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REMARKS PREPARED FOR DELIVERY BY WILLIAM T. COLEMAN, JR., SECRETARY OF TRANSPORTATION, TO THE NATIONAL CONFERENCE ON SURFACE FREIGHT TRANSPORTATION
WASHINGTON, D. C., APRIL 22, 1975

I am pleased to join you for this conference. You are dealing with a subject of profound importance to the surface transportation industry and, therefore, with a matter of major and immediate concern to me. I shall be interested in the proceedings of your entire meeting.

After I accepted President Ford's invitation to be his Secretary of Transportation, I began to expand my reading on the subject of transportation, including the history of freight transport regulation. I have learned, among other things, that the government has been proposing regulatory reform, off and on, for the last 14 years.

The need for regulatory reform extends to all modes -- air and motor carriers as well as rail. But of all our transportation sectors, the rail system is clearly in the worst shape. So I will address most of my remarks to that immediate problem.

Some of the dire forecasts from the past 14 years of what could happen to the nation's railroads, unless regulations were modernized, have come to pass. For many years now the railroads have been going downhill. When my predecessor took office, the first crisis to land in his lap was the imminent collapse of the Penn Central, keystone of a faltering Northeastern rail system shaken by the bankruptcies of the Penn Central and seven other railroads.

During my own confirmation proceedings, another railroad fell by the wayside. The 122-year-old Rock Island, locked for 12 years in merger proceedings, fell victim to a chronic rail industry problem -- the inability

-more-to obtain from conventional private capital sources the funds needed to sustain operations. The "straw that broke the back of the Rock Island," in John Ingram's words, was the 15 percent recessionary decline in freight business. But a railroad that cannot survive a temporary business downturn suffers from deeper problems. In the case of the Rock Island, investment decisions, management deferred and the non-decisions that occurred during a dozen long years of merger expectantcy seriously undermined the railroad's efficiency and economic stability.

I sometimes have heard the judicial process criticized for its deliberate pace, but I assure you the law moves with the speed of summer lighting compared to the course of regulatory change or rail merger negotiations.

You don't have to probe very far into regulatory history to find that the regulatory authority and procedures in effect today were instituted under social and economic circumstances almost totally unlike those of today.

In 1887, when regulations were first introduced, the railroads were all-powerful, with a virtual monopoly in surface transportation. The railroads were also essential to the development of the west. Regulatory authority was established primarily to restrain the railroads' monopoly power, and to exploit their capabilities for linking east with west and the development of commerce flow from west to east.

Regulation served other purposes. By setting rates it protected the small or isolated shipper, and protected the industry itself - and investors - against debilitating rate wars.

But the regulatory process also gave birth to commodity price discrimination, or the "value-of-service" pricing concept that persists today. We forget in these competitive times that in the second half of the 19th century the railroad rate structure was used effectively as a subsidy device, to stimulate development of the American west. To keep frontier incomes adequate, agricultural products and raw materials were transported at relatively low rail rates. Manufactured goods, on the other hand, were subjected to relatively high rates, since shippers had no choice and the cost could be passed on to the consumer.

When motor carriers came under regulation in 1935, truck rates were based on the existing level of rail rates, preserving the "value-of-service" principle. We must remember that the Transportation Act of 1935 was enacted during the depths of the depression. Its main purposes were to limit entry, control price reductions, and maintain discipline in the industry so that the remaining firms would not be forced out of business.

Perhaps I have spent more time than appropriate on the lessons of regulatory history, especially with an audience well-versed in the subject. My intention has been to emphasize that times have changed. If there is any similarity between the conditions that prevailed in 1887, when the

Interstate Commerce Act was passed, and 1935, when motor carriers were regulated, and in 1940 when Congress took its last close look at the ICC Act, it is the danger that the "remaining surface transportation firms" may be forced out of business. Only today, "those firms" in question are the nation's railroads.

When the costs are tallied and all the accounting is done, the first quarter of 1975 may be the most economically depressing in railroad history. Losses on the order of $100 million are expected, compared to net income of $170 million for the corresponding 1974 quarter.

As a result of this negative earnings situation, employment in the rail industry is down 21,000. Typically, many of those first to be laid off are maintenance-of-way employees. Maintenance cutbacks, in turn, further distress the physical condition of the rail industry, already showing the effects of deferred maintenance and inadequate capital investment. The figures vary and the latest ones I hear always seem to get bigger, but deferred maintenance throughout the industry is now estimated to be in the billions of dollars.

With accidents and derailments increasing despite our best safety efforts and with more deferments in maintenance likely, we may soon have a railroad system that does not meet the nation's transportation requirements -- at a time when rail fuel efficiencies and carrying capacities are so vital to our energy conservation, freight and passenger needs.

I am told already 40% of the track is on a stop or slow order. The length of time it takes a train to go across country is shocking and the use of equipment is at 14%.

That is the alarming situation that compells our attentions, and must take precedence over tradition, special interests and political decisions. It is not the railroad industry alone that is affected, but our economy as a whole.

We have lived at the brink of this economic precipice long enough. The various efforts Congress and the Administration have made over the last four years to put our surface transportation industry on a surer, safer and more financially stable foundation must be brought to fruition this year and in this session of Congress.

I have had long and serious discussions with the President that in the light of long-delayed regulatory reform and the ebb in rail revenues resulting from the current economic downturn, an emergency rail rehabilitation program may be needed. A new and dramatic program is on the drawing boards but obviously I cannot announce it now.

We must move forward urgently with legislation that will produce regulatory reforms and overcome the cumbersome machinery that frustrates rail merger and restructuring efforts.

"Regulatory reform" will be the central theme of our Department's legislative initiatives this year. As most of you know, we are working on motor carrier and airline industry reform proposals, to be submitted to Congress in the next few months. Our Railroad Revitalization and Energy Transportation Act, which contains many provisions of last year's Surface Transportation Act but includes some new "stimulants," will get to the Hill shortly -- hopefully within the next seven days.

Let me stress one thing! We do not seek total deregulation, we do not intend to abolish ICC or CAB. Our concern is for responsible change, to meet today's economic conditions.

What does the government want -- what do shippers and consumers expect -- from the nation's surface transportation industry?

Three things, I would say, in general:

First; we want a system that gets goods and services to the people at the lowest possible cost consistent with environmental and energy limitations.

Now, I know that we dwell on the problems so much that we often neglect to acknowledge that by and large we have a good freight transportation system in this country. But I don't believe for a minute, and neither -- I suspect -- does anyone here, that we have the best system...the finest, most efficient that could be assembled.

The conditions that prevent the railroads from performing efficiently have been well documented over recent months, and are being closely and professionally examined at this conference. I won't review that story, except to note that while some of our railroads are financially healthier and more efficient than others, the interlocking nature of our rail network unfortunately makes the chain only as strong as its weakest links.

While we can perhaps blame railroad managements for neglecting capital improvements, we must in fairness also blame antiquated regulatory policies for sheltering the railroads from economic realities. While other modes grew increasingly innovative and competitive, the railroads took refuge in regulatory provisions that guaranteed rates but effectively prevented the industry from changing rates to meet rising costs, responding to changing shipping patterns, and engaging in competitive marketing practices.

Now, by that remark I don't mean to say airlines and trucks aren't at fault also. At one time we thought one legislative package would fit all modes. We now know it won't.

In retrospect, the railroads' view toward the trucking industry in particular was short-sighted. The railroads refused to reduce rates to offset the traffic they were losing to truckers, and - not surprisingly - lost much of their most profitable business to the motor carriers. In 1940,

for example, the railroads accounted for 75 percent of all freight revenues; truckers, about 18 percent. In 1973 that situation was essentially reversed: trucks accounted for 56 percent of revenues and the railroads 37 percent. Yet the railroads carried almost 300 million more ton-miles than did trucks, a clear indication of the direction the higher value freight traffic has taken.

Second; we need regulatory and procedural reforms to permit a system where well-advised changes can be accomplished in a reasonable time.

Thus, in addition to regulatory reform we need procedural reform.

The Rock Island merger case, as I mentioned earlier, is a classic example of the difficulties involved in trying to consummate a marriage contract to which both principal parties agree.

I am told that 22 railroads and 200,000 pages of legal proceedings were involved in the Rock Island merger proposal which - when finally approved on a conditional basis nearly 12 years after the petition was filed - came too late to save the candidate railroad or benefit the others.

While I have been in the legal profession long enough to respect the sometimes torturous course jurisprudence often must take, I do not believe that any merger proposition can withstand long years of deliberation nor can the potential partners endure the agonies of indecision and uncertainty.

Moreover, such interminable delays appear not to be necessary. Last month, in a matter of hours, the railroads engaged in the Rock Island merger case did what they couldn't do in 12 years -- agree on the division of Rock Island routes. Ironically, the final partitioning closely matched the plan originally put forth by the Chicago and Northwestern Railroad in 1963.

I am of the opinion, as I have said previously, that mergers in the railroad industry may be necessary to strengthen our transportation system. For good and valid reasons, government traditionally has resisted proposed reductions in the number of business competitors or in the amount of competition. I am inclined to believe that an exception to that policy may be most needed with regard to the railroads. If railroads are to be merged or restructured, to avert economic disaster or loss of public service, swifter actions must be taken than present customs and procedures permit. The present vulnerability of the rail industry to economic ills is due in part to the large number of railroads and their interdependence. I think the country would be well-served by a restructuring of our national rail system and a significant reduction in the number of rail carriers. Like it or not, redundancy of capacity -- especially in the northeast and midwest -- is a serious minus factor in rail fortunes today.

Restructuring of the rail system in the northeast/midwest is another example of an action that must be accomplished within a reasonable time. The United States Railway Association's preliminary system plan was issued, on schedule, last February 26. The Rail Services Planning Office of the ICC has been conducting field hearings and will present its evaluation of the Plan before the end of this month. As Chairman of the Economic Policy Board Task Force on Restructuring, I will present specific recommendations to President Ford this next week. The next key date is July 26, when the final system plan is to be presented to Congress. Allowing ample time for Congressional deliberation and system start-up, ConRail should become an operating entity early in 1976.

In studying the Preliminary System Plan rather intensely, as I have done, I recognize that some disagreement is probably unavoidable over the proposed ConRail route system. A 30 percent reduction in trackage is bound to raise some protests, even though the slimmed-down system will accommodate 96 percent of the traffic carried by the bankrupts. But like it or not, rationalization of the system cannot be accomplished successfully without some selective abandonment of lines. If we aren't prepared to swallow that medicine, we won't work an effective remedy in the northeast.

Although the need for procedural reforms and faster decisions is most evident in the rail area, it is not restricted to rail matters. To meet the need for procedural reforms, our legislative proposals will require the regulatory agencies to act more expeditiously. And finally we must ensure that the railroads are preserved within a system that serves the economic welfare of the nation under the free enterprise flag.

The railroads are not beyond redemption. But they are sinking fast. For more than a decade, the capital expenditures of U.S. Class 1 railroads have exceeded retained income and depreciation by $6 billion in the past 12 years. Debt/equity ratio has risen to more than 70 percent. The average interest rate on debt is rising, while net working capital has declined to a negative balance that approaches $100 million.

Yet this discouraging trend can be arrested and even reversed <u>if</u> government, rail management, and rail labor make the right decisions and take the proper actions. Most urgent of these are legislative steps to provide the financial assistance the railroads need for capital improvements, and to relax the regulatory constraints that impede competitive practices. Equally important is the necessity for the industry itself to put its own differences aside in the interests of resolving common problems.

If the proper steps are taken today, the spectre of nationalization tomorrow can be banished. But the "if" is a big one. All that I have learned and observed in the past two months suggests to me that we may not be far from the point of no return -- when the prospects for retaining the railroads in the private sector will be beyond reach. The danger is a real

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one; yet still avoidable. I do not choose to believe at this point that the soul of free enterprise in this country is so lacking in vitality or so bankrupt of spirit that no solution to the railroads' problems short of nationalization can be devised or agreed upon. I cannot, and will not, accept such a premise. I will not accept it for the northeast because it would then move to the midwest and the west.

A hundred years ago the railroads were considered so vital to the growth and development of the United States that Congress gave land grants equal to 6.8 percent of our total land area to the railroads. The 35,000 miles of track in place at the end of the Civil War swelled to 70,000 miles by 1875, and to 149,000 miles by 1887.

The direct financial aid extended by the Federal government to the railroads for construction costs west of the Mississippi probably totalled $175 million, a princely sum in the mid-1800's. Yet, as a senator from Massachusetts said at the time, "what's a hundred seventy-five million for a system that connects the people of the Atlantic with those of the Pacific and binds them together."

True, indeed. The contributions the railroads - and the entire surface transportation industry in total - have made to the economic and social progress of our nation are beyond calculation.

The potential for great contributions still exists. To realize that potential to its fullest, it remains for us to revise and reform, restructure and revitalize, remodel and renew the process and the properties that constitute the surface freight transportation system in this country.

If I didn't believe that job could be done, I wouldn't have come to this podium, to this conference, or to this city.

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