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NATIONAL RAILROAD TRUST FUND

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH AND STABILIZATION

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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TUESDAY, OCTOBER 23, 1979

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TUESDAY, OCTOBER 23, 1979

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMIC GROWTH AND STABILIZATION
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 5110, Dirksen Senate Office Building, Hon. George McGovern (member of the subcommittee) presiding.

Present: Senator McGovern and Representative Moorhead.

Also present: Philip B. McMartin, professional staff member.

OPENING STATEMENT OF SENATOR MCGOVERN, PRESIDING

Senator MCGOVERN. If the subcommittee will be in order we will open this hearing on one of the important problems before the country.

We meet at a time when the United States is facing what I think is an unparalleled rail transportation crisis and that crisis is underscored by the inability of our most energy efficient means of transportation to meet rapidly growing demands placed on it by our energy short economy, and yet our success in coping with energy problems will be directly linked to the full utilization of our rail industry.

Present circumstances facing the railroads are not encouraging, as I think all you gentlemen know. We have a largely overbuilt and wornout rail system in urgent need of restructuring. Much of our rail industry, with an overall rate of return at less than 2 percent on investment, is in bankruptcy or on the brink of it. The industry continues to be beset by public subsidization of competing transportation modes. We have an industry perpetually wracked with management-labor relations problems.

The rail emergency of the Northeast is now well established in the Midwest. Today we will consider the validity of establishing a national railroad trust fund as an effective response to the challenge of raising the capital required by the rail system to eliminate a longstanding deferred maintenance and to finance new facilities and equipment. It is unrealistic to assume that the private financial market will be inclined to meet this investment need during the period of greatest demand in the immediate years ahead at anything approaching a satisfactory level. This would be so even with increased revenues stemming from significantly relaxed economic regulation.

Recent studies have been brought to my attention of the industry's capital needs ranging up to more than $50 billion in the 10-

year period ending in 1985. They tend to make the conclusion inescapable that although the idea of a rail trust fund similar to existing highway and airport development funds is not new, the present rail crisis has generated new interest and I might just say in passing that the first person to discuss this concept with me in some depth was Governor Shapp who is here today, who took the time some years ago to explain to me the urgency of the rail situation that was facing the country.

One of the features of a rail industry rather than moving it toward nationalization.

Having said that, I want to make it clear that this morning's hearing is in the nature of exploring the concept of the trust fund program rather than seeking comment on a fully developed proposal. I know that our witnesses have different opinions as to the basic idea of such a program. Nevertheless, I feel that a dialog on this subject will serve a useful purpose in terms of shaking out various options as to where the Nation's rail industry and Government policymakers should be moving in the months ahead to address the capital shortage problems of the rail industry and its ability to adequately serve rail shippers.

Gentlemen, before we begin the hearing, I'd like to point out to you that today I will introduce the Railroad Contract Act of 1979. This legislation seeks to promote mutually advantageous rail service contract agreements between railroads and shippers, particularly captive shippers, while preserving common carrier service for noncaptive shippers.

In essense, the bill is designed to give the railroads and the shippers maximum opportunity, through an exchange of commitments and negotiations, solutions to their rate and service problems. I would appreciate it if you would provide me with your comments and suggestions after you have had an opportunity to study the bill.

I think the way we're going to proceed today is to have each person open with a brief statement and at the end of those opening statements we will convert the rest of the forenoon into an informal discussion among ourselves of these issues.

Before continuing, I would like to place in the hearing record the background and discussion paper, which was sent to the hearing witnesses prior to the hearing, prepared by the staff of the subcommittee for discussion by the witnesses.

[The paper follows:]

Railroad Trust Fund: Background and Discussion Paper

A substantial capital funds gap stands as a barrier to railroad industry efforts to upgrade the system as a whole in order to meet increasingly heavy demands being placed on it.

The rail industry, facing a rate of return of less than 2 percent on investment in 1978, and rising maintenance and plant improvement needs intensified by mounting traffic demands, will be unable to satisfy the requirements of equity and debt investors. Left unanswered, the problems of inadequate capacity and deterioration will feed on themselves.

Although estimates of the capital gap vary, there is a wide consensus of opinion that it will be significant. The Department of Transportation (DOT) has estimated that the rail industry (excluding ConRail, Amtrak, and the Long Island) will require more than $42 billion for capital investment in the 10-year period ending in 1985 but will be unable to raise $13 billion to $16 billion of the total.

First National City Bank has estimated the capital deficit for this period at $21.1 billion. Harbridge House, Inc., concluded the gap could range from $5 billion to $12 billion.

The magnitude of the problem jeopardizes implementation of national energy policy and achievement of policy goals which directly rely on the full utilization of one of the most energy-efficient means of transportation for much of the country.

While a relatively few large railroads may be able to satisfy their capital investment needs, other viable and important elements in the system will not because their access to the money market is limited—in some cases extremely so. This in turn means that railroads, collectively, cannot meet urgent national transportation needs during this energy-short era because the capacity of the nationwide system is limited by its weakest links.

Absent development of significant new approaches, the stage will have been set for more intervention in the rail industry by the Federal Government as pressure mounts for full utilization of the railroad network. At best such intervention could take the form of providing more financial assistance under conditions of close Federal control of investment decisions. At worst, nationalization of some segments of the system could occur.

In the latter event, the Federal Government will have become permanently and increasingly entrenched in the operation of the rail system. There will be little hope of achieving effective, desperately needed rationalization of the industry's structure. As it is, DOT, despite its mandate to do so under the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act), cannot realistically be expected to promote timely and logical restructuring. Strong, diverse political pressures exerted on it place the task beyond its capacity. This problem would simply be compounded many times over should there be nationalization of weaker rail segments.

What is needed to effectively confront this dilemma is a tool which will assure the availability of adequate investment capital at reasonable cost while providing a satisfactory way of achieving logical, businesslike restructuring of the rail system. Establishment of a national railroad trust fund could answer this need.

What follows is a description of a basic trust fund concept for purposes of discussion at the hearing.

A national railroad trust fund, patterned somewhat after the user-fee-financed national highway trust fund, could include the following requirements:

1. Develop a pool of investment capital amounting to between $12 billion and $13 billion through the sale of Federal obligations in the financial marketplace over a short period of 6 years or less;

With such a large pool of investment capital available, the rail industry could eliminate much if not all deferred maintenance and otherwise improve plant and equipment to bring the system up to adequate service standards over a relatively short period of time.

Establishing the trust fund avoids having to rely on tax money and keeps the program out of the budget making process.

2. Make this pool of investment capital available on an equitable basis to all program participants;

To assure equity, loans available to individual railroads would be in proportion to their contribution to the program. This element in the program should be somewhat altered through possible establishment of a discretionary fund for investment where needs are greatest regardless of contributions made by railroads. For example, 10, 20, or 30 percent of the total amount in the trust fund during any given year could be utilized on a discretionary basis with the rest being apportioned on the basis of contributions.

Loans from the fund could be made at the cost of money to the Government for weaker railroads and at market rates for healthier lines.

3. Allow program participants to repay trust fund loans over a relatively long period of time (30 years) from the proceeds of a small surcharge (2 percent) levied on all traffic;

Use of a small surcharge on all traffic would allow railroads to avoid having to dip into existing revenue to participate in the program. A long repayment period is required to keep the surcharge small.

It should be noted that opinion is divided among some railroads concerning the impact of the surcharge on marginal traffic. Some roads argue that increasing the cost of service by even this amount will drive business away from railroads to truckers. Other railroads and some shippers say that little, if any, rail traffic is this sensitive to such a small change in cost.

With one or two exceptions, spokesmen for large shippers were in favor of the basic idea of the trust fund and the surcharge method of financing it. In essence, they indicated they favor the idea of taxing themselves if they can be assured that a rationalized rail system providing significantly improved service will result.

4. Require that all Class I railroads participate in the program and hold the opportunity for voluntary participation open to smaller lines;

Required participation of all Class I railroads is necessary in order to assure that the entire system is simultaneously brought up to an acceptable level of performance. This goal cannot be reached if Class I railroads are allowed to participate on a voluntary basis because some may not enter and as a result improvements from the program will be fragmented and so will the performance of the system as a whole.

Smaller railroads could be allowed to participate in the program on a voluntary basis. Their lines are not essential to the national rail system, but for the sake of equity and to avoid creating a discriminatory situation, they should be allowed in.

Representatives of some large railroads have indicated they would not favor the trust fund program because they can adequately fund their capital investment needs. They have ready access to the money market and they can finance it internally. However, their participation in the program is essential to achieve rationalization of the national rail system as a whole, as noted above. Loans at the cost of money to the Government rather than a market interest rate or some other type of inducement may be necessary to persuade them to support the program.

5. Establish a tripartite board appointed by the President with the advice and consent of the Senate and composed equally of rail, shipper and appropriate Federal representatives to administer the program from the sale of Federal obligations to approval of investment decisions by borrowing railroads;

Giving the board this structure would hand both the opportunity and responsibility of program decisionmaking to those directly impacted by it; namely, the railroads and the shippers who depend on railroads. Together, railroads and shippers could have a commanding vote margin.

The rationale for moving in this direction is that the rail industry and shippers are far more qualified than the Federal Government to decide where rail improvement investments should be made. Shippers should have an equal position on the board because they are funding the program through surcharge payments. The Federal presence in the program is held to a minimum and implementation of the program does not represent a serious, new extension of the Federal Government into the rail industry.

Any differences that develop between the board and borrowing railroads concerning the use of loan funds could be negotiated.

6. Require that loans be invested to achieve maximum benefits for both railroads and shippers in terms of eliminating deferred maintenance of mainline and major branchline tracks and to otherwise upgrade facilities and equipment to improve service to adequately meet current and anticipated traffic demands; and

7. Mandate that the board, in consultation with DOT, the American Railroad Association, various shipper organizations, and other appropriate public and private agencies and organizations, develop a plan to rationalize the structure of the nation's rail system and use the plan as a guide for investment of program loans.

These last two requirements are needed to assure that trust fund loans are not used to perpetuate existing rail industry problems and that the program as a whole serves as a tool to achieve rationalization of the national system.

Provision could also be made to end or alter the trust fund program in the following ways:

(*a*) That the trust fund program end at a date corresponding with the final loans made through the sale of Federal obligations and that receipt of loan repayments be placed in the hands of the Treasury or DOT,

This approach would answer the criticism that another self-perpetuating Federal agency was being created.

(*b*) That the trust fund program be continued indefinitely with the proviso that the Federal presence on its board is gradually eliminated and it becomes a private financial institution owned and controlled by railroads and shippers.

Even though the trust fund would continue indefinitely, it would be free of the charge that it was a Federal agency. This approach is loosely patterned on the banks for farm cooperatives that have been so successful. They were established under Federal sponsorship but eventually become private entities.

Senator McGOVERN. Congressman Moorhead is here this morning and has had a longtime interest in the problems that we are going to be discussing. He has obligations over in the House that are going to make it necessary for him to leave a little bit later on, but I wanted to call on the Congressman, especially in view of

Governor Shapp's presence today, for any comments that he would care to make.

OPENING STATEMENT OF REPRESENTATIVE MOORHEAD

Representative MOORHEAD. Thank you, Senator.

I think this hearing is extremely important. I say that particularly coming from Pennsyvlania and knowing the problems that we have had with railroad transportation across the State. In my view, Senator, you have really assembled a blue ribbon panel representing labor, farm, and industry. I particularly want to introduce Governor Shapp. I remember your concern about railroad transportation, particularly in Pennsylvania, even preceding your election as Governor, and I particularly remember your concern about the proposed merger of the Penn Central in Pennsylvania and the New York Central. I especially recall your very lucid explanations of how important to the economy of Pennsylvania a good railroad system is. I think that the same principle applies nationwide.

I would like to call to Mr. Ouellette's attention that the reason I have to leave is to chair a hearing involving the problems of another automobile company; to wit, the Chrysler Corp. We are having the Governor of Delaware and the mayor of Detroit testify today. As you know, that is a problem that is not easy to resolve even with the advice of people like the chairman of this subcommittee and the Joint Economic Committee. I hope you will forgive me for leaving, but I will take your testimony and all the other testimony with me to study. I commend you, Senator, for holding these hearings and I wish I could be with you for the entire hearing. Thank you.

Senator MCGOVERN. Thank you very much, Congressman Moorhead.

I think we will just go in the order in which you gentlemen are sitting. We will call on Governor Shapp to lead off our discussion this morning. As I said earlier, I had occasion to discuss the rail crisis on several occasions with Governor Shapp at the opening of this decade and it's good to see you here this morning, Governor, still interested in this problem.

STATEMENT OF HON. MILTON J. SHAPP, FORMER GOVERNOR OF THE STATE OF PENNSYLVANIA

Mr. SHAPP. Senator, I'm glad to be here today to talk about this subject because your committee, of course, is very much interested in the whole economic well-being of the Nation. Right now with the energy crisis that we face I just want to make a very strong statement that there's no way we're going to resolve the energy crisis in the United States until we rebuild the railroad system in this country in order to end the unnecessary reliance that we have today on the automobiles and trucks and to a certain extent even airplanes for hauling people and our goods around the country.

We keep talking about the energy crisis. There is no real shortage of energy supply in the United States. The major problems we are experiencing are due to mismanagement of our resources and to our failure to recognize as a top priority that we must rebuild the railroad systems in this country in order to reduce drastically our dependence on oil for transportation of people, raw materials and manufactured goods.

Now I have a prepared statement, but rather than read it, I'd just like to summarize the points that I make in this statement. The railroads form a backbone of transportation in the Nation. They are an irreplaceable asset. However, for whatever reasons—and I won't go into those today—there have been a whole series of mergers in this country that have harmed the economy in this Nation. I'm referring to the railroad mergers. The worst merger in history was the Penn Central.

If we do not maintain our railroad systems in this country and expand the railroads to make them more efficient, then the economy of this Nation can do nothing but go downward and we will have ever higher inflation, with more unemployment. So I tackle the railroad problem and the financing of an expanded railroad system in this country as the No. 1 step that is required if we are to end our problems on energy and also get this Nation back on the road to a strong economic future.

The Nation's railroads are an irreplaceable public asset. For more than a century they have been the backbone of America's economy and now more than ever they are essential for continued growth and prosperity. Ironically, while we have lavished public support on the rest of our Nation's transportation system through Federal and State aid for highway, water, and air transportation, we have all but ignored railroads. Actually and surprisingly, in view of the need, the transportation legislation that's been passed by Congress and most decisions rendered by the ICC have been directed toward reducing rail service in the Nation rather than increasing and improving it.

As a result, our Nation's rail system is far from healthy. Neglect has been the rule rather than the exception, not just among the bankrupt eastern railroads but across the Nation. Deteriorating track, a chronic car shortage, and poor service have generated millions of dollars in unnecessary cost for American shippers and ultimately for the consumer as well. This is a hidden but nonetheless important factor in creating inflation in America. The cost of transportation is a major part of the total cost of producing goods and the rail industry itself, once a giant of profitability, is now characterized by high cost low earnings or bankruptcy or near bankruptcy of some of the major companies.

America's railroads are at a crossroads. Either a means must be found to revitalize them or the Nation will be forced into a program of massive public subsidies or even outright public ownership, and I find neither alternative to be attractive.

The rail trust fund is a proposal to overcome this neglect, to modernize and equip railroads, to furnish high quality service that the public requires. The rail trust fund is not a proposal to nationalize railroads and it's not a Government takeover. The rail trust fund is not a subsidy program for railroads.

Rather, the rail trust fund would be a Government-sponsored self-liquidating investment program which would enable privately owned railroads to obtain sufficient funds to modernize and expand all their facilities in order to better serve the public. It provides the means of channeling billions of dollars into the track and yard improvements, electrification and rolling stock purchases over a 6-year period. Repayment will come from the surcharge on rail freight revenues which I estimate should be around 5 percent. Thirty billion dollars in loan funds would be available now and repaid over 30 years so the improvements can be completed in a matter of years, not decades.

This statement I have just read is in a booklet that I published back in 1974 when I was Governor of Pennsylvania entitled "The U.S. Rail Trust Fund."

And I think you will find, Senator, that the trust fund is an economical way, a businesslike way, to go about rebuilding the railroads.

I was in Chicago just a few days ago testifying on the Milwaukee Railway hearings that are being held by the ICC. Here we have another Penn Central in the making, a Penn Central of the West, and if the Milwaukee becomes decimated and the western railroads start to cut back, then we are going to have a situation in the West that's exactly like what we have in the East since the Penn Central was formed and went bankrupt and ConRail cut back rail service still further.

Lack of a good rail system in this country is one of the major causes of inflation, a major cause of our energy crisis, and I think that the hearing here could play a very important role in moving forward to revitalize the railroads in this Nation.

Thank you.

Senator McGOVERN. Well, many thanks, Governor.

[The prepared statement of Mr. Shapp follows:]

PREPARED STATEMENT OF HON. MILTON J. SHAPP

Energy and Rail Transportation

In mid-1977, Dr. James Schlesinger former Secretary of Energy warned Americans that unless we shifted our energy sources away from oil we would (in his words) "face economic disaster in the mid-1980's."

Last year scientists at MIT predicted that unless the United States attacks its energy problems "with wartime urgency," Americans will face catastrophe by the year 2000.

Since the energy crisis first developed in the wake of the 1973–74 Mideast War, three successive presidents have spoken of the urgency to establish a rational national energy program. But so far no occupant of the White House has developed such a plan, and Congress has wasted its own energy spinning wheels.

We are no closer to having a rational energy program in the United States today than we were 2, 4, or even 6 years ago, let alone being in the process of implementing such a program.

And, yet, there is no real shortage of energy supply in the United States. The major problems we are experiencing are due to mismanagement of our resources and to our failure to recognize that as a top priority we must rebuild the railroad systems in the United States in order to reduce drastically our dependence upon oil for transportation of people, raw materials, and manufactured products.

No national energy program can be effective until we take major steps to slash the 5.5 billion barrels of oil we use each year for trucks, passenger cars, and planes. We must also reduce the hundreds of millions of barrels of oil we use for present train service by electrifying our railroads and eliminating the need for diesel fuel to operate our trains.

All of this can be done—not over night—but with proper leadership from the White House and in Congress part can be accomplished prior to the mid-1980's and the balance before 1990. But unless we attack the overall situation with wartime urgency our Nation will continue to drift and eventually—and perhaps in the not too distant future—we will become a secondary world power.

Fortunately, the implementation of a realistic energy program will have some major economic benefits for our Nation. By utilizing the business principles of investment that has made the United States the world's greatest power, the accomplishment of this task will generate enormous economic growth opportunities within the Nation in the private sector creating millions of new jobs for the American people and thus increasing tax revenues for all levels of government while simultaneously reducing welfare and unemployment compensation costs.

Viewed in this light the present energy crisis could open the door to begin a new era of great economic growth in the United States. Billions of dollars could be invested profitably in many areas of endeavor.

Most importantly, implementation for such a program will make the United States substantially less dependent upon OPEC policies.

First and foremost, we can and must modernize our passenger and freight service with new equipment and safer track. Importantly, we should electrify the operation of our railroads. This will not only make our railroads more efficient but also it will eliminate the need to use 100 million barrels of diesel fuel each year for rail purposes.

This program can be self-financed by the Government without difficulty using practical businesslike investment bookkeeping practices. Congress should establish a national Rail Trust Fund patterned after the highly successful Federal Highway Trust Fund established in 1958 to finance the construction of the interstate highway system.

Through 1974, the Federal Government had advanced $94 billion for construction of this national highway network but had already collected $106 billion in excess taxes that were collected on the sale of tires, batteries, and other automotive accessories and from the 4-cent Federal gasoline tax that was imposed for this purpose.

Some sections of the interstate highway system are still not completed but the most important economic fact is this. Through the collection of these user types of taxes the Federal Government not only has received more than the 100 percent return on its initial highway investment, but it is also collecting many billions of dollars of revenue each year in income taxes from hotels, restaurants, factories, and shopping centers that have located along interstate highways. Also, Federal income taxes have been collected from the millions of people working in these establishments.

There is no way to easily calculate the rate of return that the Federal Government has made on the billions that was invested in the interstate highway program.

However, using this as an example it is easy to predict that a tremendous rate of return on investment can also be achieved by establishing a Rail Trust Fund to finance the rebuilding of our Nation's decrepit rail system.

Most importantly, in view of the critical oil shortage of today, this concept is more essential now than when it was first proposed by me in 1972.

Via the Rail Trust Fund Federal money would be advanced to rebuild the worn out tracks and track beds that are now unsafe on many railroads at any speed.

The Rail Trust Fund would also finance the purchase of new engines, freight and passenger cars as well as the modernization of freight classification yards and passenger vehicles.

Most importantly, the railroads financed by the Trust Fund would be electrified. Coal fired generating plants would be utilized to energize the American rail system.

Great advances are being made today in processes to virtually eliminate sulphur dioxide and nitrous oxide fumes from coal stacks.

Within the next 2 years there will be a least one and possibly three or four systems in operation for burning bituminous coal and still meeting the strictest National and State air pollution standards.

I have visited two research laboratories in Pittsburgh that have combined their talents to resolve the air pollution problems presently connected with the burning of high sulphur bituminous coal. In these pilot plants over 98 percent of the sulphur dioxide and 79 percent of the nitrous oxide fumes are being elimiated. With this new system in operation coal can be utilized without creating any new environmental problems.

Commercial application of this process is imminent and most certainly the equipment would be ready for installation before the generating plants needed to electrify America's railroads would be placed into operation.

Electrifying America's railroads offers other advantages.

First, there will be an overall saving in energy of 34 percent and no diesel fuel will be needed to power our trains.

Second, engine turn around time will be greatly reduced thus increasing the useful service time for engines and reducing costs for rail operation. A diesel locomotive requires much servicing, it also consumes much time to fill its tanks and normally, this causes a long layover period when a diesel engine reaches its destination and must be refueled.

With electric train engines, it is only necessary to reverse a switch and the engine is ready to run in the opposite direction.

Electrifying America's railroads will require an investment of about $65 billion but the savings in energy, the increased speed of operation and the lower cost of maintenance will all work to hold down transportation costs while saving billions of barrels of oil a year.

A modern high speed rail system could also be used for passenger service ala Japan, Switzerland, Italy, France, Germany, China, etc. This would greatly reduce automobile and bus traffic which in turn could save hundreds of millions of gallons of oil a year.

The plain fact is that with clean, fast train service millions of Americans would gladly leave their cars in the garage and ride the trains once again.

Mass transit systems are also required in and around our major cities. Here the economics are good even though not as favorable as with freight and passenger intercity operations. However, with gasoline now at the $1 per gallon level and undoubtedly soaring much higher in the future many people would rather ride public transportation if it were fast, clean, and available.

In and around many of our cities our old freight and passenger tracks that have been abandoned. A survey should be made by DOT in conjunction with State and local transportation officials to determine how many miles of right away presently exist that could be used for passenger train service if the tracks and switches were replaced.

Here again the financing program could be handled by the Rail Trust Fund. Local authorities similar to SEPTA in southeastern Pennsylvania or BART in the San Francisco area could be established for operation of all such commuter systems in and around our major cities.

Subsidies from the Federal Government augmented by State funds (as in the case of Federal interstate highway construction projects) would be needed to maintain low rider costs but the major consideration should be energy conservation and these savings could and should be cranked into the rail ticket pricing formula.

None of what is suggested in this statement is difficult to achieve if we but make up our minds and move ahead and improve our national transportation systems and save enormous amounts of oil in the process.

The pamphlet describing the principles of the Rail Trust Fund was prepared 5 years ago in December 1974 when I was Governor of Pennsylvania entitled "The U.S. Rail Trust Fund." At that time it was estimated that $12 to $13 billion would be needed to up-grade rail tracks, yards and rolling stock and to electrify the lines. Unfortunately, I have not up-dated the cost that would apply today but I would estimate that based upon the inflation that has taken place, and the higher rates of inflation in the future in the wake of Federal Reserve policies of constantly tightening the money supply and increasing interest rates that the proposed rail improvement and expansion program could be built in the next 5 to 8 years for about $30 to $35 billion.

However, since freight rates have also greatly increased, the same surcharge of 5 percent on freight rates that was recommended back in December 1974 should still cover the repayment program.

I also believe that a $2 billion revolving loan program for financing rolling stock purchases would suffice today. More detailed and accurate estimates can be prepared if the committee so desires.

Quite importantly, the 5 percent surcharge could be more easily absorbed by the shippers today because our railroads have become so dilapidated that the cost for hauling most products is soaring at a rate that exceeds the national inflation rate. A modernrail system would lower operating costs, reduce the tremendous losses due to accidents, and greatly increase the speed of delivery. All of these positive factors would more than off set the 5 percent freight surcharge.

Hopefully, some day in the near future, Congress and the White House will realize that energy conservation, windfall taxes on excess profits, and enormous sums invested to make synthetic fuels are important but not sufficient by themselves to constitute a national energy policy. They are important parts of such a program but more efficient means of transportation using coal to replace our nation's reliance upon oil for cars, trucks, and airplanes in essential in the future if we are to exist as a strong nation.

Since the Rail Trust concept can be used to self-finance the moderization and expansion of our national rail system and thus not only save enormous quantities of oil while greatly stimulating the economy by creating millions of new jobs and it is a concept that deserves major study and then action by the national leadership.

Senator McGOVERN. What I want to do is hold the questions until each person has summarized their prepared statement. We will proceed then to Mr. Treanor.

STATEMENT OF WALTER G. TREANOR, SENIOR VICE PRESIDENT-LAW, WESTERN PACIFIC RAILROAD CO., SAN FRANCISCO, CALIF.

Mr. TREANOR. Senator, my name is Walter G. Treanor. I'm senior vice president-law and a member of the board of directors of the Western Pacific Railroad Co. which is headquartered in San Francisco, Calif. We very much appreciate the opportunity to be here and participate in these discussions.

I have a prepared statement and I'd like to capsulize some of the highlights in that before we begin the dialog.

I wish to emphasize that my company has very strong and supportive interests in the concept of developing and implementing some plan which would be designed to accord access to adequate capital and capital funds at reasonable costs. We feel that being in on the early stages of this is very crucial for us and the people in our industry. I think in order to appreciate our real concern and interest in this matter it has to be made clear that while we are one of the smaller class I railroads in this country we sit in a very strategic position in that we are the only railroad that can provide competitive service in the Pacific west coast through the Utah and Oregon gateways. That position has been the subject of much discussion in many regulatory proceedings through the years.

As a result of that, we have had to have a strong interest in maintaining our physical properties in the best possible condition. Our management compliments itself, perhaps not unjustifiably, with its commitment to our capital investment program. The two top priorities on our railroad are maintaining the best physical properties of which we are capable and providing rolling stock in sufficient type and number to meet the demand of the shippers.

The concept which is here proposed is particularly appealing to us because it has been our experience that the present programs designed to provide some assistance to the railroads are designed primarily to provide assistance to those that are not currently in a healthy position. What we are concerned about is developing a plan where the railroads that are currently healthy can continue to be healthy. It is not so much the availability but the cost of capital that is giving us the greatest concern. That money that we are spending is only available at very high interest rates to provide these facilities, in our judgment, funds that could be much better spent in the actual facilities themselves.

With regard to the particular program, I wish to just briefly point out that we have some—I won't say concerns—but we have some questions about it. The pool of investment capital in our opinion must be made available primarily on the basis of the value and/or merit of the project desired to be financed rather than on the basis of some contribution to the fund by the potential drawers.

The reason for that is that as a small carrier obviously we wouldn't want to be in the position of being outbid by size. We would like to have it evaluated on a merit basis.

With regard to the surcharge concept, obviously to us the No. 1 priority is whether it is acceptable to the users of our service? We think if they do not find this concept acceptable, obviously it will not provide the answer. We feel that the surcharge concept has to be very carefully reviewed to make sure that it will not prove to be anticompetitive. If it has the effect of diverting traffic away from us, obviously it would not be the answer.

The establishment of a tripartite board appears to be a very sound concept. It must be carefully set up at the very outset to make sure that the managerial prerogatives are not going to be dissipated by interference by those that don't run the business on a day-to-day basis.

And finally, I must comment that the end objective is what we very much want to accomplish. The enforced participation concept gives us some pause, not from our own standpoint, but whether constitutional questions are raised.

We are not prepared to address this issue now. If debilitating litigation were to result, obviously that would be an undesirable result.

In conclusion, we applaud and support the initiation of this very serious effort to develop a solid program that will assist the Nation's railroads to find capital funds at reasonable cost levels together with a requirement that if they get access to these funds they must produce an end result that is designed to help the shippers because if it doesn't accomplish that objectivbe we are just wasting our time.

Thank you very much, Senator.

Senator McGovern. Thank you very much, Mr. Treanor, for your testimony.

[The prepared statement of Mr. Treanor follows:]

PREPARED STATEMENT OF WALTER G. TREANOR

My name is Walter G. Treanor and I am Senior Vice President-Law and a member of the Board of Directors of The Western Pacific Railroad Company headquartered in San Francisco, California. We appreciate the invitation to attend this hearing where we will have the opportunity to participate in the exchange of views on this most important subject.

Western Pacific has a strong and supportive interest in the concept of developing and implementing a plan designed to accord access to adequate capital at reasonable cost. We are appreciative of the fact that the details of such a plan cannot be formalized until there has been a thorough study of all challenging and innovative approaches to the problem faced by such a heavily capital-oriented industry.

We are mindful that there are some existing programs that were hopefully designed to provide some financial relief to the railroads but those existing programs appear to be totally inadequate in the providing of meaningful assistance to railroads that are not in immediate financial distress. It is our hopeful anticipation that a properly structured and administered program will fill the current void in the area of assisting healthy railroads in their determined effort to remain financially viable while providing high quality service consistent with modern demands of the users of the service. For any industry which is by its very nature intensely capital-oriented the availability of capital at non-debilitating interest rates is of great importance. Whether the Trust Fund concept, or something akin thereto, is the answer will have to await the completion of the very close evaluations we anticipate will develop during the course of the Subcommittee study.

To fully understand Western Pacific's particular and intense interest in the concepts which are the subject of these hearings it is necessary that there be a clear picture of the rather unique position occupied by this carrier. Although one of the smaller Class I railroads Western Pacific is strategically so located as to provide imaginative and effective competition to giant railroads and motor carrier systems via the Utah and Oregon Gateways. This unique positioning together with our aggressive and imaginative marketing programs will continue to be of significant public, as well as private, benefit so long as we are able to continue a position of leadership and responsiveness to the constantly changing transportation needs of shippers and receivers which we serve. Heavy expenditures for equipment and standing facilities of every possible description will continue to be a fact of life for Western Pacific well into the foreseeable future. The very fact that our properties are extremely well maintained, and our continuing investment in equipment very substantial, should be ample evidence of Western Pacific's commitment to the basic goal of providing our customers with the best railroad service of which we are capable. It must be equally obvious that the rate of return earned by the nation's railroads individually and collectively is totally insufficient to permit the infusion of capital without substantial borrowing, thus it is the cost of borrowing which presents a most serious concern both to the carriers and the users of their service. Funds to maintain and improve the rail carrier properties at interest rates which do not serve to dissipate the already low net revenues can and should be made available and it does not appear that the private financial market is in a position to afford any relief in that direction. Thus, the establishment of any program which can be properly structured and administered presents an exciting possibility for a solution to the dilemma of the cost of railroad capital needs.

The background and discussion paper distributed in connection with the hearing is very helpful and it does, as we are sure was fully anticipated, raise as many tough questions as it solves. It is not our intention, at this early stage, to attempt to submit our full and final views on these questions. The dialogue to be developed during this Subcommittee's hearing will be of extreme assistance in the addressing and answering of such questions and, we will take advantage of the opportunity to continue to submit our views in writing to the Committee so that we can work together toward the desired objective of establishing a plan that will meet the end objective of eliminating deferred maintenance, improve facilities and acquire equipment to meet the legitimate demands of both the present and future.

There are a great many aspects that must be thoroughly analyzed before we can begin to get a meaningful handle on any specific proposal.

As a starting point we feel that certain aspects of the Trust Fund concept requires special attention:

(1) The pool of investment capital should be available primarily on the basis of the value and/or merit of the project desired to be financed rather than primarily on the basis of contribution to the fund by the potential drawers. Otherwise, the smaller carriers could effectively be "out bid" by the larger regardless of the value of a given program to the users, i.e., shippers who will ultimately provide contributions in the form of user charges.

(2) It is not clear how the carrier program participants are expected to make a contribution. Is this through their own purchasing of the Federal obligations to be made available in the financial market place or through some separate form of contribution?

(3) The surcharge revenues, if the concept is acceptable to the shippers (and this is a must if it is to be adoptable and workable), should be set up in a manner which will make them nontaxable to the collecting railroads. The railroads should serve essentially as a collecting agent with a direct flow-through to the fund. This would appear to be beneficial to those who are paying the surcharge as it will assure that the surcharge funds are fully used to improve the rail services which is the intended purpose. This would appear to be major consideration since this type of program should be designed to position the railroads to significantly improve their service and to thereby increase their profitability increasing the likelihood of increased income taxes. Of course, the possible anticompetitive impact of the application of a surcharge would have to be carefully evaluated before it can be finally determined that it would be productive. Obviously, if competitive facts of life were to prevent the use of the surcharge it could not be viewed as a viable tool in this program.

(4) There is a considerable disparity in the financial resources of various of the larger and smaller Class I railroads and the latter should not be penalized in the event the larger overload the program.

We do have some serious reservations regarding the constitutionality of "required participation" and while we will not attempt to address those questions at this early stage they will have to be carefully analyzed prior to finalizing the program or else debilitating litigation could serve to thwart the very fine objective of establishing the program.

Noting that the Committee has received advice that some large railroads would object to the program because of their ability to finance internally it would appear that the concept of enforced participation might prove more debilitating than helpful in the long run. This must be carefully evaluated since total participation is deemed essential to achieve strengthening of the entire national rail system.

(5) The establishment of a tri-party Board appears to be a sound concept but it must be most carefully set up at the very outset.

There must be some reasonable front-end standards adopted or else the value of the program could be severely dissipated through honest and reasonable irreconcilable differences as to priorities. Undue Government interference in the operations of the carriers must be avoided if the program is to be supported and successful and, accordingly, the structuring of any plan designed to assist the infusion of capital into the industry must provide meaningful assurance against any such possibility.

In conclusion we applaud and support the initiation of a serious effort to develop some solid program that will assist the nation's railroads to find capital funds at reasonable cost levels. As the Subcommittee has already noted, some carriers may be capable of carrying the heavy finance servicing costs but most others must struggle with it under conditions which unfairly dissipate funds that could be far better used in providing facilities rather than paying for the use of the money.

We will take full advantage of the continuing opportunity to make input into the consideration and development of a positive program so designed. Following this hearing, which we fully anticipate will allow a better mutual understanding of the view and concerns of all concerned, we will be forwarding the detailed views and suggestions of our Finance people who are dealing with the challenge of the capital borrowing situation on a daily basis.

Senator McGovern. Our next witness is Mr. James T. Curtis, Jr., who is corporate director of transportation services for the Georgia-Pacific Corp. Mr. Curtis, we would be happy to hear from you.

STATEMENT OF JAMES T. CURTIS, JR., CORPORATE DIRECTOR OF TRANSPORTATION SERVICES, GEORGIA-PACIFIC CORP., PORTLAND, OREG.

Mr. Curtis. Thank you, Senator.

My name is James T. Curtis, Jr. I am corporate director of transportation services for Georgia-Pacific Corp. My responsibilities include the overall direction of Georgia-Pacific's transportation activities. In my capacity I report directly to the chairman of the board.

Georgia-Pacific Corp. is duly organized and exists under the laws of the State of Georgia with its principal place of business at 900 SW. Fifth Ave., Portland, Oreg. Georgia-Pacific is a manufacturer of tissue, paper, paperboard, converted paper products, woodpulp, chemicals, gypsum products, roofing, doors, plywood, lumber, hardboard, and various other building materials. In this capacity Georgia-Pacific employs approximately 40,000 people, has 205 manufacturing plants, and maintains 158 wholesale distribution centers throughout the United States and Canada. Georgia-Pacific is a major consumer of rail transportation, both as a shipper and receiver. Each of Georgia-Pacific's facilities is served by rail and rail transportation is the primary method of moving our commodities. Accordingly, the survival of the Nation's rail transportation network is of preeminent importance to Georgia-Pacific.

INTRODUCTION

We are pleased to have the opportunity to appear here today to testify in connection with the establishment of the national rail-

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road trust fund. It is indeed distressing that we find the Nation's railroad system inadequate to provide long-term transportation service. We concur with others in thinking that the central question of railroad viability revolves around the railroads' inability to provide capital funds needed for maintenance and plant improvement. Regardless of the exact figures of the capital shortfall, we think there's universal agreement that the number is in the billions of dollars. Our ultimate fear is that the railroad system, faced with its myriad of problems, will become further subjected to Federal intervention and ultimately face nationalization in some form or degree.

Nationalization is a condition that we find unacceptable. The idea of a trust fund that is under discussion here this morning has overtones of Federal intervention which is disturbing. Government scrutiny and supervision, to the extent it might be necessary under a trust fund, raises the possibility of nationalization. Let me state categorically that our desire is to have a national railroad system with long-term viability in the hands of the private sector.

REGULATORY REFORM

We have worked at great length with other companies, with the Association of American Railroads, the Congress, and others to improve the railroads through the process of regulatory reform. We still have hopes that legislation can be passed that will release the railroads from regulatory restraints that will permit the necessary rejuvenation and rehabilitation to take place in the private sector. In addition to legislation that would deal with lessening the railroads' regulatory burden, it is our desire that the issue of productivity be fully explored and rationalized. If a legislative program was developed that encompasses all of these concerns, we would envision a rail system in which the individual rail companies were treated under the law as any other commercial enterprise. Under these circumstances, we would ask only that the rails not be given exclusive franchise coupled with monopoly pricing power.

RAILROAD TRUST FUND

Since we cannot be certain that our desires discussed above will be accomplished, we feel it is time that those concerned with public policy begin to consider alternatives. These alternatives should be oriented to the demand of economics of transportation as opposed to supply consideration which has long been the Federal Government's method of dealing with the national transportation system. It must be remembered that shippers and ultimately consumers pay the cost of transportation. It is in consideration of alternatives that we are intrigued with the idea under consideration here today; namely, the establishment of a national railroad trust fund. Our suggestion to the subcommittee is that the idea of a trust fund should be developed only as a standby program. We believe that that standby program may be the impetus to stimulate and motivate all parties involved in rationalizing the national railroad system to take action that would permit the railroads to remain fully in private hands. This standby program should be fully developed with the idea that all railroads would have the opportunity to participate but that funds would be available only to those essential parts of the national rail system. The board or commission developed to administer this proposed standby program should be structured to represent fully all interests but with heavy emphasis on shippers and railroads having a collective majority voting interest. It also would be further essential that this program have a sunset provision in order that we would not follow the all-too-often approach of developing federally mandated programs from which the Government never extricates itself.

In closing, let me reemphasize that we favor only the national trust fund idea as a standby measure but that we fully realize that if other programs now being discussed to improve the railroads are not achieved that the trust fund may be the ultimate answer. Senator, this concludes my prepared testimony. I would be pleased to answer any questions you or other members of the subcommittee may have and to work with the subcommittee on this important legislative idea. Thank you.

Senator McGOVERN. Thank you very much, Mr. Curtis, for your testimony.

Our next witness now is Mr. William K. Smith, who is the director of transportation, General Mills, Inc.

STATEMENT OF WILLIAM K. SMITH, VICE PRESIDENT AND DIRECTOR OF TRANSPORTATION, GENERAL MILLS, INC., MINNEAPOLIS, MINN., AND BOARD CHAIRMAN, UNITED STATES RAILWAY ASSOCIATION, WASHINGTON, D.C.

Mr. SMITH. Thank you, I have a prepared statement. I will be reading the first two paragraphs of the statement and then skipping to the sixth page. When I skip to the sixth page I will be talking about one of the seven requirements suggested for the fund.

My employer is General Mills, Inc., and I serve that company as vice president and director of transportation. I am also board chairman of the United States Railway Association.

My comments today on the subject of this hearing—the basic concept of a railroad trust fund—are my own, and in no way am I speaking for either of those two organizations. Furthermore, neither General Mills nor USRA has given any consideration to or taken any position on the concept of a railroad trust fund.

The sixth requirement suggested for the fund involves a tripartite board and how this board might function. One part of the tripartite board would have railroad representation. My comments on that: A railroad's management should be better qualified than either the Federal Government or shippers to decide where rail improvements should be made. A paper in the 1977 transportation research forum's proceedings refers to a DOT study of railroad investments and the techniques used in the railroads' analysis of investment opportunities. According to the proceedings:

> It has often been asserted that the organization of the railroad industry as a large number of independent companies results in investment decisions which are not in the best interest of the railroad industry as a whole. Our investigation supports that view, and identifies general ways in which this organizational structure affects investment decisions (1) fragmentation of the industry's profits, (2) fragmentation of the industry's administrative and decisionmaking resources.
>
> Because industry profits are fragmented, economic self-interest sometimes induces railroads to undertake projects which are not desirable from the industry point of

view and sometimes discourages projects which are desirable from the industry viewpoint. One reason for this is that the railroads tend to ignore a project's impacts on other railroads.

According to the thrust of the DOT study reported in the 1977 proceedings, railroad people might not necessarily come to a tripartite board with an industry perspective. But were there a tripartite board, which had to work from an industry perspective, then the shortfalls in railroads' investment techniques, as identified in the DOT study, might find some remedial action from the existence of such board.

The requirement also refers to shipper representation. A shipper might be the customer—the business entity—that uses the railroad. Or shipper might be the person employed by the customer, the person who selects the method of transportation, the person who selects the specific carrier or carriers.

Whether the person or the employing company, I believe there are few shippers as well qualified as the railroads and their people to decide where rail improvement investments should be made.

The board also includes Federal Government representation. My comments: Federal Government representation on a tripartite board is capable of contributing strong qualifications and could more easily avoid many of the parochial aspects of the railroads and the shippers. A few of those parochialisms include: Rural shippers-urban shippers, agricultural shippers-industrial shippers, bulk shippers-merchandise shippers, "big" shippers-"little" shippers, et cetera; eastern/southern/western railroads, "have" railroads-"have not" railroads, et cetera.

My point in going through that is to give a little more emphasis to the value of the Government participation without removing the value of railroad or shipper participation.

Were there a railroad trust fund and were there a tripartite board to administer the program, I would strongly urge that it be structured within the system-research and planning responsibilities placed on the Secretary of Transportation by the railroad revitalization portion of the 4-R Act. Also, I would suggest that the funding aspects of any railroad trust fund should be within the charge given the Secretary of Transportation by the 4-R Act. I would argue against any tripartite board—for a trust fund—having responsibilities to determine the overall national needs for railroad transportation, private-railroads capabilities to meet those needs, any shortfall in capability reflecting funds shortfall, and how much an in what form should Government funding be applied to the shortfall.

Should there be a trust fund approach to railroad funding needs, I believe it should be structured by the Secretary of Transportation, applying the responsibilities of that office per the 4-R Act.

In that context, a trust fund's tripartite board decisionmaking, with respect to railroads seeking loans, would be in the context of a DOT overview of the railroad industry.

Were there a tripartite board, working within a DOT-overview context, the board would still have a decisionmaking context requiring: loan-application analysis, loan-making capability, and loan-usage monitoring capability.

From my USRA experiences, such work would require a staff to assist the tripartite board. I believe the staff could be relatively small, 50 to 100 people, about $3 to $6 million annually. The board would be appointed by the President with the advice and consent of the Senate. I agree with that.

The sixth requirement also refers to the requirement that loans be invested to achieve maximum benefits for both railroads and shippers. Then there's language in the discussion paper about eliminating deferred maintenance of mainline and major branch-line tracks. Fixing track is not necessarily "achieving maximum benefits for both railroads and shippers."

Terminals, yards, and communications, plus their support software, are frequently areas for investments that have greater potential benefit for both railroads and shippers.

My point: Any Federal railroad trust fund statutory-base should not be directed at the specifics of what part of the plant should be financed. A tripartite board should be free to decide on performance standards and not design specifics for achieving those standards.

In conclusion:

First, my comments are in the context of a discussion of a railroad trust fund and its administering board. They are either pro/con any proposal to implement the fund and board.

Second, there is a capital shortfall for the railroad industry, in the relationship of needs for funds and the industry's ability to create funds internally or finance from external private sources.

Third, I think the needs are somewhat less than what is suggested in the discussion paper.

With respect to the small surcharge on railroad freight charges, it is probable salable to the shipper. To me, small is 1 percent; 2 percent might still be small, but 3 percent is definitely the threshold to too big.

If there were a trust fund, the idea of a board appeals to me as being advantageous—but only if to assist DOT and not in lieu of DOT's responsibilities. Were there a board, the railroads and the shippers should be a part of the board and have more votes that the Government representatives. Thank you.

Senator McGOVERN. Thank you for your testimony, Mr. Smith.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF WILLIAM K. SMITH

My employer is General Mills, Inc., and I serve that company as Vice President and Director of Transportation. I am also Board Chairman of the United States Railway Association (USRA).

My comments today on the subject of this hearing—the basic concept of a railroad trust fund—are my own, and in no way am I speaking for either of those two organizations. Furthermore, neither General Mills nor USRA has given any consideration to or taken any position on the concept of a railroad trust fund.

My work experience and my continual study of many transportation issues helps me to recognize the existence of a "capital gap" for the railroad industry. I accept the estimate of the Department of Transportation (DOT) that the rail industry (excluding ConRail, Amtrak, and Long Island) will be unable to raise $13 to $16 billions in needed capital, 1978–85.

DOT, as representative of the Carter Administration's position, places great emphasis on the railroads being able to reduce substantially (possibly eliminate) the $13 to $16 billion capital shortfall by lessening economic regulation; which lessening would allow greater freedom for railroad management in the services they offer and in the prices they set for those services; and which freedom would produce an anticipated greater financial viability for the railroads.

I believe there are potentials in the lessening of some parts of economic regulation which could improve the financial viability of the railroads.

My belief does not come from the projections of economists (many of whom support less or no economic regulation) but rather from 1980–84 plans prepared by ConRail, the planning work of USRA, and the experience of the Canadian National.

ConRail's Business Plan, For The Period January 1, 1980 to December 31, 1984, as submitted to USRA on August 1, 1979, projects hundreds of millions of dollars in greater income, assuming the enactment by Congress of fundamental regulatory change.

USRA's report (a joint effort of USRA/Federal Railroad Administration staffs), Alternatives For ConRail, August-1979, also suggests hundreds of millions of dollars (1980–84) in greater net income, assisted by "regulatory reform."

Those ConRail and USRA studies lead me to believe that "less economic regulation" for that one railroad could produce a $50 to $100 million per year improvement in net income. And I can easily make the leap that "less economic regulation" for the entire railroad industry would be worth several times what I see for ConRail.

I can also refer to the Canadian National's experience (which to me has some application to this country). The Canadian railroads were basically "deregulated" (with respect to economic regulation) in 1967. Mr. Robert Latimer, senior executive of the railroad part of the Canadian National, describes the past 12 years:

> The Canadian National has gone from a zero (actually negative) return-on-investment in 1967 to an 8 percent ROI in 1978. A great deal of that financial improvement was accomplished by having less economic regulation than Canada had prior to 1967.

At a meeting in June, 1979, I asked Mr. Latimer:

> How much of this very significant accomplishment (of an 8 percent ROI) was from not having economic regulation and how much was from running the railroad more efficiently?

He replied:

> I and other people on CN have paid a great deal of attention to that question. In my opinion, about two-thirds of the accomplishment was made possible by eliminating economic regulation and one-third came about because we figured out how to run the railroad better.

He also said that running the railroad better had some help from deregulation. So in total he thought about one-fourth of CN's great economic improvement has come about from doing the job better (with no relationship to economic regulation), and three-fourthers came about from having less regulation.

My reference to ConRail, USRA, and Canadian National is also a reference to an information-base which leads me to believe there are efficiencies to be gained in the operations of many railroads; efficiencies unrelated to economic regulation, and efficiencies with dollar gains possibly equal to the potential income gains that could be assisted by less economic regulation.

I believe the railroads will have a substantial lessening of economic regulation in the next few years. Also, I believe they will more aggressively apply the lessening of economic regulation that they have been offered in the past few years. And I believe they will achieve increasing efficiencies. For me those beliefs mean that half of the $13–$16 billion capital shortfall (as projected by DOT) will be erased by the railroads performing more effectively and more profitably. Nevertheless a substantial capital shortfall will probably exist during the 1980's.

But regardless of whether the shortfall is my intuition or the computations of DOT, Citibank, etc., there will be a shortfall, and a railroad trust fund is one of the alternatives, should the Federal Government be a funding source to overcome the shortfall.

With respect to the concept of a railroad trust fund, as presented in the Subcommittee's Background and Discussion Paper, it would have seven requirements. My thoughts on the seven requirements are:

1. $12–$13 billion pool of investment capital—a lesser need could exist, possibly 50 percent less a trust fund—my experience is that neither Democrat nor Republican administrations, since 1970, has supported additional use of the trust fund financing technique (except some support for a transportation trust fund in lieu of existing "modal" funds.)

2. Loans available to individual railroads in proportion to their contributions, with some "discretionary funds for greatest needs."

3. Long term loans.

4. Surcharge—a 1 percent surcharge would produce about $220,000,000 annually; at that level, a surcharge (probably) would not be too difficult to sell and would not cause much (if any) traffic diversion. (How many $ billions could be funded by a 1 percent surcharge; with the loans made to the railroads over the next 5 to 10 years; but without repayment of the loans until 35 to 40 years from now?)

5. Compulsory for Class I railroads—would appear to be a necessary requirement.

6. Tripartite Board.

With railroad representation

A railroad's management should be better qualified than either the Federal government or shippers to decide where rail improvements should be made. But a paper in the 1977 Transportation Research Forum's Proceedings refers to a DOT study of railroad investments and the techniques used in the railroads' analysis of investment opportunities. According to the Proceedings:

"It has often been asserted that the organization of the railroad industry as a large number of independent companies results in investment decisions which are not in the best interest of the railroad industry as a whole. Our investigation supports that view, and identified three general ways in which this organizational structure affects investment decisions (1) fragmentation of the industry's profits, (2) fragmentation of the industry's capital resources, and (3) fragmentation of the industry's administrative and decision-making resources.

"Because industry profits are fragmented, economic self-interest sometimes induces railroads to undertake projects which are not desirable from the industry point of view and sometimes discourages projects which are desirable from the industry viewpoint. One reason for this is that the railroads tend to ignore a project's impacts on other railroads.

According to the thrust of the DOT study reported in the 1977 Proceedings, railroad people might not necessarily come to a tripartite board with an "industry perspective." But were there a tripartite board, which had to work from an "industry perspective", then the shortfalls in railroads' investment techniques, as identified in the DOT study, might find some remedial action from the existence of such Board.

With shipper representation

A "shipper" might be the customer (the business entity) that uses the railroad. Or "shipper" might be the person employed by the customer, the person who selects the method of transportation, the person who selects the specific carrier or carriers.

Whether the person or the employing-company, I believe there are few "shippers" as well qualified as the railroads and their people to decide where rail improvement investments should be made.

With Federal Government representation

A Federal Government representation on a tripartite board is capable of contributing strong qualifications and could more easily avoid many of the parochial aspects of the railroads and the shippers. A few of those parochialisms include: Rural Shippers-Urban Shippers-Agricultural Shippers-Industrial Shippers-Bulk Shippers-Merchandise Shippers-"Big" Shippers-"Little" Shippers, Etc.-Eastern/Southern/Western Railroads-"Have" Railroads-"Have Not" Railroads, Etc.

To administer the program from the sale of Federal obligations to Approval of investment decisions by borrowing railroads—

Were there a railroad trust fund and were there a tripartite board to administer the program, I would strongly urge that it be structured within the system-research and planning responsibilities placed on the Secretary of Transportation by the railroad revitalization portion of the 4-R Act. Also, I would suggest that the funding aspects of any railroad trust fund should be within the "charge" given the Secretary of Transportation by the 4-R Act. I would argue against the tripartite board (for a trust fund) having responsibilities to determine the overall National needs for railroad transportation; private-railroads capability to meet those needs; any shortfall in capability reflecting funds-shortfall, and how much and in what form should government funding be applied to the shortfall.

Should there be a trust fund approach to railroad funding needs. I believe it should be structured (including "suggested") by the Secretary of Transportation, applying the responsibilities of that office per the 4-R Act.

In that context, a trust fund's tripartite board decisionmaking, with respect to railroads' seeking loans, would be in the context of a DOT overview of the railroad industry.

Were there a tripartite board, working within a DOT-overview context, the Board would still have a decisionmaking context requiring: Loan-application analysis; loan-making capability; and loan-usage monitoring capability. From my USRA experiences, such work would require a staff to assist the tripartite board. I believe the staff could be relatively small, 50 to 100 people, about $3,000,000 to $6,000,000 annually.

Appointed by the President with the advice and consent of the Senate—Require that loans be invested to achieve maximum benefits for both railroads and shippers—Easily said but difficult to do—for both. Eliminating deferred maintenance of mainline and major branchline tracks—Fixing track is not necessarily "achieving maximum benefits for both railroads and shippers."

Terminals, yards, and communications (plus their support "software" are frequently areas for investments that have greater potential benefit for both railroads and shippers.

My point: Any Federal railroad trust fund statutory-base should not be directed at the specifics of what part of the plant should be financed. A tripartite board should be free to decide on "performance-standards" and not "design specifics" for achieving those standards.

7. Mandate that the tripartite board . . . develop a plan—As I have said, "the plan" belongs with DOT not with a board set established to administer a trust fund. The tripartite board should be mandated to consult with DOT on "a plan to rationalize the structure of the Nation's rail system.

Provision should also be made to end or alter the fund program—

In conclusion:

1. My comments are in the context of a discussion of a railroad trust fund and its administering board. They are neither pro/con any proposal to implement fund and board.

2. There is a capital shortfall for the railroad industry, in the relationship of needs for funds and the industry's ability to create funds internally or finance from external private sources.

3. The lessening of economic regulation, the probability of more aggressive management actions by railroads, and the probability of more efficient industrywide operations—will reduce (at least by one-half) but not eliminate the shortfall. The shortfall will still be in the billions of dollars for the decade of the 1980s.

4. A "small" surcharge on railroad freight charges, to finance a trust fund, is probably salable to the shipper. (To me, "small" is 1 percent; 2 percent might still be "small," but 3 percent is definitely the threshold to "too big."

5. If there were a trust fund, the idea of a "board" appeals to me as being advantageous—but only if to assist DOT and not in lieu of DOT's responsibilities. Were there a board, the railroads and the shippers should be a part of the board and have more votes than the Government representatives.

Senator McGovern. Our next witness is Mr. Roland Ouellette, who is the director of transportation affairs at General Motors.

STATEMENT OF ROLAND A. OUELLETTE, DIRECTOR, TRANSPORTATION AFFAIRS, GENERAL MOTORS CORP., WASHINGTON, D.C.

RAILROAD TRUST FUND CONCEPT

Mr. Ouellette. Thank you, Senator. I am pleased to participate in this hearing but at the same time I want to stress at the outset that General Motors has not taken a position for or against such a concept. Furthermore, any views or comments I offer today should not be construed as an indication of our leaning one way or another on this matter at this time.

GM is a heavy user of railroad transportation and as such is greatly dependent on this service. We have 130 plants in 23 States; 26 are car assembly plants linked to 104 widely located facilities that provide components and parts. All of this fits into a highly sophisticated and tightly controlled manufacturing and distribution process with the Nation's railroads serving as a veritable moving warehouse. As a result, any delay or interruption in railroad service generates repercussions throughout the entire GM manufacturing and distributing mechanism.

We are, therefore, very much concerned over any trend or impact that threatens the ability of the Nation's railroads to respond to U.S. freight needs. At the same time, we believe railroad freight service can and should remain a viable part of our private enterprise economy. When the railroads were essentially the sole providers of large-scale transportation needs, railroads expanded and grew accordingly. With the onset of more competition from other modes, the railroads faced a period of adjustments and retrenchment which is actually what they have been struggling with during the last 40 to 50 years.

Unfortunately, because railroads have been heavily regulated for almost 100 years, public policy has not been significantly adjusted to allow railroad management to move as boldly and as swiftly as required. This lag in public policy has resulted in an industry struggling to adapt to modern-day needs while carrying considerable excess in plant and right-of-way. Full utilization of the existing system is not, in our opinion, the answer. What is needed is a newer configuration of railroads tailored to today's intermodal competitive situation. The normal economic evolution of the industry has been weighted down too long by stagnant and excessive Government control at all levels. This, in turn, has resulted in a very serious capital formation problem for this industry—and, unfortunately, at a time when the more significant adjustments in the system should have been long ago completed.

Obviously, some method must now be found to help generate the needed capital to allow railroad management to proceed with the process of streamlining the system. As long as the Federal Government is going to be a part of the financial equation, a Federal funding mechanism that will help stimulate this badly needed reorganization certainly deserves consideration.

However, the creation of a railroad trust fund per se—in addition to being a difficult mechanism to devise so as to treat all interests equitably—should not be the first step taken.

Congress should build on the 3–R and 4–R Acts by taking dead aim at the Federal regulatory structure under which the railroads operate. Legislation to this effect is presently under consideration by both House and Senate committees having jurisdiction. Once Congress has developed new and less restrictive public policy on railroad regulation, the question of direct Federal financial involvement should then be determined. At present, we do not have sufficient information to gage Federal financial needs. Thus far, Congress has had to react mostly to crisis situations largely attributable to the fact that railroad management has not been able to adjust plant size, facilities, and organizations fast enough.

In the final analysis, then, the creation of a railroad trust fund—or any Federal funding program—needs to be related to the much broader picture of rationalizing the existing system. Your hearing today should provide more indepth information on how that thrust can be initiated.

Thank you.

Senator McGOVERN. Thank you very much, Mr. Ouellette.

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Our next witness is Mr. Mark Putney, who is the senior vice president of Iowa Power & Light Co.

STATEMENT OF MARK W. PUTNEY, SENIOR VICE PRESIDENT, IOWA POWER & LIGHT CO., DES MOINES, IOWA

Mr. PUTNEY. Thank you, Senator.

I appreciate this opportunity to appear before the subcommittee on the concept of a rail trust fund.

Iowa Power is a combination gas and electric utility serving 225,000 electric customers and 130,000 gas customers in central and southwestern Iowa. Our company's electric requirements are supplied by three large coal fired generating stations which we operate or jointly own in Iowa, a large nuclear plant in Nebraska, and several oil and gas fired turbines used primarily for peaking purposes. Iowa Power is also a joint owner of two additional 650-megawatt coal fired plants presently under construction and scheduled for completion in 1980 and 1983, as well as a third unit of similar size and design planned for 1986. All of these coal fired units are or will be using low sulfur western coal. As such, our company depends heavily upon rail deliveries of fuel to its various generating stations.

At the present time approximately 50 percent of the electricity we generate comes from coal, about 48 percent from nuclear and 2 percent from oil or gas. As such, Iowa Power depends heavily upon rail deliveries of fuel to its various generating stations.

I would say I want to emphasize we take no position, neither advocating or opposing the rail trust fund concept at this time. I would, however, like to discuss some of the problems that we face in connection with these rail deliveries of coal.

Iowa Power's need for and dependence on a viable and efficient railroad system for transportation of coal is pointed up by our new generating unit at Council Bluffs, Iowa, which went into service in December 1978. This 650-megawatt unit was designed and constructed to utilize low sulfur western coal as its fuel source. Approximately 2.6 million tons of western coal are required for operation of the Council Bluffs plant each year. This coal is shipped from AMAX Coal Co. mines near Gillette, Wyo., to Council Bluffs, a distance of about 660 miles, via unit trains on a single-line haul by the Burlington Northern Railroad. Each unit train consists of 100 or more cars, each transporting 100 tons of coal or a total of 10,000 tons of coal per unit train movement.

In order to promote and, in a sense, finance the railroad in handling these unit train coal shipments, Iowa Power made investments totaling many millions of dollars in rail-related facilities including coal cars, unloading equipment and side tracks. Iowa Power has purchased 380 coal cars for a total cost of just under $13 million pursuant to specifications provided and approved by Burlington Northern. Iowa Power also rebuilt tracks at Council Bluffs in accordance with Burlington Northern specifications at a cost of $1.3 million.

Our experience to date has not been happy. Performance of the railroad continues to be an obstacle to our efficient and economical use of western coal for electric generation purposes. The basic problem is the greatly increased turnaround times experienced with these unit train shipments. Initially, the Burlington Northern advised Iowa Power that it could expect a 73-hour turnaround time for a unit train from the mine at Gillette, Wyo., to the plant in Council Bluffs, Iowa, and back. That was subsequently increased to 84 hours and then to 111 hours. However, during the last 18 months the actual average turnaround time has exceeded 140 hours—nearly double that originally anticipated. This, in turn, has required Iowa Power to purchase and lease additional unit trains just to transport the same annual tonnage of coal to operate its Council Bluffs station.

The less than satisfactory performance by the railroad has a further and greater financial and operating impact on the railroad itself. With Iowa Power now operating four or five unit trains rather than two, the Burlington Northern must likewise supply four or five sets of locomotives rather than just two. The additional burden on the railroad's resources is obvious, not to mention the track congestion that inevitably results and further compounds the railroad's operating problems.

If Iowa Power is to fulfill its role in assisting the Nation in meeting its energy goals, we must be able to depend on timely shipments of western coal at freight rate levels which are reasonable and equitable. However, the current situation raises costs substantially for Iowa Power, the electric consumer, and the railroad.

Iowa Power is aware of many of the problems which the Burlington Northern faces. We understand the difficulties caused by greatly increased coal traffic over rail beds that are inadequate for such purposes. We also understand the high capital costs that will be incurred if rail beds are to be improved, double trackage increased, additional locomotives purchased, and modern maintenance facilities constructed.

We at Iowa Power strongly support a viable, self-sustaining rail system for the Nation. We are unequivocally opposed to any attempt to nationalize the rail system. We recognize and support the right of railroads to earn a fair profit. We do not oppose cross-subsidization of rail rates in general, but we do oppose coal being singled out to subsidize unprofitable commodities. Those markets and commodities that don't pay their own way on the railroads should be identified. Many branch lines, especially in Iowa, are uneconomical. The coal shipper should not be expected to inequitably subsidize these uneconomic commodities or branch lines.

The need to upgrade our rail system to handle increased coal transportation responsibilities is obvious. The method to be used in upgrading the rail system is less obvious.

Iowa Power has actively opposed freight rate increases which it believes are overly compensatory and unduly directed at coal shipments. Recent Interstate Commerce Commission decisions in this area cause us grave doubts as to the direction and overall objectivity of that body in seeking solutions to the railroads' problems. Accordingly, we feel that implementation of any rail trust fund concept must be in lieu of and not in addition to recent ICC actions to bring about improvements in the Nation's rail system.

Several other aspects of a rail trust fund concept are of concern to Iowa Power:

First, we feel it is only fair and equitable that those railroads that participate and make contributions to such a program should receive assistance in proportion to their contributions.

Second, and rather specific to Iowa Power's situation, increased costs to our electric customers resulting from any rail trust fund surcharges on coal shipments must be more than offset by enhanced rail shipping conditions and vastly improved unit train turnaround times.

Third, rail trust funds should not be used to upgrade rail systems that are not now, and are never reasonably expected to be, economically sound and ultimately self-sustaining.

The methods of administering a rail trust fund are also of concern to Iowa Power. The role of western low sulfur coal in meeting the Nation's energy demands throughout the remainder of this century dictates the need for a representative of the western coal shippers as an equal member of any board or commission appointed to administer a rail trust fund.

Federal intervention and a Federal presence on any such board should be minimized in our view. If a rail trust fund should be set up to continue indefinitely, then Federal presence on such a board should be gradually eliminated.

At the present time nearly 14 percent of the gross freight revenues of the railroads are from the transport of coal. Of this amount more than 50 percent comes from unit train shipments to utilities. We expect these percentages to increase dramatically in the next few years as more and more of the Nation's utilities switch from oil to coal and add new and larger coal fired units to their generating capacity.

A rail trust fund designed and administered in a fashion that will strengthen our Nation's rail system and increase the ability of railroads to timely and economically serve its coal shippers will receive Iowa Power's support.

However, freight rate surcharges or any other form of increased cost of coal transportation utilized for rail trust fund purposes must ultimately be borne by our electric customers. If these cost increases are not accompanied by greater benefits and offsetting cost reductions, little if any useful purpose will be served and our support of the concept will not be warranted.

I would like to call the committee's attention to the special report entitled "The Unit Coal Train System," appearing in the October 15, 1979, issue of Electrical World. That's the current issue. It's an excellent summary of the unit train coal operation from the utility standpoint. I have made reprints available for the committee's perusal.

Senator McGovern. Does that complete your statement, Mr. Putney?

Mr. Putney. It does, Senator.

Senator McGovern. All right.

Our next witness has been before congressional committees many times, Mr. Reuben Johnson, the director of legislative services of the National Farmers Union.

Mr. Johnson, we welcome you to the committee.

STATEMENT OF REUBEN L. JOHNSON, DIRECTOR, LEGISLATIVE SERVICES, NATIONAL FARMERS UNION, WASHINGTON, D.C.

CONSIDERATION OF THE ESTABLISHMENT OF A PROPOSED RAIL TRUST FUND

Mr. JOHNSON. Thank you very much, Senator. I want to open my statement by commending your leadership in trying to reach some solution to the dilemma we face in rail transportation. I would like to make specific reference to some of your legislative endeavors: The subterminal facilities bill which the Farmers Union supported. Your bill to be introduced today, the rail contract bill, certainly seems to be an effort to provide the railroads with the opportunity to improve service. I hope that would be the case. The rail trust fund proposal which we are here to discuss certainly has merit. I'd also like to make reference to the fact that as the No. 2 ranking majority member of the Senate Agriculture Committee you certainly made excellent use of that position to help us make a case for improved rail service to rural America.

Senator MCGOVERN. Thank you very much, Mr. Johnson.

Mr. JOHNSON. I hope your constituents are aware of all your endeavors, Senator.

Senator MCGOVERN. We're doing our best.

Mr. JOHNSON. National Farmers Union's delegates to the convention, March 11–14, 1979, in Kansas City, Mo., took some recognition of the capital needs of the Nation's railroads in recommending, and I quote: "A federally guaranteed loan program to assist railroads to purchase sufficient rolling stock to meet shipping needs and to maintain trackage, including sidings."

A later reference asked that there be assurances that Government assistance will result in "adequate maintenance" of the rail facilities.

Now these references don't address specifically the concept of a rail trust fund. However, they do address the problem of lack of capital.

Unquestionably, the railroads will have substantial need in the coming years for capital funds, considering traffic demands and the tendency of recent years in which rail management has allowed branch lines and rail equipment—and therefore services—to deteriorate seriously.

We are not qualified to estimate what the rail capital gap may be in the next 5 to 10 years, but because it may well be substantial, we suggest that the proposal for a railroad trust fund should be carefully qualified to guarantee that the assistance be made available where most needed to maintain essential services.

When a legislative bill is drafted to create the railroad trust fund, we believe it must have careful and definite criteria for use of the trust funds.

The needs of the Nation's railroads for new facilities and equipment vary greatly—and so would the capital needs.

Yet, as we read the explanation of the proposed trust fund, the pool of investment capital would be available for loans to individual railroads on the basis of their contributions. It is suggested that perhaps a discretionary fund be established from which perhaps 10, 20, or 30 percent of the total amount in the trust fund during any given year could be invested "where needs are greatest."

We could support the proposed 2-percent surcharge on all traffic, designed to repay trust fund loans, only if the bulk of the trust funds are used to maintain service where needs are most serious and immediate.

Without guidelines for the use of the trust fund to maintaining existing essential services, proceeds of the trust fund might offer little help to the rail systems in the "bread basket" of the Nation, where there is little truly excess trackage and facilities.

We urge that these safeguards be written into the program of the trust fund:

One, that proceeds of the trust fund be denied to any railroad where the capital would be invested in nonrail or nontransportation operations, or would result in the diversion of other capital of that rail system into nontransportation investments.

Two, that special consideration in allocation of trust fund loans be given to systems of rail lines where there are captive shippers without reasonable alternative services; and Senator, that's particularly a problem in the area that we know best, that big part of rural America out there that depends upon rail service almost exclusively for getting its commodities to market.

Three, that granting of trust fund loans be conditioned upon fulfilling of common carrier obligations by the railroads and good faith efforts to maintain essential lines and services.

With such qualifications, we believe that the proposed trust fund could be productive and useful and we are supporting the concept. Thank you Senator.

Senator McGovern. Thank you very much, Mr. Johnson.

Our next witness is Mr. J. R. Snyder, who is the chairman of the Legislative Committee of the Railway Labor Executives' Association, the national legislative director of the United Transportation Union, and we are happy to welcome you to the committee.

STATEMENT OF J. R. SNYDER, CHAIRMAN, LEGISLATIVE COMMITTEE, RAILWAY LABOR EXECUTIVES' ASSOCIATION, AND NATIONAL LEGISLATIVE DIRECTOR, UNITED TRANSPORTATION UNION, WASHINGTON, D.C., ACCOMPANIED BY WILLIAM G. MAHONEY, COUNSEL, RAILWAY LABOR EXECUTIVES' ASSOCIATION

Mr. Snyder. Thank you, Senator. I am wearing two hats here this morning. I have a very short prepared statement. I would request that it be incorporated in the record.

Senator McGovern. Without objection, it will be.

Mr. Snyder. I will begin my remarks on the bottom of the second page.

Establishment of a railroad trust fund is, of course, not a new idea but it is one which may now be considered acceptable, if only because some positive action must be taken if we are to avoid a continuous parade of Penn Centrals, Milwaukees, and Rock Islands through the bankruptcy courts of the country and before this Congress.

Senator, as you accurately point out in your background paper for this hearing, the railroad industry must invest billions of dollars into its plant merely to bring it to a state of maintenance which will enable it to serve adequately our Nation's rail transportation needs. The blame for the situation in which the railroad industry finds itself may be attributed to a number of sources but we are now past the point where we can afford the luxury of criticism. We must find a cure and find it very soon.

It is obvious that the railroad industry alone cannot perform the staggering repair and maintenance task confronting it. Each day brings additional news of further increases in interest rates and worsening inflation. Consequently, each day the industry's ability to cope with its repair and maintenance task weakens a bit more.

Today no one seriously challenges the fact that a viable, efficient railroad system is vital to the economic health of this Nation. If the collapse of the Penn Central Railroad did nothing else, it convinced this Nation of the importance of our railroad system. And now the railroad network is recognized as vital to the welfare of the country for an additional reason—fuel efficiency.

Measured by any acceptable, recognized standard, the railroad train is the most fuel efficient method of transportation available to us today and for the foreseeable future. It must be preserved.

Senator, the very helpful background paper which you prepared for the use of the witnesses at this hearing uses the word "rationalize" in referring to the development of a plan for the future structure of the Nation's rail system. That term, in the past at least, has meant but one thing to the Department of Transportation and railroad managements: "Rationalize" has been synonymous with "abandonment" and "reduction" in the size of our national rail network. We believe that to be a convenient misuse of a term by those who would strip our railroads of all but a few main lines east and west, and north and south. If rationalization of our rail system means the development of a system to provide for and serve adequately the present and future transportation needs of this Nation, the term must mean abandonment of lines which have no present or future promise and the expansion and development of lines which do provide such promise. We must not be misled into abandoning railroad lines which we will have to reconstruct in the future at exorbitantly inflated costs.

The RLEA is convinced that, properly designed and administered, a national railroad trust fund could provide a solution to the industry's repair and maintenance dilemma, from our vantage point today it would appear to offer the only promise of solution to this problem.

In the establishment of a railroad trust fund, care must be taken to insure that funds will be available for the repair, maintenance, and upgrading of lines which show substantial promise of future need; that the poorer railroads and less healthy rail lines are not discriminated against as they have been in the administration of the 4-R Act; that any board or other administrative tribunal established to oversee any aspect of the fund should be provided with a representative from rail labor as well as from rail management, shippers, and the Federal Government and the States; and, finally, that those selected to "develop a plan to rationalize the structure of the Nation's rail system and use the plan as a guide for investment of program loans" be selected from those who believe that "rationalization" includes, where appropriate, development and expansion and not restrict such membership to those who, since the early 1970's when they began working for the Department of Transportation, have insisted that "rationalization" be used as a means to reduce severely and extensively the rail network of this country.

Senator, the railroad employees of this Nation thropugh their statutory representatives stand anxious to assist you and your staff in any way possible to develop legislation which would result in an effective railroad trust fund.

Thank you for this opportunity to present rail labor's views to you on this most important subject.

Senator McGOVERN. Thank you for your testimony, Mr. Snyder.

[The prepared statement of Mr. Snyder follows:]

PREPARED STATEMENT OF J. R. SNYDER

On behalf of the Railway Labor Executives' Association, its members and the employees of this nation's railroads whom they represent, I wish to express our appreciation for the opportunity to present to you the views of rail labor on a subject which we believe could prove to be of immense benefit to our transportation system and our economy as well as the railroad employees whom we represent.

My name is J. R. Snyder. I am Chairman of the Legislative Committeee of the Railway Labor Executives' Association and the National Legislative Director of the United Transportation Union. My office is located in the Railway Labor Building at 400 First Street NW., Washington, D.C. Accompanying me is Mr. William G. Mahoney, counsel to the Railway Labor Executives' Association.

The Railway Labor Executives' Association is an unincorporated association with which are affiliated the chief executive officers of all of the standard national and international railway labor unions in the United States. The organizations whose chief executive officers are members of the RLEA are listed below:

American Railway Supervisors Association.
American Train Dispatchers Association.
Brotherhood of Locomotive Engineers.
Brotherhood of Maintenance of Way Employes.
Brotherhood of Railroad Signalmen.
Brotherhood of Railway Carmen of the United States and Canada.
Brotherhood of Railway, Airline and Steamship Clerks, Freight Handlers, Express and Station Employes.
Hotel and Restaurant Employes and Bartenders International Union.
International Association of Machinists and Aerospace Workers.
International Brotherhood of Boilermakers and Blacksmiths.
International Brotherhood of Electrical Workers.
International Brotherhood of Firemen and Oilers.
International Longshoremen's Association.
International Organization of Masters, Mates and Pilots of America.
National Marine Engineers' Beneficial Association.
Railroad Yardmasters of America.
Railway Employes Dept., AFL-CIO.
Sheet Metal Workers' International Association.
Seafarers International Union of North America.
Transport Workers Union of America.
United Transportation Union.

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Senator, as you accurately point out in your background paper for this hearing, the railroad industry must invest billions of dollars into its plant merely to bring it to a state of maintenance which will enable it to serve adequately our nation's rail transportation needs. The blame for the situation in which the railroad industry finds itself may be attributed to a number of sources but we are now past the point where we can afford the luxury of criticism. We must find a cure and find it very soon.

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Senator, the railroad employees of this nation through their statutory representatives stand anxious to assist you and your staff in any way possible to develop legislation which would result in an effective railroad trust fund.

Thank you for this opportunity to present rail labor's views to you on this most important subject.

Senator McGovern. Our final witness is Mr. Jerry Conlon, who's a senior vice president for planning and public affairs of the Chicago & North Western Railroad. Mr. Conlon, I'm happy to welcome you to the committee.

STATEMENT OF JERRY CONLON, SENIOR VICE PRESIDENT FOR PLANNING AND PUBLIC AFFAIRS, CHICAGO & NORTH WESTERN RAILROAD, CHICAGO, ILL., ACCOMPANIED BY RAY CHAMBERS, WASHINGTON, D.C., REPRESENTATIVE

Mr. Conlon. Thank you, Senator.

I'd like to say that I feel that this hearing is very appropriate. I'm very pleased to be able to make a few comments. In my prepared statement which we have submitted I find that there's more than a few comments, so I'm going to summarize it as briefly as possible.

I think that a railroad trust fund is a constructive vehicle in which to discuss some of the greater problems the railroad industry faces. I also feel that a railroad trust fund is an idea whose time has not yet come. I'd like to specifically state why I find that way and when I feel it might be more appropriate to discuss it.

First, you're essentially dealing with the capital shortfall of the railroad industry. The capital shortfall which we have all mentioned today which was I think well documented in the FRA-501/904 study is essentially, I believe, a symptomatic problem and not a causal problem. I believe it is symptomatic because the railroad industry by its history, maybe through its own mistakes over the last 100 years, has been put into a straitjacket which makes it very, very difficult to get a return on investment and thereby has put it into a negative spiral causing a capital shortfall.

Until we solve the return on investment problems, the concept of a trust fund is, in my opinion, premature.

In that vein, I'd like to point out that there are several ongoing dialogs today which I believe should be resolved before it would be appropriate to discuss greater massive funding through a trust fund concept for the railroad industry.

The first of these is regulatory reform. I think it's very important that the regulatory reform legislation go forward and be put in place.

Second, we have existing programs today which tend to deal with this shortfall of capital and deferred maintenance problem. Those are the title V programs that came out of the 4-R Act, essentially preference shared funding and guaranteed loans under the 4-R Act. I believe that we have gone through the shakedown cruise on these programs and that these programs are today beginning to have an effect in helping to cure the capital shortfall.

Third, and very important, the fact that we do have a capital shortfall raises the subsidized competition argument. If the country is going to address capital shortfall, I think it has to address the fact that the great cause of the capital shortfall we have today in our industry is the subsidization of our competing modes of transportation.

Fourth, very quickly, I believe that the tax laws as they relate to railroads are inefficient and need to be reviewed in terms of being equitable.

Finally, after determining that progress will be made or will not be made in any of these subjects, I think that will be the time to discuss a railroad trust fund.

I have several qualifications that I think will have to be considered in the dialog which I'm sure will come in the future on this trust fund.

First, I think it's very important that a trust fund not be used as a vehicle to institutionalize obsolescence in the railroad industry. I believe that would take away from productivity and harm the concept which we are all trying to get of an efficient, good servicing railroad system.

Second, outside funding should continue to be encouraged. I believe it is important for the railroad industry and for the country that the traditional capital markets be encouraged to continue to invest in the railroad industry. It would be counterproductive, in my opinion, to substitute Government money for outside money.

Third, the surcharge does cause problems to me. I'm afraid that it would be anticompetitive and that it would harm those who have stood with us in the past with the regulatory straitjacket we have had in the past. Many of the people who now are showing faith in the railroads, are continuing to use our service, are either captive or they are there because of the basic economics of the railroad. If you don't get a change where we can draw back a better mix of shippers into our industry, I have a fear that continuing to draw from this public would not be fair to the extent that they have stood with us in the past.

I would suggest in the future that a hard look be made by real economic experts as to what a surcharge would do to the competitive position of the industry and what it would do to helping us get back good markets that have been taken away from us in the past.

In closing, I would thank you very much for having me here.

Senator McGOVERN. Thank you, Mr. Conlon, for your testimony.

[The prepared statement of Mr. Conlon follows:]

PREPARED STATEMENT OF JERRY CONLON

Senator, I am Jerry Conlon, Senior Vice President for Planning and Public Affairs of the Chicago and North Western Railroad. With me is Mr. Ray Chambers of the firm of Parrish and Chambers who serves as Washington representative to our company.

The Chicago and North Western Railroad is pleased to appear before this Committee to discuss the future of rail transportation in the nation. It is particularly a pleasure to testify before you, Senator McGovern, because of your long-term interest in rail transportation and your responsible approach to solving the very serious rail problems in the midwest.

This Committee does not need me to rehash the seriously deteriorating condition of the rail industry in the United States. Suffice to say that ten railroads have gone into bankruptcy in this decade. The Rock Island and the Milwaukee are the latest and they have deteriorated to a point that it appears a traditional reorganization will not be possible.

No major rail carrier in the United States today enjoys rail earnings that are even close to what they should be. Any composite picture shows that the industry which should be the backbone of American commerce is on a downward spiral and is simply not self-sustaining. The future is uncertain and unless government and the private sector take some bold and imaginative steps we may be forced to confront the question of nationalization, which would be a tragedy for our country and a tragedy for rail shippers.

No one can look at the rail situation in the midwest today without realizing that there will be major changes and substantial federal involvement in the rail transportation network over the next few years. It is vitally important that the Federal role in this restructuring should have as the end goal a money making and efficient private rail sector system. In calling these hearings on concepts for financing the capital shortfall in the rail industry, this Committee is clearly taking a responsible step in the right direction.

What has caused our problems? Many things. There has been too much regulation causing us to maintain too much plant at too high a cost with too little traffic. Regulatory rigormortis kept us from attracting business from highways and barges with flexible operating and pricing strategies. Conversely, our unregulated truck and barge competition undercut our prices and attracted away our traffic. They forced our rates down to the point that they were often at, or below, the cost of our service.

What factors gave such an abundance to truck and barge? Primarily they were running over highway and waterways for which they paid little or nothing while railroads maintained, paid taxes on, policed and generally provided for their own rights of way. Highway and inflation and railroad inflation has been incredible over the last 15 years. For example between 1967 and 1976 I understand that inflation increased highway maintenance costs by about 102 percent. Yet the federal fuel tax on trucks at 4 cents a gallon has remained stable. Railroads, with a similar inflationary spriral pay for it dollar for dollar. While it varies from railroad to railroad, something like 25 cents cents from every revenue dollar goes back into the cost of owning and maintaining railroad rights-of-way. Motor carriers put back less than 5 cents on the revenue dollar into user fees. That 20 percent differential is something we must pass directly on to our shippers if we are to survive. Starting out with this roughly 20 percent disadvantage, we have watched our traffic, particularly our boxcar and general merchandise traffic, slip into the interstate highway system. The highways are now breaking up and the energy loss from this transferred freight is a disgrace, but still the traffic keeps slipping away. As that traffic is lost to truck, our extensive plant facility, with its rapidly increasing maintenance costs, becomes an ever-increasing burden to be paid for by those shippers—in some cases captive shippers—who continue to send their traffic via our railroads. The barge inequity is even worse.

Suffice to say, it is this inequity which is at the core of our problem. It is the direct result of government policy, aided and abetted in my view, by a railroad industry which failed to come to grips with what was happening to it. It is this that we must begin to address.

Now, let us turn to the measurable magnitude of the problem. Exactly one year ago this week, Federal Railroad Administrator John Sullivan released a report entitled, "A Prospectus for Change in the Freight Railroad Industry." That report, pursuant to Sections 504 and 901 of the 4-R Act, was over two years in preparation and is an excellent document. We at CNW believe that that document presents a realistic view of the railroad industry and should serve as the base, the first step, in the confrontation of the enormous problems facing this industry. The 504/901 study builds an overpowering case, in my view, that this industry faces a potential capital shortfall of between $13.1 billion and $16.2 billion during the period 1976–1985. While no one, of course, can accurately predict inflation, business cycles, impact of regulatory policy, operating efficiencies, traffic levels and so forth, that could either improve or diminish the industry outlook, we believe the reports probably conservative. Events surrounding the Milwaukee and Rock Island, and the ConRail performance would indicate that the 504/901 study is basically on target.

What is the solution? A better question would be, what are the solutions? Before this Committee is a proposal for a trust fund that would attempt to cure the disease with one massive dose—a trust fund reminiscent of the highway trust fund. While we do not dismiss this idea, we feel it is potentially flawed, perhaps even fatally flawed. We would urge that Congress take a hard and serious look at experimental pluralistic programming designed to treat the various symptoms of the disease, as opposed to unitary massive dose. Congress may even which to set for itself and informal time frame, in which it carefully monitors and measures the pluralistic approach to determine which programs and policies are having the greatest effect in correcting the intermodal inequity which has been killing railroads and restoring a measure of financial health. If it is ultimately assessed that collectively these programs will fail, then Congress may which to turn to consideration of the "big fund" for rail rehabilitation.

First, I will speak of our concept of the pluralistic approach and then I will address the unitary approach of a trust fund.

Pluralistic programming could have four major programmatic and policy groupings for implementation and measurement. These could be: (1) a Private financing; made possible through rate deregulation and regulatory reform. (2) Intermodal equity. (3) Federal financial assistance; limited federal programs of loans and grants. (4) Tax policy change.

INCREASED CAPITAL THROUGH REGULATORY REFORM

The North Western strongly supports the concept of deregulation as one of the pillars of financial renaissance of the rail industry. We believe that increased flexibility in rate-making may make a significant contribution to the income of the rail industry and to its ability to generate funds internally.

Like most carriers in our industry, we have severe reservations about specific elements in deregulation. We feel that some of the academic theories that find their way ito legislative proposals are wrong-headed and could be destructive to the industry.

Let me cite one example, the question of deregulating market entry to encourage "strong" carriers to intrude into markets served by carriers in less fortunate circumstances. The North Western's self-interest here is pretty clear. But, I believe there is a serious national interest question which is frequently overlooked. While we may not enjoy the prosperity of a western carrier, for example, there are reasons for that which relate to historic accidents of geographical location as opposed to any superiority in management systems, in our view. The North Western, because of where we are located, sees that a major prong of its future is good service to the grain-gathering territories we serve. We can do this in part because of the lucrative overhead traffic we enjoy that moves between the populous east and west coast. I can assure you that any profitable southern or western carrier, which proposes to extend its territory to serve population centers in the midwest is doing so to split off that lucrative overhead traffic—not to provide good local service to the breadbasket we serve—to split off that lucrative transcontinental traffic will result in diminution of our ability to serve as a major granger road. In deregulation, and in various other legislative proposals which are currently under consideration, the North Western has vigorously opposed attempts to strip from the ICC the authority to make carefully considered transportation judgments on major market extensions.

In the final analysis, we seriously doubt that deregulation of rate-making, which we support, will yield to the industry the economic benefits claimed for it by the purest advocates. Basically, almost all of our general merchandise traffic, a high percentage of our grain traffic, and many, many other commodity classes are highly susceptible to truck and barge competition. Much of that traffic either doesn't or barely covers its costs today.

There is very little upward rate potential on it. Raising the rates will drive it off the rails. Therefore, most of the potential will be in that traffic commonly known as captive or that traffic where we provide such superior service that they stay with us despite increasing competition for their business. To raise the rates on that to cover our capital shortfall could create serious economic disruptions to major segments of our economy, specifically including the suppliers and providers of energy.

In short, we feel that deregulation will not, in and of itself, end the problems of our industry and allow us to meet our capital needs fully from within the private sector. But we believe the concept is a good one; that it will free the industry to move imaginatively and aggressively into new marketing techniques, to provide innovative and reliable service and to meet the local rail service needs of the nation.

INTERMODAL INEQUITY

One answer is to end the direct and indirect subsidies of the other modes of transportation to put rail, barge and truck on an equal footing. This is an objective that our industry has pursued vigorously. I will not belabor the point, but I fear the objective is unrealistic in today's political environment. I feel strongly that we in the industry should continue to press the objective of fair user cost recovery of federal expenditure. However, having participated in the vigorous multi-year struggle to recover some costs from barge owners for the construction and maintenance of the multi-billion dollar waterway system, and having seen the piddling result, I simply cannot be optimistic when I look toward a potential battle against the "Road Gang" aimed at full recovery of highway costs that directly relates to truck-caused deterioration. While the battle should be pressed because it is the right policy, realistically, it is not going to solve the rail industry's serious problems in the next decade.

FEDERAL REHABILITATION PROGRAMS

Out of the necessity of a series of railroad failures, the government has already begun to experiment with various federal loan programs for rights-of-way rehabilitation that to some degree can be justified as a redressing of the intermodal inequity as well as being the only option when faced with a breakdown and cessation of essential rail service. Some of the early programs, such as the Emergency Rail Services Act, were designed simply as a temporary bailout of a sinking vessel.

Other programs, especially those of Title V of the 4-R Act, have attempted to get somewhat ahead of the problem and provide rehabilitation loans for essential rights-of-way work that otherwise would not be possible because of the drying-up of private sector funding for these purposes. These programs should be continued, expanded upon, and monitored. The Chicago & North Western is a major participant in the existing program. With 511 loan guarantee money we have embarked upon a major car repair program. This program has been critical to our ability to move grain in record amounts while port strikes and railroad failures around us paralyzed much of the grain-moving capacity in the region. With 505 redeemable preference share equity financing, provided by the Department of Transportation, we are presently engaged in a major rebuild of our Chicago to Omaha main line. We are presently negotiating on a $231 million federal loan guarantee which will provide rail competition for movement of the enormous deposits of low sulphur Powder River Basin coal out of Wyoming.

Several other railroads have taken advantage of Title V assistance for rehabilitation of essential lines and car repair. It has worked well. It is in place. Its regulations are fully understood and have evolved into a workable format. It has already gone through its "shakedown" cruise. We see no need to dramatically reorient it. We strongly urge a continuation of Title V funding. It seems probable that expansion of the funding may be necessary to encompass acquisition and rehabilitation in the midwest. We support such increased appropriations and whatever changes in authorizations are necessary to upgrade and incorporate embargoed elements of the Rock Island and Milwaukee into interested acquiring railroads that do not have access to sufficient private sector funds for that purpose.

There are a variety of other programs that should be continued or initiated and experimented with. One example of this is the nationally renowned "Iowa Program" through which railroads, government and shippers enter into agreements to finance and upgrade local lines. This mutuality of interest in making rail service work on marginal lines has proved effective. The McGovern approach to grain storage consolidation, utilizing federal planning assistance and loan guarantees, could prove of major benefit in concentrating the traffic base in a way that will better support the required railroad plant needed for efficient transportation.

Another creative and positive proposal is Congressman Silvio Conte's H.R. 1335, to provide assistance in the form of labor grants to rebuild railroad right-of-way. Under the Conte concept, in times of high unemployment, the government would provide wages and benefits while railroads would provide equipment, material and supplies for rights-of-way rebuilding. This is a good concept which meets many objectives. Similar bills have passed the House and the Senate in the past, and should be signed into law.

Another public interest justification for railroads programming involves the energy saving potential of railroads. Today, mass transit is a politically popular means of effecting energy savings—and as the operator of a major fixed rail mass transit system (more than 110,000 people ride our commuter trains into Chicago each day), we certainly endorse that concept. However, we should recognize that a gallon of fuel saved moving a ton of freight is just as important as a gallon of fuel saved moving people—and it has far less disruptive impact on the daily lives of our people.

The McGovern resolution, S. Res. 241, is the first to recognize this important fact. This bill requires the President to submit a plan to use at least $10 billion from the windfall profits tax for freight and passenger rail rehabilitation projects. S. Res. 241 recognizes railroads are the most energy efficient means of transportation and that inequitable federal subsidies across all transportation modes have contributed to the degradation of the nation's rail system. It establishes the national objective of increasing diversion of passengers and freight traffic to more energy efficient transportation modes. If there is going to be a windfall profits program, the McGovern resolution should be enacted.

As has been demonstrated, there are a variety of federal loan and grant programs underway which begin to take a stab at correcting the intermodal inequity and the C. & N.W. advocates that we should continue to experiment with, monitor and measure those programs and to create new ones which might have an impact.

ALTERATION OF TAX POLICY

Federal tax policy has been used for many years to stimulate private investment in job creating industries. The 10 percent investment tax credit for instance, has become a standard capital investment stimulant that is used generally by American industry—with the exception of those businesses, like the less fortunate railroads, which do not generate sufficient revenues to pay income taxes. While other, richer railroads receive a 10 percent tax advantage for every dollar spent on their equipment, the non-tax paying railroads receive no incentive for similar investments—even though these railroads may desperately need the capital infusion. This has resulted in two alternatives: (1) The non-taxpaying railroad can pay 10 percent more than its rail or truck competition for its equipment; or (2) it can enter into somewhat tortured leasing agreements so that profitable leasing companies can take advantage of the tax credit and perhaps pass a small portion back through a reduced lease payment. The latter choice, which is the one which most marginal railroads have been forced into, has the distinct disadvantage that at the end of the lease time, the railroad has no ownership of the equipment. Such equity in this time of equipment shortage, can be of considerable value.

In short, the tax investment policy of the government has served to dampen the incentives for badly needed capital investment by less fortunate railroads and has accelerated the downward spiral toward financial instability and service deterioration. I therefore strongly urge the Congress to enact tax legislation which would allow direct refundability to the railroads of those investment tax credits which they are unable to use because of their flat earnings. Thus, weaker carriers would be equalized and stimulated to invest in needed capital projects and would receive the equity advantages of their wealthier competition.

Another tax issue arises out of the tax treatment of rights-of-way which creates additional intermodal inequity. Barge line, truck and airline rights-of-way owned, developed and maintained by the federal and state governments is taxpayer provided and property tax free. Partial recovery comes only through a minimal "use" tax through fuel surcharges and so forth.

Railroads on the other hand, not only have to pay the full expense for the repair and maintenance of their rights-of-way, but they must pay property taxes on them as well. Often the more effort they make to provide good track to meet local needs, the greater the value of their property becomes and the more they are taxed. In 1975, for example, the railroads of the nation paid $475,868,000 in property taxes and other taxes in lieu of property taxes. Such a figure is staggering for an industry which had a national return on investment of less than 1 percent last year, and may well have no earnings in 1979. When property tax is linked to the industry's capital needs, we can see that the forgiveness of property taxes alone could wipe out nearly one-third of the entire industry's capital shortfall for the next decade. By far the least government intrusive action this Congress could take would be to transfer revenue sharing funds perhaps earmarked for transportation projects to those states and localities which forgive taxes on railroad rights-of-way. This would directly place capital funds into the hands of hard pressed railroads to improve their rights-of-way, and thus their service.

THE TRUST FUND

If the above programs are implemented and collectively or individually fail to produce the revenue that will allow the modernization of our rail plant, then we may have to consider the concept of a railroad trust fund on the magnitude of the highway trust fund which was used to build the existing interstate highway system (which in itself has proven so destructive to freight rail transportation). I will not attempt to divine what the nature of such a program should be, but do wish to raise some thoughts for consideration.

A pay-as-you-go freight user charge is not workable. First, that freight which is competition-sensitive to other modes would simply be driven from the railroad. We would be back to the downward spiral where the captive shipper or the shipper who is loyal (because we provide good service or he simply wants a rail alternative for his own protection) pays more for the continuing plant. Second, even if that were the answer, the money could be raised within the railroad industry itself through rate deregulation without the need for a trust fund or any kind of government bureaucracy. As I indicated earlier in this testimony, I simply do not believe that the upward rate flexibility is there to address the entire problem.

Without getting into specifics, any future trust fund concept could raise mney quickly through Federal Treasury processes. The money could be expended relatively quickly through a plan dominated from the private sector. I do not object to a user fee. However, any such user fee could be designed to reimburse the fund over many years, perhaps 50 years, so the rates are not forced dramatically upward. This user payback principle could allow domination by the private sector over the fund. The fund should probably make grants, not loans, to the railroad companies. However, it might be possible to build in a range of loans, loan guarantees and grants out of the fund depending on circumstances of the corporation and the public interest in the projects. As I indicated, we would hope that the fund would be for a major one-time upgrading that would redress the intermodal inequity problem in a fell swoop and see the industry returned to a viable private sector condition. I recognize there are glaring questions in these suggestions. One problem is private enrichment through sale, lease or transfer of property improved with public assistance. I am confident that a variety of safeguard mechanisms would be possible. Another grave difficulty surrounds the strings, conditions, interference and permanence that usually surrounds any government bureaucracy established with funding and responsibility of the magnitude of a trust fund.

In conclusion, the C. & N.W. commends Senator McGovern and the Committee for initiating a national dialogue which we hope will result in an end to the inequitable treatments of the freight carrying modes. To date, there have been bailout programs to address rail emergencies, solid studies that have defined the problem well, some well considered and solidly administered programs such as Title V financial assistance, and a variety of other piecemeal approaches to the program.

While the problems are real, we at the C. & N.W. do not believe they are irresolvable. We plan to participate in the solutions. We are even optimistic. We feel we are going to survive the northeast-midwest debacle and we plan to be one of the string rail carriers of the future. The problems confronting us and our industry are still enormous. We think there are solutions which will allow private sector viability are there and we pledge to work with you to find those solutions.

Senator McGOVERN. Gentlemen, what I would like to do now for the balance of the forenoon is to use this time as informally as I can as I go through some of the questions we have worked out. They are designed to sharpen your own positions. I hope the rest of you feel free to break in any time if somebody is answering a question and you're inspired to add to the answer, to get in some different point of view. Please feel free to break in and we will conduct this as informally as we can.

Governor Shapp, we've heard some testimony today indicating that any shippers' surcharge to bankroll a trust fund could divert traffic away from the rails. I guess that's always one of the anxieties we have to be concerned about when you set a user fee on a competitive form of transport, whether you are in fact going to drive trade away to some other mode of transport.

I wonder what your comment is on that concern.

Mr. SHAPP. I don't think that that's much of an issue at all. Holiday Inn, Ramada Inn, Hilton, Marriott, and the rest of these big chains and hotels who get private entrepreneurs who put up a lot of capital to put up a hotel and then charge a surcharge for helping them manage it, helping them get things going, these entrepreneurs have not found that the surcharge they have to pay to these companies puts them out of business. In fact, there's a lot of help that's involved there and I think that you're overlooking some very important factors when we talk about a surcharge being destructive.

In the first place, what I'm recommending is a surcharge around 5 percent. Now freight bills are going up 6, 8, 10, 12 percent almost every 4 to 6 months, so the surcharge we're talking about is only a small part of the actual increase in freight bills that have taken place.

Now, why are those freight bills going up? It's because our railroads are inefficient. In many cases they are managed horribly, but mostly the inefficiency is due to poor rolling stock, very poor tracks, a high cost of energy, and as a result, the freight rates are just soaring; and I think if we had a rail trust fund in place, furnishing funds to the railroads and having a surcharge around 5 percent placed on the freight bills, with modern equipment and a better track, the railroads could be operating more efficiently and this would tend to reduce the ultimate cost to the shippers rather than constantly increasing the cost as is now the case.

I listened to the comments from the other gentlemen here and I have about six pages of notes that I took and I will be able to reply more directly to some of the points; but I think that the basic problem in our railroads is not to get away from regulation and deregulate the railroads. The big railroads have been operating like they have been deregulated anyway because they have had the ICC in their hip pocket in many cases, and I refer to the Pennsy and the New York Central and some of the other railroads, and I refer now to what's going on with the Burlington Northern and the Milwaukee case. They are getting complete cooperation of the Government agencies at the present moment in trying to strip away the small railroads and this is what is a major disaster in this country.

One of the gentlemen who spoke before, the gentleman from Iowa, talked about the Iowa Power & Light Co. You're getting the deluxe service of the railroad. You've got unit car service and it's all direct. You have your own cars and yet you're complaining about the railroad, and rightfully so, because the railroad is not giving you good service. But just think of the people who need just two or three boxcars a week in order to stay in business and the type of service they must be getting from a railroad that is not operating in proper shape.

Now, I don't want to criticize all railroads in this country because I think the Southern Railroad is a very good example of a railroad that gives good service and there are others that give good service and they are constantly modernizing their roadbeds, their equipment. They have good maintenance programs and they have taken good care of their yards and so they do give good service and they make money. But a lot of the railroads, unfortunately, earlier in the century, got into the hands—well, in the last century too—of people who were just entrepreneurs who were not interested in using the railroads except for control purposes, and the Penn Central is a great example of two very profitable railroads that got greedy and they actually ruined the economy of many areas in the Eastern and Midwest section of this country.

And what's still going on is this merger mania. If we deregulate, it's going to get worse. I think what should be looked at here is that unless we rebuild the railroads of this country, then our costs are going to keep soaring because the cost of transportation will be rising. Unless we electrify and get away from oil usage, then we can't solve the energy problem in this country. And above all, unless we adopt as a policy that a modern transportation system is a must for the United States and it must be funded somehow and the railroads don't generally have the money to do it, then you accept as a concept outside funding coming in in the form of a trust fund that will help lower the costs to improve equipment and have higher productivity. If we don't move in this direction, I see the country just going further and further into the hole economically. I'm very much concerned about the future unless we take some major steps forward that allow us to modernize our railroads.

I would say—I only made some notes on some of the things that have been said here, but I have less confidence in the ability of the present agencies to take care of things than perhaps has been expressed here by some of the others. But I do believe that if we make the investment and improve the railroad structure of this country, then we can help the economy of this country and help to control inflation by reducing some of the cost of transportation which is mixed in with the cost of everything we buy.

Senator McGOVERN. Thank you, Governor.

Mr. Smith, I think you also referred to the surcharge. If I understood your position, you indicated that if we don't go above 1 or 2 percent you would not see it as a factor that would divert traffic from the rails. As a matter of fact, it is—and Governor Shapp has used the 5-percent figure—but what I have been thinking about was in the range of 1 or 2 percent, at least to begin with, on the surcharge.

What are your feelings about the impact of that on traffic?

Mr. SHAPP. I used the term of 5 percent because I think 5 is still not too high in today's economy.

Senator McGOVERN. Thank you.

Mr. SMITH. I don't see 1 or 2 percent as being very diversionary. I agree with what the gentleman from Iowa was saying—whatever the level, the shipper is going to look at the kind of value that might be received in the future in supporting the level. One percent would generate about $220 million a year. Two percent would generate about $440 million a year. We've got some arithmetic on how fast the money would be invested, the payback funds, and what could be supported by $220 million or $440 million a year. Of course, you've got the arithmetic on what is needed. Governor Shapp in his 1974 work suggested something like $30 billion, I think he said a moment ago.

Mr. SHAPP. In 1974 it was $13 billion. I put in an inflation factor now and it's somewhere around $30 billion.

Mr. SMITH. And DOT is still referring to $16 billion. I think those numbers are on the high side myself. I think there will be some increased revenue generating capabilities in the railroads through less regulation and through increasing efficiencies. My gut feeling is it's perhaps half of the $13 to $16 billion, but it's an arithmetic thing of what is needed and what can you support with this kind of funding through 1 or 2 percent—$220 million, $440 million a year—but that 1 or 2 percent is a generality. I don't think that's going to throw too many shippers from one mode to another if they see a value coming.

Senator McGOVERN. Mr. Treanor, the railroad deregulation issue is now before the Congress. As you know, the Department of Transportation, I think, has been trying to see that as the way to close this capital shortfall in the rail industry and to end the need for large Federal assistance to the railroads.

Would you tend to concur in that view, that deregulation as it's presently pending, could resolve the industry's capital needs?

Mr. TREANOR. I would disagree, Senator, with that concept. I testified before Senator Cannon's group in Reno at the opening sessions, and I have had a chance to look thoroughly into that.

The railroad industry, in my judgment, obviously doesn't fall into neat little categories. Obviously, I think the views of the Southern Pacific, one of our head-to-head competitors, might be quite different than those that would be shared with the Western Pacific. Our major competitors are, by any measure, 10 times our size.

I think in the deregulation bill there are more features that tend to help the larger—and incidentally, I must say, we are favorably inclined toward the major features in the deregulation bill. I want to make that clear. I just don't think it's the total answer.

Along that line, I must comment here that Jerry Conlon has expressed some views that are maybe somewhat opposed to my position on the trust fund and I want to clarify that.

Obviously, I agree 100 percent with Mr. Conlon in his outlining of the major problems faced by the railroads. Where he and I might tend to part is his assumption that perhaps by moving ahead with the trust fund, people may be misled into believing that that's the panacea for solving all of our problems, and I detect in what he said a very genuine concern that if we went ahead here there may be not a lot of attention paid to the very real remaining problems. That's where Jerry Conlon and I have some difference of opinion.

I don't view the trust fund as proposed here as something that is viewed as the total answer to all of our problems or that it would have the impact of taking attention away from our other problems. So, therefore, I can continue to support the concept of the trust fund, provided we get over some of the problems that have been raised in our own position paper and have been the subject of the dialog here, but the deregulation bill, Senator, in my opinion, does not begin to solve the problems for all of the railroads, and most assuredly not for the smaller, aggressive railroads such as my company.

Senator McGOVERN. Well, I think that's a good point. I might just ask if any other members of the panel want to address this issue? I think that some of the members of the panel have indicated they think that the rail trust fund might jeopardize the possibilities of regulatory reform. As one Member of the Senate who supports both, I would like to see commonsense regulatory reform, but I would hate to think that we can't proceed with consideration of the trust fund except at the risk of damaging the possibility of regulatory reform.

I'm wondering how other members of the panel feel on that general question.

Mr. JOHNSON. Senator, I would just make my comments very brief. I would like to identify with the comments of Governor Shapp, especially in his commentary with regard to deregulation, and the other gentleman here, Mr. Treanor. I don't know whether it would serve any great purpose, but we in the Farmers Union did testify and we gave quite a bit of thought to the administration's proposal and had considerable policy discussions within the ranks of our membership, and we decided that the deregulation proposal did not offer what we would consider to be a meaningful solution to the problems that need correction. Certainly, whether or not there is deregulation, I don't think that that really applies to the merits of the rail trust fund.

Senator McGOVERN. That is my own view, that they are not contradictory.

Mr. JOHNSON. They are not contradictory.

Senator McGOVERN. They are not really at war with each other.

Mr. JOHNSON. I suppose you might say if we went the route of deregulation, as the administration proposes, it might make the trust fund more applicable.

Senator McGOVERN. Mr. Conlon, you were trying to get recognition?

Mr. CONLON. Thank you, Senator. It's sympotomatic, perhaps that what's wrong with this industry is that the only other railroad on the panel disagrees with me. I think that's part of the problem you've got. But that's probably part of the bad management they're always talking about.

Mr. TREANOR. He means his end, not mine.

Mr. CONLON. I'd like to clarify what I was trying to say. I do have concerns that one might take structural precedent over the over, but what I was really trying to say is I believe the capital shortfall is symptomatic and to solve the symptom, which I believe a funding mechanism does, does not solve the problem. So I was suggesting that the other issues I mentioned were addressing the causal relationships that caused the capital shortfall in the industry. That's all I was trying to say.

Senator MCGOVERN. I think some of your points are very well taken and certainly capital shortfall does reflect some serious underlying problems that have to be addressed by methods other than simply getting additional capital.

I think it was Mr. Curtis in his testimony—correct me if I'm wrong, Mr. Curtis—but I think you indicated that you saw the trust fund maybe as a step toward nationalization of the railroads. I'm struck by that because I see it as just the opposite, as essentially a private sector approach that would be financed basically by the users. The Federal Government would be playing a role in it, but the source of the funding would be the rail users. I guess I see it as an alternative to nationalization. I don't advocate nationalization of the rails and I would not want to think of the rail trust fund as a step in that direction but, rather, as one that might avert it.

Mr. CURTIS. As I did indicate in my testimony, that was one of the things that was troubling about this. Obviously you have thought through the concept much further than I have, Senator, and therefore see the ultimate objective of the trust fund or the trust fund itself in a fleshed-out situation more than I would. I would have to go into it and if I saw the trust fund in that manner, then I might share your opinion on that situation. I do have that reservation, that I would prefer not to see any more Government control in the transportation industry and therefore the trust fund and how it would be administered would have to be well thought out to prohibit that situation, but I do raise that fear.

Mr. SHAPP. Senator, I'd just like to make a point here that this is a Subcommittee on Economic Growth and Stabilization and what we are dealing with here is, of course, transportation, which is absolutely vital to the economy of any nation. One of the things that disturbed me for a long time, ever since really the Penn Central merger got started which was the first parallel-line merger of major areas—up until then, we had had the end-to-end mergers that didn't discontinue service and, in a sense, these types of mergers really improved service. But with Penn Central and now with the Burlington Northern situation and Milwaukee, these types of railroads that are parallel railroads, there's another very important factor that is not considered by the hearing examiners, by the ICC, that has tremendous bearing, though, on the economy of the

Nation, upon regions, cities, and States; and that is that transportation is vital to the economic growth and stability of any region.

In fact, throughout history it's been axiomatic that those regions of the world, those nations of the world that have enjoyed the most modern transportation facilities that were then in vogue at that time, whether you go back to just the camel trails or you to back to the British ruling the oceans or what have you, the nations that have enjoyed modern transportation facilities have had thriving economies and those that have been denied that type of transportation for one reason or another have usually slipped into second, third, or fourth rate powers or just disappeared entirely.

The same way with the communities. In the Penn Central merger, for example, between Pittsburgh and Erie, there were two routes. One was to go the old north-central route which was from Pittsburgh to Youngstown and the other was to go across Newcastle and Sharon into Pennsylvania. In their merger they cut out all the service in western Pennsylvania and went through Ohio. As a result, we have a stagnant population there. Industry is moving out and very little industry is moving in because all industry is moving into the Ohio area.

I could just name dozens of similar cases that have happened with railroad mergers. That's one reason why I'm so concerned about deregulation, because without any regulation a railroad might find it could save $50,000 or $100,000 or $250,000 a year in operation costs by eliminating some line, but the community or communities served by that line might die on the vine. So the overall cost to this Nation is far greater than whatever savings that railroad may make.

The purpose of the trust fund is to enable money to be available to railroads that can't raise the funds today in the marketplace because of high costs so that they can improve their service and give better service to the communities and bring in new industry and create more jobs in addition to the railroad itself getting more revenues and earning higher profits.

I think these two concepts have to go side by side and that's reason why I'm concerned about efforts towards deregulation if it allows the railroads to just go in there and cut out service.

I'm concerned also about the lack of funds available for modernization and as a result you have a situation like the Milwaukee Railroad now that could be cannibalized to the great detriment of many of the Western States and grain States and other producing States of this Nation. I would rather see the funding made available so that the railroads can modernize, expand, and provide better service. That, in the long run, is going to hold down costs in far greater respect than any surcharge a railroad might have to pay.

Senator McGovern. Thank you, Governor.

Mr. Ouellette, you say that full utilization of the existing rail system is not so much the answer, that what is needed is a newer configuration of railroads that are tailored to today's intermodal competitive situation. Couldn't a trust fund program be structured in such a way as to hasten this streamlining process by providing the necessary capital to implement it?

Mr. Ouellette. Senator, that's true, it could; but there are a number of things that would have to happen first. There's got to be some—I hate to use the word, overall plan—but there's got to be some objectives that you're trying to reach. You've got to decide on the type of system. Somebody has to decide on a type of system that will be responsive to the needs of industry and the public in general. This is not an easy thing to do. This is like being half pregnant.

If you're going to try to plan a system and not inject the Federal Government into it, to the extent that some people are proposing, I think you're just whistling Dixie. If you're going to plan all the way out, if you're going to say the Federal Government has the responsibility 100 percent for the planning of the entire system, then there's no question that you have embarked on full nationalization.

We'd like to think that the marketplace can be a good determiner in that whole planning process. The one thing the Governor tends to overlook is that there's actually two kinds of competition to the railroads. There's the common carrier type transportation—trucks, aviation, and automobiles. In addition, there's a second one that's very powerful and one which goes beyond the economic parameters the Governor spoke to, and that is private transportation, and it relates to service, the service to the customers that the company is very much interested in, and many companies will forfeit common carrier service and set up their own system and use the private carrier regardless of the cost—or I shouldn't say regardless, but certainly if the cost is greater—if in fact they get the service they want to satisfy their customers.

Now, if they had their druthers, obviously they would go to a common carrier system, all things being equal, and certainly our position in our corporation over the years has favored a common carrier system. We do not own, nor would we like to own, any equipment or company that provides transportation. We do it only when there's an absence of common carrier service. I think that's what's got to be built into this whole approach as to how you decide what kind of a carrier system you need.

We believe sincerely today there's far too much railroad service out there, at least in terms of facilities and equipment and so forth. It's based on a time where the railroads had to be virtually everywhere in the United States. Somebody now has to decide to contract this whole system to bring it down to a good, viable unit, and then let it expand if it's going to based on the marketplace. If it becomes competitive, at that point you'll find the railroads responding.

But what we're trying to do is two things at one time: Maintain what we've got, which is very uneconomical; and at the same time, lay out a plan for strengthening the system we should have.

Senator McGOVERN. Well, Mr. Ouellette, as I see this trust fund, what we have proposed in a tentative way is that you would have a tripartite administration of the fund with the railroads participating, the shippers participating as a second group, and the Government involved as the third component. Now that's weighted with a 2-to-1 advantage in the private sector. It seems to me that would be something that would appeal to you, that you would want to support the trust fund concept as a shipper, that you would want some voice in how those funds are going to be invested. If your point is right, and I'm inclined to think it is, that we need to streamline the rails in this country, it would seem to me that that kind of an administration of the trust fund might serve the objective you had in mind.

Mr. OUELLETTE. We have no problem with that and it certainly would be an improvement over a lot of other Government structures we have today. We think the shipper would have to have direct involvement and we certainly would go along with that.

Senator McGOVERN. Mr. Treanor, I'm struck in your statement today about your concern about protecting the interests of the smaller lines, and I agree with that. How do you see that being done under the trust fund concept? What kind of safeguards would have to be built into the system so that we take care of the smaller lines and at the same time get the participation of the larger ones?

Mr. TREANOR. Once again, Senator, it's very hard to categorize all the smaller lines in the same group, but I'd like to zero in on our own situation. I think accountability—and I don't want to use any buzz words—but I think we in the industry know that carriers have to be prepared for full accountability in withdrawing the funds through the structure and formulate the programs that we feel will protect us in the area of keeping our property, our rolling stock, as well as our track structures, yards, and so forth. I think the trust fund has to, however, come up with some device which does not make our ability to qualify for the funds for what we would hope would be determined to be a meritorious project on our ability to put money in at the forehead. If we had the ability to put the money in and start drawing on it, we wouldn't have to be going to the public market in the first place and paying the high interest rates.

From our standpoint, recognizing our limited access to substantial capital amounts, there has to be built in some form of structure which would not make our ability to draw out totally contingent on a frontend contribution by the purchase of the Federal securities or whatever might be involved because I think obviously, as I say, if we were in a position to put the money up in the first place, we wouldn't be going to the market.

And I also want to point out that along the lines of the last speaker from General Motors, I cannot emphasize enough the importance of what he's saying from our perspective as railroads. We can, in my judgment, reduce excess plant without impairing the competitive forces that are important to the betterment of the entire shipping community.

A good example is our relationship with the Southern Pacific Railroad. We are direct, head-to-head competitors, and yet through virtually the entire State of Nevada we are jointly sharing facilities. Instead of having double sets of tracks, duplication for both railroads, the two railroads which are head-to-head competitors, have worked out arrangements where we share each other's facilities.

I think that that type—if we could put our money into the type of projects we're talking about, into worthwhile projects to make sure we're not duplicating, wasting people's money and energies, we can do that. Those are the type of things we think are very important and the railroads are moving very much in that direction.

We and the Southern Pacific, on a daily basis, are considering projects where we can shift from one facility to the other, maintaining competion, get rid of useless plant, but keep both carriers in full competition.

Mr. OUELLETTE. That's a very good point. The example he brings out highlights what I was trying to say.

Senator McGOVERN. I think it is a good point.

Mr. Putney, you indicated in your testimony that the allocation of funds from a rail trust fund should be in proportion, a direct proportion, to the contributions made by a given carrier.

Given the fact that some railroads are in such desperate need for funds for capital improvements, would you object to a small percentage of the funds—I don't know what that level ought to be—15, 20, 30 percent or whatever—being held in reserve for discretionary use by the board administering trust fund revenues? It seems to me without some kind of a discretionary reserve that a trust fund could be seen as a means of making the healthy railroads richer and driving the more marginal carriers into bankruptcy. I would be interested in your reaction to that modification of the general principle of allocating the funds based on what each carrier produces and also how any other members of the panel would feel on that possibility.

Mr. PUTNEY. I think that is a good point, Senator. There obviously has to be some of those funds available for discretionary purposes. I think the range is rather far reaching when you're talking 10, 20, 30, or 40 percent, as I remember from the paper. That's a little wider range than I even care to think about.

However, again, this is perhaps a selfish purpose and I'm speaking of a highly concentrated market of cost that I'm trying to pass on to some electric customers within a given geographic area—I think to the extent that they participate in those costs that those costs ought to be directed very largely to improvement and ultimately holding the line on costs for transporting the commodity that provides their electric service.

So to divert a very substantial portion or any portion of that gives me a little problem. I can see some discretionary portion involved here, but it can't very much because the benefit again to those people who are paying that cost directly evaporates.

Senator McGOVERN. Do any other panel members want to comment? Mr. Conlon, do you want to comment on that?

Mr. CONLON. I would be inclined to support a high degree of discretionary use of the trust fund money. I agree 100 percent with what Mr. Treanor just said. I believe that the criteria for investment should be on accountability that would take into consideration the productivity of the investment. I think to limit the discretion of the investment of the proceeds would limit the ability to get the highest productivity. I think the highest productivity can be only achieved by moving away from the parochial vulcanization of the rail industry by corporate carriers and to recognize that the interdependence part of the plant will be of benefit to all of the people by the highest productivity investment of the money.

Senator McGOVERN. You would argue that one of the objectives ought to be to upgrade the whole rail system nationwide and that stengthening lines that are now weak in the long run helps the whole system?

Mr. CONLON. Yes; what I'm really saying is that productive investment somewhere else in the country helps the unitary nature of our industry respond to service, to upgrade the service on my railroad and then to have to give it to a carrier who cannot respond, hurts my shippers just as much as if I put it into my own railroad. I think you've got to look at where you're going to get the best bang for the buck.

Senator McGOVERN. That makes sense to me. Do other members of the panel have any comments on that? Because I do think this is going to be one of this is going to be one of the issues as we move to consider the trust fund that's going to be very sharp, the question about how those funds are allocated.

Mr. Snyder, you mentioned in your statement that you thought we had to be very careful about the design and the administration of the fund.

What did you have in mind there?

Mr. SNYDER. Yes, I did refer to that in my statement. Simply the fact that I think the whole approach to this is to have a viable railroad system, a competitive system that would compete with other forms of transportation by all service. The most important thing is service to the consumers, and the real key to this is to meet our energy needs.

What I was referring to there is we can't go out here and do major surgery on the present railroad system and the priorities shouldn't be in setting up the trust fund for the large railroads. In the marginal railroads, the weaker railroads, there's a lot of potential lying there. I know for a lot of months we have been dealing with the Milwaukee roadbeds. We have just had one independent review where the potential on the Milwaukee Railroad in the future—the energy needs, the coal, the grain shipments there—this is what we're saying. We're not saying keep every branch line in the United States on every railroad. We never have taken that position. We think that it should be carefully reviewed for the future where our energy needs are concerned and our transportation needs are concerned.

Senator McGOVERN. Thank you, Mr. Snyder.

Mr. SHAPP. Senator, I think this point you have raised goes right to the heart of the matter. I think the trust fund can really help this Nation obtain some of its national goals in seeking higher productively in this Nation. A more viable railroad system in this country would certainly help increase our productivity. It would help if trust funds were made available to strengthen the weaker lines and then you get into this whole concept of electrifying the railroads.

Right now we are using hundreds of millions of gallons of oil for our railroads that is not necessary. We could electrify the railroads through the trust fund, use coal, have a quicker turnaround with the engines because all you have to do is throw the switch and you don't have to fill the tanks and so forth.

We could use the trust fund for making sure we have safer tracks and we would eliminate a lot of accidents which would cut down costs and also eliminate the danger of these chemicals spills that are becoming more and more prevalent.

If you go into passenger service and high speed trains—I think it's ridiculous in the United States we don't have a passenger service that equals Red China at the present time, or that of any of the European nations or Japan. If we cut down on the use of private cars, we save enormously on oil and, again, commuter lines around our cities are doing the same type of thing. When you consider one train with 100 to 125 cars can handle the same freight as 200 or 250 trucks, and there are only five employees—in some cases six—on such a train, whereas you have to have two employees in each truck, you're increasing efficiency of transportation and reducing costs.

So, no matter how you look at it, rebuilding and putting our railroads in this country in better shape is a step in the right direction to help us resolve almost every problem. So I think having a trust fund available which would represent a source of funds for the railroads to accomplish these goals is going to be a step forward in helping what is a main issue before your committee, which is to improve the economy of the United States.

Senator McGOVERN. I'd like to pose a hypothetical question to any members of the panel that might want to respond and maybe we could begin with you, Mr. Smith. This may not be so hypothetical.

Let's suppose that Congress doesn't do anything on deregulation this year, but next year we enact part of what the administration is asking, not as far reaching a proposal but some substantial concessions on the deregulation side; and let's also assume we are continuing to operate next year under double-digit inflation with probably the price of oil going to $30 a barrel, as the chairman of the Senate Energy Committee has predicted.

Under these circumstances, do you think that the rail industry can eliminate the capital needs shortfall through existing channels? In other words, what I'm getting at, if we don't have the trust fund in place in the next year or so, how do we take care of the capital needs of the railroads, given these rather discouraging circumstances that seem to be ahead of us on the inflation and energy front?

Mr. SMITH. I'm not sure of the impact of the higher fuel costs you're talking about, but other than that——

Senator McGOVERN. Wouldn't that have the effect of diverting more transport to the rails if you have oil going that high?

Mr. SMITH. I don't know. I doubt it very much.

Senator McGOVERN. Maybe not. It's speculative.

Mr. SMITH. I think all the talk about railroad energy efficiency—that's in generalities. I question a lot of what was said about railroad energy efficiency by people here, by the railroads and so forth. I think a unit train full of coal is a very efficient user of petroleum products. When you're moving one hopper car on a branch line someplace, I question that that should be included as an efficient energy utilization. When the Burlington Northern moves a freight car on a Minneapolis to Seattle straight line and then south down to California, versus the third side of the triangle, I don't think that is an illustration of efficient utilization of energy.

Also, there's a great deal of talk about the empty truck. The figures on the empty boxcar are much more pronounced than the empty truck. I think there is an energy potential on the railroad, but I think you have to talk in specifics. I think we are all misleading ourselves when we start talking about generalities in the short range.

Now, when you start electrifying—what Governor Shapp is talking about—that's a longer range and I'm not sure what that would do in some parts of the industry. I think without changing regulations in 1980, with the railroads merely applying—without doing away with the ICC—with the railroad applying price and freedoms that were intended in the 4-R Act, I think there are hundreds of millions of dollars per year improvement possible in railroad income. I think there's also a lot of efficiency taking place within the railroad industry that is very slow which is worth hundreds of millions of dollars a year. I'm not sure that the next couple years really requires the trust fund being in place.

I think there are some aspects of the railroad industry today where we can't invest any faster than we are investing. People talk about freight car supply. I don't think you could get a boxcar delivered before 1981 if you ordered it today. There are some other kinds of equipment too I don't think you could get that soon. If you were to order some locomotives from Mr. Ouellette's electromotive division, I think you would have great difficulty in getting some locomotives very quickly.

Senator McGovern. That's an argument for getting the orders in now, isn't it?

Mr. Smith. Well, yes, but they are fairly well booked up. ConRail puts in about 4 million ties a year, new railroad ties. I don't think doubling that is going to achieve anything, and I doubt if they have the capability of doubling that. That may be not a fair illustration because they have done a lot the last few years, whereas a lot of other railroads haven't.

I think there are a lot of restraints in the application of investments in the railroad industry which would not necessarily be enhanced in the next couple years were you to legislate a trust fund now. That's not saying that I'm opposed to it. I still think it's something to be considered as a longer term possibility. I'm not very excited I guess about having it legislated tomorrow.

Senator McGovern. I don't think there's much danger of that happening, the way things work around here. We usually operate on a 2-year cycle. When we get a bill introduced, it takes about a year of hearings and arguments and debate, and next year we get it through one House and we're lucky if we make the other.

Mr. Shapp. Senator, it's taken 7 years to get it this far.

Senator McGovern. I'm painfully aware of that.

Mr. Ouellette. I would like to associate myself with many of the remarks Mr. Smith made. I think in terms of getting the railroads to respond in the next couple years, we have already begun to see that trend. Their earnings are up rather substantially in some cases, and that's a good omen. That means more progress will happen in that industry. We think that if they have the ability to go out and earn a reasonable rate of return we will begin to see some good changes take place.

That's why we think it's important that the regulatory situation be dealt with as a starting step. Then if you're going to have some rationalization of the rail system, and everybody can agree on the funding mechanism, the funding approach becomes the third element that certainly would have to be resolved. But at this stage of the game it's kind of like the start of the Federal mass transit program in the early 1960's, which was debated very hotly. All kinds of figures were thrown out, but nobody ever sat down and tried to figure out just exactly what was going to be needed. The net result was that we had a program that's been badly administered simply because it hadn't been properly thought out. The needs were not properly determined. If we're going to launch a full-fledged Federal-aid-to-railroads program we ought to stop and consider what we're trying to get from our efforts.

Senator McGOVERN. I think you gentlemen are aware of the fact that we've got a special interest in this whole rail situation in my State. I doubt very much if there's another State in the Union that's in any more vulnerable position right now than South Dakota. We are basically a farm State. Right now, probably, the most serious economic problem we have in the State is the rail situation. Even when we get a bumper crop—in fact, especially when we get a bumper crop, we are in serious economic difficulty because we can't market it, can't get it off the farms and out of the elevators and into the markets until the farmers have taken a beating on the price. It's costing us a good many millions of dollars in lost income. There's a possibility of going to trucks, but it's awfully expensive trying to move large quantities of grain by truck. Beyond that, it beats up our highways.

So beyond that, I have come to the conclusion that the rail problem is the No. 1 problem we have in South Dakota. It's partly because of that State interest that I'm so concerned about this, but beyond that, I think the whole country does suffer from the present condition of the railroads.

I realize that what you say is true, Mr. Ouellette, that some of them are doing better at the moment, but we have had studies by the Department of Transportation which indicate that if this much-heralded recession continues to take hold, these earnings are going to dry up very fast on some of the lines that are now making it.

In any event, we are faced with a bankrupt Milwaukee system in our State and a possible loss of substantial service. I just feel it's almost imperative that we do something. I don't want us to do the wrong thing. I think we have to think through very carefully what we're going to do. It's not a question of just doing something. We want to do something that makes sense, but I do see this trust fund idea as one that's worthy of a very careful look, along with some of the contract reform that I'm introducing in legislation today and some of the other things that I think might be helpful. We're going to have to have some direct loans to shippers and rail authorities in our State to save the branch lines I think, but in any event, I do appreciate the views that have been expressed here this morning on the whole question of our rail futures.

Are there any other points that any of you want to make?

Mr. PUTNEY. I'd like to suggest, Senator, the possibility of perhaps an alternative source of financing that might be made available and perhaps that has already been considered.

In the utility industry we have been able to meet a considerable amount of investment in environmental protective type facilities in our powerplants through the use of the pollution control facility financing. It's tax-exempt financing sponsored by a local community or local governmental area, a township or country of something like that, but widely used throughout the Nation. It has been a source of low-cost funds to permit us to go ahead and install those facilities. I don't know if any consideration has been given in the rail industry to the possibility of perhaps tax-exempt bonds that could be similarly issued. I think there's an element of the financial market that would be attracted. It's an alternative that might be considered. It has been very helpful to us.

The other thing if that in the absence of the railroad—and I must admit that the Burlington is better off than all of them, I guess—in the absence of the railroad committing itself to provide the coal cars for us, wer have taken it upon ourselves to assume that investment. But Congress has made investment tax credit available to us and that has been an incentive to us to foster our investment as well as improve our reliability of service.

The problem we have, though, is that the ICC must give recognition to the investment we have made which freed up capital for the railroad to go about its other business commitments. We want to make sure that we have a responsible reflection of that investment in whatever tariff rates are approved by the ICC.

Mr. CONLON. I'd just like to briefly comment on the tax question because it's something I spent a lot of my life working on.

I think that the basic idea of tax incentives to railroads would be helpful is correct. Unfortunately, most railroads are not in a taxpaying position because of the other things that have caused the capital shortfall. There are many things that can be done, one of which would be to make an investment tax credit available to the railroads on a refundable basis.

Today, the way it works is if you have a fortunate railroad that is fortunate enough to have the kind of income to pay taxes, they in fact can buy a freight car for 90 percent of what a less fortunate railroad can buy it for. It causes a distortion of equipment ownership to those who are more fortunate.

I think another very grave concern to me is the way this is reflected in the per diem rate. Going back to the flow of provisions of the investment tax credit, the per diem rates captured, the capital spent—and it is asserted that the law provides that you have to capture in your rental from other railroads the entire cost and thus do not share in the investment tax credit which accrues to the taxpaying but more fortunate railroad. I think there are many things in the tax law that can be changed, and I really applaud anybody who says we should look at it strongly.

Senator MCGOVERN. Thank you, Mr. Conlon.

Does anybody else now have any point they want to make before we adjourn?

Mr. SNYDER. Just one final comment, Senator. I appreciate the opportunity to hear the gentlemen here. I think the hour is late on the trust fund. A good example is here we have the Rock Island on directed service. This is costing the taxpayers millions of dollars. In having directed service, the Milwaukee estimated that directed service would cost anywhere from $80 to $100 million. This is right here today. It's happening.

What I'm saying is that under the Federal statute that we have on the books now, at the end of 8 months if they go to the limit on the directed service, you still have a problem. I think the time to act is now with all the wisdom we have in the railroad transportation industry. Now is the time to do it. We are late now. We are late now because the railroad industry in some areas is falling apart. Thank you very much.

Senator McGOVERN. Thank you, Mr. Snyder.

Well, gentlemen, many thanks for your contributions here today. This has been very helpful to me and I'm sure the transcript will be helpful to other members of the committee. We would like to stay in touch with you. I'm tentatively planning to introduce the rail trust fund legislation at the beginning of next year in January, but not unless we can get some solid indications of support from the kind of interests that are represented here. So we will be staying in touch with you and we appreciate your testimony today.

Before closing, I will place in the hearing record at this point a position paper by Mr. Lee Cisneros, director of physical distribution, Firestone Tire & Rubber Co., requested by me, on the merits of establishing a railroad trust fund.

[The position paper follows:]

POSITION PAPER BY LEE CISNEROS, DIRECTOR, PHYSICAL DISTRIBUTION, FIRESTONE TIRE & RUBBER CO., AKRON, OHIO, ON THE MERITS OF ESTABLISHING A RAILROAD TRUST FUND, REQUESTED BY THE HON. GEORGE MCGOVERN

The Nation's railroads continue to display an alarmingly precarious financial position in spite of some isolated positive performances by a minority of railroads. Railroad earnings have not surpassed 3 percent in more than a decade and have been below 2 percent since 1975.

Estimated capital requirements, made by the ICC's Bureau of Economics as part of Ex Parte 271, projected $27.8 billion in equipment capital needs for railroads over the 1976 to 1985 decade. Forward projections were made at a rate of inflation that has been exceeded substantially since the Ex Parte 271 case. Even a low growth scenario by the National Transportation Policy Study Commission in 1975 dollars projects capital requirements through 1985 at $52.7 billion, and through the year 2000, total requirements of a staggering $116.73 billion.

Regardless of which study is reviewed, it is apparent that the magnitude of the requirements are beyond the ability of the industry to manage; and even though a relatively few large railroads may be able to satisfy their capital investment needs, the system itself is jeopardized because of the need to maintain comparable service levels throughout the system in order to provide a service and cost competitive environment.

The Subcommittee on Economic Growth and Stabilization of the Joint Economic Committee has requested comments in connection with a proposal for the establishment of railroad trust fund. Attached to the request was a briefing paper drafted by the subcommittee to elicit comments and dialogue on the proposed trust fund.

The following is intended to comment on the various sections of the briefing paper:

"1. Develop a pool of investment capital amounting to between $12 billion and $13 billion through the sale of Federal obligations in the financial marketplace over a short period of 6-years or less."

We believe that such a trust fund could be used to bring our rail transportation system to a level consistent with anticipated projected user requirements as well as our national defense.

Because some of the requirements for maintaining transportation system vary, the source of repayment funds should be developed so as to attempt to reflect a proper proportion of responsibility for the general public sector and the specific user of a transportation service.

Something along the following lines might be one approach:

Railroad Trust Fund

A. *Source of Funds.*—(1) Twenty-five to thirty percent from general revenues to cover costs associated with: Social benefits not directly related to the transportation function, i.e., labor protection, service for depressed areas to improve economic potential, etc. National defense, i.e., maintenance of a total transportation system consistent with minimum required from a national defense standpoint; (2) User surcharge as adequate percentage of freight bill to repay trust fund advance over a long period of time.

B. *Amtrak.*—Trust fund could not be used to cover costs associated with operation of Amtrak.

"2. Make this pool of investment capital available on an equitable basis to all program participants."

We concur that no railroad should be excluded from access to their funds and the alternate sliding scale of interest rates could be used to allocate the available funds.

"3. Allow program participants to repay trust fund loans over a relatively long period of time (30 years) from the proceeds of a small surcharge (2 percent) levied on all traffic."

We do not concur with the railroads who feel that the trust fund recovery charge would increase the risk of loss of business to alternative modes. The railroads are daily making judgments on increases in rates which are related to their costs primarily. Since the costs, which are to be covered by trust fund dollars, now come from current revenues and must be recovered, it would seem that the opposite effect would occur. In other words, the trust fund recovery charge should represent less dollars, which they recover in their freight charges than no trust fund costs represent. (See also Source of Funds section.)

"4. Require that all Class I railroads participate in the program and hold the opportunity for voluntary participation open to small lines."

From a practical standpoint, this may be necessary to make the program workable, but the approach in No. 2 seems the approach with the least amount of potential negative reactions from the public financing community as well as the relatively financially strong railroads.

"5. Establish a tripartite board appointed by the President with the advice and consent of the Senate and composed equally of rail, shipper and appropriate Federal representatives to administer the program from the sale of Federal obligations to approval of investment decisions by borrowing railroads."

This approach represents a practical compromise which sets up the least amount of government control in the operation of the trust fund and we support this or some similar approach that would retain these principles.

"6. Require that loans be invested to achieve maximum benefits for both railroads and shippers in terms of eliminating deferred maintenance of mainline and major branchline tracks and to otherwise upgrade facilities and equipment to improve service to adequately meet current and anticipated traffic demands."

Concur in this approach. In addition, some consideration should be given to avoid the possibility of excessive dividend policies by railroads, because dollars from the trust fund were used to cover expenses which they would normally have deleted from a "dividend fund."

"7. Mandate that the board, in consultation with DOT, the American Railroad Association, various shipper organizations, and other appropriate public and private agencies and organizations, develop a plan to rationalize the structure of the nation's rail system and use the plan as a guide for investment of program loans."

It seems to us that one dollar of trust fund money can be spent without first determining what part of the system must be retained. Without this first step of rationization of the system, money spent on lines or branches that may not be essential would be a waste of fund dollars.

8. Life of the Trust Fund

We believe the trust fund should have a finite life, but that recommendations for extensions must be made and justified no less than 18 to 24 months prior to the expiration date.

We hope these comments will be helpful in developing the dialogue on this very important issue, and we thank you for the opportunity to participate at this stage of your deliberations.

Senator McGOVERN. The subcommittee stands adjourned.

[Whereupon, at 11:50 a.m., the subcommittee adjourned, subject to the call of the Chair.]

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