

**A Financial Analysis of H.R. 2329,  
The High-Speed Rail  
Investment Act of 2001**

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The House Committee on Transportation and Infrastructure has asked the Congressional Budget Office (CBO) to analyze H.R. 2329, the High-Speed Rail Investment Act of 2001. The bill would provide assistance to the National Railroad Passenger Corporation (known as Amtrak) by permitting Amtrak to sell \$1.2 billion in bonds each year for the next 10 years. The federal government would pay the interest on those bonds in the form of income tax credits to the bondholders.

This analysis focuses on the proposal for tax-credit bonds and on how those bonds compare with alternative financing mechanisms. It does not address broader issues of federal policies toward passenger rail. The main conclusions of the analysis are as follows.

- The bond program authorized by H.R. 2329 would cost the federal government about \$7.4 billion in present-value terms.<sup>1</sup> The matching contributions that states would be required to make would cost about \$1.8 billion, bringing total government costs to \$9.2 billion. However, the bond program would raise only about \$8 billion (in present-value terms) for Amtrak, making that approach about 15 percent more costly than providing Amtrak with \$8 billion through federal appropriations and state matches. In other words, the tax-credit funding mechanism would essentially be a new and more expensive way for the federal government to assist Amtrak.
- The bond program would cost the federal government substantially more than authorizing the same amount of funding through tax-exempt bonds issued by states. In that case, the states would bear the cost of paying interest on the bonds and repaying the principal, and the federal government's cost would be the forgone revenue associated with such tax-exempt debt.
- The bond program in H.R. 2329 would obscure the costs to the federal government of subsidizing Amtrak. What is fundamentally a new spending program would be reflected in the budget as reduced tax collections, and much of the federal cost would appear outside the 10-year budget window.

## PURPOSE AND SUMMARY OF THE LEGISLATION

H.R. 2329 would help Amtrak raise funds for capital investment. The railroad has received some \$25 billion from the federal government over its 30-year history—including an appropriation of \$521 million for fiscal year 2001—and continues to require federal financial assistance to meet both its operating and its capital costs. (For a discussion of Amtrak's budgetary status, see Box 1.) Amtrak's revenues have risen in recent years, but its costs have risen more.

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1. A present-value calculation adjusts future payments for the time value of money to make them comparable with payments today.

BOX 1.  
SHOULD AMTRAK BE ON-BUDGET?

Because Amtrak is considered a private corporation, its transactions are not included in the federal budget. However, guidelines in the *Report of the President's Commission on Budget Concepts* suggest that entities like Amtrak should be treated as federal.<sup>1</sup> The commission's report, which provided the conceptual basis for the government's overall budget, concluded that the budget should include all programs of the federal government and its agencies.

According to that report, the criteria for determining whether an entity is federal include its ownership, the source of its capital, who selects its managers, and the degree of control that the President and the Congress exercise over the entity. Applying those criteria to Amtrak suggests that the decision to exclude the railroad from the budget should be revisited.

- *Ownership.* Some of today's freight railroads hold common stock certificates that could be interpreted as giving them nominal ownership of Amtrak. Those certificates were issued to the railroads as compensation for some of the rolling stock and lines that were used to form Amtrak in 1970. However, those common shares convey virtually no benefits to the holders. Amtrak does not produce any earnings or dividends and does not convene an annual meeting of shareholders. The first claim to any profit that Amtrak might earn is held by the U.S. Secretary of Transportation, who owns all preferred stock in Amtrak.
- *Source of Capital.* The federal government is the primary source of capital for Amtrak, without which the railroad could not survive. When Amtrak was created, the hope was that such assistance would be temporary until Amtrak became self-supporting, profitable, and creditworthy. Thirty years later, that hope has still not been met.
- *Selection of Managers.* The President appoints Amtrak's entire board of directors with the advice and consent of the Senate.
- *Degree of Control.* The federal government has extensive control over Amtrak's policies through the board of directors that it appoints and through the leverage that it gains by providing essential financial support.

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1. See President's Commission on Budget Concepts, *Report of the President's Commission on Budget Concepts* (October 1967).

H.R. 2329 would authorize Amtrak to sell up to \$1.2 billion in bonds per year for 10 years to pay for capital projects such as acquiring, financing, or refinancing equipment and rolling stock; improving tracks and signals; and eliminating grade crossings.<sup>2</sup> The federal government would pay the interest on the bonds in the form of income tax credits. The amount of those tax credits would equal the face value of

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2. For an analysis of a similar Senate bill, S. 250, see General Accounting Office, *The High-Speed Rail Investment Act of 2001 (S. 250)*, GAO-01-756R (June 25, 2001).

the bonds multiplied by an interest rate (the “credit rate”) set by the Secretary of the Treasury. That credit rate is intended to be “equal to an average market yield . . . on outstanding long-term corporate debt obligations.”<sup>3</sup> The tax credits would be considered taxable income to bondholders, just like ordinary interest income. But after computing their tax liabilities, bondholders would be able to take the amount of interest income as credits against their taxes.<sup>4</sup>

The bonds would have a term of no more than 20 years. Once they matured, their principal would be repaid primarily from a dedicated trust account that would contain the matching contributions of states that agreed to cosponsor Amtrak’s investment projects. Under H.R. 2329, those matching contributions would have to equal at least 20 percent of the cost of a project. CBO’s analysis assumes that states would meet the matching requirement with cash payments. (The Senate version of the legislation, S. 250, would allow states to match project costs with in-kind contributions.) The trust account would also hold the unspent proceeds from bond sales and the income earned on the balances in the account. If the trust account did not have enough funds to repay the bonds, Amtrak would be responsible for making up the shortfall.

H.R. 2329 would establish arbitrage rules intended to ensure that the proceeds from a bond issue were spent on qualified rail projects within three to four years and not merely invested in financial assets.<sup>5</sup>

If a bond ceased to meet the requirements of the legislation, Amtrak would be required to pay back to the U.S. Treasury the amount of the tax credits, plus interest, for the taxable year in which that happened and for the preceding two years. If Amtrak failed to make such payments, the owners of the bonds would be required by H.R. 2329 to do so.

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3. Section 101(a) of H.R. 2329, the High-Speed Rail Investment Act of 2001, which adds Section 54(b) to the Internal Revenue Code.
  4. The Amtrak bonds are similar in design to Qualified Zone Academy Bonds (QZABs). For more information about QZABs, see Steve Maguire, *Qualified Zone Academy Bonds: A Description of Tax Credit Bonds*, CRS Report for Congress RS20606 (Congressional Research Service, December 15, 2000).
  5. Those arbitrage rules are less restrictive than the ones that apply to tax-exempt bonds issued by state and local governments.

## THE COST TO THE FEDERAL AND STATE GOVERNMENTS

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The proposed legislation would cost the federal and state governments a total of about \$9.2 billion in present-value terms, CBO estimates.<sup>6</sup> Of that amount, the cost to the federal government of the tax credits would be about \$7.4 billion, and the cost to state governments of their matching contributions would be about \$1.8 billion.

CBO calculated the cost of the income tax credits to the federal government by multiplying the “credit rate” by the face value of the outstanding bonds. That calculation assumed a credit rate of 6.5 percent, which reflects the typical spread between interest rates on government securities and rates on long-term corporate bonds with investment-grade ratings of A or AA.<sup>7</sup>

CBO’s analysis suggests that the trust account containing states’ matching contributions would most likely run out of money to repay the principal of the bonds issued in the last five years of the program (as explained below). It assumes that investors, in valuing the bonds, would not expect Amtrak to be able to cover the shortfall, nor would they expect a federal bailout. If such a bailout were to occur, it would cost the federal government about \$1 billion in present-value terms, CBO estimates.

## ESTIMATING THE AMOUNT OF FUNDS FOR AMTRAK

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CBO’s analysis suggests that investors would be willing to pay slightly more than face value for bonds sold in the first five years (raising about \$1.21 billion a year for bonds with a face value totaling \$1.20 billion); about 78 percent of face value (\$935 million) for bonds sold in the sixth year (for which investors would probably get only part of their principal back); and about 73 percent of face value (\$880 million a year) for bonds sold in the seventh through 10th years (for which investors would most likely

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6. CBO's analysis follows the conventions of cost estimating, which generally hold overall levels of economic activity constant. Sales of tax-credit bonds might set in motion behavioral responses that could yield some increase in tax receipts on bond interest. The magnitudes of such behavioral responses are uncertain and are not normally included in cost estimates. If any such effect were to occur, it would apply equally to issues of bonds by the government. Thus, it would not change CBO’s conclusion that assisting Amtrak through tax-credit bonds would cost more than assisting Amtrak through debt-financed appropriations.

7. Staff at the Treasury Department have indicated that the Secretary would set the credit rate equal to an average of the interest rates on investment-grade bonds, probably bonds with a rating of AA. If the Treasury included the higher interest rates on speculative-grade bonds in its calculation of an average corporate rate, it might set the credit rate for Amtrak bonds in the range of 7 percent to 7.5 percent. A higher credit rate would make the Amtrak bonds more costly to the federal government. For example, if the rate was 7.5 percent, the present-value cost of the tax credits would be about \$8.5 billion rather than \$7.4 billion.

receive only the tax credits but no repayment of principal).<sup>8</sup> As a result, CBO estimates, the bonds would raise a total of \$10.5 billion—or about \$8 billion in present-value terms—for Amtrak.<sup>9</sup>

### Valuing the Stream of Tax Credits

Although investors would probably consider the 20-year stream of tax credits associated with the bonds to be relatively free of the risk of default, that stream could be disrupted under certain circumstances.<sup>10</sup> If a bond ceased to meet the requirements of the legislation, for example, the flow of tax credits would end and bondholders would be liable for repaying those credits to the Treasury if Amtrak failed to do so. The stream of tax credits could also cease if a bond was redeemed before maturity. That could happen if the proceeds of a bond issue were not spent as quickly as required under the bill's arbitrage provisions.<sup>11</sup>

### Uncertainty about the Repayment of Principal

A number of factors create uncertainty about the adequacy and safety of the trust account, which would be the primary source of funds to repay the bonds' principal at maturity.

Adequacy of Funds. Alternative assumptions yield different answers about whether the account would have enough funds available to repay all of the bonds. If the trust account held only the states' 20 percent matching contributions, it would need to earn an after-tax return of about 8.4 percent a year to generate enough income to repay all of the bonds. That return is higher than the current pretax yield on corporate bonds with the lowest investment grade and about 3 percentage points higher than the return

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8. The estimate that investors would be willing to pay a small premium for bonds issued in the first five years is based on CBO's analysis that investors would consider the stream of tax credits to be less risky—and thus require a lower rate of return—than the credit rate set by the Treasury. If the Treasury set the credit rate higher than the 6.5 percent assumed by CBO, the premium on those bonds would be higher still. Allowing in-kind state contributions, however, would reduce the price that investors would be willing to pay for the bonds, because it would lessen the probability of their being repaid.

9. That estimate assumes that investors would not expect Amtrak or the federal government to assist in redeeming the bonds.

10. CBO's estimates assume that the stream of tax credits would last for 20 years. If investors thought that the credits might be cut short, they would offer less for the bonds than CBO estimates and Amtrak would receive less funding.

11. Section 101(a) of H.R. 2329, the High-Speed Rail Investment Act of 2001, which adds Section 54(g)(2)(A) to the Internal Revenue Code.

on long-term Treasury securities (which are often used to provide funds for repayment of debts with very low risks). To the extent that states made in-kind contributions, the rate of return would have to be even higher.

The trust account would also earn income on the proceeds from bond sales, which would be held in the account until spent. However, those proceeds would have to be spent within three to four years to comply with the arbitrage provisions of H.R. 2329. Weighing all of those factors, CBO's analysis suggests that the account's trustee would have difficulty finding investments that would provide a sufficient return to repay the principal.

Taxes. Although H.R. 2329 is not entirely clear about the tax status of the trust account, it appears that the account would owe income taxes—thus making the required pretax rate of return higher. S. 250, by contrast, appears to treat the trust account's income as Amtrak income. Because Amtrak currently has a substantial amount of losses that it could carry forward to offset future income, no tax liability would be expected, at least in the near term. But if the trust account were considered an entity separate from Amtrak, it would probably owe income taxes, and it would need a higher rate of return to earn enough funds to repay the bonds' principal.<sup>12</sup>

Size of State Contributions. H.R. 2329 would not require state matching funds for projects involving the Alaska Railroad or for improvements related to construction at the railroad station at the Farley Post Office Building in New York City. Consequently, to the extent that such projects were financed with tax-credit bonds, the balance in the trust account and the amounts available for repayment of principal would be correspondingly smaller. S. 250 would allow states to meet the matching requirement by contributing land or other nonfinancial assets; that too would diminish the size of the trust account and the surety of repayment of the bonds' principal.<sup>13</sup>

The proposed legislation includes an incentive, however, that could lead states to contribute more than the minimum 20 percent of the cost of a qualified project and thereby strengthen the trust account. The bills require that the Secretary of Transportation give preference, among other things, to any project with a state matching contribution of more than 20 percent. Thus, if there were competition among states for projects, they might bid up their share and increase the funds available for repaying bonds.

Commingling of Funds. H.R. 2329 is silent about how the trust account would be administered. It appears that the matching contributions for all projects and the

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12. CBO's analysis assumes that the income of the trust account would be taxable.

13. CBO's analysis assumes that all projects would receive a 20 percent match in cash.



proceeds from all bond issues would be commingled in the account. Although the documents establishing the bond covenants would probably provide guidance on the administration of the trust account, any shortfall in funds available to repay bondholders would most likely affect buyers of bonds issued in the later years of the program more than purchasers of the earliest issues. Depending on how bond buyers in later years assessed that risk, bonds issued in those years could sell at a steeper discount than earlier issues. (Even if bond buyers expected no repayment of principal, the stream of tax credits would still have significant value.)

Amtrak's Backing. In the event that the trust account had insufficient funds, H.R. 2329 would make Amtrak responsible for repaying the bonds. In view of the railroad's past financial performance, however, investors would most likely assign a low probability to Amtrak's ability to pay off the bonds.

Federal Backing. Investors might assume that the federal government would step in to repay the bonds. Under current law, the federal government is not liable for Amtrak's obligations.<sup>14</sup> However, the Congress could enact legislation to authorize and appropriate funds to repay holders of Amtrak bonds.

Federal backing is an important factor in the investment-grade ratings currently given to Amtrak by Standard & Poor's and Moody's.<sup>15</sup> If investors were certain that the federal government would bail out Amtrak, they would consider Amtrak bonds to have as little risk as Treasury bonds—but with a higher interest rate (credit rate) than Treasuries. In that case, investors would be willing to pay a premium for Amtrak bonds.

## COMPARISON WITH ANNUAL APPROPRIATIONS

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Comparing tax-credit bonds with annual appropriations as a means of providing financial aid to Amtrak requires that one use either the cost of the bonds or the

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14. The Comptroller General has stated that the federal government is not responsible for Amtrak's debt. See opinions B-277814 (October 27, 1997) and B-217662 (March 18, 1985), and General Accounting Office, *High-Speed Rail Investment Act of 2001*, p. 3.

15. Standard & Poor's has given Amtrak a credit rating of BBB, and Moody's has given it an A3 rating. Moody's explains its reasoning in part by saying that "the Federal government will continue to provide financial support for Amtrak's capital programs. Amtrak's status as a private corporation whose preferred stock is entirely owned by the U.S. Department of Transportation, and its insulation from bankruptcy are additional positive credit factors." Standard & Poor's supports its rating by stating that "substantial evidence of political support . . . is taken into consideration and reflected in the current rating, since without such support, Amtrak would not cover its cash operating expenses from operating revenues." See Moody's Investors Service, "Moody's Investors Service Assigns Financial Strength Rating of A3 to Amtrak" (press release, December 1999); and Standard & Poor's, "S&P Rates Amtrak Issuer Credit Triple-B" (press release, January 2000).

amount of aid given to Amtrak as a starting point. Because of the uncertainty in estimating the market value of the tax-credit bonds, CBO started with the cost to the government.

Using the estimated cost to the federal government of the tax credits (\$7.4 billion), CBO calculated that for the same present value, the government could provide Amtrak with an annual appropriation of \$980 million for 10 years.<sup>16</sup> Adding the same amount of state matching funds (\$240 million a year) as under the bond proposal would bring that total to \$1.22 billion annually. That amount is slightly higher than what CBO estimated the bonds would sell for in their first five years (about \$1.21 billion per year) but substantially more than it expects them to sell for in later years (about \$935 million in the sixth year and \$880 million annually in the remaining four years).

The reason that Amtrak would receive more funding from direct appropriations than from tax-credit bonds (relative to the government's costs) is that appropriations avoid the cost of compensating private investors for the risk they would take in buying the bonds.

## COMPARISON WITH TAX-EXEMPT BONDS

An entirely different approach to funding capital investment in rail projects is through state financing with tax-exempt debt. That mechanism—which could be used in addition to or as a substitute for appropriations and tax-credit bonds—would make states the key players in investment decisions. It would not necessarily involve Amtrak, except as one competing provider of passenger service.<sup>17</sup> States would select and sponsor the projects—presumably choosing ones that provided the greatest benefits to their residents.

Under this approach, states would pay both the principal and interest on the bonds they issued. Because interest on the bonds would be exempt from federal income taxes, the federal government would bear the cost of forgoing those tax revenues. That federal cost would total about \$2.0 billion in present-value terms, assuming that the states issued tax-exempt debt to raise the same amount that CBO estimated Amtrak would receive from the tax-credit bonds. The reason that the federal cost would be substantially lower for tax-exempt bonds than for tax-credit bonds is that the federal share of interest costs on the tax-exempt bonds would be just the

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16. That calculation uses a discount rate of 5.5 percent, the assumed cost of capital to the federal government.

17. That approach would be consistent with the Amtrak Reform and Accountability Act of 1997, which repealed Amtrak's statutory monopoly.

marginal tax rate (30 percent in CBO's analysis), compared with 100 percent on the tax-credit bonds.<sup>18</sup>

## TAX-CREDIT BONDS AND BUDGET POLICY

The proposed legislation would obscure the costs to the federal government of assisting Amtrak and would not be consistent with some important goals of federal budgeting—such as transparency, accountability, and the timely recognition of costs. Moreover, the legislation would avoid some of the budgetary disciplines that the Congress has established and found useful in allocating resources and controlling spending. Specifically, it would:

- *Count federal payments as reduced tax collections.* H.R. 2329 has the appearance of a revenue measure because it would provide tax credits to holders of Amtrak bonds. However, like a spending bill, it would mandate interest payments to those bondholders. Reducing tax collections has the same effect on the federal budget as increasing outlays, but costs are much more visible and identifiable if they are displayed in the budget in a spending account.
- *Obligate specific sums of federal monies without an appropriation.* Using tax credits in place of cash would remove the funding from the annual appropriation process, in which the Congress allocates federal resources among alternative uses. Thus, the legislation would provide considerable federal support to Amtrak outside that decisionmaking process.
- *Shift current federal costs to the future, many of them outside the 10-year budget window.* The best budgetary practices require that costs be recognized in the budget when they are incurred. The federal cost of the Amtrak bonds would become an obligation of the government when the bonds were issued. The proposed bill, however, would spread the recognition of the costs of each annual bond issue over the following 20 years. As a result, much of the cost of the bond program would be removed from the discipline provided by the Congressional budget process.

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18. If CBO had instead assumed an average marginal tax rate of 25 percent, the present value of the federal cost would be \$1.6 billion.