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REMARKS PREPARED FOR DELIVERY BY SECRETARY OF TRANSPORTATION BROCK ADAMS, TO THE WALL STREET FINANCIAL LEADERS NEW YORK CITY FEBRUARY 1, 1979.

A NEW FOUNDATION FOR THE NATION'S RAIL SYSTEM

In his budget message last week, President Carter said he foresees generally stable business conditions for most sectors of the economy. Railroads are the exception. The rail industry, he said, "is struggling for financial survival."

This, of course, is not news to the financial community. Or to those of us in government concerned with transportation and budgetary matters. Together we have tried over the years to prop up the ailing railroad industry in piecemeal fashion -- with a variety of loans, an assortment of laws and an abundance of advice.

I come to you today with a new and, for the first time, comprehensive plan for the economic revival of the railroads. I have come here because you represent a broad and perceptive segment of the business leadership of this country. And what we are proposing is to put the railroads back into business -- on the healthy side of the ledger.

I cannot recall many times during the last five or six years when I have not been worried about the nation's railroads. I'm not alone in this, of course. The President, Congress, the business community -- we all are concerned. Some railroads, like the Southern and Union Pacific, are enjoying adequate earnings. But many U.S. railroads are in desperate straits. Since 1967 10 companies have filed for bankruptcy protection. More than 40 percent of today's rail freight services are provided by rail companies that can only be described as "financially weak."

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All this has happened under government regulation and despite repeated government assistance.

Amtrak was created in 1970 to relieve the freight railroads from the financial burden of passenger service. The Regional Rail Reorganization (3-R) Act was passed in 1973 to salvage crumbling rail service in the Northeast. The Railroad Revitalization and Regulatory Reform (4-R) Act three years later established Conrail and authorized a smorgasbord of financial, regulatory and reorganizational provisions for troubled or needy railroads.

No one can say that government has not been responsive. But has government faced up to its full responsibility? If regulation is part of the problem, as many economists say it is, who is government protecting, by continuing to keep the railroads shackled to 19th century economic theories and 90-year old regulatory policies?

It's time to cut the cord -- to quit making basic business and operating decisions for a multi-billion dollar industry -- to build that new foundation. The separation, after so many years, may be painful in some respects. But as the late Adlai Stevenson said, "there are no gains without pains."

If the railroads are to survive as private institutions -- indeed, survive at all -- we will have to take some painful steps together. But the gains can be worth all the effort. We're talking about the economic recovery of a major industry. And we want -- and <u>need</u> -- the counsel and leadership of the business community.

Our program is in three parts;

<u>First</u>, we are redirecting the Northeast Corridor improvement program. We are asking for more time and some more money to put this massive project on a realistic schedule and within a budget that will enable us to carry out a carefully phased construction program and develop a system that accommodates all Corridor users. There are, for example, nearly 1500 trains now operating in the Corridor every day, including 1100 commuter trains, 125 intercity passenger trains, about 200 freight trains and several mail trains. All of these, and others to come, must be scheduled for optimum convenience and efficiency.

We continue to believe that high-density, medium length travel corridors represent the best market for intercity passenger rail service. The $2.5 billion being invested in the 456-mile Washington-Boston route will result in safer, more comfortable high-speed rail travel between the cities along the corridor. The funds we're investing in this project will return future dividends in the form of reduced maintenance costs, greater reliability, energy savings and increased passenger comfort and convenience.

To get this project back on track and on target we are asking for $654 million in additional funding and a two-year extension -- to 1983 -- of the completion date.

Second, we must reconfigure the Amtrak route structure to bring it closer in line with the demand for rail passenger service.

I view our Amtrak restructuring proposal as a life-saving operation. Our rail passenger system is a national resource that cannot be replaced and should be preserved -- but at a cost we can meet today and a price we can pay tomorrow.

We simply cannot afford Amtrak in its present form. The Federally-funded deficit has been steadily increasing. Whereas six years ago Amtrak's customers paid approximately one dollar for each dollar in operating subsidy paid by the taxpayer, today the customer is paying only 59 cents for every taxpayer dollar.

Last year Congress directed the Secretary of Transportation to recommend a restructured rail passenger system. I have done that. I have submitted a revised route plan that scales down the existing system by 43 percent in route miles but reduces ridership by only nine percent.

That is what we have to do -- trim away the routes least used so resources can be focused on the routes with the greatest promise. The route structure we are recommending serves 22 of the nation's 25 largest population centers, 40 of our 50 largest cities and a total of 40 states. It comprises a "national grid," with three major East-West routes and three North-South routes.

We are making the Amtrak recommendation for three reasons:

1. The revised system will cost substantially less to operate. Savings over the next five years are estimated at $1.4 billion -- a 23 percent reduction.

2. Many of the existing regional and otherwise little traveled routes are incurring subsidy costs far in excess of their social or energy-saving values.

3. After eight years, Amtrak still attracts fewer than one half of one percent of the intercity passenger traffic. We also believe our recommended system will be responsive to changes in passenger markets by airline deregulation.

Let me emphasize that our proposed "downsizing" of the system can be good for Amtrak. We are recommending a three year financial authorization for Amtrak, so that with the $760 milion we are proposing for 1980, and with a knowledge of proposed funding for the next two years, and a higher-yield less costly system to operate, the Corporation can concentrate on providing better service to the public.

I would add that Alan Boyd and other Amtrak executives are committed to improved cost controls, better public service and strong efforts to stabilize and eventually reduce the system deficit.

Let me turn now to our third proposal for dealing with the nation's rail crisis.

The President said it very clearly in his State of the Union message. Deregulation of the airlines has reduced prices for the consumer and increased the industry's earnings.

"For one of the few times in history," President Carter said, "we are actually dismantling a major Federal bureaucracy. This year we must begin the effort to reform our regulation of the railroad, bus and trucking industries."

That process is already underway. Legislation is being drafted and will soon be sent to the Congress, calling for substantial changes in economic regulation. The railroads are our first priority because they are hurting. Their vital signs compel our immediate attention.

As one who has ridden to the rescue of the railroads several times now, I am convinced that Federal financial assistance alone cannot substitute for more fundamental changes in the ability of railroad managements to increase revenues and control costs.

Our best analysis indicates that if the railroads continue on their present course, doing business the same way, the industry simply will not generate enough revenues to meet its needs over the next 10 years. In fact, we estimate a capital shortfall of $13 to $16 billion between 1976 and 1985. That's money needed for equipment and facilities and debt service that the railroads won't be able to raise internally, or get from the private money market -- unless they improve their earning power.

An alternative, of course, is the public treasury. Funding the $16 billion "nut" estimated in our study would cost the taxpayers $2.5 billion a year. Add to that the estimated $500 million annual cost of Conrail and the $1.1 billion Amtrak deficit predicted by 1984 (if the route system is not restructured), and we get a staggering $4 billion annual due bill for rail support.

Many will consider that too high a price to pay. But what is worse, even with a $4 billion Federal subsidy, the industry would not be profitable. Nothing would have changed. We would simply be repeating prior mistakes at a higher cost. And we would reach a point not far in the future when the price exceeds what Congress or the public or shippers could pay, and the system would collapse of its own weight.

The railroads have several very basic problems: (1) the system as a whole is being forced to provide service at revenue levels that do not cover full costs; (2) the present system is inefficient in many respects; and (3) many branch lines do not generate enough traffic to pay for their upkeep.

Outright subsidies do not, and will not help this situation.

Four billion dollars a year in Federal aid would simply freeze the existing system, and shift its problems from the stockholders to the taxpayers.

I say there's a better way.

Rationalization, not nationalization.

Competition, not complacency.

Innovation, not regulation.

Public ownership is not a solution. It is an admission of defeat. Nationalization has not solved other nations' rail problems.

-- In Japan, subsidies represent nearly 15 percent of the railways' total revenue. And jobs are being cut.

-- The German Federal Railways depend on government funds for 45 percent of their costs. And there, as in France, mileage is being trimmed to reduce expenses.

-- The subsidy required by Britain's railroads has been even higher -- amounting to nearly 60 percent of revenue.

I view nationalization as I have always viewed it -- a last resort, the least desirable option, the equivalent of throwing in the towel and saying 'private industry has failed, government has failed, we have failed together.'

The better way -- the preferred alternative - is innovation. The railroads are not a lost cause. There is too much pride and purpose and potential in rail freight transportation for the industry to run up the white flag.

I say what I have been saying for 10 years -- railroading is not inherently unprofitable or competitively impotent. There are railroads in this country that make money. Others can do as well. But we have to fix the present system, and that's why I believe the 4-R Act didn't go far enough. It encouraged deregulation but it didn't require it. New legislation should be aimed at a rationalized rail freight system designed to serve those markets where rail transportation is competitive with, or superior to, other modes.

The railroads should survive in the private sector because there is strong and growing demand for the services the rail freight industry can supply best. The railroads handle 70 percent of all the coal and 60 percent of the grain shipped in the United States. They are the primary carrier for pulp and paper products, automotive products, food stuffs, chemicals and basic metals.

The railroads are also the most energy efficient means of transportation for many goods, and in some circumstances even have an energy advantage over barges.

The potential for growth is substantial in piggyback and container traffic. And without the railroads we could not even think of doubling our coal tonnage, as now envisioned by the national energy plan.

The traffic is there to support and nourish a healthy, private rail industry. Blocking that objective are the railroads' classic problems: an overbuilt system, especially in the Northeast; a backlog of deferred maintenance; shifting markets and increased competition; and a blanket of government regulation that has dulled initiative and discouraged innovation.

We have to create a new system.

We have to give the rail industry new hope and new economic opportunity -- a predilection for competition, not protection; a free hand, not a handout.

So here's our proposal to get America's railroads back on the track to economic progress. It's in four parts.

1. We will continue to work closely with the Interstate Commerce Commission to streamline procedures.

Chairman Dan O'Neal is making a worthy effort to modernize the ICC and to institute needed administrative changes. We believe his efforts deserve our full support.

2. Encourage innovation through new regulatory freedoms.

This is the heart of our proposal and involves three basic changes:

First, gradually reduce the ICC's authority over rates. We're talking here about the freedom of a railroad to price its services independently and -- I would hope -- innovatively, so that shipper and carrier can negotiate directly on price and level of service. Long-term contracts, explicitly legalized, would be a likely result. To prevent any dislocations abrupt rate freedoms might cause, and to protect against abuses, we are recommending a five-year phase-in period during which rates could be raised without regulation only within the boundaries of a pre-determined "zone of reasonableness."

Second, allow railroads to abandon money-losing lines. The railroads have been regulated for nearly a century. In that time our economy has changed drastically. Population and market centers have shifted. Suburbanization has moved factories, warehouses and shopping centers away from the city. The highway network has made the truck a strong competitor for freight traffic. Yet the railroads, as 100 percent regulated common carriers, are required to provide service and to operate light-density lines even where other transportation services are available to shippers.

Two thirds of the rail traffic today moves over 40,000 miles of the existing 194,000-mile rail network. Twenty percent of the rail system is doing 67 percent of the work. And each mile of excess track is costing the industry an estimated $4,600 a year to maintain. We believe the railroads should be relieved of this burden. Regulations aimed at curbing 19th century robber barons are producing 20th century bankruptcies.

Under our proposal, route regulation would lessen significantly. After a three-year adjustment period railroads could discontinue service or abandon a line by giving the public eight months' notice. Service could be retained only through a state or local subsidy, or sale of the line at its liquidation value to someone willing to operate it.

Third, prohibit anti-competitive rate-setting activity by rate bureaus. Our plan would, in fact, prohibit industry-wide general freight rate increases.

It would also encourage mergers which do not inhibit competition.

As the President's budget message indicated, the proposed deregulation will be coupled, over the next five years, with $1.48 billion in new financial aid to assist in the transition to an unregulated environment.

I might note here that Conrail will also benefit from the regulatory reforms being proposed. The total Congressional authorization for Conrail presently stands at $3.3 billion. Whether more will be needed in the future depends partly on the fate of our deregulation proposal. We are due to get a report on Conrail next May telling us where they stand. We have discussed the regulatory reform options with Conrail management and they are factoring these into their plans. But Conrail is no different than the other roads, in the sense that meaningful improvements in their economic picture can't be achieved without greater regulatory freedoms.

Our program also calls for development of an efficient national rail system.

To create a new rail system we have to change the rail map. The restructuring process authorized under Section 401 of the 4-R Act has already begun in the Midwest, and we hope that what's happening there becomes an industry pattern.

We want to see an efficient system determined to a large extent by the actual flow of freight. That's happening to some degree with the Rock Island, the Milwaukee, the C and NW, and the other roads serving the Midwest. The restructuring logic is now spreading to the South and Northeast. We intend to encourage the process by continuing our program of financial and technical assistance. And we will publish this year for the first time an optimum mainline rail network report which should serve as a useful planning tool for us and for the railroads.

These proposals, along with the revised Northeast Corridor and revamped Amtrak recommendations I mentioned earlier, comprise the Department's 1979 rail improvement program and policy.

It is a well-reasoned, comprehensive program. And because it requires a break with tradition, it is a bold and aggressive program.

It is also the railroad industry's last chance to recover from its financial doldrums and rebound in the private sector of our economy. Its acceptance depends on the wisdom of the Congress and the willingness of the industry to trade a sheltered existence for the real world of competition.

The program's success depends in large part on the support and direction of America's financial and business leaders.

The railroads, I am confident, can come back strong. Our job is to make the process as painless as possible for the railroads concerned, profitable for the industry and productive for the nation's economy.

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