Testimony of Robert E. Gallamore
Deputy Administrator, Federal Railroad Administration
Before the Senate Committee on Commerce,
Science and Transportation
Surface Transportation Subcommittee
Monday, March 31, 1980

RAIL RESTRUCTURING ASSISTANCE ACT

I am pleased to appear before this Committee to testify on the importance of swift enactment of S.1151, the proposed Rail Restructuring Assistance Act, which would establish new programs to provide Federal assistance which promotes restructuring and improved labor efficiency. With me are William Loftus, FRA's Associate Administrator for Federal Assistance, who would oversee the bill's implementation and Raymond James, FRA's Chief Counsel.

The Rail Restructuring Assistance Act is an improvement over existing financial assistance programs. The bill authorizes a total of $1.475 billion in financial assistance over a five-year period. The bulk of the funds would be available in the form of low-cost debt or equity financing for projects which promote restructuring by consolidating mainline facilities and yards through mergers, acquisitions and joint trackage arrangements. A maximum of $275 million of the total authorization would be authorized for two purposes -- labor protection payments in connection with restructuring and the promotion of innovative changes to work rules and operating practices which improve productivity.

The Secretary's report to Congress, mandated by sections 504 and 901 of the Railroad Revitalization and Regulatory Reform Act of 1976, emphasized two major changes which are necessary if the railroad industry is to become healthy again. The national railroad system has to be restructured in order to consolidate operations into economic, high density railroad routes, eliminating unneeded main lines and, through reinvestment in profitable lines, reducing substantially the system's current deferred maintenance. At the same time the industry has to be relieved of that economic regulation which handcuffs the industry's ability to respond to changing market conditions. Two major pieces of legislation have been transmitted to the Congress as the Administration's recommendation to implement the 504/901 findings. These companion legislative proposals are the Railroad Deregulation Act of 1979 and the Rail Restructuring Assistance Act, which we are discussing today.

Federal funds cannot and should not be expected to meet more than a small share of the estimated $13-16 billion ten-year shortfall in the industry's (excluding Conrail) cash requirements. We believe that railroad restructuring and lessening regulation are the most productive ways to get maximum benefits from whatever Federal funds are to be available as a contribution to the shortfall.

The Rail Restructuring Assistance Act would provide us with a tool to encourage railroad restructuring by conditioning low-cost assistance on significant actions to restructure the industry. This proposal contrasts with the original section 505 program which emphasized the reduction of deferred track maintenance without regard for changing the underlying economics of the system -- which may have caused railroads to let their tracks deteriorate in the first place.

The 4R Act established two new aid programs; section 505 preference shares and section 511 loan guarantees, both providing needed capital to the railroads. Section 505 of the Act provides attractive Federal assistance and has been successful in achieving its purpose, but its ability to promote restructuring has been limited in three respects: (1) the solvent railroads which might have undertaken significant restructuring with financial incentives were not eligible under the present law until the recent enactment of the Milwaukee Railroad Restructuring Act; (2) the Secretary was not permitted to condition assistance on a railroad's agreement to restructure its system or to provide low-cost funds except for deferred maintenance projects; and (3) there was no express labor protection feature.

Marginal railroads generally cannot afford to undertake large scale restructuring without Federal assistance. Their facilities and financial prospects have continued to deteriorate at least in part because they have tried to provide service that is not compensatory in the long-run and will not support reinvestment without greater traffic density but nonetheless does produce short-term positive cash flow. Meanwhile profitable railroads which might have been interested in merging with a restructured marginal railroad or buying line segments if rehabilitation requirements were minimal, now have little reason to risk their financial positions on such speculative opportunities. It would be far better to restructure the properties, develop new service patterns based on operational advantages of adjacent railroads, and thus preserve valuable lines as part of the private railroad system.

The Rock Island and Milwaukee are cashless and the Rock Island is being liquidated. Many of the Rock Island and Milwaukee lines are clear candidates for acquisition by healthy railroads. Because capital is scarce however, and the risks are great, some of the stronger railroads are reluctant to finance purchases of major lines of the two bankrupts' systems. If substantial low cost Federal assistance were available -- and particularly with labor protection flexibility --I believe many healthy railroads would be much more likely to acquire these lines and preserve service on them.

Some railroads have favored continuation of the existing section 505 program with minor modifications to promote restructuring but continued emphasis on overcoming deferred maintenance. This view, we believe, gives inadequate recognition to current budgetary realities. We can no longer afford to subsidize rehabilitation of low density track where there are ample other railroad main lines.

The bill also includes a program to improve the effective employment of labor in the railroad industry. The Secretary would be authorized to loan funds to a railroad to pay up to one hundred percent of payments to employees who suffer financial loss due to changes in work rules or operating practices which are designed to improve system productivity. These funds would serve as seed money to enable railroad labor and management to cooperate in projects to determine whether new operating practices will improve operating efficiencies. Successful projects would then be implemented on a full scale basis. By indicating ways to reduce operating costs, this program, too, would help improve a railroad's cash flow when it implemented a successful project on a full scale basis.

With two major Midwestern carriers selling off vast amounts of railroad, we have an opportunity, however unwanted, to reshape the Midwest railroad system. If the Rail Restructuring Assistance Act were to be enacted shortly, the positive aspects of that effort could be addressed nationwide. Specifically in the Midwest, the availability of low cost financial assistance will make the acquisition and rehabilitation of key Milwaukee and Rock Island lines more attractive to acquiring railroads and thereby help to establish permanent service arrangements.

As a final note I should say that the operating and pricing flexibility which would be provided under the Administration's deregulation proposals is also essential if we are to avoid future railroad bankruptcies. We must act now, and for the above reasons I urge quick enactment of this bill.

I will be happy to answer your questions.