EXECUTIVE SUMMARY

The railroad industry of the United States, exclusive of the currently bankrupt roads, faces a cash shortfall of some $500 million annually over the next decade against desired levels of expenditure. In addition, individual railroad companies face bankruptcy, with turmoil in the transportation system and possible requirements for significant public costs as the result.

Rail freight service is not an obscure anachronism. It handles more intercity freight than trucks and barges combined, and it will continue to play a major role under virtually any imaginable scenario of the next decade. These problems will simply not just "go away."

The range of legislative proposals discussed in the body of this report contains the elements of an appropriate response to the railroads' problems, at both the industry level and that of the individual weak roads. The proposals also contain a significant danger of inappropriate solutions with serious adverse consequences for the long-run viability of the industry. This summary attempts to identify both the solutions and the dangers in turn.

solutions

A legislative package designed to appropriately address the problems identified in this study would include:

- Rehabilitation. This would be a selective program of federal assistance for the rehabilitation of railroad fixed plant. The program would focus on those railroads which are weaker than the industry average in terms of cash needs and potential bankrupts. With this focus, and also through explicit criteria, the rehabilitation would be directed at expenditures which produce high cash returns to the railroads, concomitant benefits in terms of service quality, and such societal aspects as energy conservation and enhancement of the environment. The intent would be to augment the limited cash flows available for this purpose to the weaker roads and not to simply replace private capital in the stronger sector of the industry. To be effective, the public funds would have to be made available as outright grants or as very low cost loans with terms which avoid burdensome interest or repayment features which would defeat the objectives of the program.

The amount and timing of funds would depend on events (particularly trends in the national economy), but would probably be $3 billion to $4 billion, or something less than the total $5 billion projected shortfall.

- Restructuring. The part of the problem to which restructuring may present solutions is not that of industrywide cash shortfall. The massive nationwide restructuring exemplified by the Livingston Plan for four transcontinental rail systems is too uncertain as to its effects and, in any event, would be of limited benefit in the ten-year horizon being discussed here. Less ambitious restructuring, however, can contribute one means of dealing with the bankruptcy problem. Legislation to enhance this effect would include provision for some analytic and planning effort without which the federal government cannot act nor even react rationally to voluntary industry-initiated proposals. It would also include provision for the expeditious processing of whatever voluntary restructuring proposals emerge from the industry in its efforts to avoid the bankruptcy problem. In addition, it would provide for the use of rehabilitation funds, discussed above, as leverage to promote or encourage restructuring activity which appears desirable based on the financial condition of specific roads and the planning process. (It should be evident from the above that the planning process envisioned must not be limited to producing a grand scheme for the railroads for the year 2000. It must deal with the short-term specifics of individual railroad companies, routes, and markets in the short term, but also be guided by a longer range perspective.)

- Rates. Of the areas encompassed by this report, rate legislation is the most difficult in terms of the visibility of potential impacts. This is due to the wide-ranging nature of the impacts, including effects on rail traffic, its relation to other modes, and the cost of transportation to society. It is also due to the limited amount of analysis (as opposed to doctrinaire beliefs, of which there is no lack) currently available. The analytic evidence that is available suggests that legislative "rate reform" contains much potential for disruptive effects both within the rail industry and within the general economy. These dangers will be discussed below. On the more positive side, several observations can be made.

--Some rate flexibility should be provided to rail management, downward to explore market opportunities and upward to relieve the industry of some of its “loser” traffic, either by covering costs or permitting the railroads to price themselves out of some markets. It is unlikely that rail carriers will make significant rate reductions.

--To be effective, such flexibility must take into consideration all regulatory restraints that currently apply to rail rates. E, in practice, Sections 3 and 4 of the Interstate commerce Act inhibit flexibility, they should be modified legislatively.

--Changes in this area should be made in such a way that truly disruptive effects am avoided. One proposed approach is to lift regulatory constraints gradually over time.

--Consideration must be given to regulatory change in other transportation modes since the interactive effects may be more significant and less well understood than the single-mode perspective.

- <u>Other</u>. Service on light-density lines which generates cash losses for the railroads and which is required for the public good should be subsidized with some form of public monies. This will relieve the railroads of a financial burden which they cannot afford and, by requiring overt rather than hidden subsidy, will provide a means of ensuring that real public needs determine the service requirement.

  Discriminatory taxation of rail property arises from the economics of an earlier era. It is not now appropriate and should be effectively stopped.

  The effects of these two actions will add approximately $100 million annually to railroad cash flows. This amount is significant in relation to the cash needs of the industry over the next ten years.

<u>Dangers</u>

As noted, the range of legislative proposals reviewed in this study is believed to contain an appropriate response to the problems of the rail industry. In addition, however, numerous adverse impacts could also be experienced if inappropriate options are drawn from that same range of proposals. These dangers should be kept in mind throughout the legislative process. They are highlighted below:

- Rehabilitation. One major danger associated with rehabilitation is that of "overkill." This refers to the possibility of federal assistance for marginal rehabilitation activities that provide no cash gains to the industry and little public benefit in terms of service gains or energy and environmental benefits. Alternatively, such federal overkill would simply result in replacing currently available private capital with public monies.

  The other danger associated with federal rehabilitation assistance is that of attaching such stringent financial terms that the funding cannot reach, or cannot benefit, the weaker railroads which need it most and which are otherwise forced to defer maintenance that would provide relatively higher financial and public returns.

- Restructuring. The danger here is that history will repeat itself and that undesirable mergers will be permitted to take place while the voluntary restructuring aimed at the weaker roads will be dragged through an endless procedural and conceptual morass. A planned and expedited federal response to (and participation in) industry-initiated restructuring appears to be essential.

- Rates. The dangers associated with rate reform are very real and involve adverse impacts on both the rail industry and the public. If done carelessly, the revision of historical regulatory treatment of the major modes could cause massive shifts of traffic away from the railroads. In addition, unrestrained freedom in the rate area could cause widespread increases in rail transportation costs. Such increases may be inevitable--and even desirable--over an extended period of time, but the potentially disruptive short-run impacts must be minimized.