

PRESERVING AN ECONOMIC ENVIRONMENT

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FOR Conrail, 1987 is an historic time. The largest public stock offering in U.S. history – the sale of the government's 85 percent ownership interest in Conrail to the private sector on March 26 – culminated a process started more than eleven years ago when Conrail began operations.

Now, as a company with responsibilities to a broad base of shareholders – just like every other major railroad – our ability to attract investors will depend on our continuing success as a competitor in the transportation marketplace.

Conrail's future and the future of the railroad industry are closely tied to the environment of that marketplace. Since October 1980, when the Staggers Rail Act became law, that environment has included significant regulatory freedom, which has given the railroad industry the opportunity to compete as never before.

As a consequence, the vast majority of shippers have benefitted directly from regulatory reform of the railroad industry. Benefits include lower transportation prices, better service and more responsive and innovative marketing programs.

Therefore, it is of critical importance that railroads, rail shippers, and the business community in general be aware of the threat to railroad regulatory reform currently looming in Congress.

A handful of special interest groups – primarily supported by major coal companies, electric utilities and some farm interests – are attempting to roll back substantial portions of the regulatory freedoms provided by the Staggers Act. These groups characterize their campaign as "fine-tuning", an attempt to address allegations of problems caused by railroad actions under the Act. But, as a look at the not-too-distant past makes clear, an attack on Staggers is an attack on every business which relies on rail



transportation, and therein lies the danger.

Regulation Led to Rail Failures

During the 1970's more than twenty percent of the nation's rail system was in bankruptcy – mainly because regulation prevented railroads from reducing needless costs and effectively competing with the largely unregulated trucking industry. Regulation prevented railroads from adjusting prices to meet competition and changing market conditions, and forced railroads to equalize rates over all available routes, regardless of costs. Because the equalized rates were set at levels to protect the less efficient carriers and routes, railroads could not compete in a marketplace dominated by trucks. Regulation also prevented railroads from adjusting service and rationalizing plant in declining markets, thus leading to needless and costly duplication of routes. Finally, regulation stifled badly needed innovation in pricing and technology.

The consequences of regulation were traumatic for shippers and railroads alike: deferred railroad maintenance, poor rail service, safety problems, higher operating costs, red ink – and the bankruptcies of the Penn Central and other railroads. When Conrail was formed to rehabilitate, modernize, and consolidate six bankrupt rail systems (including the Penn Central) into one in the Northeast and Midwest, many critics still suggested that the only medicine that would cure the railroads of what ailed them was nationalization.

As a nation, we chose the more difficult route: We faced up to the economic realities, and sought rational, economic solutions.

Staggers Act Assists Conrail And Rest of Rail Industry

The Staggers Act sought to restore efficient and reliable rail service and keep the industry in the private sector, by relying on competition instead of government regulation. In late 1981, Congress also addressed some of the severe and unique problems that still bedeviled Conrail by passing the Northeast Rail Service Act of 1981 (NERSA). NERSA enabled Conrail to transfer money-losing commuter services to local transit agencies, to rapidly shed uneconomic lines, and to reduce its workforce to levels in balance with its traffic/revenue base.

With the combined benefits of Staggers, NERSA and unprecedented cooperation from our labor unions, and a profit-oriented management approach, Conrail proved that railroads could compete effectively, and this financial and marketplace performance ultimately persuaded Congress that it could stand as an independent company. The Conrail Privatization Act, enacted last October, mandated that Conrail be returned to the

private sector through a public stock offering.

Railroads Learned to Compete Under Regulatory Reform

As Conrail became stronger in the 1980's, the rest of the industry also adjusted to the new world of less regulation and more competition. Through vigorous price competition and innovative marketing, railroads have begun to recapture a portion of the traffic previously lost, halting the historic decline in market share. The opportunity provided by the Staggers Act to earn a reasonable return on investment has also resulted in railroads investing more of their money in upgrading track, facilities and rolling stock and eliminating deferred maintenance – all of which has paid off for shippers in the form of lower transportation costs and improved service. The improved physical plant has also enabled the railroad industry to dramatically improve its safety record.

Even with the railroad industry's improved financial performance, railroad rates of return are still below those of most of its customers and below levels necessary to attract required long-term investment. Yet some would take away the opportunity (the Staggers Act contains no promises) to improve upon those rates of return. The first casualties of revision of the Staggers Act freedoms would be the railroads. And shippers would suffer the dire consequences.

Benefits of the Staggers Act to railroads and shippers are numerous. Highway trailers now race coast-to-coast in ever increasing numbers – not on highways, but atop railroad flatcars. Marine containers are double-stacked aboard special railcars, adding a new dimension to landbridge traffic that could one day make the Panama Canal obsolete. Boxcars, their future once questioned, are again becoming an attractive transportation alternative. Contracts, by the thousands, embody specific transportation requirements at competitive prices. (By the end of 1986, Conrail alone had almost 1,800 contracts with shippers, covering some 40 percent of its partially regulated traffic.) Rail industry prices in 1986 were 9 percent lower in current dollars than in 1981; and constant dollar charges per ton-mile declined from 3.2 cents in 1981 to 2.5 cents in 1986 – a 21 percent reduction.

It is hard to argue with legislation – the Staggers Act – which has made railroads better off while at the same time producing significant rate reductions for the average shipper and lower delivered costs for the consumer. By any reason-

able standard, the Staggers Act has been the most successful transportation law that Congress has ever enacted.

Who Wants to Reregulate Railroads?

The current push to rewrite Staggers is fostered by a vocal minority of shippers who seek special treatment – protection from the laws of the marketplace. Who are they, and what do they want?

- They are some major coal shippers and some electric utilities which want lower rail rates at the expense of other shippers; they also want to limit railroads' ability to price commodities based upon marketplace demand for rail services. It is this pricing ability that has allowed railroads to recapture some of the traffic lost to trucks.
- They are certain farm interests, which want a revival of equalized joint rates over inefficient routes.
- They are some manufacturers, which

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want forced access for competing railroads on tracks owned by other railroads and within terminal areas, even where there is truck competition and where rail rates are not even alleged to be unreasonable.

None of these groups is strong enough to secure its agenda by itself. Instead, they must become allies; and what they are pleased to call “fine tuning” is in fact full-blown reregulation. Should they succeed, these interests will harm themselves and bring irreparable harm to the railroad industry. Railroad costs will again be driven upward and railroad marketing efforts will be constrained.

Consequences of Reregulation

If coal shippers are seeking lower rates through reregulation, they are unlikely to obtain them. In the long run, reregulation will bring higher costs, and the resulting loss of volume in more competitive commodities will force the railroads

to try to increase rates or cut service to coal shippers in an attempt to continue to cover fixed costs.

Similarly, farm interests and small manufacturers will find that the achievement of their reregulation goals will lead to cash flow problems for railroads, a return to deferred maintenance and poor service.

To understand the problem clearly, consider just one of the special interest proposals – that no rate for coal or any other commodity should be allowed to exceed 180 percent of variable cost. The Association of American Railroads estimates that this proposal would reduce railroad revenue by \$1.5 billion annually. Because competitive pressures would prevent any offsetting rate increases, the revenue loss would flow directly to the bottom line. If this proposal had been in effect in 1985, the pre-tax income of the nation's railroads that year would have been more than wiped out – in fact, it would have resulted in a net loss of \$100 million.

It is not hard to see why, if adopted, these regulatory changes would destroy the vitality of the nation's rail freight transportation system.

Preserve Deregulation

The Staggers Act works. It was not written for the purpose of subsidizing utility rates, or the grain trade, or any particular railroad customer. Nor was it written to guarantee railroads profits. The Staggers Act intended to achieve consumer benefits, through vigorous price competition. That has happened, and consumers and taxpayers alike are the beneficiaries. Staggers is working – even for the people who are trying to change it.

If there are still specific problems with Staggers, there are better ways of resolving them than asking Congress to pass a new law reregulating the railroads. When Staggers-related problems have been specifically identified, railroads and shippers have been able to resolve them through negotiation – rather than litigation or legislation – and can do so in the future.

Reregulation for railroads means eventual disinvestment and dilapidation for the nation's rail network. The question, clearly, is whether railroads will be run in the public interest or under artificial restraints that inhibit competition and innovation for the sole benefit of a few special interests. The right answer – embodied in Conrail's success in the Staggers Act era – is obvious. **CM**