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STATEMENT OF JOHN A. VOLPE, SECRETARY OF TRANSPORTATION, BEFORE THE HOUSE INTERSTATE AND FOREIGN COMMERCE COMMITTEE REGARDING RAILROAD LOAN GUARANTEE LEGISLATION, WEDNESDAY, JUNE 24, 1970.

Mr. Chairman and members of the Committee:

I appreciate this opportunity to discuss with you H.R. 18125, a bill which would authorize the Secretary of Transportation to guarantee loans to railroads.

One only has to look at the current headlines to see that all is not well with the railroad industry today. Going behind the headlines, it is not difficult to demonstrate the serious financial condition of the industry:

(1) The margin of net operating income to gross has deteriorated markedly since 1966 when it was 8.2 percent and is now down to about 4.5 percent, little better than the 4.0 percent of the critical period of 1960-61.

(2) Financial strains are reflected also in net working capital, which has declined steadily since 1963. Net working capital in that year was $828 million. By December 31, 1969, this figure had dropped by almost $800 million -- reaching a low of $58.4 million. If any single statistical trend captures the essence of the industry's financial problem, it is this one.

(3) In recent years, cash flow from retained income and depreciation/retirement charges has provided for only about 60 percent of gross capital expenditures. The remainder has come principally from additional borrowing for equipment and drawing upon working capital.

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(4) Equipment obligations outstanding increased from $2.5 billion at the end of 1962 to $4.2 billion at the end of 1968, or by almost 65 percent over this period.

Comparing 1969 over 1968, there was a 10 percent drop in net income; operating revenues were up 5.4 percent to a record of $11.5 billion, but operating expenses rose 5.6 percent to a record $9.1 billion; and net railway operating income for 1969 was off about $24 million. Twenty-one of the 74 Class I railroads show deficits for 1969; of these, fourteen railroads are in the Eastern districts, six in the West, and one in the South. The results for the full year 1969 were worse than 1968; and the industry entered 1970 in no better financial condition than in the preceding year.

One of the best indicators of the health of the industry is the rate of return on investment. From a post-war high of 4.22 percent, the rate of return reached a post-war low of 1.97 percent in the recession year of 1961. From that low, the rate of return rose to a high of 3.9 percent in 1966. Since 1966, it has steadily dropped, reaching 2.38 percent in 1969.

While the general health of the industry is disturbing, I should not leave the impression that all railroads are in financial straits. Obviously, if 21 of the 74 Class I railroads showed deficits for 1969, 53 either broke even or showed a profit. We are dealing with a national system, however, and the effects of disturbances anyplace in that system are felt throughout it. Taking the Penn Central Railroad as a case in point, 21 percent of all freight cars loaded pass over the Penn Central, and 70 percent of Penn Central traffic involves other railroads. This traffic moves either from the Penn Central to another road or from another road to the Penn Central. When one considers

that of total intercity freight movements the railroads move 66 percent of our food, 84 percent of our lumber and wood products, 73 percent of our pulp and paper, 66 percent of our primary metals, 69 percent of our transportation equipment, and 58 percent of our chemicals, we can appreciate the role of the Penn Central Railroad in the efficient functioning of our entire railroad system. If traffic moves inefficiently over this road, the loss may be felt by every other railroad. If for any reason traffic were to stop moving over this road, it would result in loss of employment and revenues not only to the Penn Central but to many other railroads and the industries they serve.

You have all seen or heard the railroad commercials and I would have to agree that we do all need the railroads. In 1969, the railroads carried 780 billion ton miles of freight, or an increase of 34 percent over the 580 billion ton miles carried in 1960. I should note that, notwithstanding this gain, the railroads' share of traffic is declining as a result of strong competition from other modes -- in the last 20 years their share of total has dropped from 56.2 percent to 41.2 percent.

Looking to the future, we estimate that by 1980, the railroads will be carrying almost 43 percent more freight than they carried in 1969, or well in excess of 1 trillion ton miles. The railroads will continue to be by far the largest single mover of intercity freight. No other modes of transportation singly or in combination could conceivably fulfill the role of the railroads. In fact, the other modes will have their hands full meeting the projected demands for their own services. There can be no question -- if

we are to move efficiently the goods necessary to meet the needs of this Nation, we must maintain a healthy railroad industry. Our projections are based on the assumption that we will.

Without attempting to identify all of the problems facing the railroads today, and which must be overcome, I would like to mention a few -- some of which the Administration and this Committee are attempting to deal with. As I indicated in my testimony before the Committee three weeks ago, we urgently need to improve rail passenger service and, at the same time, relieve the railroads of the very heavy passenger service deficits they are currently experiencing. Another way in which railroad finances could be almost immediately improved would be by prohibiting discriminatory State taxation. Bills dealing with this problem are before the Committee and I would urge your favorable consideration of them. Another matter of great urgency -- and the accident at Crescent City early this week underscores the need -- is improving rail safety. I commend the Committee for moving affirmatively to deal with this problem. While there may be short-run costs to the industry in meeting higher standards of safety, there should be very substantial long-run savings. Finally, I would mention the problem of freight car shortages. The Department and the I.C.C. are now examining the ways by which this problem might be solved.

These measures will all help improve the financial condition of the railroads but more is needed. Last week the Administration forwarded to the Congress the bill before us this morning which would authorize the Secretary to guarantee loans to rail carriers to aid them to meet temporary and urgent

financial requirements. The very serious financial condition of the Penn Central Railroad, as well as several other roads, prompted the legislation. Because of the uncertainty as to whether the Administration's bill would be promptly enacted, the Defense Department's interim loan guarantee was not forthcoming. As you know, the Penn Central thereupon filed for reorganization under the Bankruptcy Act. I do not believe that this fact has lessened the need for the authority we seek.

The Penn Central needs cash. We would hope that trustee certificates providing the necessary cash could be sold without a Government guarantee but the consequences of any failure to raise cash make it imperative, in my view, that the guarantee authority be available to be used if needed. I do not wish to imply that passage of the legislation would assure a guarantee to the Penn Central or any other railroad. In this and every other case, the request for a guarantee will be carefully scrutinized and made only if there is a reasonable chance for repayment of the loan.

The problem is not simply the Penn Central. Several other railroads are now experiencing financial difficulties and their condition could deteriorate. Should situations arise where the timely guarantee of a loan by the Government might avoid a financial crisis such as that being experienced by the Penn Central, the authority to avert it should be at hand. And that authority is contained in H.R. 18125.

Very briefly, H.R. 18125 would authorize the Secretary to guarantee a loan to a rail carrier for the purpose of meeting its temporary and urgent financial requirements -- and we would assure that the funds were used <u>only</u>

for railroad purposes. The loans guaranteed could not exceed the interest rates established by the Secretary and could not extend beyond 15 years from the date of issuance. The outstanding aggregate amount of all loans guaranteed could not exceed $750 million. A guarantee fee would be charged in connection with each loan. A rail carrier receiving a guaranteed loan could not declare a stock dividend without the consent of the Secretary. This flexibility in the payment of dividends is necessary to cover the situation where dividends are paid to a parent railroad company by a subsidiary. We would not want to cut off this cash flow. In the event of default on a guaranteed loan, the Secretary would make good on the default by borrowing from the Secretary of the Treasury. The Secretary's authority to guarantee loans would expire five years after the date of enactment.

In both form and substance, this bill is very similar to the 1958 law granting authority to the Interstate Commerce Commission. As you know, that authority expired in 1963. One of the major differences between the Administration's proposal and the former I.C.C. authority relates to the purposes for which the guarantees could be granted. The Congress limited the I.C.C. guarantee authority to loans needed for capital expenditures. This is not the problem facing the railroads today. The railroads in trouble need cash to pay current operating expenses. Unless the guarantees could be used for that purpose, they would be of little use.

The other major difference between the previous and proposed legislation relates to the method by which funds would be obtained to make payment in the event of default. Under the I.C.C. Act, the Secretary of the Treasury

paid the lender from appropriations made for that purpose. Under our proposal, the Secretary of Transportation would be authorized to borrow the necessary funds from the Secretary of the Treasury. This permits an immediate payment to a lender rather than requiring him to wait for an appropriation and enhances the attractiveness of the guarantee.

Some minor amendments to H.R. 18125 are necessary as a result of the failure to obtain an interim loan guarantee for the Penn Central and its subsequent petition for reorganization. If the Committee desires, we will be happy to work these out with the Committee staff.

In conclusion, Mr. Chairman, I believe it is imperative that the Congress promptly enact H.R. 18125. The standby authority which it provides is a tool which we must have available to assist the railroad industry in this critical period.