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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Federal Assistance To Rehabilitate Railroads Should Be Reassessed

Title V of the Railroad Revitalization and Regulatory Reform Act of 1976 authorized $1.6 billion in assistance to the Nation's railroads. Eight railroads have rehabilitated more than 2,100 miles of track and restored 8,800 locomotives and freight cars under the program.

Despite the program's past benefits, there is little demand for further assistance solely to overcome deferred maintenance. GAO suggests several matters for the Congress to consider in evaluating the need for more Federal assistance.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report is an appraisal of how the Department of Transportation has administered Federal assistance to railroads under title V of the Railroad Revitalization and Regulatory Reform Act of 1976, as amended. It outlines several matters that should be resolved before authorizing new Federal assistance programs.

We made this review because the assistance provided to railroads seemed small compared with the amounts authorized by the act and because administration of the program had been criticized.

Copies of the report are being sent to the Director, Office of Management and Budget, and to the Secretary of Transportation.

Milton J. Socolar
Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FEDERAL ASSISTANCE TO
REHABILITATE RAILROADS
SHOULD BE REASSESSED

D I G E S T

When the Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976 authorizing $1.6 billion for two programs to help the Nation's railroads overcome deferred maintenance, it expected the funds to be used up quickly. But 4 years later, much of the program authority was unused, and there seems to be little remaining interest in assistance solely to overcome deferred maintenance.

As of November 30, 1979, the Department of Transportation's Federal Railroad Administration had furnished $518 million--or about 30 percent of the funds authorized by title V of the act--to eight railroads to rehabilitate more than 2,100 miles of track and restore 8,800 locomotives and freight cars. (See p. 14.) Applications were pending for only $387 million of the $1 billion in unused program authority.

Four of the seven pending applications, totaling $348 million, were from railroads that had already received assistance and the three from railroads that had not already received assistance totaled only $39 million. Much of this pending assistance was not to reduce deferred maintenance on essential track segments. For example, one $230 million project was mainly to construct a new rail line. (See p. 15.)

Since November 30, 1979, the Federal Railroad Administration received six additional applications for assistance, but these were generally not for projects solely to overcome deferred maintenance. Between December 1, 1979, and May 31, 1980, six additional applications for $219 million in assistance were received. Only one of the six, for $3.5 million, requested assistance solely to reduce deferred maintenance, and it was from a railroad that had already received assistance. (See p. 17.)

GAO concluded that Federal assistance solely to overcome deferred maintenance is not essential. Marginal and bankrupt railroads do need Federal assistance for this purpose; however, most of them have already received assistance for essential parts of their systems. Other railroads that carry most of the freight either do not need or do not qualify for Federal assistance. (See p. 19.) GAO is not recommending that the title V programs be abolished because the Department of Transportation has proposed, and GAO believes that the Congress should consider, altering the programs to provide restructuring assistance.

NEED FOR RESTRUCTURING THE RAIL SYSTEM

The Department of Transportation has identified 10 rail corridors (routes between important shipping and receiving centers) that have too many rail lines. Freight traffic could be consolidated on one or two of the four or more rail lines in these corridors. But the railroads have been reluctant to consolidate operations because these lines are important to their operations and revenues. These actions also must be approved by the Interstate Commerce Commission. (See p. 22.)

The Congress is considering legislative proposals to reform the Interstate Commerce Commission's authority to regulate railroads to preserve a private, competitive rail industry while allowing it to earn adequate profits, attract capital, and change its system to meet market demands. (See p. 24.)

Federal assistance could be used to help achieve the necessary restructuring for an efficient national rail system. Amendments to the title V program currently authorize about $100 million for restructuring assistance. The Department of Transportation, however, has proposed a new 5-year, $1.475 billion restructuring assistance program, but the specific purposes and goals of this program are not clear. The Department's proposal would provide funds for restructuring projects initiated by and developed within the rail industry. The Department believes that it should not define the national rail system and should have flexibility on how Federal assistance will be used. GAO believes that the Congress should ensure that any restructuring assistance has specific purposes and goals so Federal assistance will achieve a desirable pattern of consolidation for the national rail system. (See p. 26.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress should consider how pending regulatory reforms will affect the rail industry's need for Federal assistance and whether national priorities permit spending public funds to induce restructuring. Since Federal assistance availability could affect the way the rail industry initiates restructuring actions, the Congress should require that the Secretary of Transportation formulate specific restructuring assistance goals and plans to achieve them.

In this connection, GAO believes that the Congress should direct the Secretary of Transportation to specify which restructuring projects are essential to a healthy industry and should therefore be eligible for assistance.

DEPARTMENT OF TRANSPORTATION'S COMMENTS

The Department of Transportation agreed that GAO's report sets forth the critical issues to be considered in formulating a program of Federal financial assistance to the railroad industry. The Department said, however, that clarification was necessary in several areas.

The Department regarded as inaccurate GAO's conclusion that Federal assistance solely to overcome existing deferred maintenance is no longer essential. GAO believes that its conclusion is appropriate and accurate. (See p. 19.)

The Department said that GAO's conclusion that it has not specified criteria for choosing restructuring projects raised, perhaps, the most difficult policy issue at stake. It said that a Government framework for industry initiative, including appropriate financial assistance with restructuring as a condition, was necessary. (See p. 28.)

The Department agreed that pending regulatory reforms will affect industry's need for Federal assistance but said that both a preliminary estimate of those effects and a firm estimate of railroads' capital need or shortfall were lacking. GAO believes that these are persuasive reasons for requiring that the Department formulate specific plans for using any assistance the Congress authorizes. (See p. 28.)

The Department's written comments are included as an appendix to this report. The matters discussed above, as well as a number of factual and editorial items suggested by the Department, have been incorporated into appropriate sections of the report.

Contents

ABBREVIATIONS

DOT	Department of Transportation
FRA	Federal Railroad Administration
GAO	General Accounting Office
ICC	Interstate Commerce Commission

CHAPTER 1

INTRODUCTION

The Railroad Revitalization and Regulatory Reform Act of 1976 (the 4R Act, Public Law 94-210) established several programs to revitalize the Nation's railway system and restore its financial stability. Title V of the 4R Act provided $1.6 billion in financial assistance to rehabilitate and improve railroad facilities and equipment. This interim program was to assist railroads until the Department of Transportation (DOT) completed a study to (1) determine the amount and type of capital financing required by the rail industry over a 10-year period ending December 31, 1985, and (2) recommend the additional Federal financing, if any, that should be provided.

BACKGROUND AND PURPOSES OF RAILROAD REHABILITATION AND IMPROVEMENT FINANCING

In the early 1970s, the Penn Central and other Northeast and Midwest railroads went bankrupt. The threat posed by these bankruptcies to the economy focused national attention on the railroad industry. The Congress responded by passing the Regional Rail Reorganization Act of 1973, which provided financial assistance to cope with massive levels of deferred maintenance and delayed capital improvements on the bankrupt railroads. On February 5, 1976, the Congress passed the 4R Act to restore financial stability to the industry nationwide.

Title V of the 4R Act authorized two financial assistance programs:

--Preference share program, which provided $600 million in financing for railroads to maintain, rehabilitate, improve, or acquire facilities and for any other financing needs approved by the Secretary of Transportation.

--Loan guarantee program, which provided $1 billion for railroads to rehabilitate, improve, or acquire facilities or equipment.

Both of these programs created advantages for the railroads. Under the preference share program, the Government purchases a railroad's preferred stock. The railroad must repurchase the stock within 30 years. The railroad's advantages are that payments against the principal amount of the stock are deferred for 5 to 10 years, interest payments are deferred for 10 years, and the railroad's interest rate can be as low as 2.03 percent. Under the loan guarantee program, the Government guarantees a railroad's repayment of commercial loans. The railroad's interest cost is about the Government's cost of borrowing money.

Later legislation changed and expanded the authorized uses of preference share financing. Under the 4R Act, all railroads are eligible for title V financial assistance. However, the Rail Amendments of 1976 (title II of the Rail Transportation Improvement Act, Public Law 94-555) gave marginal and bankrupt railroads priority for preference share financing to overcome deferred maintenance on tracks and facilities. Later, in November 1979, the Milwaukee Railroad Restructuring Act (Public Law 96-101) authorized DOT to approve preference share financing for railroad restructuring--that is, activities, including consolidations, coordinations, mergers or abandonments, which improve the long-term profitability of railroads and enhance the national rail freight system by achieving higher traffic densities or improved asset use.

THE PROBLEMS OF DEFERRED MAINTENANCE AND TOO MUCH TRACK

A railroad ordinarily has regular maintenance programs to renew or replace equipment, track, and related structures. In times of depressed revenue or increased costs, however, it may defer some maintenance because these deferrals do not affect operations in the short run. Yet, continual maintenance deferrals, such as occurred in some marginal or bankrupt railroads, eventually affect operations and become an insurmountable economic burden. Correcting deferred maintenance is generally referred to as rehabilitation.

Restructuring, on the other hand, is related to a railroad's track configuration. During the rail industry's earlier prosperous years, when there was traffic for all the railroads, competing railroads built extensive and often redundant track networks. However, the industry has been declining for some time. Competition for traffic is now keen, and much of the redundancy has become excess capacity in the national rail system. As a result, individual competing railroads have too little traffic to support their extensive track networks. Restructuring eliminates excess capacity by achieving more traffic per mile of track. It can involve one or many railroads and may include consolidating separate rail facilities into fewer facilities, agreeing to jointly use one railroad's track or facilities, or downgrading or abandoning excess facilities.

DOT STUDIES OF THE RAIL INDUSTRY UNDER TITLE V OF THE 4R ACT

Title V required two studies of the rail industry: one to classify and designate rail lines according to their essentiality to the rail transportation system and economic worth (section 503) and one to recommend the amount and type of financing the industry required over the 10-year period ending December 31, 1985, and how Federal financing, if any, should be provided (section 504).

As a result of its January 1977 study of rail line essentiality, DOT placed 194,000 miles of track in one of four categories according to the amount of traffic carried, markets served, and other factors. The study also identified clusters of rail lines where consolidating traffic on fewer lines seemed possible. According to the study, categorizing the lines established a guideline for choosing future track investment and began to reveal the portions of the rail system most important to the flow of interstate commerce.

In its October 1978 study of the industry's financing needs, DOT concluded that financial assistance to the railroad industry will not, in itself, solve the industry's capital shortage problem. DOT projected a capital shortfall in the industry (exclusive of Conrail and the Long Island Railroad) of between $13.1 and $16.2 billion from 1976 to 1985. Despite this shortfall, the study stated that continued Federal assistance would be appropriate only if fundamental changes were made in how the Government regulates railroads and competition between different transportation modes and in industry structure and practice. In the study, DOT discussed several ways Federal assistance might be provided, but did not recommend a specific amount or program.

In commenting on our draft report, DOT said that Federal assistance is necessary along with the fundamental changes referred to above. It said that continued Federal assistance would be ineffective without regulatory and structural change and that regulatory and structural change would be more effective with limited and directed Federal assistance.

APPLICATIONS AND AGREEMENTS FOR ASSISTANCE UNDER TITLE V OF THE 4R ACT

As of November 30, 1979, the Congress had appropriated $590 million for preference share financing and specified a ceiling amount of $600 million for loan guarantees.

Of those amounts, about $670 million remained unobligated and was available for additional assistance to railroads--$200 million for preference shares and $470 million for loan guarantees. As shown in the following table, the Federal Railroad Administration (FRA) had financing agreements with eight railroads totaling about $518 million and applications for an additional $387 million were pending.

Title V Financial Assistance Programs
Agreements Reached and Applications
Pending as of November 30, 1979

	Financial agreements (note a)	Applications pending (note a)
	--------(millions)--------	
Chicago & North Western Transportation Company	$192.5	$282.9
Illinois Central Gulf Railroad Company	166.4	-
Chicago, Milwaukee, St. Paul and Pacific Railroad Company	55.2	65.2
Chicago, Rock Island and Pacific Railroad Company	43.0	(b)
Boston & Maine Corporation	26.0	-
Missouri-Kansas-Texas Railroad Company	22.5	-
Delaware & Hudson Railway Company	8.0	-
Columbus & Greenville Railway Company	4.1	-
Indiana Harbor Belt Railroad Company	-	31.2
Auto-Train Corporation	-	4.5
Peoria & Pekin Union Railway Company	-	3.5
Total	$517.7	$387.3

a/Between December 1, 1979 and May 31, 1980, FRA received six applications for assistance and granted three agreements. As of May 31, 1980, financial agreements had increased to $637.2 million, and $533.3 million in applications were pending.

b/Excludes applications for $170.7 million from the Chicago, Rock Island and Pacific Railroad Company, which FRA considers inactive.

SCOPE OF REVIEW

We reviewed FRA's administration of the 4R Act's title V assistance programs because the assistance provided railroads seemed small compared with the amounts authorized by the act and because FRA had been criticized by the Congress and industry for slow and overly conservative handling of applications and agreements. We researched the legislative history of the 4R Act and subsequent amendments. We interviewed officials in FRA's Office of Federal Assistance and Office of the Chief Counsel concerning program policy, reviewed FRA program files, and visited each railroad that participated in the preference share and loan guarantee programs. We obtained extensive evidence on how federally assisted projects related to the railroads' operation and need, and on how the issues that arose during financing agreement negotiations were resolved.

We obtained only limited data on applications for assistance received between December 1, 1979 and May 31, 1980, and did not develop sufficient detail to incorporate information on these applications throughout the report. The applications' effect was noted where appropriate.

We did not attempt to review how railroads were spending or accounting for Federal funds and did not review FRA's administrative procedures in detail. Our report entitled "Improved Controls Needed Over Federal Financial Assistance to Railroads" (CED-76-161, Nov. 15, 1976) recommended improvements in FRA's administration of the financial assistance programs.

The review was conducted at FRA headquarters and at the headquarters of the following railroads:

--Chicago, Milwaukee, St. Paul and Pacific Railroad Company;

--Chicago & North Western Transportation Company;

--Columbus & Greenville Railway Company;

--Chicago, Rock Island and Pacific Railroad Company;

--Illinois Central Gulf Railroad Company;

--Boston & Maine Corporation;

--Missouri-Kansas-Texas Railroad Company; and

--Delaware & Hudson Railway Company.

We also interviewed officials from other railroads and the Association of American Railroads.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our draft report, DOT questioned our summary of its positions in the January 1977 study of rail line essentiality and the October 1978 study of the industry's financing needs. As explained below, we believe our statements correctly summarized the studies.

DOT said that our characterization of the information in the essentiality study was incomplete and possibly misleading. DOT said that the study was a retrospective examination of link traffic loadings; that it was not a prioritization, and that it looked only at previous usage rather than future requirements.

We agree that DOT classified the rail lines according to traffic volume. In characterizing the study, however, we reported what the study said:

> "The process results in a prioritizing of rail lines which can serve as a guideline for future investment in track, and, from an initial standpoint, begins to depict those portions of the rail system most important to the flow of interstate commerce. The process, which is continuous in nature, should further aid railroad management with future decisions regarding investment, operations, and facilities rationalization, lead to safer operations, and furnish a useful tool to both federal and state planning agencies."

DOT said that we should summarize its position in the October 1978 study of the industry's financing needs by saying that continued Federal assistance is "necessary along with" fundamental changes in how Government regulates railroads instead of "(would be) appropriate only if." We believe that the suggested change would alter the position stated in the study.

The October 1978 study states:

> "With these points in mind, the capital shortfall should not be viewed as the cause of the railroads' current difficulties. Rather, it is a symptom that the rail industry is in trouble and that the problem is sizable.

"* * * Numerous actions must be initiated if continued Government financial assistance is to be appropriate to help the railroads. * * * In concert with and to help facilitate changes such as these, Federal financial assistance can be appropriate and effective."

CHAPTER 2

FEDERAL ASSISTANCE SOLELY TO OVERCOME DEFERRED MAINTENANCE IS NO LONGER ESSENTIAL

Despite start-up problems and delays, title V's goal of providing assistance to needy railroads to overcome deferred maintenance on lines critical to the national rail system appears to have been substantially achieved. When FRA initially gave priority to loan guarantees, the Congress amended the 4R Act to direct FRA toward using the lower cost preference share program for deferred maintenance projects. Demand for assistance solely to overcome deferred maintenance, however, was less than expected, and the need for more assistance of this type, beyond applications already pending, is questionable. Few railroads qualify for the assistance and most of the assistance sought has been granted.

TITLE V FINANCING APPROVED SLOWER THAN EXPECTED

Because deferred maintenance was widespread throughout the rail industry, it was commonly believed that the $1.6 billion in Federal assistance would be spent quickly. FRA initially expected to obligate $1 billion by the end of fiscal year 1977--$400 million in preference share financing and $600 million in loan guarantees. Later, in February 1977, FRA's Office of National Freight Assistance Programs projected that $600 million of preference share financing would be obligated by the end of fiscal year 1979.

These expectations did not materialize. No preference share funds were obligated until the last quarter of fiscal year 1977 (1-1/2 years after passage of the 4R Act) and it was more than 2-1/2 years before preference share obligations passed 25 percent of the funds authorized. As of November 30, 1979, the principal amount of loans guaranteed had yet to top 25 percent of the $1 billion authorized by the 4R Act.

FRA was severely criticized by the Congress and the rail industry for slow and overly conservative program implementation. As discussed below, start-up problems and other factors, such as the small amount of deferred maintenance on main line track, caused the slowness.

Industry favored preference share financing, but initial DOT policies emphasized loan guarantees

The loan guarantee and preference share financing programs included in title V had different origins. DOT originally proposed that the Congress limit assistance to loan guarantees. At the same time, the Union Pacific Railroad proposed that the Government provide assistance through a program where it would purchase redeemable preference shares of stock issued by railroads.

The proponents of these two programs held widely differing views about Federal financial assistance. DOT believed that Federal assistance should only be provided if it had authority to require restructuring, and it felt that the subsidies given to private corporations should be minimized by using loan guarantees. The rail industry, on the other hand, believed that even if loan guarantees were available, the low-cost financial assistance that preference share purchases could provide--available without delay or inhibiting conditions--would still be necessary. In congressional testimony, a rail industry spokesman stated that high-cost loan guarantees (with an interest rate estimated at about 8 percent) would be of little use as a source of funds for rehabilitation since it has a low financial rate of return.

The 4R Act provided both kinds of financing and gave the Secretary of Transportation wide discretion to establish a project's eligibility for financial assistance. Subject to general findings that a project was in the public interest, the Secretary could approve or disapprove virtually any application for preference share financing. The Secretary had similar discretion under the loan guarantee program.

DOT and industry tried to increase participation and redirect implementation

FRA's initial policy emphasized loan guarantees--the program DOT had supported when the 4R Act was written. Industry, however, argued that this policy conflicted with the 4R Act's original intent, and it promoted wider use of the lower cost preference share program. Despite industry objections, FRA's final regulations retained its loan guarantee emphasis.

By mid-April 1976, barely 2 months after the 4R Act became effective, DOT was considering the need for legislative amendments to make the loan guarantee program more workable and attractive to prospective applicants and lenders. For example, DOT wanted an amendment guaranteeing repayment of title V loans by the full faith and credit of the United States. In addition, DOT wanted title V loans secured by any assets and/or the future earnings of the applicant. The 4R Act initially required that loans guaranteed by the Government be secured by the value of the equipment or facilities to be financed, but their value may not provide adequate security because of prior mortgages and liens. DOT also sought amendments to modify the 4R Act's restrictions on railroads' dividend payments to stockholders and the use of their assets.

During June 1976 hearings before the House Subcommittee on Transportation and Commerce, DOT supported these as well as other proposed amendments to the loan guarantee program. DOT neither supported, nor proposed, amendments to the preference share program. Thus, the Department's efforts to improve title V in 1976 followed its belief that loan guarantees should be the principal vehicle for providing Federal assistance to the industry.

At the same time DOT was trying to stimulate demand for the loan guarantee program, industry was promoting wider and more liberal use of the preference share program--the program it had proposed and supported when the 4R Act was written. By June 1976, several railroads had said they would like to apply for preference share assistance, and FRA had proposed regulations which specified its rules for submitting those applications and its policy for approving them. Industry believed DOT's proposed regulations would not permit the use of preference share financing that Congress intended--mainly for rehabilitation.

The principal advantage of preference share assistance, in industry's view, was its ability to give low-cost assistance to railroads so they could reduce accumulated deferred maintenance. In testimony, industry pointed out that the legislative history of the 4R Act was replete with references focusing preference shares on such assistance. FRA's policy seemed to frustrate these advantages. Industry testified in favor of legislation to require changes in FRA's policy and also tried to convince FRA that changes should be made. For example, industry wanted to change the proposed policy so preference share assistance would be available predominately at a low cost. In proposed regulations published in June 1976, FRA had said that in most cases the Secretary would set the financing cost to equal the Government's cost rather than at a lower cost as permitted by the 4R Act. Industry testified that this policy would place severe financial burdens on those railroads that needed assistance, and it proposed that only the minimum cost be permitted.

Industry also wanted to change the proposed policy to give first priority for assistance to railroads seeking to cure deferred maintenance. It also wanted several other changes in FRA's policies and procedures. Under FRA's proposed policy, first priority in preference share funding would be given to projects that involved a consolidation, coordination or other restructuring action; second priority to projects that improve competition; and third priority to projects that enhanced the carriers' ability to transport freight or passengers--which would have included assistance primarily to cure deferred maintenance. Industry believed the act intended that rehabilitation to cure deferred maintenance receive first priority.

FRA's final regulations, published in October 1976, retained the policy of providing assistance in most cases at the highest permissible cost to the applicant and gave low priority to deferred maintenance projects.

Rail Amendments of 1976 deal with most early problems

The Congress amended title V in October 1976 to resolve the conflicting opinions about the implementation of title V's assistance programs. The amendments required that deferred maintenance projects receive higher priority for preference share funds and lowered the cost of funds by setting a ceiling rate equal to a railroad's return on its total capital. Other amendments to the preference share program removed the requirement that applications for rehabilitation assistance be delayed until a study and classification of rail lines was completed, specified that FRA publish specific and detailed application review standards, and gave FRA more flexibility to assist bankrupt railroads. FRA revised its regulations accordingly.

For loan guarantees, the amendments extended the full faith and credit of the Government to make commercial loans available at lower costs, removed requirements that FRA ensure that loans were fully secured by the value of facilities and equipment financed, added that security for loans could be provided by value of leases and the prospective earning power of the equipment financed, and specified the conditions and amounts of dividends that railroads could pay while receiving and repaying Federal assistance.

Following these amendments, FRA completed negotiations on tight, but less restrictive, financial agreements, which the railroads believe are fair and reasonable.

Inability to obligate funds stemmed from several factors

The amendments discussed above to change the preference share funding priorities and to make the loan guarantee program more workable may have delayed financing. We believe, however, that the following were important factors affecting FRA's ability to obligate title V funds.

--Deferred maintenance was not a pervasive problem on main line track. As discussed on page 18, much of the accumulated deferred maintenance was not disrupting mainline traffic and probably should not be fixed. Therefore, the problem addressed by title V was limited to a few marginal railroads.

--The preference share program was directed at assisting marginal railroads. Initially, FRA expected considerable latitude in choosing among applicants and projects for preference share assistance and expected to be able to assist stronger railroads. The Rail Amendments of 1976 limited eligibility to marginal railroads. Therefore, the number of potential applicants was reduced to a dozen or so railroads.

--Railroads failed to make extensive use of loan guarantees. FRA anticipated that substantial amounts of track rehabilitation would be accomplished through loan guarantees. Loan guarantees, however, are not financially attractive for either track rehabilitation projects, which have a low rate of return, or for new equipment purchases, for which private capital is readily available. Railroads have used loan guarantees primarily for freight car rehabilitation programs, which are not easily financed from private lenders.

--The proposed projects themselves were larger and more complex than FRA anticipated, and, as will be explained in the following section, the financing agreements were hard to negotiate. While the railroads expected few restrictions, FRA pressed for air-tight agreements, and compromise came slowly.

Negotiation problems delayed preference share financing agreements

Soon after the 4R Act was passed in February 1976, FRA began negotiations with eight railroads for preference share financing and loan guarantees. The first preference share financing agreement was not completed until July 1977.

Completion of the initial financing agreements was delayed by a number of factors. First, the applications were for large complex projects, some exceeding $100 million. The railroads had to spend considerable time and effort to adequately plan and document project work that was to be spread out over 3 or 4 years. Such plans and documents were developed initially under the June 1976 proposed regulations and had to be adjusted first to meet the requirements of the final regulations published in October 1976 and again following the Rail Amendments of 1976.

Under the Rail Amendments of 1976, projects designed to overcome deferred maintenance are eligible for preference share funds with an interest rate as low as 2.03 percent and no higher than the railroad's return on total capital. Other work not classified as deferred maintenance was eligible for funds, but at a cost equal to the Government's cost of borrowing--about 8 percent when the act became effective. Consequently, FRA had to develop and publish guidelines for railroads to classify project work as deferred maintenance eligible for low-cost funds or as improvements eligible for higher cost funds. (Eventually, nearly all of the work was eligible for low-cost funds.)

In commenting on our draft report, DOT said that its policy was to fund all work categorized as deferred maintenance at the minimum terms provided by the statute. It said that this policy would accomplish the highest reduction in the level of deferred maintenance within the funding levels authorized by the Congress and recognize the applicants' marginal status. DOT said that subject railroads probably could not pay dividends, redeem the preference shares, and meet their other financial needs had the maximum permissible rate been assessed. We agree.

Preference share financing agreements were also delayed by FRA's provisions to protect the Government's interest and assure repayment of funds as required by the 4R Act. For example, the financial agreements include mandatory repayments, but only if, as provided for in State laws, railroads have adequate earnings or capital available. If a railroad defaults, FRA is authorized to accelerate repayments and to increase the interest rate.

Other provisions in the financial agreements are intended to prevent the railroads from avoiding repayments because of evasion or mismanagement of their assets. For example, FRA initially sought, during the 30-year term of preference share financing, to prohibit dividend payments to stockholders and to require the railroads to provide on-going maintenance to their entire rail system in accordance with plans FRA approved. Such requirements were changed during negotiations to permit dividends equal to the amount paid or added to retained income during the previous 5-year period and to require maintenance only on the portion of the rail system rehabilitated with preference share financing.

The 4R Act clearly requires that preference share financing be repaid and that FRA negotiate financing terms and conditions necessary to ensure the proper use and subsequent repayment of these funds. We believe that FRA's negotiated provisions are reasonable. We also believe that FRA properly looked to the statutory provisions of the loan guarantee program, as it did for dividend restrictions and maintenance requirements, for guidance in negotiating similar provisions in the preference share agreements.

BENEFITS FROM TITLE V ASSISTANCE PROGRAMS

Title V programs are helping eight railroads rehabilitate more than 2,100 miles of track and restore 8,800 locomotives and freight cars. Each of these projects benefits both the railroads and the national rail system because railroads that otherwise would have been unable to obtain financing are able to rehabilitate key track segments and restore locomotives and freight cars.

As of November 30, 1979, eight railroads had financial agreements totaling about $518 million in title V assistance. Of the amount funded, $387 million was for preference share programs and $130 million was for loan guarantees, as shown in the following table.

Railroads Participating In Title V
Programs as of November 30, 1979

Railroad	Total amount of financing agreements		
	Preference share program	Guaranteed loan program	Total
	(millions)		
Chicago & North Western	$147.5	$ 45.0	$192.5
Illinois Central Gulf	166.4	-	166.4
Chicago, Milwaukee, St. Paul and Pacific	33.8	21.4	55.2
Chicago, Rock Island and Pacific	9.5	33.5	43.0
Boston & Maine	26.0	-	26.0
Missouri-Kansas-Texas	-	22.5	22.5
Delaware & Hudson	-	8.0	8.0
Columbus & Greenville	4.1	-	4.1
Total	$387.3	$130.4	$517.7

The six railroads participating in the preference share program are rehabilitating more than 2,100 miles of track. Projects range from upgrading the Chicago & North Western's 463 mile high-density Chicago to Omaha main line to upgrading 133 miles of the Columbus & Greenville Railway. These projects generally involve upgrading ballast and replacing ties and rail to increase operating speeds and improve safety.

Three railroads have used guaranteed loans to rebuild 8,800 locomotives and freight cars. The loan guarantee program was also used to rehabilitate 197 miles of track in the Missouri-Kansas-Texas Railroad's main line and to refinance locomotives on the Delaware & Hudson Railway.

EXTENSIVE DEMAND FOR TITLE V ASSISTANCE IS NOT EVIDENT

Out of 41 class I 1/ and hundreds of class II railroads, only 11 had participated in or were applying for

1/Class I railroads are railroads with annual revenues of $50 million or more; other railroads are class II.

financial assistance. As of November 30, 1979, seven applications for $387 million in assistance were pending. Only three of these applications, totaling $39 million, were from railroads that had not already received assistance--Indiana Harbor Belt Railroad Company, Peoria & Pekin Union Railway Company, and the Auto-Train Corporation. Also, much of the assistance requested as of November 30, 1979, was not to cure deferred maintenance on essential track segments. As of May 31, 1980, FRA had received six additional applications, primarily for restructuring assistance and labor protection 1/ made possible by the Milwaukee Railroad Restructuring Act, and for equipment repair.

As the following table shows, applications for loan guarantees make up $267 million, or more than two-thirds, of the $387 million pending. Most of that amount is one large application for $230 million primarily to construct a new rail line to transport coal. The remaining $37 million in pending loan guarantee applications is for equipment repair. If all of these applications were approved and added to the $130 million already approved as of November 30, 1979, barely 40 percent, or $397 million, of the $1.0 billion loan guarantee authority contained in the 4R Act would be used.

1/The Milwaukee Railroad Restructuring Act provides for the protection of employees adversely affected as a result of a reduction in service or a restructuring transaction carried out by the Milwaukee Railroad. Such employee protection may include, but need not be limited to, interim employee assistance, moving expenses, employee relocation incentive compensation, and separation allowances.

Title V Financial Assistance Program
Applications Pending as of November 30, 1979

Railroad	Applications pending (note a) Preference share program	Loan guarantee program	Total
	---------(millions)---------		
Chicago & North Western Transportation Company	$ 52.4	$230.5	$282.9
Chicago, Milwaukee, St. Paul and Pacific Railroad Company	32.9	32.3	65.2
Indiana Harbor Belt Railroad Company	31.2	-	31.2
Peoria & Pekin Union Railway Company	3.5	-	3.5
Auto-Train Corporation	-	4.5	4.5
Total	$120.0	$267.3	$387.3

a/Excludes applications for $171 million from the Chicago, Rock Island and Pacific Railroad Company. The Director, National Freight Assistance Programs, told us FRA considers them inactive.

The four pending applications for preference share financing shown in the above table total $120 million, about one-half of the $200 million unused program authority as of November 30, 1979. One of the projects, for $52 million, is to install centralized traffic control on a main line that has already been rehabilitated through preference share assistance.

Program activity increased between November 30, 1979, and May 31, 1980, but the increase generally did not reflect demand for assistance solely to overcome deferred maintenance. No new preference share assistance agreements were reached, and the $69.5 million in new applications was primarily for restructuring assistance. New loan guarantee agreements increased by $120 million, primarily for labor protection ($75 million) and for equipment repair. Pending loan guarantee applications increased by $86.1 million, but continued to be dominated by the one large coal line project, which was increased to $300 million.

As of May 31, 1980, FRA had received a total of six additional applications requesting $219 million in assistance.

Two applications, totaling $69.5 million, were for preference share assistance. One of the two applications, for $66 million in restructuring assistance to rehabilitate track and facilities, was made possible by the Milwaukee Railroad Restructuring Act. The other, for $3.5 million, was from a railroad that had already received assistance.

The remaining four applications, totaling $149.1 million, were for loan guarantees. One of the four applications was for $75 million in labor protection funding made possible by the Milwaukee Railroad Restructuring Act. The remaining three were for (1) rehabilitating equipment, (2) acquiring and rehabilitating facilities and equipment, and (3) purchasing rail and track materials.

Six of the nine applicants for preference share and loan guarantee assistance as of May 31, 1980, had not already received assistance. The six railroads, however, accounted for only 27 percent, or $144 million, of the $533 million total amount pending.

We found no evidence that FRA denied assistance to eligible applicants. The Director of National Freight Assistance Programs told us that a number of railroads, shippers, and interested persons informally inquired about title V assistance programs and that only two--suppliers of railroad products--were told that they would be refused assistance.

UNCERTAIN NEED FOR REHABILITATION

Much of the deferred maintenance included in estimates the Congress considered when the 4R Act was passed does not need to be fixed. DOT's October 1978 financial needs study estimated that deferred maintenance had accumulated to some $5.4 billion over the past decade. The study acknowledged that all rail companies have some deferred maintenance, but concluded that the problem is particularly prevalent among marginal and bankrupt railroads. In fact, during the study, healthier rail companies reported little or no deferred maintenance. FRA has funded almost all of the projects submitted by marginal and bankrupt railroads.

The Nation's class I rail system has 194,000 miles of track--50 percent are main lines having freight traffic that exceeds 5 million gross tons per mile, per year; 50 percent are branch lines. The main lines, which carry three-fourths of the Nation's total rail freight, are in good condition and account for only 3 percent of DOT's estimate of total deferred maintenance. By contrast, branch lines, yards, and facilities contain most of the deferred maintenance since railroads tend to invest their resources on their main lines where high quality track is most important.

CONCLUSIONS

Federal assistance solely to overcome existing deferred track maintenance is no longer essential. Much of the amount requested in pending applications will not reduce deferred maintenance on essential track segments, and only three additional railroads have applied for title V assistance. The need for Federal assistance to overcome deferred maintenance is limited to marginal and bankrupt railroads, and most of these railroads have received assistance for essential parts of their systems. However, as discussed in chapter 3, the title V program has been amended to allow all railroads, regardless of their financial status, to receive assistance for restructuring the national rail system--that is, consolidating rail facilities, combining rail freight traffic, and eliminating excess facilities to improve the long-term profitability of the rail industry and enhance the national rail freight system. DOT and the rail industry believe that changes in the national rail system are needed to help improve the financial status of the rail industry.

AGENCY COMMENTS AND OUR EVALUATION

DOT regards as inaccurate our conclusion that Federal assistance solely to overcome existing deferred maintenance is no longer essential. DOT said that continued rehabilitation of railroad fixed plant is necessary, but that the Department intends to bring about restructuring as well. DOT believes that rehabilitation and restructuring are closely related issues and that our report creates the impression that they are separate issues.

We believe that the distinction made in our report is valid because the history of the preference share program supports it and because the Congress and industry did not accept restructuring as a condition to the assistance in 1976, as discussed in this chapter. We do not disagree that the two problems may be related. We believe, however, that it is up to DOT to establish that relationship.

Our conclusion did not imply that continued rehabilitation of railroad fixed plant was unnecessary. We question, however, whether Federal assistance solely for that purpose is necessary. Our conclusion is based on the fact that few railroads, for whatever reason, used the title V program that provided low-cost financial assistance for that purpose. In its comments, DOT agreed that continuing a program aimed only at curing track problems on marginal or bankrupt railroads would not be in the public interest. We believe that our conclusion is appropriate and accurate.

CHAPTER 3

NEED TO DETERMINE THE AMOUNT AND PURPOSE OF FEDERAL ASSISTANCE TO RAILROADS

DOT's October 1978 financial needs study concluded that the rail industry needs higher earnings to overcome a multibillion dollar capital shortfall over the next decade and to improve the quality of its service and the productivity of labor, plant, and equipment. The Congress is considering legislation to reform the Interstate Commerce Commission's (ICC's) authority to regulate the rail industry to achieve maximum reliance on competitive market forces while allowing it to earn adequate profits, attract capital, and change the structure of the rail system.

DOT believes that Federal assistance is needed to help restructure the weaker parts of the rail system. One program for Federal restructuring assistance is already in place--title V of the 4R Act. DOT, however, has proposed a new 5-year, $1.475 billion restructuring assistance program. Before new Federal assistance legislation is enacted, we believe that the Congress should consider how pending regulatory reforms will affect the rail industry's need for Federal assistance. We also believe that the Congress should have DOT establish program purposes and goals and state specifically how the goals will be achieved.

NEED TO IMPROVE OPERATIONS AND RETURN ON INVESTMENT

In spite of a record year, financial strength on an industrywide basis continues to elude the Nation's railroads. Although class I railroads' profits increased to a 5-year high during 1979, the industry's rate of return was still only around 2 percent. DOT estimated that from 1976 to 1985, railroads will need $41 to 44 billion to gradually overcome existing deferred maintenance and properly maintain tracks and facilities. Of that amount, railroads will earn only $26 to $30 billion, resulting in a shortfall of $13 to $16 billion. 1/

1/Projections were based on current trends in inflation, business cycles, regulatory policies, operating efficiencies, levels of service, and availability of private capital. No assumptions were made to adjust the projected shortfall for regulatory reforms or major changes in the rail structure that could reduce the capital shortfall for the industry.

Although the shortfall affects all railroads, the effects are more critical to financially weaker railroads located primarily in the Northeast and Midwest. According to DOT's October 1978 financial needs study, these railroads would have 50 percent of the shortfall, but would generate only 20 percent of the industry's revenues. The financially weaker railroads' finances and services would have to improve greatly to increase their rates of return in the short run, and their traffic would have to increase greatly to make them self-sustaining in the long run. According to the study, Government assistance may help increase traffic on some railroads; however, much of the increase would be diverted from other railroads, thus weakening other portions of the industry.

DOT concluded that Government assistance cannot substitute for fundamental changes in the railroads' ability to increase revenues and control costs. It also concluded that changes must be made in the rail industry structure and in Government policies and regulations toward railroads. The rail industry agrees with these conclusions.

The Congress is considering legislation to reform the economic regulation of railroads to achieve maximum reliance on competitive market forces while allowing the rail industry to earn adequate profits, attract capital, and change the structure of the rail system. The legislation would change ICC's authority to regulate rail freight rates and control the construction and abandonment of railroad lines, mergers, acquisitions, and the issuance of rail securities.

NEED FOR RESTRUCTURING THE RAIL SYSTEM

Even though Federal assistance may no longer be essential to restore critical links in the Nation's rail system, investing public funds may still be desirable if such expenditures are necessary to achieve public policy goals in rail transportation. Restructuring the rail industry is one goal that may warrant such assistance. DOT believes restructuring is needed to ensure safe and profitable rail service in the private sector and that the Government should provide funds for restructuring.

Many changes have occurred since the rail system was built. Population centers have shifted, industries have changed and moved, and other transportation systems have developed. Yet, because of Federal regulation, the physical structure of the railroad system has stayed largely the same, and now some parts of the country have more rail lines than are needed. DOT's January 1977 study to classify and designate rail lines identifies 10 corridors (routes between important shipping and receiving centers) that have too many rail lines:

	Number of main line rail routes	Number of railroads	Freight traffic	Freight capacity
			(million gross tons)	
Chicago-Kansas City	8	8	175	383
Chicago-Southern Gateways (To Cincinnati, Louisville and Evansville)	7	5	102	194
Kansas City/Omaha-Colorado	6	5	127	247
Dallas/Ft. Worth-Houston	5	5	81	151
Chicago-Omaha	5	5	123	233
Chicago-Minneapolis	5	5	111	306
Chicago-St. Louis	5	4	95	205
Chicago-Detroit	4	4	85	195
Chicago-Pittsburgh	4	3	163	384
Chicago-Buffalo	4	3	129	264

Even though, in many cases, all the rail lines carry substantial tonnage, the traffic could be consolidated on only one or two of the lines. Consolidation would substantially reduce the investment and maintenance cost per unit carried and free funds for use on other parts of the rail system. Unfortunately, the competing railroads are reluctant to consolidate operations because the corridor lines are their main lines and have good cost characteristics for the individual railroads even though they could be even better if consolidated. Also, ICC must approve such changes.

Railroads have tried to eliminate excess capacity in some instances. For example, the Milwaukee Road, Chicago & North Western, Missouri-Kansas-Texas, and Illinois Central Gulf railroads have active branch line abandonment programs. The Missouri-Kansas-Texas is trimming excess track and consolidating operations with neighboring railroads.

Bankruptcies may force Rock Island and Milwaukee Road into restructuring and thereby abandoning or selling significant portions of their systems. Interest in restructuring these railroads to date, however, has centered on their branch lines as well as their main lines, even though main lines are in a higher priority category according to DOT's study to determine rail line essentiality.

PREFERENCE SHARE FINANCING AUTHORIZED FOR RESTRUCTURING RAILROAD SYSTEM

One program for providing restructuring assistance is already in place. The Milwaukee Railroad Restructuring Act (Public Law 96-101, Nov. 4, 1979), authorized preference share financing to rehabilitate and improve Milwaukee Railroad property that has been sold or transferred to another person or retained by the restructured Milwaukee Railroad. The act also amended the 4R Act to authorize preference share financing for restructuring other railroads.

Thus, the amended 4R Act allows all railroads, regardless of their financial status, to participate in the preference share financing program for funding rehabilitation projects, if they are part of a significant restructuring of the rail system. Any line which carried an average of at least 3 million gross tons of freight per mile, per year during the past 3 years is eligible for financing. Financing for restructuring any one railroad may not, however, exceed 50 percent of the preference share financing available. As of November 30, 1979, about $100 million was available for restructuring assistance.

DOT's PROPOSED RESTRUCTURING ASSISTANCE

On May 9, 1979, DOT sent a bill to the Congress containing a new restructuring assistance program. Unlike the preference share program, which provides assistance for either rehabilitation or restructuring, 1/ the proposed Restructuring Act would provide assistance only for projects that contribute toward restructuring. The bill proposes $1.475 billion over 5 years for restructuring assistance and a program to improve manpower effectiveness. Of that total, up to $275 million would be available for (1) labor protection costs related to the restructuring assistance program and (2) an employment effectiveness improvement assistance program to encourage changes in railroad work rules or operating practices.

1/Preference share funds terminate on September 30, 1980.

DOT's restructuring assistance would be available only for projects which include consolidating and coordinating facilities, mergers, or abandonments, or which otherwise contribute to restructuring the railroad system. The projects would be based on either a restructuring plan submitted by a railroad or developed by the Secretary using his authority to initiate cooperative agreements between railroads. Funding would be either through (1) low-interest Federal loans at an interest rate equal to three-fourths of the Government's cost or (2) the Government's purchase of redeemable preferred stock having a dividend rate equal to one-half of the Government's cost of borrowing money. Interest would not accrue until the fifth year; the securities would be repayable within 20 years.

Rationale for proposed
Restructuring Assistance Act

The proposed Restructuring Assistance Act is based on DOT's perception of how to address the problems of the railroad industry. Based on its Statement of National Transportation Policy (Sept. 17, 1975) and its Transportation Policy for a Changing America (Feb. 6, 1978), DOT has believed for some time that restructuring assistance is the most effective way of financially assisting the rail industry. Also, recent DOT studies indicate that restructuring assistance should take priority over rehabilitation assistance because rehabilitating much of the existing deferred maintenance is not cost effective, or not cost effective unless restructuring also occurs.

FRA's Associate Administrator for Federal Assistance stated that the $1.475 billion restructuring assistance program would supplement the work started under the preference share program. The assistance would continue to be directed at the marginal and bankrupt railroads in the Midwest and Northeast. He said that the Milwaukee Road and the Rock Island Railroads are immediate candidates for restructuring assistance and several other Midwest and Northeast railroads may need assistance in the near future.

The proposed legislation provides assistance only to projects that include significant restructuring and that would not be accomplished without Federal assistance. Such a program would provide financial incentives that support national transportation policy goals. In addition, FRA believes that the program would reduce the stigma attached to Federal assistance so that financially stronger railroads will be encouraged to accept financial incentives from the Government in return for the added risk of acquiring and rehabilitating a deteriorated line.

FRA proposes to provide restructuring assistance financing by purchasing either a fixed debt obligation or a special issue of preferred stock. In addition, the cost of financing and repayment schedules will be fixed by law. FRA believes these provisions will reduce negotiation problems associated with the preference share financing program.

CONCLUSIONS

Although its profits increased, the rail industry's rate of return remains low. DOT believes that restructuring some parts of the Nation's rail system, along with regulatory reform, will be necessary to improve the industry's performance. DOT believes that Federal assistance can aid, but not replace, these processes, and industry generally agrees.

For several parts of the Nation's rail system, restructuring would appear beneficial. The Congress has provided some restructuring assistance through a modified preference share program, which could be extended. Alternatively, DOT has proposed a new program for providing restructuring assistance which it believes has advantages over the existing program. Either program would provide some level of restructuring assistance. The need, scope, form, and duration of Federal assistance to the rail industry will, however, be affected by pending regulatory reforms and how quickly they are enacted.

DOT proposes that restructuring assistance be used to finance worthwhile projects initiated by and developed within the rail industry. DOT believes that it should not define the national rail system and that it should have the flexibility to choose how Federal assistance is used.

DOT, however, has not specified what type of projects it intends to assist. DOT has identified parts of the Nation's rail system where it believes traffic can be consolidated on only a few of the existing lines. These system segments involve a number of railroads--five in the case of the corridor between Omaha and Chicago. But restructuring to date has proceeded on the basis of problems associated with only one railroad at a time, thus reducing the likelihood that a desirable systemwide pattern of consolidation will result.

In addition, DOT has not specified criteria for choosing restructuring projects for Federal assistance. The rail line essentiality study does not address the actions that are needed to restructure a portion of the rail system. Efforts to restructure the Milwaukee Road and Rock Island systems, for example, have centered on branch lines as well as main lines, even though branch lines are less essential according to the essentiality study. A redefinition of essentiality, therefore, may be needed.

We believe that several matters should be resolved before a Federal assistance program is acted upon.

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress should consider how pending regulatory reforms will affect the rail industry's need for Federal assistance and whether national priorities permit lending public funds to induce restructuring. Since Federal assistance availability could affect the way the rail industry initiates restructuring actions, the Congress should require that the Secretary of Transportation formulate specific restructuring assistance goals and plans to achieve them.

In this connection, the Congress should direct the Secretary to establish whatever criteria are necessary to determine which restructuring projects are essential to a healthy industry and should therefore be eligible for restructuring assistance.

AGENCY COMMENTS AND OUR EVALUATION

Our draft report concluded that it was unclear how restructuring assistance would help eliminate excess rail facilities. We were concerned because previous title V projects have sought to preserve physical plant rather than eliminate it. In commenting on our draft, DOT said that the Department would make restructuring a condition of its assistance, the assistance itself actually paying for rehabilitation projects. DOT said that the availability of restructuring assistance should help overcome the railroads' reluctance to initiate restructuring negotiations. We believe that DOT's explanation highlights the overall policy issue presented in our report. That is, whether Federal assistance should be used to achieve a desirable result--restructuring--by funding projects that are not necessary in the existing structure.

DOT said that the classification of rail lines in the essentiality study was based on quantity of traffic, not on degrees of essentiality and that there were circumstances where a low-density branch line might be more essential than a high-density main line. We agree that DOT classified the rail lines according to the quantity of traffic. DOT, however, submitted the study to the Congress pursuant to section 503 of the 4R Act, which required the Department to develop and publish (1) standards for classifying main and branch lines according to the degree to which they are essential to the rail transportation system and (2) designations of each main and branch line in accordance with the standards.

The study noted that there was considerable confusion about the legislative intent concerning essentiality and that there was no requirement that the Secretary of Transportation identify "essential rail lines" or an "essential rail system," but rather a set of categories reflecting a hierarchy of importance. We believe that the commentary in our conclusions is consistent with the DOT position in the study.

DOT believed that our conclusion that it has not specified criteria for choosing restructuring projects raised, perhaps, the most difficult policy issue at stake. DOT agreed that a framework for evaluating restructuring projects is desirable. It said that the Department is analyzing future (1990) railway freight flows to determine what main line railroad network will be necessary to handle those flows. It said that the Department plans to consider projects in the context of future network requirements and is developing the techniques to evaluate those requirements. DOT said that the results of its efforts to initiate restructuring negotiations between railroads under the anti-trust immunity provisions of section 401 of the 4R Act could also yield criteria for future restructurings.

We agree that the Government should provide a framework for the assistance and that if DOT's policy is to achieve a restructured system, that the framework should include the network of lines the Department deems essential. The analysis of future (1990) railway freight flows and development of associated network requirement evaluation techniques, however, appear to be long-term undertakings of uncertain outcome. DOT said that it believes that if funds become available to finance restructuring projects, they will be promptly and fully subscribed. Our conclusion questioned the applicability of available criteria to the projects DOT contemplates under the proposed program and whether that criteria should be altered for evaluating proposed restructuring assistance projects.

DOT agreed that pending regulatory reforms will affect industry's need for Federal assistance, but said that even a preliminary estimate of those effects would not be possible before late 1981. DOT said that its program was based on its should be rather than on a firm estimate of industry's need. We believe that these are persuasive reasons for requiring DOT to formulate specific plans for using any assistance the Congress authorizes.

INFORMATION ON FEDERALLY ASSISTED PROJECTS UNDER TITLE V OF THE RAILROAD REVITALIZATION AND REGULATORY REFORM ACT OF 1976, AS AMENDED

CHICAGO & NORTH WESTERN TRANSPORTATION COMPANY

Preference share program

The Chicago & North Western received $148 million to renovate 77 percent of its main freight line between Chicago and Omaha. The project is primarily directed at upgrading the main line, although it also includes work on the main yard in Chicago. These improvements are essential to maintain Chicago & North Western's high density connection between the Union Pacific and Conrail lines.

Loan guarantee program

The Chicago & North Western also received $45 million to rehabilitate 4,800 freight cars and to finance the value of reusable materials from the preference share track rehabilitation program. The project is expected to improve fleet capacity and reduce the number of unserviceable cars.

ILLINOIS CENTRAL GULF RAILROAD COMPANY

Preference share program

The Illinois Central Gulf received $166 million to rehabilitate several segments of its 905-mile Chicago-New Orleans corridor. The line is the railroad's high capacity freight main line, carrying more than 20 million gross tons annually. The project includes replacing ties and laying welded rail on main line, yard, and siding to improve track speeds and safety. The Railroad also expects to reroute traffic onto the improved line as it abandons or downgrades more than 3,000 miles of marginally used track.

From a national perspective, this project also helps to maintain a competitive rail route between Chicago and New Orleans. No other rail line parallels the Illinois Central Gulf throughout this route, although the Railroad shares markets along portions of the route with other railroads.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

Preference share program

The Chicago, Milwaukee, St. Paul and Pacific (Milwaukee Road) received $34 million to rehabilitate track and sidings along its Milwaukee to Minneapolis main line. The project includes replacing ties, restructuring ballast, and laying some new welded rail on 316 miles of the 404-mile main line. The project is expected to increase train operating speeds and improve traffic along the line.

Rehabilitation of the Milwaukee-Minneapolis line is essential to the reorganization of the bankrupt Milwaukee Road. The Milwaukee Road has the shortest of the five lines in the Milwaukee-Minneapolis corridor and the highest line capacity.

Loan guarantee program

The Milwaukee Road also received $21 million to rehabilitate 950 freight cars and 111 locomotives to reduce the Railroad's car shortage. The funds were also used to install pollution control devices in repair shops.

CHICAGO, ROCK ISLAND, AND PACIFIC RAILROAD COMPANY

The Chicago, Rock Island, and Pacific has both a trustee certificate share agreement 1/ and a guaranteed loan totaling $43 million. Under the guaranteed loan for $34 million, 2,915 freight cars and 10 locomotives were to be rehabilitated and 12 locomotives were purchased. A $10 million preference share project was approved to rehabilitate segments of main line tracks in Illinois, Iowa, and Missouri. However, FRA suspended the project in October 1979 after ICC directed the Kansas City Terminal Railway to provide services for all traffic on the lines of the railroad.

1/Trustee certificates are obligations issued by bankrupt railroads.

BOSTON & MAINE CORPORATION

Preference share program
(Trustee Certificates)

The Boston & Maine received $26 million to rehabilitate its main line between Willows, Massachusetts, and Mechanicville, New York. Two-thirds of the railroad's freight moves on this line. The project calls for track, signal, and bridge improvements intended to improve services, decrease maintenance expenses, and reduce derailments and other accidents.

MISSOURI-KANSAS-TEXAS RAILROAD
COMPANY

Loan guarantee program

The Missouri-Kansas-Texas received a $23 million loan guarantee to rehabilitate 197 miles of main line track between Durant, Oklahoma, and Temple, Texas. Rehabilitation included replacing ties, restructuring ballast, and laying welded rail in selected areas.

The rehabilitation will allow the Railroad to operate freight trains at 50 mph. Before the rehabilitation, operating speed varied between 10 and 25 mph.

DELAWARE & HUDSON RAILWAY COMPANY

Loan guarantee program

The Delaware & Hudson obtained an $8 million loan guarantee to refinance 20 locomotives secured under a previous obligation to the United States Railway Association. The refinancing enabled the Delaware & Hudson to obtain additional funding for working capital from the Association.

COLUMBUS & GREENVILLE RAILWAY
COMPANY

Preference share program

The Columbus & Greenville, the only class II railroad to receive financial assistance under title V, received $4 million to rehabilitate 133 miles of track between Columbus and Moorhead, Mississippi. The railroad connects the Tombigbee Waterway on the east and the Mississippi River on the west and also links with three major railroads. Work completed includes track renewal, tie replacement, bridge strengthening and brush cutting. Rehabilitation will allow the railroad to operate at 30 mph and to handle heavier cars.

APPENDIX II

U.S. Department of Transportation

Office of the Secretary of Transportation

Assistant Secretary for Administration

400 Seventh Street, S.W.
Washington, D.C. 20590

May 12, 1980

Mr. Henry Eschwege
Director, Community and Economic
Development Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

I have enclosed two copies of the Department of Transportation's (DOT) reply to the General Accounting Office (GAO) draft report, "Federal Assistance To Rehabilitate Railroads Should Be Reassessed."

The report effectively sets forth the critical issues to be considered in formulating a program of Federal financial assistance to the railroad industry to serve the public need. Clarification, however, is necessary in several substantive areas. We have also noted a number of factual and editorial items which should be considered in preparation of the final report.

If we can assist you further, please let us know.

Sincerely,

Karen S. Lee, for

Edward W. Scott, Jr.

Enclosures

DEPARTMENT OF TRANSPORTATION REPLY
TO
GAO DRAFT REPORT OF APRIL 4, 1980,
ON
FEDERAL ASSISTANCE TO REHABILITATE RAILROADS
SHOULD BE REASSESSED

SUMMARY OF GAO FINDINGS AND RECOMMENDATIONS

Title V of the Railroad Revitalization and Regulatory Reform Act of 1976 (4 R Act) authorized $1.6 billion in assistance to the Nation's railroads. Eight railroads have rehabilitated over 2,000 miles of track and restored 9,000 locomotives and freight cars under the program. GAO concludes the following:

-- The need for Federal assistance solely to overcome existing deferred track maintenance is no longer essential.

-- It is unclear how the Department's proposed restructuring assistance would help eliminate excess rail facilities.

-- The Department has not specified criteria for choosing restructuring projects for Federal assistance.

GAO offers several matters for the consideration of Congress including how pending regulatory reforms will affect the need for Federal assistance and whether national priorities permit the expenditure of public funds to induce restructuring. GAO suggests that Congress may wish to require the Department to formulate more specific plans for restructuring, including the conduct of studies.

SUMMARY OF DEPARTMENT OF TRANSPORTATION POSITION

The report effectively sets forth the critical issues to be considered in formulating a program of Federal financial assistance to the railroad industry to serve the public need. Clarification, however, is necessary in several substantive areas. We have also noted a number of factual and editorial items which should be considered in preparation of the final report.

POSITION STATEMENT

The Department regards as inaccurate the GAO conclusion that Federal assistance solely to overcome existing deferred maintenance is no longer essential. The draft throughout creates the impression that "restructuring" and "rehabilitation" are two separate issues while in fact they are closely related. Continued rehabilitation of railroad fixed plant is necessary, but the Department intends to use the financial assistance to bring about restructuring as well.

The Administration has proposed a replacement for the Title V program. The basic purpose of the proposed new program is to help the railroad industry deal with its problem of shortage of capital. Approved projects will aid the industry directly and also indirectly through financing conditions that could lead to increased efficiency. Many of the projects to be funded would rehabilitate track, but the funds also could be used for bridges, tunnels, yards, shops, signaling and telecommunications facilities, and management information systems. In all cases, the Department would make restructuring a condition of the financial assistance.

The Title V funding provided to railroads so far financed rehabilitation on critical facilities where there had been much deferred maintenance. To continue a program aimed only at curing track problems on marginal or bankrupt railroads would not be in the best interest of the taxpaying public, and in the long term would not be successful. The Department's study entitled "A Prospectus for Change in the Freight Railroad Industry" indicated that while 50% of the capital shortfall in the railroad industry is attributable to the marginal and bankrupt lines, the other 50% is attributable to the so-called healthy railroads in all regions of the country.

GAO is uncertain how restructuring assistance would help eliminate excess railroad facilities. The Department would make restructuring a condition of its assistance, the assistance itself actually paying for rehabilitation projects. In the abstract, a track upgrading project could be either a restructuring project or a line preservation project, depending on the conditions applied to the financial assistance. The Department's policy is to achieve the restructured system, not simply to preserve lines that proved inefficient in the past. Both cure some "deferred maintenance," but the Department's policy will have a much better return, because it will force consideration of future benefits to the national rail system, not just the separable needs of a single railroad. The key is the choice of the type of rehabilitation project, the specific line to be upgraded, the traffic consolidation aspects of upgrading that line, and other conditions imposed in return for the funding assistance.

A Federal program is needed to induce consolidations and reductions in duplicate tracks, facilities and the like because, without a restructuring obligation or a solvent partner, the financially weak railroads have been unwilling and unable to undertake restructuring voluntarily. They see significant restructuring as having an immediate adverse effect on cash flow, regardless of long-term benefits. There are, however, segments of such weaker railroads which would be economically attractive in partnership with the systems of stronger carriers if the systems were restructured. This could occur, for example, through coordination agreements or line transfers. The program would encourage solvent railroads to undertake such restructuring with the aid of low-cost Federal assistance. The availability of the assistance should help considerably in overcoming the railroads' reluctance to initiate restructuring negotiations while making the benefits more consistent with their corporate goals and priorities. Based on interest indicated by the rail industry, the Department believes that if funds become available to finance such projects, they will be promptly and fully subscribed.

The GAO conclusion that the Department has not specified criteria for choosing restructuring projects raises perhaps the most difficult policy issue at stake. On the one hand the Department has long said that innovative solutions to the problems of the railroad industry can best come from the railroads themselves and the markets they serve. One fundamental goal is a private sector solution that will ensure a strong private sector rail system. We also believe, however, that the Government can and must encourage the private sector solution by providing a framework for industry initiative, including appropriate financial assistance conditioned on restructuring. The Administration's proposed legislation will enable the Department to focus financial assistance on projects with the highest prospects for efficiency improvements which will contribute to the private sector solution.

Also with regard to the issue of restructuring criteria, the Department is analyzing future (1990) railway freight flows and will determine what mainline railroad network will be necessary to handle those flows. The Department plans to consider projects in the context of future network requirements and we are developing the techniques that would enable us to evaluate those requirements. When available, this analysis should ensure that individual restructuring actions by separate railroads will be part of an overall system that makes sense. The financial assistance applications would also be evaluated against technical, economic, and financial criteria.

Section 401 of the 4R Act granted the Secretary of Transportation special authority to work with rail management, shippers and labor (under anti-trust immunity), to negotiate and effect the rationalization of the nation's rail facilities. The Department has initiated a 401 restructuring process in the Midwest which could become a pattern for how the industry might go about reshaping itself.

The Department's Local Rail Service Assistance Program will continue to assist State and local governments in ensuring that support to branch and feeder railroad lines responds to a locally developed consensus. We will work with State and local officials and also with labor organizations to ensure that restructuring actions are implemented as smoothly as possible.

GAO offers for consideration of the Congress the issue of how the pending regulatory reforms will affect the need for restructuring assistance. The Department is not now able to determine the "need" of the railroad industry for Federal financial assistance. The regulatory reform legislation, its interpretation by the Interstate Commerce Commission, and the response of railroads to both will all affect the "need." The Department will not be able to make even a preliminary assessment of such effects until late in 1981. The size of the $1.475 billion program was not determined on the basis of a firm estimate of railroad industry "need" or "shortfall" but rather on the basis of what an appropriate Government resource level should be in order to assist and facilitate railroad restructuring and improved manpower effectiveness.

The Administration's bill before the Congress proposes a limited program of financial assistance over a five year period. This assistance will help facilitate the important period of transition to a less regulated railroad industry, in particular problems related to existing rigid rate structures and the retention of unnecessary, uneconomic services. The proposed assistance focuses on the problem of restructuring a redundant rail system into a more efficient and economic network and it also seeks to stimulate improved productivity. The premise is that by thus improving the efficiency and profitability of the railroad industry, the industry should be better able to assume the total responsibility for meeting its rehabilitation and restructuring needs and, in effect, reduce the need to correct all deferred maintenance. The Department's ultimate goal is to eliminate dependence on public funding, but this will take some time to achieve. Some financial assistance will be required in the interim.

The following are our comments and suggestions concerning specific wording in the draft report.

Throughout the draft report, GAO refers to "DOT's study of October 1978." We suggest that it be referred to initially by its full title--"A Prospectus for Change in the Freight Railroad Industry"--and then when making subsequent references to it refer to it as the "Prospectus."

Page i, lines 1-5: [See GAO note, p. 40.]

This statement is not entirely correct. Section 101 of the 4R Act indicates that the purpose of the act, including its financial assistance provisions, is to "assure adequate rehabilitation and improvement of facilities and equipment."

Page i, lines 13-17:

We suggest that an additional clause be added to the sentence as follows: "in the programs as they are now structured."

Page ii, lines 35-39:

The word "decided" should be replaced with "agreed upon."

Page 2, lines 40-43:

The final phrase should read "or downgrading or abandoning excess facilities."

Page 3, lines 15-20:

This is an incomplete and possible misleading characterization of the information in the 503 report. That report was a retrospective examination of link traffic loadings. It placed lines into four categories depending on the amount of traffic which had moved over the lines. It was not a prioritization, and it looked only at previous usage rather than future requirements.

Page 3, line 23:

The word "cash" should be replaced by the word "capital."

Page 3, lines 24-31:

The words "is appropriate only if" should be replaced by "necessary along with." Another sentence should be added: "Furthermore, it believes that continued Federal assistance would be ineffective without regulatory and structural change, and that regulatory and structural change would be more effective with limited and directed Federal assistance."

Page 11, lines 30-33:

In accordance with the 4R Act, the Department has discretion to assess a dividend rate for deferred maintenance projects between the statutory minimum and the rate of return on total capital. Pursuant to that discretion, the Department has established as a matter of policy that all work categorized as deferred maintenance will be funded at the minimum terms provided by the statute. This policy is based on the view that it is appropriate to use the statutory terms whenever possible to accomplish the highest reduction in the level of deferred maintenance of rail facilities within the funding levels provided by the Congress. The policy also recognizes the applicants' marginal status. The Department's financial analyses of the two railroads showed ample margins of projected funds to provide for preference share dividends and redemptions on the minimum terms provided by the statute, but it was doubtful that the subject railroads could pay dividends at the maximum rate permitted by the act, and redeem the shares, and at the same time finance their equipment and other capital needs.

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Page 21, lines 6-9:

This sentence does not describe the proposed program correctly. It should be rephrased "The proposed new program would provide assistance only for projects that contribute toward a restructuring of the railroad system and to improve manpower effectiveness."

Page 21, lines 16-18:

A clause should be added to this sentence as follows:
"or which contribute to a restructuring of the railroad system."

Page 21, lines 35-37:

This statement is incorrect. The proposed Restructuring Assistance Act is based on the Department's perception of the appropriate Federal participation in the capital requirements of the entire railroad industry, the healthy as well as the bankrupt and marginal companies.

Page 23, lines 24-35:

The classification of lines in the 503 report was based on quantity of traffic not on degrees of essentiality. There are circumstances where a low-density branchline might be more essential than a high-density mainline. The concept of essentiality of railroad lines is one that is very hard to define. What is required instead, and what the Department proposes to determine in its study of the 1990 railroad mainline network, is how much capacity will be required on the mainlines in the network, and what lines, which are mainlines now, can be downgraded to feeder lines.

Page 23, lines 40-44:

This sentence does not describe the proposed program correctly. The final clause should read "and whether national priorities permit the lending (at low-interest rates) of public funds along with proposed regulatory reforms to induce restructuring and to assist and facilitate the railroad industry in becoming financially healthier."

GAO note: Page references in this appendix refer to the draft report and do not necessarily agree with the page numbers in the final report.

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