

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

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Center for
Transportation

MEMORANDUM FOR THE PRESIDENT

Subject: Railpax issues for your decision

On October 30 you signed into law the Railroad Passenger Service Act, which creates a for-profit, public corporation to assume and operate intercity all* rail passenger service beginning May 1, 1971. To implement the Act, Secretary Volpe must:

- By November 29, announce his proposed basic system of routes on which the Corporation must provide service for at least two years;
- By December 29, receive all comments by the ICC, the State commissions, the railway labor organizations, and the railroads; and
- By January 28, the Secretary must report to the Congress along with the comments the basic system chosen for implementation, which is then not subject to judicial review.

During the first two years of operation, the Corporation may increase service or add routes to the prescribed basic system, but no routes can be eliminated.

Our review of the Department of Transportation proposal for a basic system raises several issues for your consideration:

- Determination of the basic system of routes;
- Impact on the labor force;
- Creation of such an extensive basic system with so many unprofitable routes that the Corporation will not be able to operate on a sound basis; and

* The discussion which follows assumes that all railroads will pay Railpax to take over their intercity rail passenger service. However, the Act does not require that; it only permits it.

- Domination of the Corporation by DOT.

These issues will be discussed below.

Determination of the Basic System

Maximum profit and maximum service are the two fundamental but conflicting system criteria. The DOT position tends toward maximizing service, although their proposed system is profitable under their optimistic assumptions. My position leans toward maximizing profit, although my alternative is responsive to adequate service requirements.

Underlying the DOT proposal are the following beliefs:

- The Act intends and requires an extensive system.
- Political considerations require an extensive system.
- The DOT proposal represents the smallest politically acceptable system.
- Promoting more transportation service of all types is in the public interest.

On the other hand, my position rests upon these convictions:

- The Act does not require an initially prescribed system as extensive as the DOT proposal.
- Profitability and financial soundness of the system are mandatory so that your Administration cannot be blamed for the failure of the Corporation, the demise of national intercity rail passenger service, and possibly the ultimate nationalization of the railroads.
- The subsidy of virtually all rail passenger service in the rest of the country by the Northeast Corridor may be unacceptable to the people in the Northeast and may be inconsistent with current considerations of transportation deregulation. The Northeast is substantially profitable not only because of great population densities and congestion problems which make rail passenger service viable, but also because

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these patrons are to be charged 7.5 cents per mile or almost 80 percent more than the 4.2 cents per mile projected fares in the rest of the country. The projected discriminatory fare in the Northeast is 2.5 times the projected cost of that service (3 cents per passenger mile).

◦ If the initial basic system is sound and substantially profitable, and if the optimistic projections of DOT are correct, then the Corporation can expand the system even beyond what DOT envisions as experience is gained and economic viability becomes clear.

This paper presents five system options ranging from a profit maximizing option (#1) through a service maximizing option (#5). At Tab A you will find an Option Comparison Summary followed by route maps for each option. The service maximizing option (#5) is the DOT proposal. Options #1 through #4 are OMB alternatives for your consideration which are gradations to the maximum profit option.

First, consider a system which stresses substantial service (DOT proposal, option #5, attached):

1. Service maximizing option (#5) advantages:

- Less reduction in service from present level;
- Less (about 60 percent) initial reduction of present employment in rail passenger service;
- Maximum RR contributions to Railpax capital; and
- Good interregional service.

2. Service maximizing option (#5) disadvantages:

- Although profitable on very optimistic assumptions, there is much less financial margin for error in admittedly weak projections;
- Decreases Corporation flexibility and viability by including numerous routes which will not be profitable by 1975;

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- Maximum risk of Federal subsidy beyond the initial \$40 million grant and the \$100 million loan guarantee;* and
- Maximum Presidential risk of being blamed for possible failure of the Corporation, demise of national intercity rail passenger service, and possible ultimate nationalization of the railroads.

Next, consider a system at the other end of the range, in which every route must be profitable by 1975 (option #1, attached):

1. Profit maximizing option (#1) advantages:

- Financially sound with ample margin for error in admittedly weak data;
- Smallest system to preserve Corporation flexibility to expand as experience justifies, without being saddled with poor routes at the start;
- Minimum risk of Federal subsidy beyond the initial \$40 million anticipated in the Act; and
- Minimum Presidential risk of being blamed for possible failure of the Corporation, the demise of national intercity rail passenger service, and the possible ultimate nationalization of the railroads.

2. Profit maximizing option (#1) disadvantages:

- Does not connect well by rail passenger service the Northeast, Southwest, and Northwest with the rest of the country;
- Maximum reduction of service from present level;
- Maximum (about 87 percent) initial reduction of present employment in rail passenger service;

* In addition to the \$40 million to start the Corporation, the Act also authorizes \$100 million in loan guarantees for the Corporation's capital and other expenditures as well as \$200 million for either direct loans or loan guarantees for railroads to carry out contracts entered into under the Act.

- Minimum RR contributions to Railpax capital;
and
- Minimum political acceptance.

NOTE: Whatever option you choose, you would probably wish to affirm publicly a Corporation goal of increasing intercity service as quickly as economically feasible.

Finally, consider systems which compromise between profitability and service (options #2, 3, 4, attached). These compromise options tend, of course, to mitigate the disadvantages of both the profit maximizing and service maximizing options at the cost of some dilution of their advantages. These options differ as follows:

- Option #2: Profitable routes as in option #1 plus routes with projected losses of less than \$1 million per year each;
- Option #3: DOT proposal with service (frequencies) reduced to minimize losses; and
- Option #4: Routes as in option #3 plus one corridor service route each for the Midwest and the West.

Naturally there are any number of variations on these options. While no systems smaller than option #1 should be considered, there are, of course, systems larger than the DOT proposal which would reduce the impact on employment and provide service to more people. However, I see no need to consider seriously anything more extensive than the DOT proposal for the initial announcement of the basic system.

Recommendation

DOT proposes option #5, and projects a 1975 profit of \$24 million. To account for various optimistic assumptions about costs and revenues, we consider a range of \$12 million profit to \$11 million loss to be much more realistic.

I recommend option # , with an estimated 1975 profit of \$ million. Relative to the DOT proposal based upon their beliefs stated earlier, my recommendation is more conservative in keeping with my own convictions on this matter, also enumerated earlier in this memorandum.

Impact on the Labor Force

Of the 28,000 railroad employees now in passenger service, the DOT proposed system (option #5) initially needs only 40 percent or about 11,000. Some of the unneeded personnel could probably be absorbed in other railroad operations but probably not a substantial number.

Because the other options constitute systems smaller than the DOT proposal, the employment impact is greater as shown in the Option Comparison Summary attachment. However, it should be kept in mind that these other options are financially superior and may well represent a better basis for future growth in rail passenger employment offsetting the initial disruption.

The probability of a strike is difficult to assess because all options are substantially disruptive. Would the difference between a 60 percent reduction in employment (option #5, DOT's) not cause labor unrest whereas an 80 percent reduction (option #2) would?

Recommendation

I think it advisable to let other factors dominate your choice of options and plan a labor strategy to try to minimize risk of strike on whatever option.

Creation of an Extensive Basic System with many Unprofitable Routes

The Corporation will need to hold open as many of its service options as possible until it can develop a sound marketing strategy. In its November 29 announcement, DOT would like to impose requirements for types of service (corridor or long haul), for frequencies of service, and possibly for stops at major cities other than route end points.

The DOT version of the announcement is needlessly restrictive. A more appropriate policy/political strategy should have these features:

- Announce a small system on November 29, judge the reaction, reevaluate our position, and decide on the minimum acceptable system for January 28.
- This decision basis would allow the Corporation to start small and to provide service to the additional

communities who desire service badly enough to subsidize two-thirds of the losses incurred by providing it. This is a key provision of the Act which should not be overlooked.

Recommendation

I urge you to instruct Secretary Volpe to use the following guidelines in making his November 29 announcement:

- Make no distinction whatsoever between "corridor service" (higher frequencies) and "long haul" (one daily or less).
- Avoid specification of frequency of service. If necessary, the Secretary should say only that in general frequencies will be set in keeping with demand and that frequencies of at least one a day in each direction are contemplated on most routes--the Corporation can add more if justified.
- Specify only the end points of routes--no intermediate stops, and no intermediate routes where choices exist.

Domination of the Corporation by DOT

A close public association of Railpax with your Administration may be highly undesirable in view of the very substantial risks of failure of the Corporation, demise of rail passenger service, or nationalization of the railroads. The Administration is already associated with Railpax because it sponsored the legislation and because the Secretary of Transportation is a member of the Board of Directors.

Minimizing the Administration's further involvement with the risks of Railpax would be accomplished by appointing a board of strong, independent, profit-oriented individuals who want to see Railpax succeed as an alternative to nationalizing the railroads. Also, the Secretary and the Department of Transportation would have to minimize their involvement in the Corporation.

Recommendations

I suggest that you instruct Secretary Volpe to minimize the Department's role in Railpax as soon as the incorporators can be appointed.

Center for
Transportation

Director

Attachments

cc: Official File - DO
Director
Deputy Director
Mr. Rice
Mr. Niskanen
Mr. Niemela

ED:RWNiemela:dmd 11/24/70

OPTION COMPARISON SUMMARY

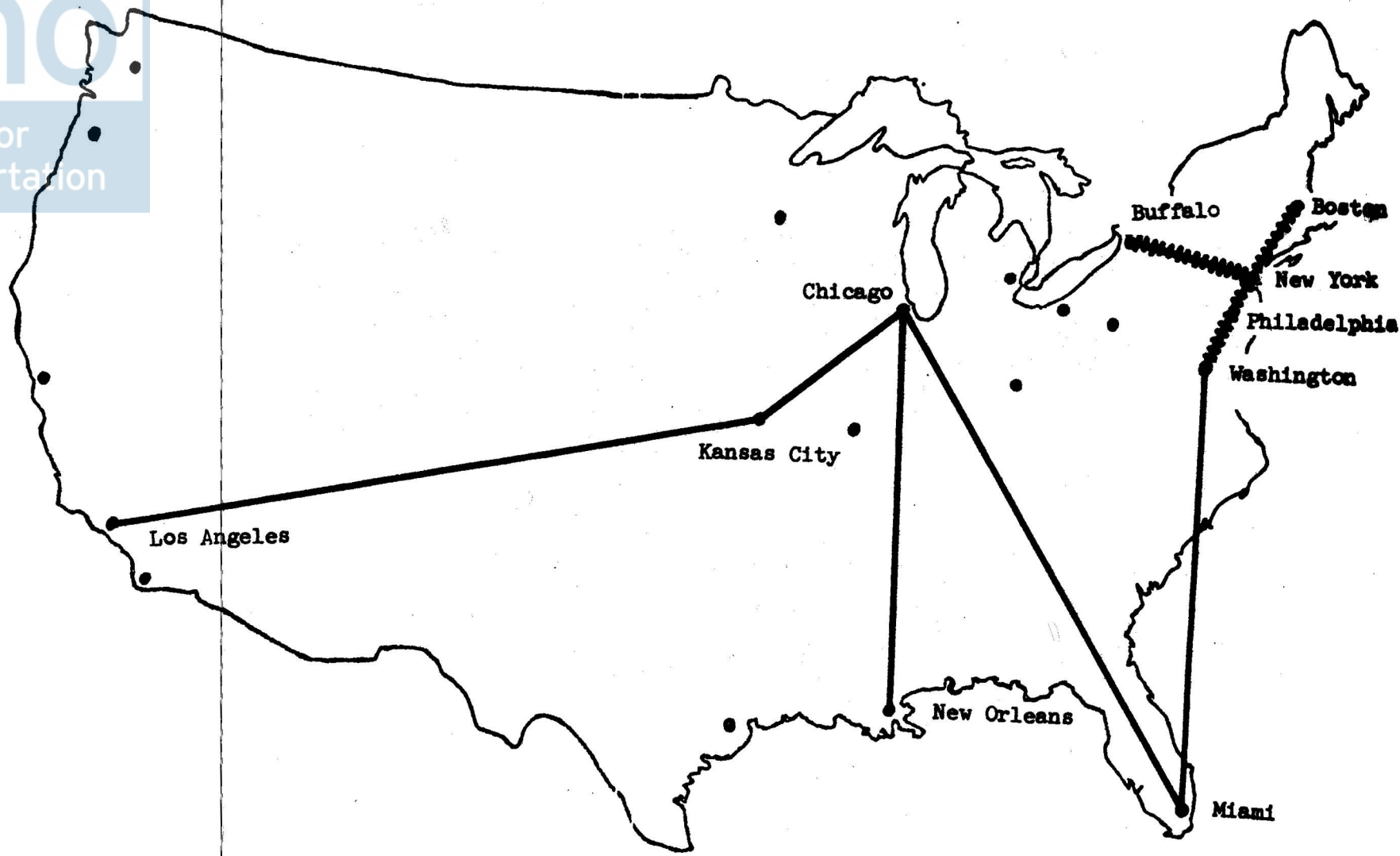
	<u>Option #1</u>	<u>Option #2</u>	<u>Option #3</u>	<u>Option #4</u>	<u>Option #5</u>
a. Revenues in 1975	\$180M	\$217M	\$255M	\$257M	\$269M
b. Profit (loss) in 1975:					
-- DOT estimate	54M	51M	43M	41M	24M
-- OMB high estimate	45M	41M	32M	28M	12M
-- OMB low estimate	28M	23M	15M	11M	(11M)
c. Capital contribution of RR to Railpax:					
-- Dollars	57M	106M	196M	196M	196M
-- Percent of maximum	28%	53%	97%	97%	97%
d. Population served: percent of that currently served	46%	61%	87%	87%	87%
e. Passenger train miles operated: percent of present	13%	21%	28%	28%	40%
f. Passenger RR employees:					
-- Percent retained	13%	21%	28%	28%	40%
-- Number liable to lose jobs	24,500	22,300	20,500	20,300	17,100
-- Likely cost in severance pay (to RR's, but possibly Federal Government)	\$490M	\$450M	\$410M	\$400M	\$340M
g. Interregional links	Very limited	Limited	Good	Good	Good
h. Extensiveness of service	Very low	Low	Moderate	Good	Very good
i. Probability of continuing Federal subsidy	Very low	Very low	Moderate	Moderate	High
j. Presidential risk of blame for killing RR passenger service:					
-- Short run (through 1973)	Moderate	Moderate	Low	Low	Moderate
-- Long run	Very low	Very low	Low	Moderate	High

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OPTION #1

PROFIT ON ALL ROUTES BY 1975

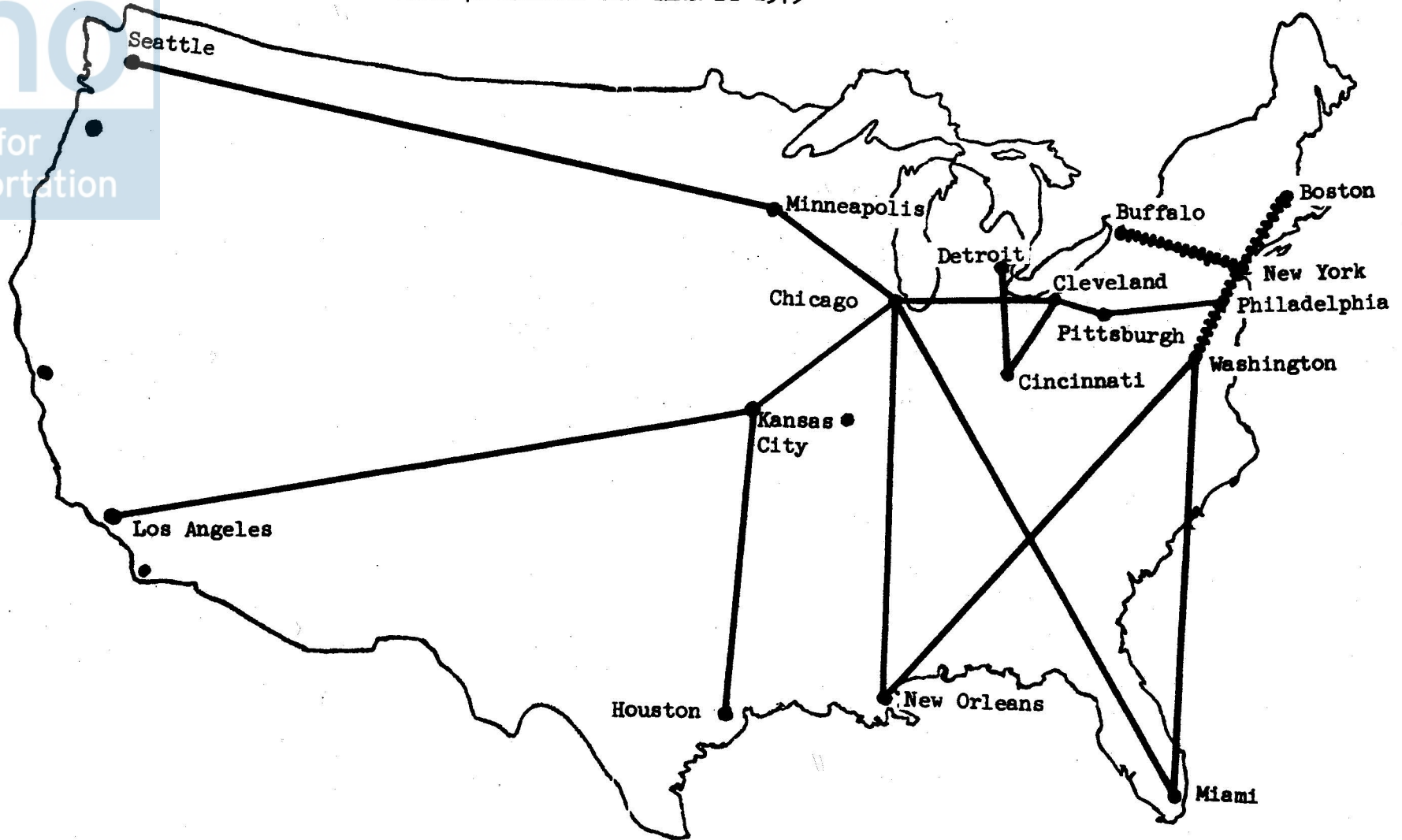
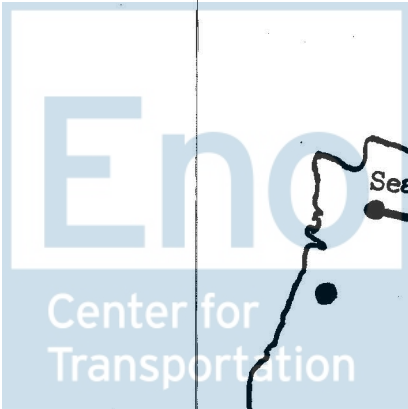


----- Corridor Service

Recommend nature of service not be designated in November 29 announcement.

OPTION #2

PROFITABLE ROUTES AND ROUTES LOSING LESS
THAN \$1 MILLION PER YEAR BY 1975

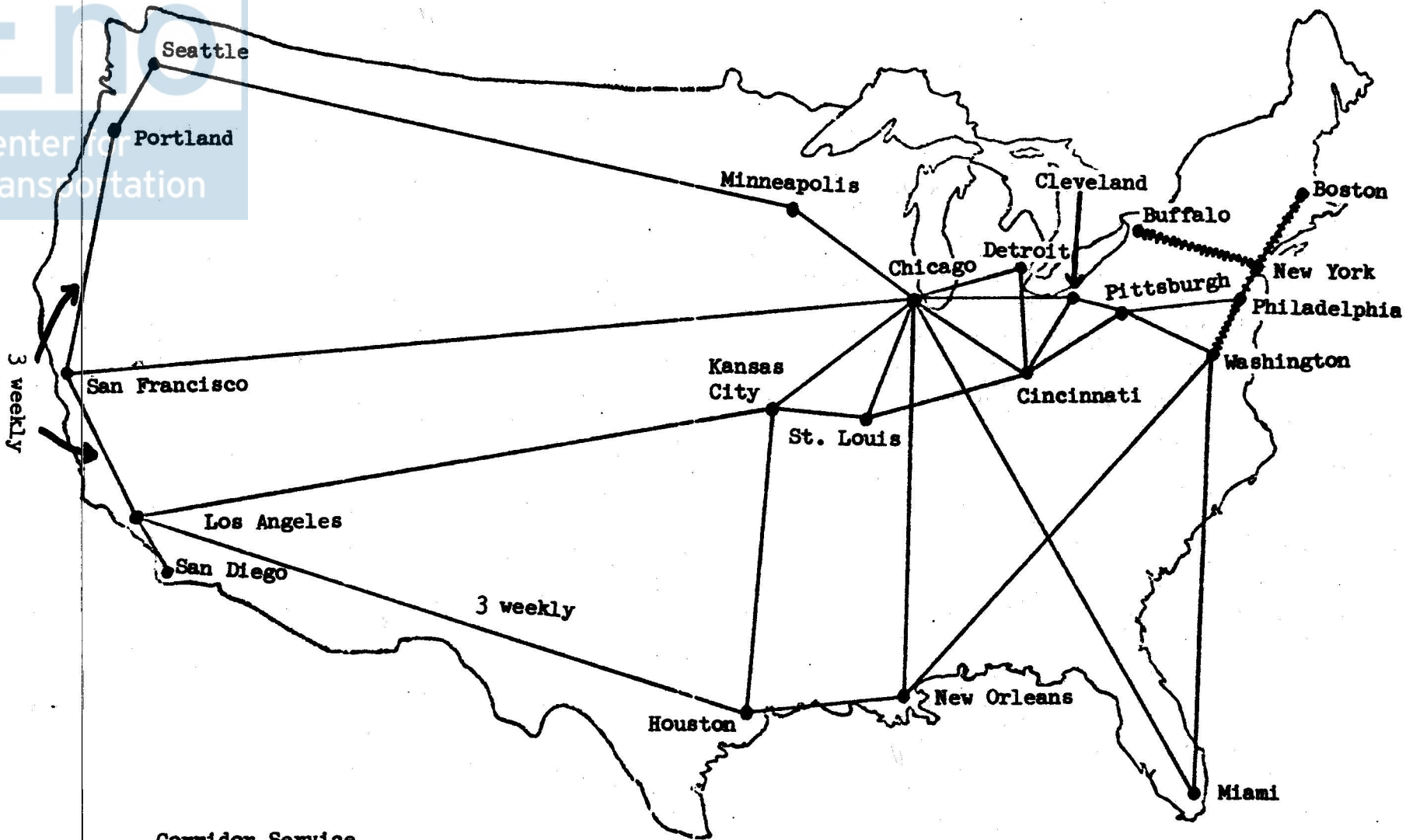


-----> Corridor Service

Recommend nature of service not be designated
in November 29 announcement.

OPTION #3

DOT PROPOSAL WITH SERVICE REDUCED TO MINIMUM LOSSES

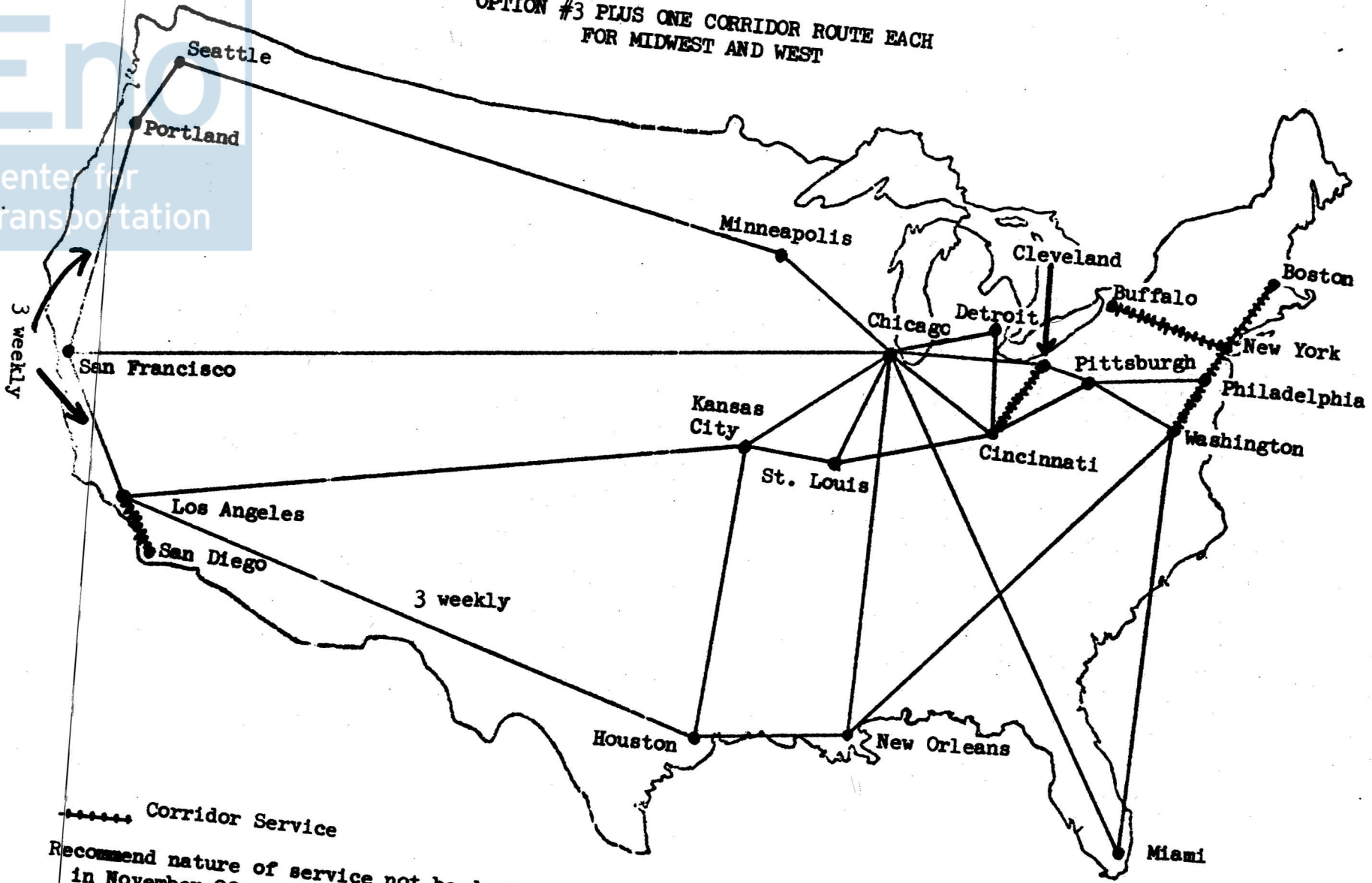


..... Corridor Service

Recommend nature of service not be designated
in November 29 announcement.

OPTION #4

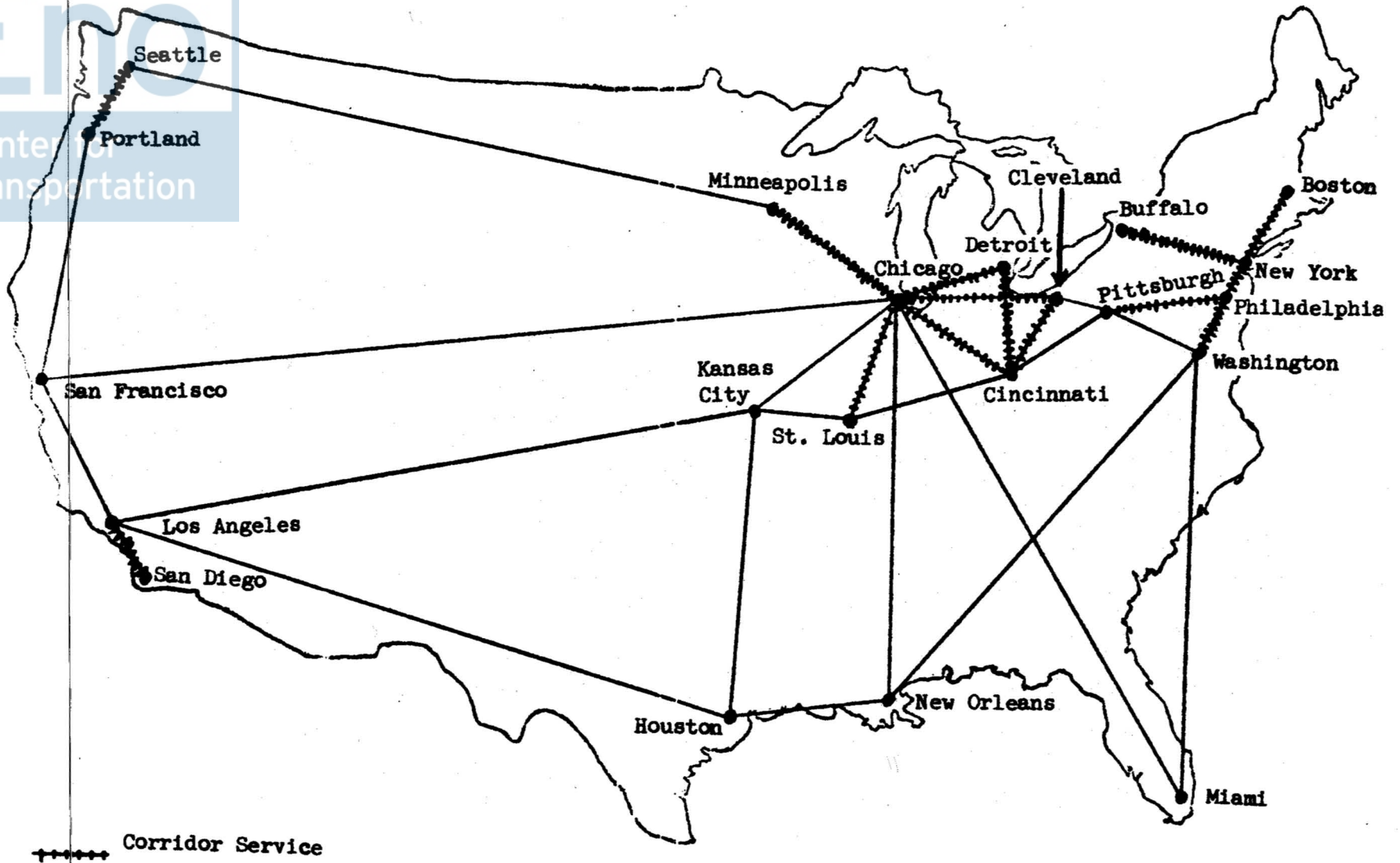
OPTION #3 PLUS ONE CORRIDOR ROUTE EACH FOR MIDWEST AND WEST



----- Corridor Service
Recommend nature of service not be designated in November 29 announcement.

OPTION #5

DOT PROPOSAL



----- Corridor Service

Recommend nature of service not be designated
in November 29 announcement.