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REMARKS PREPARED FOR DELIVERY BY SECRETARY OF TRANSPORTATION BROCK ADAMS, TO THE PITTSBURGH TRAFFIC CLUB, PITTSBURGH, PENNSYLVANIA, JANUARY 26, 1978.

I want to talk tonight about railroads, because the survival - and revival - of America's freight railroads is essential to the best interests of our nation, this community, and the members of the Pittsburgh Traffic Club.

But before I do I would just like to mention that I am aware of the leadership role Pittsburgh has traditionally had in transportation. That tradition is continuing with the East Busway, which is the city's newest addition to public transportation progress. The Busway, which is expected to carry 90,000 commuters a day by 1983 - at great savings in time and fuel - recently received a Federal grant of $32 million from the Department of Transportation to continue engineering and begin construction work.

In addition, Western Pennsylvania starts seeing some big potholes about this time of year, and I want you to know that the condition of the Nation's roads as well as public transit programs are addressed in our highway and public transportation legislative package that the President has just sent to Capitol Hill.

I feel very strongly about this legislation. It's a keystone in our energy-saving efforts, it strengthens the program structure by equalizing federal matching grants, the definitions of recipients and the planning system, and schedules the completion of the Interstate highway system by establishing cut-off decision dates.

Now I would like to turn to the subject of the railroads. Most of my comments will deal with the Midwest rail situation. The decisions we make there will be felt in Pittsburgh, and eventually, by every shipper, consumer and taxpayer in the nation.

Five years ago, as a member of Congress, I assisted in putting together the Rail Reorganization Act that created the framework to reorganize Penn Central and seven other lines. I was also privileged to have a hand in the Railroad Revitalization and Regulatory Reform Act. That Act was signed in 1976 and provides $2.1 billion in Federal assistance and $1.75 billion for the Northeast Corridor Improvement Project.

We suspected then, and it has since become abundantly clear that the rail industry's problems would not be totally solved by the "QUAD R" Act. I was in Chicago last week to preside over a public hearing on the proposed restructuring of railroads in the Midwest. Additional meetings on that issue are scheduled for February 16 and 17. We are also completing a railroads capital needs report - a comprehensive study of the railroads' capital requirements through 1985, along with an examination of alternative ways of meeting those needs.

The preliminary report will be available in 30 to 60 days. However, because we want the widest possible range of public and industry comments before sending the final report to Congress, we will schedule a series of hearings to discuss the findings and invite comment.

Because I would very much like to have your professional opinions on both of these areas, I would like this evening to (1) outline the situation in the Midwest as we see it; and (2) preview for you the findings and recommendations contained in our capital needs report.

I tried to say very clearly in Chicago that I do not believe the situation there warrants a Northeast-type solution. We do not need a "ConRail West" amalgamation of the Granger railroads. Some restructuring is possible and advisable. The Federal role, as I see it, is to be a matchmaker, not a map-maker. I believe that a well orchestrated revision of the midwestern rail network could produce a slimmed-down, leaner, more efficient system - sufficiently structured to provide needed levels of service and strong enough to survive. And I believe that the job situation in the Midwest will be helped, not hurt, by the presence of a vigorous, financially healthy railroad system.

Now, I have been working on the nation's railroads long enough to appreciate the difficulties involved in realigning and redistributing privately-held assets. It is impossible to find a solution totally satisfactory to all concerned, and close to impossible to find one acceptable to the majority.

Yet I think we have before us the last opportunity for a private enterprise resolution of the Midwest rail problems. As it happens, it may also be the best opportunity that has come along in many a moon, partly because Section 401 of the 4-R Act provides anti-trust immunity for joint discussions, and because the ICC is prepared today to act more quickly on mergers and consolidations than at any time in the past.

The specific event that triggered last week's meeting in Chicago was the bankruptcy of the Chicago, Milwaukee, St. Paul and Pacific Railroad. But other lines in the region are shaky.

We foresee three possibilities. We can allow the bankrupt lines to be shut down. We can propose a Federal takeover, in effect using tax dollars to bail out the faltering railroad's shareholders and creditors. Or we can use the Federal resources available to assist in a private sector solution by encouraging voluntary actions by the rail managements, state governments, shippers and labor to consolidate operations and redistribute or eliminate duplicate or uneconomic track.

As I have indicated, it is the latter course of action that in my judgment makes the most sense and will best serve the long-term interests of the railroads and their customers.

There are several reasons why the formula for rescuing the freight railroads in the Northeast -- as applied in the Rail Reorganization and Recovery (3-R) Act -- would be inappropriate and therefore should not be adopted in the Midwest.

For one, the economies of the two regions are different. Generally speaking, the economic decline was sharper in the Northeast relative to the rest of the country.

The railroad structures themselves are different. The Penn Central was far more dominant in the Northeast than any single carrier is in the Midwest. Seven other carriers representing nearly all the mileage in the Northeast also were in bankruptcy. Moreover, in the congested Northeast, a manufacturer is often dependent on a single rail line, with no or few other shippers using that same line.

In the Midwest, on the other hand, shippers may have the choice of several lines, the result of "spider web" rail construction in the last century which spun track in all directions throughout the Plains.

Iowa and Kansas each have more than 7,500 miles of track, compared to 5,200 in New York State and only some 7,000 miles of track in all of California. The small town of Albert Lea, Minnesota, is served by four separate railroads operating six lines.

For these reasons, then, the Northeast carriers were in the most difficult position of all. The reorganization required a major governmental planning process, during which funding of $660 million in trustee certificates, grants and rehabilitation loans were required to keep them alive.

I think you can appreciate what the effect would have been on Pittsburgh's economy if the services provided by the Penn Central had suddenly ceased and had not been replaced. In order to provide an income-based reorganization and to capitalize ConRail, Congress has, thus far, authorized $2.1 billion in preferred stock and income debentures.

The railroads, in my judgment, should compete more aggressively as total transportation systems and less just among themselves or in fear of other modes. Competition is a healthy thing, but if a region is overbuilt with transportation systems like the Midwest it results in service at rates too low to support the equipment and facility investments that would improve efficiency. Soon there is neither service nor a system.

As I mentioned earlier, and as I said at the hearing in Chicago, this is a good time to take remedial action, for several reasons.

First, the underlying markets in the Midwest are strong. Business is available for the rail operator who can compete efficiently and effectively.

Second, shippers want better service than they are getting from the marginal carriers.

Third, much of the excess plant in the region can be restructured without terminating service to any important shipping point. Perhaps as much as 20 percent of the track can be excised or reduced in level without seriously affecting service.

And there are other ways. "Market swaps" can shorten distances and eliminate the need for maintaining through service over some secondary tracks or even certain mainlines. "Joint use" arrangements can consolidate overhead services on fewer facilities, with old mainlines perhaps reverting to local service. Branch line abandonments can be speeded up or the lines transferred to state plans, especially where alternative service is available. The Iowa plan which relies on state and shipper cooperation offers a good model. Purchase of some lines by stronger carriers is another important option.

In brief, there is ample opportunity - I believe - to make better economic sense out of Midwest rail operations, under circumstances short of mergers. We are interested in service, not the preservation of existing corporate structures.

Now, I'm not against merger as an acceptable and sometimes preferable business practice, but what counts is what happens on the rail lines themselves, not at the corporate level. If the partnership does not reduce total overhead, improve profitability and benefit shippers then merger has no value. In short, even the merger option must be part and parcel of a restructuring process.

We are making the resources and experience of our offices available. We will make Title V funds available as the law provides. We will use the authority under Section 401 of the 4-R Act to the fullest. The ICC will be involved in the process, for approval of property transfers, trackage agreements or abandonments. I have made it clear that I will be willing to argue for such changes before the ICC, if we can achieve substantial agreement among the parties involved in the 401 process.

I am even willing to seek facilitating legislative change if that is needed. But let me emphasize two important ground rules:

One, my goal is to avoid large-scale railroad reorganization legislation; I think we should make what we have work first. Two, under the 401 provision, the initiative lies with the carriers. They must originate the proposals.

Let me turn now to a few comments on the rail policy capital needs study that I referred to earlier.

The study, required under Sections 504 and 901 of the 4-R Act, is aimed at the industry's long-range problems and prospects from three standpoints:

-- The railroads' capital needs through 1985 and what role the Federal government should play in helping the industry meet those needs.

-- The condition of the industry, together with the possibilities for improvements.

-- The effect Federal policies toward other modes may have on the railroads.

The industry's capital needs are sizeable, with substantial gaps between identifiable needs and projected revenues. Most of these needs, however, are concentrated in the marginal carriers.

The report acknowledges that all the nation's railroads are not in dire need. Many, in fact, are quite profitable. Yet the condition of some marginal carriers is such that, unless corrected, the entire industry will ultimately suffer. The strong lines will be in danger of being dragged down by the weak links in the rail chain.

Our findings confirm previous diagnoses of the U.S. rail system's most troubling problems. Reduced to the basic common denominators, they are: (1) a failure to change with the times, (2) a surplus of facilities, and (3) maintaining light density lines at too high a level of activity for the revenues they produce.

Economies of density, we find, are highly significant. A mechanism must be devised that permits an orderly reduction and restructuring of light density lines. A total restructuring can be an appropriate device if done effectively.

But the main message of the report, I believe, is the necessity for <u>change</u> -

(1) In the way the railroads are regulated, so that all modes are treated the same;

(2) In government investment policy toward competing modes;

(3) In the physical structure and configuration of the rail network; and

(4) In the ways the railroads operate.

But, again, let me emphasize that change must come from within. It cannot, and should not, have to be imposed by Federal government planners. Needed change will rely on good faith effort by both labor and management - determined to work together for a strong and prosperous industry.

I know that this audience has an interest in the progress and the future of ConRail. We still must be concerned over whether funding provided in the 4-R Act will be sufficient to get ConRail on its feet on a self-sustaining basis. But operationally, the line is doing better. Its customers, I believe, feel that improvements are being made in the levels and quality of service. There have been better marketing efforts and progress has been made in track rehabilitation.

The severe weather last winter and equipment that proved to be in much worse shape than originally estimated - both problems not of ConRail's making - have aggravated the line's economic problems. We will continue to monitor ConRail's progress carefully and will work with USRA to determine what, it any, additional funds may be necessary.

I would like to end my remarks tonight on an optimistic note. The railroad industry suffers from the problem that for many people it is an invisible service. They never know it's there until it stops. The bankruptcy of the Milwaukee has produced much talk in the press of a "railroad crisis." I think that's a lot of malarkey. Somehow the fact that the railroads carried a record amount of traffic in 1977 and had gross revenues of $20 billion seems to have escaped the notice of the press. At the same time the Milwaukee bankruptcy was on the front page, the record earnings of Western and Southern roads and their plans for very large capital investments was buried on the financial page.

I think it is clear that the railroads have proved that they are essential to a sound transportation system. There are problems - yes. But they are problems that can be cured. I think that we are on the verge of a new era for railroading. As I said in Chicago, this is not the beginning of the end, but the end of the beginning. The energy shortage makes this fuel efficient mode ever more important. And as we shift to coal as a major source of power, the railroads will be the dominant carrier of this fuel. The sharp increase in piggyback traffic shows increasing coordination between truck and rail - a trend I want to see continued.

I have said there needs to be change; and I am confident that management, labor and shippers working together will bring about that change. There is a great future ahead for privately owned railroads. The passage of the Quad-R Act marked a turning point and a new beginning. The government has done its part and we will continue to seek a better regulatory system and to provide financing where needed. But whether the great future I foresee is achieved is to a large extent up to the people in this room.

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