, the most likely alternatives fall between contracting and franchising. Amtrak's intercity passenger services are unlikely to be privatized—they lose too much money—although Amtrak could be liquidated, its assets sold and government could buy-in whatever passenger services it determined were in the public interest.[1]

Why Involve Private Service Providers

Amtrak is a private corporation under the current statute (but it is largely, though not entirely government owned). It is charged with operating intercity passenger services. It is considered by some to be a failure, by others to be the last chance for intercity rail passenger services. Over Amtrak's life, it has received some $26 billion in subsidies. Many are concerned that the subsidy has not been well spent.

Several proposals for reforming or changing Amtrak have been discussed. The Amtrak Reform Council (ARC), in a study authorized by Congress, published a comprehensive plan last year. Most reform proposals seek to obtain greater value-for-money from intercity rail passenger subsidies. Rather than discuss all the potential reform methodologies here, I will limit my discussion to the use of private companies to provide such services.

Many benefits arise from the involvement of the private sector in intercity rail transport. Generally, as the use of private companies moves from simple contracting towards franchising, more activities come under competitive pressures and the benefits increase. These benefits do have real impacts. Using private operators to replace Amtrak operation of some or all of its services could have these benefits:

Greater Transparency

Competitive tendering provides transparent determination of train costs. The most uneconomic services are easily identified and eliminated, reducing subsidy costs. This usually results in better choices about what services to provide and often a better split of payment responsibility between customers, and local, state and federal governments.

[1] Many questions arise about what happens to Amtrak's operating rights on private freight railroads in this case. It should be noted that many state governments and local communities have negotiated access arrangements with private freight railroads for the operation of commuter services without recourse to Amtrak's rights.

Improved Service Quality
Private companies are usually more sensitive to market and customer requirements. Service quality and ridership typically increases. Ridership increases in the UK were significant (up by about 36% since the start of reforms) after decades of decline.

Improved Productivity and Reduced Costs
Competition tends to drive down costs. Increased patronage on the best services, elimination of the worst services, better use of assets and resources, and the use of fewer and less expensive employees all tend to reduce costs and increase productivity. On average, cost reductions of around 20% from all sources are typical, but results vary greatly. Productivity improvements are generally greater, in the range of 35 to 40%.

Improved Safety
Contrary to popular perception, safety is not typically sacrificed as private companies become involved in passenger train services. Private train service providers are usually under increased safety scrutiny and are at least partially privately insured for many safety-related issues—so a lack of safety costs them money. In the UK, notwithstanding the adverse publicity from a few major accidents, rail passenger safety has improved by a factor of three since reforms in 1994; UK rail services are now among the safest in Europe. Safety improvements have also been recorded in Japan and Australia.

Increased Use of Private Capital
Finally, longer-term agreements (either contract or franchise) permit greater use of private capital for providing assets for passenger services, particularly rolling stock. Debt associated with such assets is taken on by private companies and investors, rather than by government.

What Problems Might Arise?

US intercity rail passenger services are operated in a very complex environment with many stakeholders and competing interests. While there are many benefits from greater involvement of the private sector, some difficulties are also likely:

Labor Dislocations
Competition for contracts and franchises will improve the productivity of intercity passenger services. Work rules are likely to be different; wage rates for some activities may be lower. Unless passenger services are increased, fewer employees will be required. Employees and railway labor unions are likely to resist, disrupting service and reducing ridership. Many governments have acted to reduce the impact of outsourcing on employees by guaranteeing incomes for existing employees. Such guarantees can be expensive.

Increased Railroad Retirement Costs
Amtrak and its employees participate in the railroad retirement program, the special rail industry version of social security. The program is already considerably more expensive than social security for employers. A significant reduction in the number of employees involved in passenger services would increase the contributions needed from private railroads. Private railroads would likely want to be relieved of these increased costs.

Increased Complexity in Managing Infrastructure
The operation of rail services is a complex business involving thousands of delicate tradeoffs between investments and operating decisions and day-to-day management of the balance. Coordinating the business is difficult (as evidenced by the trouble the industry had in absorbing mergers and dealing with weather-related problems). While some rail lines already

have multiple operators, additional *new* operators could further complicate operations, disrupt freight services, and cause harm to railroads and the public. Individual rail freight carriers may seek some assurances that they would not have to deal with many different private operators. This could complicate competitive bidding practices.

Limited Infrastructure Capacity

Since deregulation in 1980, private freight railroads have worked diligently to match assets and operating costs to business levels, but they continue to have had difficulty earning their cost of capital and attracting investors. One result is significant pressure to reduce railroad investments. On many railway lines, available capacity is closely matched to the amount of traffic. One of the expected benefits of using private companies to operate passenger services is to make those services more attractive, thus increasing intercity passenger traffic. But, some railway lines will not have sufficient capacity to permit additional passenger trains without affecting freight services. An increase in the number of passenger trains should be accompanied by offsetting investment to increase line capacity or freight service will deteriorate.

Potential Challenge to Property Rights of Infrastructure Owners

Private railroad companies are concerned about being required to permit additional operators on infrastructure they have built and maintain for their own services. There is concern that the precedent of being forced to give a private operator access to their infrastructure will reduce their ability to prohibit others from accessing their lines. The ability to control access to their private network is essential to maintaining profitability. This problem should be addressed if private railroads are to agree to private operation of passenger services across their lines.

Liability Issues

Currently, Amtrak indemnifies private railroads from some of the significant liabilities associated with the operation of intercity passenger trains. Any use of private operators should address these liability issues.

Disintegration of Network

Introducing a number of private companies into the national rail passenger system, either as contractors or as franchise operators, could make development and coordination of an integrated national network difficult. Setting up contracts for and coordinating services between many operators is a difficult task. Such a system can sacrifice flexibility in many ways (for example, moving equipment between services, now quite easy, is more difficult when it must be negotiated between private operators). If an integrated national network is desired, a national reservation system should be maintained (though that, too, can be contracted) and a government body responsible for developing strategy and planning is likely to be necessary.

Should Amtrak Be Changed?

Amtrak has changed greatly since its founding in 1971. While it has met its objective of lifting the burden of passenger losses from freight railroads, it has also required more than $26 billion in government subsidies. Amtrak covers only about 70% of its operating costs from revenue. In the future, many of its rolling stock assets must be replaced and northeast corridor infrastructure must be renewed and upgraded to take advantage of the high-speed train technology used in Acela services. The investment needed to maintain and renew Amtrak's assets will be significant—billions of dollars. Currently, too little money pays for too many services and too little infrastructure investment. Amtrak, with its current structure, cannot fix these problems. In

fact, Amtrak's monopoly on intercity rail passenger services often blocks creative solutions sought by state and local governments.

Faced with burgeoning financial requirements, the Committee has wisely decided to reexamine US passenger rail service, including what services should be provided, how they should be funded, and how they should be provided. I have outlined options for providing passenger service. A range of viable alternatives to Amtrak current structure are used in the US for commuter rail services and internationally for a full range of metro, commuter and intercity rail services. I have also shown that many companies including Connex, Herzog, and some US freight operators already provide some passenger rail services. Many other firms are active in Europe, Australia and other parts of the world.

The Committee has a choice between trying to improve the efficiency of Amtrak within the current structure, or adopting a new structure that harnesses private enterprise and competition to a greater degree. The private enterprise/competition alternative has the potential for significant cost savings and better customer service. But, by increasing transparency and removing many decisions from the political sphere, it would likely spark changes that have political as well as economic consequences. Key among these are the potential for reduced employment in the intercity passenger rail sector, and increased complexity in interactions with private railroads. The "improve-Amtrak" alternative would give government greater control over politically-charged issues such as railway employment and route adjustments but would have less potential for efficiency improvement.

Amtrak was designed in the last century on the model of a European-style monopoly state railroad. It would not be designed the same way now. Many governments have come to realize that private sector participation in intercity rail services can have great benefits. Today, even European governments are reforming their monopoly state-owned rail systems and introducing competition in an effort to improve rail market share and productivity, and to reduce the demand on public resources.

Reform of Amtrak is overdue. The recommendations for restructuring Amtrak developed by ARC are certainly a place to start, along with the similar approach outlined today by Deputy Transportation Secretary Jackson. More rapid involvement of the private sector is a reasonable course of action.

One thing is certain: if you wish to rely on the private sector to own and operate intercity rail passenger services, many private companies will be interested in participating.

Questions for Mr. Winner
from the Committee On
Commerce, Science & Transportation
Amtrak Reauthorization Hearing

Tuesday, April 29, 2003

1. *Having listened to the testimony of Deputy Secretary Jackson, how would you characterize the Administration's plan in terms of the categories of contracting, franchising, and privatization you discuss in your written statement?*

Deputy Secretary Jackson described reforms that, if implemented, would allow all forms of private sector participation described in my testimony to be applied to intercity passenger services.

As I understand Mr. Jackson's testimony, over a six-year reform period, a part of Amtrak would be restructured into a train operating company. As an operator, Amtrak would obtain contracts for the operation of intercity trains from States and Regional Rail Operating Companies. At some point, these contracts would be opened to competitive bidding, introducing the competition for contracts discussed in my testimony.

From the Deputy Secretary's description, the Administration's vision of the future intercity passenger train environment would allow some named long-distance trains (*e.g.*, the Coast Starlight) and high-speed services to be franchised. Under franchising, train services are more closely matched to market demands since the franchise operator assumes some revenue risk. Typically, franchising reduces subsidy requirements. If franchise agreements are long enough, improved, upgraded, or even new rolling stock can be financed by private sector franchise operators.

Once Amtrak gains experience as a train operating company, it could be privatized to compete with other train operating companies for intercity, suburban, and metro operating contracts and franchise opportunities.

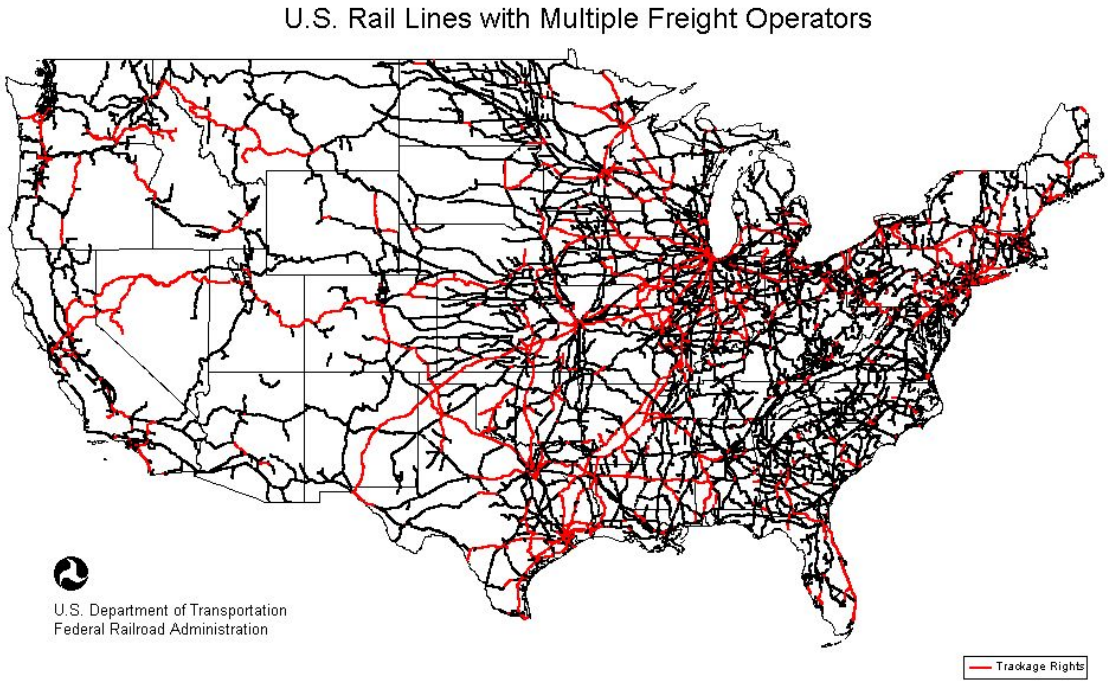
Do you think the Administration has thought through all of the critical issues for instituting reform?

Reform of intercity rail passenger services in the United States will be a complex undertaking. Developing a system that encourages local and state participation, introduces competition, and deals effectively with the problems that might arise with increased private participation will be very difficult.

It is unlikely that anyone could foresee all the problems that may arise. But that should not be an excuse for delay. The framework described by Deputy Secretary Jackson is a reasonable place to start.

2. *In your testimony, you discuss some of the challenges to be faced in transitioning to a new model for passenger rail service. One area in particular that you highlight is the problems that will be faced by infrastructure owners in dealing with multiple operators on their rail lines. While the prospects of problems are real, in your opinion are they insurmountable?*

The problems associated with multiple operators on rail lines are well known to the rail industry. There are many privately-owned rail lines with multiple operators. The map below shows, in red, US rail lines with multiple freight operators as recorded by the Federal Railway Administration in 2002.



The red lines represent about 20% of the rail network in the United States. On some red lines there are several operators—more than two, sometimes four or more. Clearly, having multiple rail operators on a rail line is not unusual. Private railroads have been negotiating access rights to track for a long time.

However, high-speed, high-priority passenger trains consume a lot of rail line capacity and many lines are near capacity. As new passenger trains are introduced, given a higher priority, or their speed increased above that of other trains on the line, some investment in line capacity is likely to be required. Investments and train schedules should be the subjects of negotiations with infrastructure owners.

What steps could be taken by Congress in restructuring passenger rail service in the United States to minimize the disruption to other rail operations?

Identifying and planning for mechanisms to deal with operating companies' access to insurance, resolution of capacity limitations and commercial conflicts, the effect of reforms on railway retirement, labor issues, and liability claims will be necessary to minimize disruption.

3. *Are these same problems faced when new commuter operators enter the market, and if so, how do the freight railroads deal with them in that context?*

The commuter rail passenger services market is the fastest growing area of rail passenger services in the United States. New commuter services are being implemented with many different arrangements. Some of the problems discussed above must be faced when new commuter operators start service.

Most expansion of commuter rail services has occurred over the infrastructure of private railroads. The parties have freely negotiated terms that are mutually satisfactory and services have expanded as a result. Some private railroads have shifted operations and sold infrastructure for commuter rail passenger services to local authorities. Others have reached agreements covering service conditions, investments, and liability protections and codified these agreements into commercial contracts.

On the other hand, in a commuter operation, the scope of problems is limited to a region or a relatively short stretch of line. Railway retirement is not usually an issue; the use of an operator, other than the infrastructure owner or Amtrak, is often not considered; and the role of operator is often not subject to bid. Clarification of the role of Amtrak, ownership of Amtrak's right-of-access, labor and retirement payments, and insurance and liability issues would ease the formation of new commuter and intercity routes.

4. *What do you believe are the next steps to take regarding Amtrak's future and that of intercity passenger rail in the United States?*

Legislation to restructure Amtrak will need to address train operations, asset ownership, access to intercity rail markets, accounting systems, and infrastructure management. Amtrak's board could take some of these steps today. It should create an accounting structure and system that clearly identifies operating costs by train service, and separates infrastructure operating and renewal costs from train operating costs. It should also form an infrastructure subsidiary to manage ownership of the northeast corridor property.

5. *How long do you expect restructuring to take?*

The restructuring process is likely to take six to 10 years, during which time the restructuring process will continue to evolve and conditions will change. It is likely that legislation will need to be modified as the process proceeds; that is the typical experience in the restructuring of complex public entities.

6. *Can you describe how restructuring has been implemented in other countries?*

Books have been written about railway restructuring in other companies; I have spent the last 25 years helping governments restructure rail industries. So it is difficult to describe briefly how passenger rail restructuring has been implemented in other countries. Governments all over the world have already, are now, or are planning to restructure their state-owned rail systems. Each country has taken a unique approach, tailored to its own particular circumstances. Some examples:

Europe

In most of Europe, freight and passenger services lose significant amounts of money. Each EU country is using a different approach to restructuring, but the effect of all approaches is to increase competition and break up integrated state rail enterprises. Countries of the European Union are in the throes of reform and have been since the mid 1990s. The EU has

taken a deliberate approach and agreements have been difficult to achieve between countries with private railroads (*e.g.,* Switzerland) and those with a tradition of strong state support for state-owned railroads (*e.g.,* France and Germany). The EU has required at least accounting separation of rail operations from infrastructure as a means to improve transparency. Most national railways are being restructured along lines of business—infrastructure, intercity passenger, local passenger, and freight. Once-large engineering and maintenance departments are being separated and privatized; many engineering services are now contracted in. Operation of local and regional passenger trains is increasingly contracted or franchised to private operators. Rail freight transport is on the cusp of significant restructuring as new EU competition laws require access to state-owned infrastructure for any EU-approved rail service provider.

For example, in France, the government moved rail infrastructure and almost all debt from the French national railway (SNCF) to the newly-formed French Railways Infrastructure Authority (RFF) in 1997. Between 1997 and December 2001, debt had climbed to nearly $40 billion and some resolution was needed. The French government formed the High Council on Railway Public Service (CSSPF) to control the development and evolution of the rail sector and provide recommendations for resolution. In January, 2002, the government transferred responsibility for planning and financing local passenger transport to regional authorities. EU competition policy requires that contracts for local service must be competitively bid. Outsourcing of local services is set to increase, and freight services will be subject to competition from other rail operators. Railway labor unions have objected to the split of SNCF operations and infrastructure and caused significant unrest. Conventional intercity passenger ridership and rail freight traffic have dropped significantly in response to increased unreliability. SNCF and RFF are both under significant and increasing financial pressure. Thus, the ultimate fate of restructuring in France has yet to be decided.

The German National Railway, the DB, was established as a private-sector company in 1994. In the process, it separated infrastructure from transport organizations (with DB AG as a holding company), opened the rail network to third parties with payment of trackage charges, made the federal government responsible for rail infrastructure investment, and transferred the responsibility for suburban passenger transport to the states. These reforms have had some salutary effects on costs: DB employment declined by 30% and many light density lines were closed. Suburban and commuter service patronage has increased 33%. But despite a full-cost road pricing scheme for German motorways and higher fuel prices, financial performance of the holding company has deteriorated and further reform will be necessary.

The restructuring process in Europe has been underway for many years and it is likely to take many more years. As European rail systems become more market oriented, restructuring is likely to continue in a long process of creative destruction characteristic of market economies.

The UK

Much has been discussed about the complex railroad restructuring process that has taken place in the United Kingdom. The British government ended a moribund vertically-integrated state monopoly rail system by privatizing the entire system. The process was complex and fraught with difficulty; some of the problems have been well reported. However, good aspects of the restructuring process are often overlooked. These include stimulation of rail services—passenger ridership is up more than 36% over the reform period; the number and kinds of passenger services offered has doubled; an increase of more than 42% in freight traffic; and a significant increase in private investment in rolling stock. A

little-noted feature of the reform of British Rail is that rail passenger safety has improved by more than a factor of three.

While the UK reforms were criticized as being overly complex, they were bold and have been successful in many ways. The government is taking new steps to adapt regulations and reforms to changing conditions and to weaknesses in the original restructuring process, but it is *not* re-nationalizing rail services. One of the characteristics of rail reform in most countries is that restructuring processes must be adjusted over time to take into account new issues that arise in a now-dynamic rail industry. Dynamic change was not a characteristic of the industry before reforms.

Latin America

Rail restructuring has also been proceeding for many years in Latin America. While most Latin American railroads were built by private enterprises, during the 1960s virtually all were nationalized. By the beginning of the 1990s, nearly all state-owned Latin American railroads had fallen on hard times, with track in bad condition, rolling stock out of service and poorly maintained, and rail freight and passenger services spiraling downward. At the same time, government subsidy requirements were spiraling ever upward.

With high deficits, growing demand for public monies, and limited availability of public funds, restructuring was the only mechanism remaining to sort out railway problems. While restructuring has been different in each country, most countries have used contracting, franchising, and privatization as restructuring mechanisms. By the beginning of the new millennium, there were *no* significant publicly-operated freight railroads remaining in Latin America and many suburban passenger railways and metros had also been transferred to private operation.[2]

Japan

The largest rail industry restructuring occurred in Japan with the breakup and partial privatization of the old Japanese National Railways (JNR). The deterioration of JNR did not occur suddenly; there were at least six attempts to reform JNR since 1964. It is difficult to summarize the complex transitions that took place, but some $200 billion in debt was transferred to a government Settlements Corporation, along with excess staff. Three major rail passenger corporations, JR East, JR Central, and JR West, were established and privatized.

Since privatization, the three companies have been generally profitable. Labor productivity has trebled (and is now about five times the comparable labor output of EU railways), fares have been stable, and government subsidies have been transformed from payments of about $5 billion annually to positive income of some $3 billion a year in tax payments from the private companies. Investment in infrastructure and rolling stock has continued to grow while service quality and reliability has improved significantly.

In sum, restructuring is a complex, multi-year process. World experience shows that many different restructuring methods can work and that all forms of contracting, concessions, and privatization are useful means to accomplish restructuring. World experience also shows that publicly-owned monolithic and monopoly railways operating behind government-constructed barriers to competition are a recipe for the demise of rail services.

[2] "*Changing Railway Structure and Ownership: Is Anything Working*," Louis S. Thompson, Railways Adviser, The World Bank. 2002

Questions for Mr. Winner
From Senator Ernest F. Hollings
For The Committee On Commerce, Science & Transportation
Amtrak Reauthorization Hearing

Tuesday, April 29, 2003

1. *In your testimony, you propose that certain sectors of the passenger rail industry could be franchised as a form of privatization. Franchises could run the gamut, from franchises to market passenger rail to larger franchises to rehabilitate stations or modernize rolling stock. Franchises call for higher start-up costs and greater risks, but the franchisee stands to make more money if it is successful. You note that the UK franchised train services. When the UK tried to wean its rail franchisees from huge government subsidies, the franchisees were forced to make operating cuts that led to customer dissatisfaction. Several franchisees went bankrupt. The franchises were transferred to other companies, but with a substantial increase in subsidy level. Today, the number of franchisees has been cut by half, and passenger rail service in the UK requires a higher level of government support after privatization than before. In the state of Victoria, Australia, three of five passenger rail franchisees have been abandoned because of financial losses. In Argentina, when the national government withdrew all subsidies, no private company stepped in to provide passenger rail service because it could not be profitable without subsidies. Passenger rail service disappeared in Argentina.*

   With the background knowledge of so many franchise failures in other countries, one has to question the motivation of a private entity seeking to enter the rail passenger business as a franchisee. Is it because it genuinely expects to earn a profit due to its stellar management and efficiency, or because it expects to benefit from a significant government subsidy that will roll in year after year regardless of the entity's management abilities?

Franchising is one of several methods that may be used to involve the private sector in providing intercity rail passenger services. Private companies will participate if they have an opportunity to earn a return on their investment of capital and labor; returns expected would be related to the level of risk. Since intercity rail passenger services can rarely be operated profitably (including investments for rolling stock and infrastructure), it is unlikely that any intercity rail passenger services would be offered in the United States if there were no payments from government entities or agencies.

The U.K. railway restructuring process was very complex and will be debated for a long time. Franchising involves risks and some U.K. franchises failed. Even so, many of the outcomes of that restructuring have been very good. Intercity rail passenger travel grew about 36%, freight services grew 50%, the number of daily trains nearly doubled, stations were improved, subsidies declined by £200-300 million a year for over four years, there was a surge of new *private* investment in rail passenger rolling stock, and rail safety improved considerably. On the other hand, the increase in daily train services resulted in a shortage of qualified staff and congestion on the rail network, and increased congestion caused deterioration of on-time performance. Today's higher government payments for rail services in the U.K. are primarily for infrastructure investments necessitated by underinvestment in the past, the need for new capacity, and promised line upgrades.

Franchising in Argentina was successful in helping to restructure a rail system consistently costing the government more than $1 billion a year while producing little transport output for the economy. That loss was replaced by income from freight concessions and taxes paid by

franchise operators, and a limited and defined subsidy payment for passenger services. As a result of restructuring, commuter ridership soared, freight transport increased for the first time in decades, and private investment poured into rail rolling stock and infrastructure. Intercity rail passenger services were not contracted, franchised, or otherwise subsidized by the national government; states elected not to subsidize them either. Therefore, intercity passenger services ceased. When the economy of Argentina collapsed recently, all companies were adversely affected, many closed—some rail franchises were among them. When a franchise fails, the franchised assets return to the government.

A bidding process for franchises would likely foster competition between private companies to win the bid. However, what about the franchise system would generate competition once the contracts are all awarded?

In most places franchises are awarded in a competitive bidding process and competition arises during the bidding process. If there is only one franchise, once the franchise is awarded, there is no further competition between franchise operators until the end of the franchise. If there are multiple franchises, there is usually a great deal of competition between operators to improve performance of their underlying franchise. Most franchise contracts are written with performance targets and bonuses for improved schedule performance, reduced customer complaints, increased ridership, and other measures. Most rail passenger services also have a great deal of competition from other modes—automobile, air, and bus. In fact, it was the rise of inexpensive and convenient highway and air travel that ultimately made intercity rail services unprofitable.

Wouldn't franchising a certain segment of the rail passenger industry to a private entity just be, in effect, exchanging one monopoly (Amtrak) for another?

A franchise is not likely to become a monopoly for several reasons. First, the term of a franchise is limited and there is competition for the franchise each time the term is up. Second, performance criteria are usually written into a franchise agreement. An operator who does not meet those criteria loses the franchise. If a franchise operator does a poor job, or goes out of business, the assets revert to the government and the franchise can be awarded again.

Contrast this with the present situation. Under existing law, Amtrak's franchise is never up—it is a monopoly. If Amtrak does a poor job, there is not much that the government can do about it.

Contracting and franchising are more flexible than government ownership. The process is usually not politicized and operator changes occur as a part of a natural process. Franchise periods vary, depending upon the investment required (investments may be for equipment, station improvements, or for branding and advertising). Some are two to three years; others, which have larger investment requirements, are for longer periods—say, seven to ten years.

Finally, there is usually a lot of competition for rail passenger transportation services; automobiles, buses, airlines, carpools, and even taxis compete with rail transportation. Most franchise agreements give the operator an incentive to increase ridership, usually by improving customer service. So, even if a single franchisor has a de-facto rail monopoly for some period of time, it must still create a loyal customer base and compete with other transport modes. Amtrak has done this in some places, particularly the northeast corridor. Yet, even here, where Amtrak has its greatest market power, it commands only about 35% of the market between Washington and New York, hardly a monopoly.

2. *You say that in North America, all of the major freight railroads are qualified to be private-sector operators. I cannot argue with that statement; but it is also a fact that Amtrak, a government-operated national passenger rail system, was created 30 years ago precisely because these freight railroads did not want to engage in the passenger rail business.*

When Amtrak was created, the nation's railroads were in financial distress. Many had gone bankrupt or were on the verge of bankruptcy, particularly in the eastern part of the United States. Private railroads had been required to provide passenger services for many years under a regulatory system that encouraged cross-subsidization of rail passenger services by rail freight services. However, competition from trucking, boosted by completion of the interstate highway system and deregulation, greatly reduced the ability of private railroads to charge freight prices high enough to continue cross-subsidies. Privately-owned railroads could not continue to engage in a money-losing passenger rail business.

Amtrak was created to relieve railroads of this burden. Railroads made significant contributions of capital and equipment to start Amtrak in exchange for relief from passenger transport losses. It is through these investments that many private freight railroads continue to be minority shareholders in Amtrak.

Do you know of any specific major U.S. freight railroads that have expressed an interest in operating passenger rail in this country?

Several U.S. freight railroads currently operate rail passenger trains. These services are almost all commuter or suburban services in major cities and are operated under contract for local transit authorities. In the past, at least one U.S. freight railroad was involved as an operator of commuter services in Buenos Aires, Argentina. Some freight railroads have indicated that they would want to operate passenger trains that travel over their rail lines should Amtrak fail.

3. *You specifically mentioned particular private entities that you believe are good examples of rail privatization that has worked, including Connex, National Express, and Arriva. In fact, Connex was the first rail company in the British system to be stripped of its franchise because of long delays, dirty trains, and other operational problems. The British government wound up bailing out the rail operator to the tune of 58 million pounds. Similarly, the British government had to raise 115 million pounds ($165M) to bail out another private rail operator you mentioned, National Express, that was facing crippling losses and projected little chance of ever returning a profit by the end of its franchise. Arriva, which you cite as being staffed with 15,000 employees, was forced to cut 160 trains in Britain because of problems it had with recruiting and retaining train operators.*

With so many demonstrated failures in other countries, what would make you think that somehow the experience would be different in the United States?

Franchising has worked very well in many markets; there are more successful train operating companies in the U.K. than failures. Franchise operations in Argentina worked well until the collapse of the economy. Experience with private operation of rail passenger services throughout much of Europe has been positive. Private operation of passenger and freight services has been expanding successfully throughout the world and there are now a number of large international operators with a great deal of experience.

Under the proposals that have been discussed, a rail operating company arising from within Amtrak would also compete in the market. Further, there are a number of U.S. rail companies with a great deal of experience operating successful train services. With the world's largest market-based economy; experience in contract, franchise, and private operation of train services; a fully developed legal and contract system; and many private railroads, the U.S. has the right environment for any effort to inject private participation into intercity rail passenger services.

When rail markets in the U.K. were restructured, no private rail operating companies existed in that market. Government-owned British Rail had a monopoly on both passenger and freight rail services, so a competitive market had to grow from scratch. Given the much greater experience with privately-operated rail services in the U.S. and the number of different operators already in the U.S. market, contracting for rail operating services and franchising rail operations is more likely to be successful here than in other markets.

4. *Japan's privatization of passenger rail service is touted as one of the best-managed railroad transportation systems in the world, but it began with a $300 billion investment by the Japanese government. Although Japan is about the size of California, $300 billion represents well over 11 times the amount spent by the U.S. on supporting Amtrak in the past 30 years. Today, Amtrak is $5 billion in debt and has $6 billion in backlog of state-of-good repair investments.*

   If $300 billion were invested in Amtrak's infrastructure and operations, do you think the railroad could then be profitable?

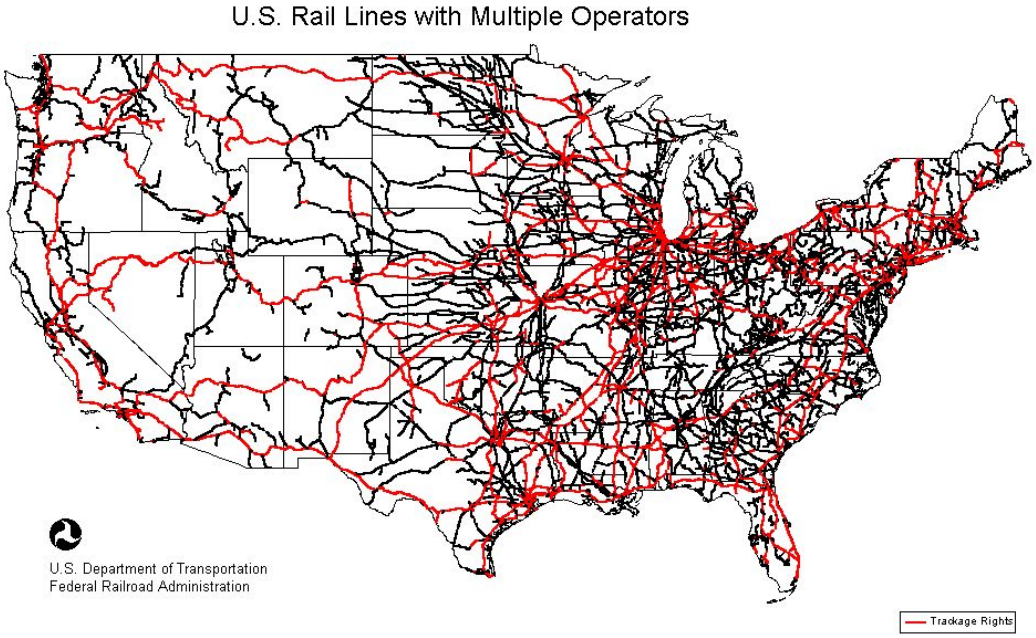
The restructuring and eventual privatization of parts of the Japanese National Railway (JNR) was a significant achievement. After World War II, JNR was converted from a government ministry to a state-owned corporation. It was also forced to provide employment to returning servicemen, bloating its workforce and driving up pension and wage costs. Japan also constructed many branches to serve smaller communities. Rail tariffs were controlled and kept quite low, causing JNR to operate at a loss. Pensions, investment and operating loses were financed by debt. As the Japanese economy recovered and personal wealth grew, many interstate-type highways were constructed and rail market shares fell rapidly while JNR debt continued to climb. Even construction of high-speed lines (Shinkansen) and introduction of Bullet-Train services starting in 1964 did not improve JNR's financial position. Restructuring Japan's rail system was complex and took many years. As part of the restructuring, some $200 billion of JNR's $340 billion debt (all guaranteed by the government) was transferred from the government-owned company to a new government-owned Settlements Corporation. The Settlements Corporation also assumed responsibility for excess employees and assets. The remaining portion of JNR debt was transferred to the operating companies that were eventually privatized.

The investment of billions of dollars did not help JNR become profitable. It took a restructuring process that injected private-sector financing and incentives into the operation of the railway. While investing $300 billion into rail passenger infrastructure and rolling stock in the U.S. would certainly provide many high-speed lines and upgrade most rolling stock, it is unlikely that this alone would allow Amtrak to operate profitably. If that investment were not counted as Amtrak debt, and if passenger revenues were not expected to renew or replace those assets as they wore out, then it is possible that some Amtrak routes and services could be operated profitably.

5. *The American passenger rail system is partially privatized in that most of the rail infrastructure over which Amtrak operates is privately owned. If we franchise passenger rail operations to private rail operators other than Amtrak, large freight railroads that own thousands of miles of track over vast portions of the United States may have to deal with a number of private operators on their track.*

   How would you suggest we convince the freight railroads to allow these other railroads to operate over their tracks?

Many private rail lines currently have multiple operators. The map below shows U.S. rail lines with multiple operators, including Amtrak. Amtrak operates few intercity passenger trains on most private rail lines (two trains per day—one in each direction—is typical on many miles of private rail line outside the northeast corridor), so the issue of multiple operators on any one line may not be an important issue for many freight railroads. In any case, access, train priority, required speeds, liability, insurance and many other issues should be settled with private railroads in the process of negotiating access agreements. Private railroads are experienced in negotiating access agreements, although some arbitration or settlements process may be needed for disputes that cannot be settled through negotiation.



Significant increases in rail passenger services or speeds across private railroad lines are likely to require investments in new capacity.