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When the Consolidated Rail Corporation (Conrail) began operations in April 1976, financial projections made by the United States Railway Association (USRA) assumed that the $2.026 billion appropriated for Federal loans and purchases of stock would be all of the Federal financial assistance that the railroad would need. USRA's Final System Plan (FSP), prepared as a basis for Federal funding decisions, forecast that the railroad would become profitable in 1979. Information about Conrail's current operations were compared with the forecasts developed when Federal funding decisions were being made; experience to date was compared with FSP projections of: output and inflation in the economy as a whole; tonnage carried by Conrail; total Conrail revenues, expenses, and deficits; and Conrail freight revenues and expenses per ton.
Findings/Conclusions: The FSP projections depended on two fundamental assumptions: (1) Conrail would maintain traffic until 1979 while the infusion of Federal funds permits repair and renovation of the physical plant; and (2) while repairing and renovating the physical plant, Conrail would reduce the rate of increase in unit costs below the rate of increase in the Consumer Price Index. Actual Conrail performance has been different from that forecast. Losses in 1977 were larger than in 1976 rather than smaller; tons of freight carried by Conrail were below projections although the national economy has performed better than expected; and increases in costs per ton carried have been much more than forecast. Unless changes occur in current revenues and unit costs, the Conrail system, as currently designed, will not become profitable. (RRS).

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STUDY BY THE STAFF OF THE U.S.

General Accounting Office

Conrail's Profitability: Framework For Analysis

Conrail has expressed a need for $1.3 billion, in addition to the $2.0 billion appropriated in 1976. Financial projections made by the United States Railway Association in 1976, when Conrail began operating, assumed that $2.0 billion would be all of the Federal assistance that the railroad would need to become self-supporting.

Because of this probable change in Conrail's financial outlook, the Congress should reassess the information which it needs to fulfill its oversight responsibilities. This study shows that to be able to make its own assessments of the prospects for Conrail's profitability, the Congress will need information and analysis explaining how Conrail's experience matches key assumptions underlying the financial projections.

UNITED STATES GENERAL ACCOUNTING OFFICE

PAD-78-52
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PREFACE

Recently, GAO has been looking for new ways to assist congressional committees involved in the budget process by adding to existing sources of information which discuss GAO's work. Our objective is to provide significant and timely information with insights unique to GAO's missions and perspective about matters of current interest and concern. This staff study on the Consolidated Rail Corporation's (Conrail) profitability is one product of that effort.

The Congress may soon be faced with a choice of either providing additional funds to Conrail or permitting a reduction in the quality or quantity of rail service in the Northeast. Conrail's stated need for additional funding may become a major issue during congressional consideration of the 1979 budget or a 1978 supplemental appropriation.

This report describes the kind of information about Conrail which we think would be useful for the United States Railway Association (USRA) or other agencies to report publicly in order to assist the Congress in making decisions on future Federal involvement and support for the railroad. The Congress needs information which systematically analyzes (1) the economy and markets which Conrail serves, (2) Conrail's success in competing for traffic, (3) Conrail's ability to control costs and achieve improvements in productivity and accomplish other goals in the Final System Plan's (FSP) financial forecasts, and (4) comparisons with other railroads and competing modes of transportation.

The analysis for this study was completed before Conrail released its new 5-year Business Plan on February 15, 1978. The new plan indicates a need for $1.3 billion in additional Federal assistance through 1982, postpones by 1 year (to 1980) the time when Conrail will achieve a profit, and reduces forecast profits by $1.490 billion resulting in a net loss of $35 million over the 5-year period. Although this study makes several references to the new Business Plan, we have not analyzed the Plan. The fact that Conrail is seeking additional funding after operating less than 2 years does, however, underscore the need for the Congress to receive detailed, quantified analysis of how Conrail's performance compares with forecasts made when Federal funding decisions were made.

To illustrate the importance of the framework for the information the Congress receives about Conrail, we have made comparisons of Conrail's experience through the third quarter of 1977 with selected forecasts from the FSP. USRA prepared this plan in 1975 as a projection for Conrail. Our analysis shows that Conrail's performance differs significantly from what was forecast:

--Losses in 1977 are larger than in 1976 rather than smaller.

--Tons of freight carried by Conrail are below projections in the Supplemental Report to the FSP, although the national economy has performed better than expected.

--Increases in costs per ton carried have been much more than forecast in the FSP, although the economy's inflation rate, as a whole, has been less than forecast.

Unless changes occur in the current revenue and unit cost characteristics described in this report, the Conrail system, as currently designed, will not become profitable.

This overview of Conrail financial indicators and of the information needed to assist congressional oversight supplements other reports which the Congress has or will receive from agencies responsible for Conrail financing. By May 31, 1978, USRA must submit its second annual report on Conrail operations to the Congress. USRA has indicated this year's report will be much more comprehensive than last year's, reflecting the longer period available for monitoring and Conrail's failure to meet financial forecasts. In addition to USRA's report, the 1979 Budget indicates that the impact of Federal assistance to Conrail is being reviewed by the Department of Transportation. The Interstate Commerce Commission has also indicated that followup reports to the Early Warning Report issued in November, 1977 will be forthcoming.

Within GAO, the Community and Economic Development Division is examining various aspects of Conrail operations in more detail. They are preparing a report on service changes on Conrail lines and have recently issued reports on freight car utilization and commuter safety.

Given the short time frame for developing this analysis, we have not been able to perform additional research, evaluation or audit work. We also have not verified information and analysis drawn from non-GAO sources. The contents of this study were discussed with USRA, Conrail, Federal Railroad Administration, and ICC officials. Their comments are included where appropriate.

GAO's Community and Economic Development Division helped to prepare this study. Any questions regarding this analysis should be directed to Roger Sperry, Assistant Director, (202) 275-1907, or Stephen Swaim, (202) 275-1551. For further information about other GAO reports on Conrail, contact Hugh Wessinger, or Herbert McLure, Community and Economic Development Division, (202) 426-2506.

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ABBREVIATIONS

CPI	Consumer Price Index
Conrail	Consolidated Rail Corporation
DOT	Department of Transportation
FSP	Final System Plan
GAO	General Accounting Office
GNP	Gross National Product
ICC	Interstate Commerce Commission
TOFC	Trailer-on-Flat-Car
USRA	United States Railway Association
3-R Act	The Regional Rail Reorganization Act of 1973
4-R Act	Railroad Revitalization and Regulatory Reform Act of 1976

CHAPTER 1

INTRODUCTION

When the Consolidated Rail Corporation (Conrail) began operations in April 1976, financial projections made by the United States Railway Association (USRA) assumed that the $2.026 billion appropriated for Federal loans and purchases of preferred stock would be all of the Federal financial assistance that the railroad would need. 1/ USRA's Final System Plan, prepared as a basis for Federal funding decisions, forecast that the railroad would become profitable in 1979. After that date, funds from internal sources and the private market would provide for continued renovation and purchase of rolling stock and other capital needs. In 1985, income (before interest expense, income taxes and extraordinary items) was projected to be $1.1 billion or 15 percent of revenues.

The new Conrail 5-year Business Plan confirms earlier evidence that Conrail performance is not meeting planned objectives. 2/ Failure to achieve the degree of profitability expected in the FSP could result in requests for the Congress to consider increased authorization and appropriations of Federal funds for the 1979 budget or for a supplement to the 1978 budget.

1/The $2.026 billion is the amount of Federal rehabilitation investment needed to improve freight operations. Additional Federal funds are to be provided for passenger operating losses, passenger working capital, and net asset additions.

USRA officials say that the Association anticipated a need for a $250 million margin of safety plus an additional $400 million in the Secretary of Transportation's discretionary account. They state that the Congress eliminated the Secretary's discretionary fund and all but $74 million of the margin of safety was absorbed in the increased funding of the larger Conrail system, which came into being as a result of the inability of unions of some of the bankrupt lines and the Chessie System to reach final labor agreements.

2/The "Early Warning Report" that the Interstate Commerce Commission (ICC) issued on November 1, 1977, entitled "Financial Condition and Prospects of Conrail" concluded that "Conrail has been incurring net losses in excess of the projections outlined in the Final System Plan and that major problems exist in the operational revenue generation, and cost control areas." On February 15, 1978, Conrail released the summary to its new 5-year Business Plan. The summary said $1.3 billion in additional Federal funds would be needed in the 1978-82 period.

The President's budget for fiscal year 1979 does not include additional funding for Conrail. The budget document does indicate, however, that the impact of Federal assistance to Conrail is being reviewed by the Department of Transportation (DOT) and USRA, and that reports to the Congress on Conrail's financial condition will be completed during fiscal year 1978.

SCOPE OF WORK

This report compares information about Conrail's operations with forecasts which were developed when Federal funding decisions were being made. We compared experience to date with FSP projections of

--output and inflation in the economy as a whole;

--tonnage carried by Conrail;

--total Conrail revenues, expenses, and deficits; and

--Conrail freight revenues and expenses per ton.

We drew our information about Conrail's experience from Conrail's quarterly financial statements and from quarterly reports on tonnage and revenues by commodity class filed with ICC. We have used the constant dollar gross national product (GNP) and Consumer Price Index (CPI) statistics published by Commerce and Labor as economic indicators. We have also examined the 1976 USRA Report to the Congress on Conrail's Performance, submitted to the Congress on May 31, 1977, pursuant to section 307(b) of the Regional Rail Reorganization Act of 1973 (the 3-R Act), as amended. Conrail corporate plans or other privileged information was not used.

The forecast of expected Conrail performance, to which we have compared recent experience, is drawn from the FSP. USRA prepared this plan under provisions of the 3-R Act. The first such plan was issued by USRA in July 1975. It assumed that other railroads (primarily the Chessie System) would purchase significant portions of the assets of the bankrupt Erie Lackawanna and Reading railroads. In September 1975, a Supplemental Report to the FSP described a unified Conrail system based on the assumption that other railroads might not purchase assets, as set forth in the July report. The Conrail system which began operating on April 1, 1976, following enactment of the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act) on February 5, 1976, was the larger unified Conrail system described in the Supplemental Report to the FSP. 1/

We based our discussion of Conrail performance on our analysis of both the July 1975 FSP and the September 1975 Supplemental Report. The Supplemental Report contains financial and tonnage projections for the larger Conrail system, but explicit assumptions about the economy and improvements in productivity are contained only in the July 1975 report. In the text, the term FSP, refers to both documents unless otherwise stated.

In preparing our comparisons we also used restated USRA financial projections prepared in June 1976. These projections, which do not differ substantially from those in the Supplemental Report in the areas of basic freight operating revenues and expenses, incorporate Federal purchase of debentures and preferred stock as authorized by the 4-R Act. 2/ For reference, information from these projections is included in appendix II.

We recognize that deviations from the FSP should be expected since Conrail must respond to changing conditions like any commercial enterprise. Nonetheless, the FSP is the best available measure for comparing Conrail performance to assumptions made when Federal financing decisions were made, and the 4-R Act does make the FSP a basis for funding decisions by USRA and by the Finance Committee of the USRA Board. We believe that the summary comparisons made in this report are examples of the broader range of program and financial information which could be systematically reported to the Congress to assist it in carrying out its funding and oversight responsibilities.

1/The Conrail system actually implemented did not include the Ann Arbor Railroad. This was not reflected in the Supplemental Report but it is likely that it has only a very small effect on the revenue and tonnage forecasts in the FSP.

2/The Restated FSP projections include all FSP assumptions with the following modifications:

1. Conveyance date delayed from 1/1/76 to 4/1/76.

2. Southern Railway did not take over the Delmarva Peninsula lines.

3. D & H obtained trackage rights.

4. The Northeast Corridor was sold to Amtrak instead of being leased.

THIS REPORT'S RELATIONSHIP TO OTHER GAO WORK

This report supplements other work in GAO. The Community and Economic Development Division is examining various aspects of Conrail's operations in more detail. Recently, they have issued a report on commuter safety and are now preparing a report on service changes on Conrail lines.

Another recent GAO report concerns Conrail's progress toward implementing an improved freight car utilization system. ("Conrail's Attempts To Improve Its Use Of Freight Cars," CED-78-23, Jan. 24, 1978.) The report noted that Conrail is trying to improve use of freight cars which USRA recommended in the FSP, but that it was too early to tell whether the improvements being made would meet FSP expectations. Conrail indicated the improvements would cost more than USRA projected and may not be implemented as soon as the FSP indicated.

CHAPTER 2

CONRAIL'S EXPERIENCE COMPARED TO FSP FORECASTS

The Final System Plan projections that showed Conrail becoming profitable by 1979 depended on two fundamental assumptions:

--Conrail would maintain traffic until 1979, while the infusion of Federal funds permits repair and renovation of the physical plant. After 1979, this restored equipment would permit Conrail to better compete for and attract increased traffic.

--While repairing and renovating the physical plant, Conrail would reduce the rate of increase in unit costs below the rate of increase in the Consumer Price Index assumed to be about 6 percent. Simultaneously the revenue per unit was to increase more quickly than the CPI, thus permitting Conrail to become profitable after renovations were completed.

Actual Conrail performance has been different from this forecast. Unit costs are higher than expected and revenues and tonnages are lower, although the national economy has performed slightly better than expected. If Conrail's experience in the past year which is described in this chapter indicates future trends, the financial projections used as a basis for developing Federal financing policies toward Conrail will have to be revised substantially. Changes must occur in Conrail's revenue and cost trends described in this chapter if the system, as presently designed, is ever to become profitable. Chapter 3 discusses the need for further information and analysis for the Congress to know why there are problems with Conrail's finances.

OUTPUT AND INFLATION IN THE ECONOMY AS A WHOLE

Since demand for rail transportation is based on production and sale of goods in the economy, demand for Conrail service can be expected to be sensitive to changes in the general level of economic activity in the region served. Although it would also be desirable to measure Conrail's performance in relation to indicators of regional production and commerce, the FSP contained no quantified measures of economic performance by regions. However, the FSP did indicate that its forecasts for Conrail were derived from an input/output model and analysis of rail demand in the eastern region, which were based upon forecasts of the gross national product for the economy as a whole. 1/ We have, therefore, used GNP as a basis for comparing the economy's performance with the FSP forecast. The FSP forecast of Conrail's performance which was derived from the national economy's outlook assumed that the Eastern District share of the Nation's total rail-originated tonnage and Conrail's share of Eastern District tonnage would both decline. 2/

We have also used the CPI because it provides a widely accepted measure of the economy's inflationary pressures, which can be used to evaluate changes in Conrail's revenues and costs. Although various specific price indices were used in the FSP, the CPI is the macroeconomic indicator of inflation published in the plan.

Actual performance of the economy since Conrail began operations, as measured by the change in GNP, has been slightly better than FSP forecasts. (See table 2-1.) In addition, the rate of inflation, as measured by the CPI, has been slightly lower than forecast.

Table 2-1

Economic Indicators: Final System Plan Versus Actual Experience

	GNP(real) INDEX: 1975=100		CPI INDEX: 1975=100	
	Plan	Actual (note a)	Plan	Actual (note b)
1975	100.0	100.0	100.0	100.0
1976	105.8	106.0	106.7	105.8
1977	110.3	111.2	114.0	112.7

a/From The Bureau of Economic Analysis, Department of Commerce.

b/From The Bureau of Labor Statistics, Department of Labor.

1/The input/output model used was the INFORUM model of Chase Econometrics. The rail tonnage estimates based on the INFORUM forecast for the economy as a whole were prepared by the consulting firm of Temple, Barker, and Sloane.

2/USRA officials attribute the decline in Conrail's share to two commodity groups: paper and chemicals.

TONNAGE CARRIED BY CONRAIL

Tonnage carried, the major source of revenues needed to achieve profitability, is one of several statistics which can provide a measure of Conrail performance. Since tonnage is the only output indicator for the system as a whole for which estimates were published in the FSP, we have used this as the basis for comparing Conrail performance to the FSP forecast. 1/ The FSP assumed there would not be much change in the commodity mix carried by Conrail. 2/ For actual tonnage that Conrail carried we have used the amounts that Conrail reported to ICC and contained in its Quarterly Commodity Statistics Report.

Table 2-2 shows total tonnage carried by Conrail reported to ICC in the last three quarters of 1976 and the first three quarters of 1977. Quarterly averages of FSP forecasts are also provided.

Although the FSP forecast a quarterly average increase in total tonnage from 1976 to 1977, actual second and third quarter tonnages in 1977 were below those of the same 1976 quarters.

Planned versus projected tons by various commodity classes appear in Appendix I.

1/USRA officials indicate that comparisons could also be made with other measures not published in the FSP such as ton-miles, train miles, and car loadings.

2/Examples: The share of total tonnage accounted for by coal, the commodity with the largest volume increase in tonnage, was expected to change only from 27.8 percent of the total tonnage in 1976 to 29.9 percent by 1985. As a percentage of total revenues, coal was expected to change from 12.7 percent in 1976 to 13.0 percent in 1985. Trailer-on-Flat-Car (TOFC) traffic grows 72 percent in tonnage and 54 percent in revenue from 1976 to 1985. However, the share of TOFC tonnage which was 2.26 percent of the total tonnage in 1976 grows to only 3.08 percent in 1985. Similarly, TOFC revenue as a share of the total grows from 9.6 percent in 1976 to only 11.1 percent in 1985.

Table 2-2

Tonnage Carried by Conrail in 1976 and 1977: Actual Tonnage Reported to ICC Each Quarter Compared to FSP Estimates of What Conrail Would Carry

Year	Estimate (quarterly average) Supplemental FSP estimate for the larger Conrail system that was implemented (note a)	Actual First quarter	Actual Second quarter	Actual Third quarter	Actual Fourth quarter
	(millions of tons)				
1976	91.70	(b)	76.23	72.49	72.67
1977	94.35	59.61	74.48	68.18	(c)

a/Estimates could be expected to exceed actual figures due to some double counting in the FSP. The tonnage forecast in the FSP contained the following footnote: "Tonnage contains some double counting because of joint movements by two or more constituent Conrail carriers; this double counting was eliminated in preparing *pro forma* revenue and expense projections for Conrail."

b/Conrail did not begin operating until the beginning of the second quarter of 1976.

c/Not available at the time this report was being prepared.

Source: Supplemental report, FSP, table 6, p. 117. Annual amounts have been divided by 4 to obtain a quarterly average.

The total tonnage that Conrail carried in every quarter shown in table 2-2 ranges from 17 to 28 percent below tonnage projections contained in the FSP. 1/ Conrail and USRA state that the discrepancy is so large due to FSP multiple counting of traffic moving between constituent railroads. Conrail

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1/However, the percentage calculation excludes the first quarter of 1977 due to the effect that severe winter weather had on tonnage and revenues.

believes that the overcounting in the FSP forecasts is as high as 15 percent. USRA has not yet revised tonnage forecasts free from multiple counting, but states that allowing for the FSP's overestimate, the tonnage Conrail carries is below what was forecast.

The drop in tonnage from 1976 to 1977 contrasts with the increase in real GNP, which was higher than the FSP forecast. (See table 2-3.) The information in table 2-3 involves tons carried in the period from April through September 1976, compared to the same period in 1977. This comparison involves the only quarters which are 1 year apart for which data is available; it excludes the severe winter of 1976/77.

Table 2-3

Percentage Changes in GNP and Conrail Tonnage: Forecast Versus Actual

Commodity category and GNP	Forecast in supplemental report to Final System Plan: Average annual rate of change from 1976-1979	Forecast in supplemental report to Final System Plan: Annual rate of change 1976-77	Actual tonnage reported by Conrail to ICC: percent change from second and third quarters of 1976 to second and third quarters of 1977
	(Percent change)		
Metallic ores and non-metallic minerals	-0.4	-2.6	-16.2
Coal	1.8	2.8	3.8
Automobiles and transportation equipment	.7	9.0	4.6
Stone, clay, glass, and other lower value commodities	0	2.2	-6.2
Primary metals, food, and other higher value commodities	-1.2	1.9	-4.8
TOFC (note a) and all other	5.0	18.1	-11.8
Total	0.23	2.9	-4.3
Change in constant dollar GNP	2.3	4.3	4.8

a/TOFC is grouped with "all other" because ICC reports do not list individual railroad TOFC traffic separately. It is quite possible that Conrail TOFC alone grew during the 1-year period.

Table 2-3 shows that of the six commodity groupings used to describe Conrail traffic, only coal shows a percentage increase from 1976 to 1977 greater than that forecast in that year's FSP, and this difference was not large. By contrast, the percentage changes for most other commodities were considerably lower than changes forecast in the FSP. 1/

We did not have available the information needed to determine causes for decline in tonnage reported. Poorer economic performance in the region served by Conrail than that reflected by national economic indicators could be one reason. Another could be a loss in Conrail's ability to maintain its market share compared to other railroads and modes of transportation. Repercussions from the severe winter of 1976/77, the steel industry's poor performance, and strikes also could have affected the tonnage carried by Conrail. An information system such as that described in chapter 3 could be designed which could help the Congress understand various factors affecting Conrail's operations.

TOTAL CONRAIL REVENUES, EXPENSES, AND DEFICITS

Conrail's experience regarding total revenues, total expenses, and net income for the last three quarters of 1976 and the first three quarters of 1977 is compared with the FSP forecast in table 2-4. Because yearend statistics for 1977 have not been reported, actuals for the first three quarters of the year are compared with 75 percent of the FSP forecast for 1977.

Total losses for the first six quarters--$452 million--have been about what was forecast. More significant than the level of loss, however, may be the fact that losses in 1977 were greater than in 1976. Conrail projections, upon which Federal financing is based, assume that losses would decline in 1977 and disappear entirely by 1979. The Conrail trend appears to be going the other way--the third quarter loss in 1977 is greater than the same quarter loss in 1976.

1/For TOFC the FSP forecast a tonnage increase of 12 percent from 1976 to 1977. However, ICC does not break down TOFC separately; therefore, actual TOFC movements could not be compared to FSP projections.

Table 2-4

Conrail Revenue, Expense, and Deficit: Forecast Versus Actual for 1976 and 1977

Item	Restated USRA forecast, June 1976		Amounts reported in Conrail financial reports
	(millions)		
A. 1976 (Second, third, and fourth quarters)			
Revenue (note a)	$2,352		$2,447
Expense (note b)	2,629		2,609
Deficit (note c)	$ -277		$ -162
B. 1977 (First, second, and third quarters)			
Revenue (note a)	$2,657	(note d)	$2,466
Expense (note b)	2,870	(note d)	2,756
Deficit (note c)	$ -213	(note d)	$ -290

a/Revenues are total operating revenues, including passenger, commuter subsidy, and branch line subsidy.

b/Expenses are all expenses, including depreciation, net car hire, payroll tax, and all other expenses, but excluding interest, taxes, and extraordinary items. (There was no extraordinary item during the period under consideration.)

c/Deficit is loss before interest expenses, income tax expense, and any extraordinary item.

d/Estimates reflect USRA computations of the effect of seasonality.

Sources: --Restated USRA forecasts of Conrail financial statements reflect the unified Conrail system.

--Conrail quarterly financial statements, which are based on depreciation accounting and not ICC accounting.

REVENUE AND EXPENSES PER TON

While USRA did not base its revenue and cost estimates on the CPI, results of the FSP strategy for Conrail's profitability can be summarized as forecasting that revenues per ton will increase at a rate greater than the CPI but that costs per ton will increase at a rate lower than the rate of increase in the CPI (which represents a general measure of inflation in the economy). Table 2-5 indicates that revenues per ton have increased more than the CPI, as forecast. These increases in unit revenue appear to be largely the result of across the board rate increases approved by ICC for all railroads. Analysis of how rate increases affect Conrail's revenue and market share--and the impact of such increases on major classes of shippers--is another example of the kind of information which would assist the Congress in its oversight function.

Table 2-5

Percentage Change in Revenue and Expenses Per Ton: Plan Versus Actual

Item	Plan (note a) Average annual percentage change from 1976 to 1979	Plan (note a) Percentage change from 1976 to 1977	Actual Percentage change from 1976 to 1977
Revenues per ton	9.1	11.0	9.3
Expenses per ton	3.5	5.6	10.3
Consumer Price Index (note c)	5.9	6.8	6.7

a/Since this table shows percentage changes, the results of the calculations are not affected by multiple counting of tonnage in the FSP forecast. If there is some year-to-year change in multiple counting, the percent changes may be slightly affected.

b/The change in CPI is from May 1976 to May 1977. The actual revenue and cost per ton compare the second and third quarters of 1976 and 1977. This excludes the winter quarters of 1976-77, which severely reduced the tonnage carried.

c/The CPI is used in this table for expository purposes as a general measure of inflation.

With respect to expense per ton, however, experience to date is very much different than the FSP anticipated. Expense per ton from 1976 to 1977 increased faster than the CPI and the increase in revenue per ton. The increase in Conrail unit expenses can result from two different causes:

--Failure to achieve projected tonnages would be expected to raise unit costs because fixed costs must be spread over less traffic.

--Failure to achieve very major gains in productivity built into the FSP would result in higher than expected unit costs.

We did not have information to quantify the effect attributable to each cause. Variances between Conrail's experience and FSP projections do not necessarily mean that Conrail is improperly or inadequately managed or that trends experienced through the third quarter of 1977 will continue in the future. They could mean that the FSP was overly optimistic, or that the weather, economic conditions, other factors, or a combination of these (over which Conrail has no control) were having a great impact. The following chapter describes the kind of information and analysis which the Congress could use to better understand why Conrail's experience differs from the forecast.

CHAPTER 3

FURTHER INFORMATION AND ANALYSIS NEEDED

FOR CONGRESSIONAL OVERSIGHT

When Conrail was created, it was assumed that Conrail would not need continued Federal funding. 1/ It now appears that Federal financial involvement may be increased and Conrail could continue to be a Federal budgetary item for quite some time. Because of this probable change, it would be appropriate for the Congress to reassess the information necessary for fulfilling its oversight responsibilities. As USRA recognizes, an annual report which might have been satisfactory when Conrail appeared to be meeting the goals established by the 3-R and 4-R Acts may no longer be sufficient to serve the Congress' needs.

In considering Federal funding alternatives and in conducting investigations, the Congress first needs to determine why Conrail funding arrangements have not worked as planned. Questions to be answered include:

--Was the FSP itself overly optimistic?

--Is the economy in the region served by Conrail doing worse than forecast?

--Why is Conrail unable to compete as effectively as expected with other railroads and trucks for the available traffic?

--Is Conrail moving as expeditiously as it could to cut costs and improve productivity?

--To what extent can Conrail's financial situation be explained by strikes or other unforeseen factors?

--Is Conrail requesting the rate increases it needs?

--Are ICC rulings preventing the realization of revenue expected under USRA financial projections?

--How important are Federal, State, and local government policies concerning branch-line and commuter rail subsidies in explaining Conrail's financial condition?

1/Except for passenger and operating loss subsidies for uneconomical branch lines.

USRA has indicated that it will answer these questions, but many are not likely to be answered easily or quickly, and the ability to answer them will depend largely on the quality of available information and analysis. If the Congress wants to make its own assessments of Conrail financing, it will need information and analysis which systematically explain how key FSP assumptions match actual experience.

EXAMPLES OF THE KIND OF INFORMATION NEEDED

In the FSP, collecting revenues needed to pay operating expenses and repay Federal obligations depends primarily on achieving a 26-percent increase in tonnage in 1985, compared with 1976. Most of the increase was to occur after 1979, and the commodity mix was expected to change very little. By carefully analyzing (1) the mix of commodities carried by Conrail with the FSP projection, (2) the performance indicators for the northeast economy and major industries, and (3) the commodities carried by other railroads and other modes of transportation, it would be possible to determine whether failures of Conrail to meet FSP projections were due to a changing economy or shippers choosing other carriers. 1/

Systematic reporting of efficiency improvements could help the Congress monitor how well Conrail is meeting its goals. The FSP estimated that total freight operating expenses on a constant dollar basis in 1985 were to be below total freight operating expenses estimated for 1977. Unless actual experience is compared to the plan, there is no means of knowing how well Conrail is meeting these efficiency goals, which are critical to its performance.

Similarly, the FSP indicates that wages, the major component of cost, would be subject to inflationary pressures considerably exceeding the rate of increase in the CPI for the economy as a whole. (See table 3-1.) At the same time, however, expenses per ton of freight carried were to increase at a rate less than the rate of change in CPI, as noted in chapter 2. If the employment and productivity changes implied by the FSP would be made explicit and become the basis for comparisons with actual experience, the Congress would be in a better position to understand Conrail's financial position.

1/Full information concerning commodities carried by other modes of transportation is not available since data filed with ICC is only reliable for regulated carriers and thus excludes such things as shipping exempt commodities and private trucking.

Table 3-1

FSP Forecasts for the Annual Percentage Change in the Consumer Price Index and in Average Wages Paid to Conrail Employees

	CPI	Wages
1976	6.7	9.4
1977	6.8	8.3
1978	6.2	10.3
1979	4.8	9.5
1980	3.6	8.5
1981	3.5	8.0
1982	4.2	7.0
1983	4.6	7.0
1984	5.1	7.2
1985	6.3	7.5

Source: the FSP.

USRA officials say that employment and productivity changes implied by the FSP cannot be stated simply because the FSP efficiencies envision complex interactions between capital expenditures and operations' changes. Qualitative review of Conrail's operations by people with substantial railroad experience is necessary. However, this does not lessen the importance of developing selected, key indicators which summarize the employment and productivity assumptions lying behind Conrail's forecasts. If these employment and productivity assumptions are not realized, the need for additional Federal funding for Conrail is likely to continue. We would expect systematic reporting of selected key indicators would be augmented by analysis, which explains the reasons for and financial significance of variances from projections.

USRA changes in Conrail's financial plan which may be forthcoming could, of course, change FSP assumptions. While it would be appropriate to use the most recent plan as a basis for developing reports to the Congress, it is also important that the framework for evaluating performance does not change frequently.

SOURCE OF INFORMATION

During 1978, Congress will be receiving reports about Conrail from USRA, DOT, and ICC in addition to Conrail's new 5-year Business Plan which was released on February 15, 1978. It is not clear at this point, however, to what extent the information reported publicly to the Congress by these agencies will contain the necessary systematic analysis of Conrail.

The most logical place for the Congress to look for information comparing and analyzing Conrail's performance with FSP forecasts is USRA, the agency which prepared the FSP and which is responsible for monitoring Conrail's performance. Pursuant to section 307(e) of the 3-R Act (as amended by section 609(b) of the 4-R Act), by every May 31 USRA must submit a report to the Congress on Conrail's operations.

USRA's first annual report submitted to the Congress in May 1977 did not emphasize quantitative comparisons of Conrail's performance against FSP forecasts, which analyzed

--the economy and markets that Conrail serves,

--Conrail's ability to compete for traffic,

--Conrail's ability to control costs and improve productivity.

USRA officials point out, however, that this year's report will be much more comprehensive. They state that when it became apparent that Conrail could not achieve FSP objectives, the operations and financial monitoring staffs were increased substantially and separated to enable USRA to monitor and evaluate Conrail's operations more closely, with the result that USRA expects this year's May report on Conrail to be substantially more detailed than the law requires.

Useful information to the Congress in assessing Conrail's financial prospects might also be contained in the reports which DOT and ICC are planning to prepare. While these agencies may be in a better position to gather information about the economy, other railroads, and other modes of transportation, they are less familiar with FSP details and are not directly responsible for reporting Conrail's performance to the Congress.

There is, of course, no reason for USRA or other agencies to prepare information on a systematic basis for the Congress which it does not feel it needs. Therefore, an essential step appears to be action by one or more committees responsible for Conrail to define, as clearly as possible, the kind of information which they believe is necessary for overseeing Federal financing to Conrail. GAO could assist in defining requirements for such information if asked.

QUARTERLY OPERATING STATISTICS

COMPARED TO FSP FORECASTS

This appendix compares six quarters of operating experience for Conrail. For each quarter, the FSP projection is compared to commodity groupings derived from actual numbers found in Conrail Financial Statements or ICC Quarterly Commodity Statistics.

The July 1975 FSP does not really represent the Conrail created by the 4-R Act. Because the sale of several lines from bankrupt railroads to non-Conrail, profitable carriers, did not take place as planned, USRA developed a revised FSP in September 1975. This enlarged Conrail plan was the one approved by the Congress and represents the Conrail currently in operation.

In this appendix, commodity projections in the FSP and Supplemental Report are compared to actual tons for 1976 and 1977.

The 15 major categories in the FSP and Supplemental Report have been regrouped, based on higher revenue or greater tonnage. They are

--metallic ores and nonmetallic minerals;

--coal;

--automobiles and transportation equipment;

--stone, clay, glass, and other lower value materials;

--primary metals, food, and other higher value materials; and

--TOFC and others.

The six categories were selected based on the relationship of revenue to tonnage. Coal, coke, waste, and scrap materials; stone, clay and glass; and pulp and paper items are commodities for which the revenue received per ton of service is relatively low. Transportation equipment, primary metals, chemicals, lumber, farm products, and food are in a higher value group. Coal and automobiles are separate due to the amount of total revenue produced. TOFC should be a separate category, but it is included with "other" because

TOFC shipments are not specified in ICC data. TOFC and "other" is a residual obtained by subtracting the subtotal of the revenue and tons of the five other commodity categories from the total commodity revenue and tons. Using these six categories permits easier observation of how similar value commodities or single commodities with great revenue importance vary over six quarters compared with the FSP forecasts. 1/

Table I-1 compares the actual tons of the last three quarters of 1976 with the quarterly average tons in the FSP and Supplemental Report. Table I-2 compares the tonnage for the first three quarters of 1977.

1/Tonnage variations alone cannot be compared exactly with revenue changes because length of haul may change and this is a component of ton-miles and, therefore, total revenues. Also, the amount of traffic terminating rather than originating on a railroad is an important revenue factor.

Table I-1

Tonnage Carried by Conrail in 1976: Actual Tonnage Reported to ICC Each Quarter Compared to Estimates of What Conrail Would Carry

Commodity	Estimate (quarterly average) (note a)	Actual (note b)		
	Supplemental Report estimate for the larger Conrail system that was implemented	Second quarter	Third quarter	Fourth quarter
	(millions of tons)			
Metallic ores and nonmetallic minerals	14.2	11.65	13.30	10.57
Coal	25.5	21.62	18.55	22.35
Automobiles and transportation equipment	3.6	3.76	3.11	3.36
Stone, clay, glass, and other lower value materials	16.0	12.50	11.82	11.11
Primary metals, food, and other higher value materials	26.2	21.29	20.54	20.19
TOFC and other	6.3	5.41	5.17	5.09
Total (note c)	91.7	76.23	72.49	72.67

a/Quarterly average from annual total divided by four. Totals contain some double counting because of joint movements.

b/From ICC quarterly commodity statistics.

c/Totals may not add exactly due to rounding.

Table I-2

Tonnage Carried by Conrail in 1977: Actual Tonnage Reported to ICC Each Quarter Compared to Estimates of What Conrail Would Carry

Commodity	Estimate (quarterly average) (note a)	Actual (note b)		
	Supplemental FSP estimate for the larger Conrail system that was implemented	First quarter	Second quarter	Third quarter
	(millions of tons)			
Metallic ores and nonmetallic minerals	13.7	5.51	10.86	10.62
Coal	26.2	17.52	22.25	19.45
Automobiles and transportation equipment	3.9	3.34	3.97	3.22
Stone, clay, glass, and other lower value materials	16.3	9.73	11.75	11.17
Primary metals, food, and other higher value materials	26.7	18.91	20.88	19.02
TOFC and other materials	7.5	4.59	4.77	4.70
Total (note c)	94.3	59.61	74.46	68.19

a/Quarterly average from annual total divided by four. Totals contain some double counting because of joint movements.

b/From ICC quarterly commodity statistics.

c/Totals may not add exactly due to rounding.

APPENDIX II

PRO FORMA FINANCIAL STATEMENTS FOR CONRAIL

PREPARED BY USRA

These two tables contain information from the Pro Forma Income, Investment, and Source of Financing Statements from the June 1976 revised unofficial Conrail forecast. The financial statements were prepared by USRA to reflect financial assumptions of the 4-R Act.

TABLE II-1

Conrail-Forecasted Statements of Net Income or Loss (-)

Unofficial Forecast, June 1976 (note a)

	1976 (note b)	1977	1978	1979	1980	1981	1982	1983	1984	1985
	(millions of inflated dollars)									
Operating revenues:										
Freight	$1,974	2,964	3,2[illegible]1	3,536	4,089	4,356	4,742	5,142	5,576	6,053
Passenger (note c)	279	396	427	461	495	530	562	596	634	677
Total operating revenues (note d)	2,352	3,509	3,782	4,144	4,743	5,049	5,473	5,912	6,389	6,915
Operating expenses:										
Total freight	1,886	2,690	2,766	2,880	3,114	3,265	3,464	3,708	3,987	4,297
Passenger	279	396	427	461	495	530	562	596	634	677
Total operating expenses	2,165	3,086	3,193	3,341	3,609	3,795	4,026	4,304	4,621	4,974
Net operating revenues	187	423	589	803	1,134	1,254	1,447	1,608	1,768	1,941
Other income (expenses):										
Total, net	-464	-667	-650	-638	-666	-656	-705	-754	-810	-881
Income or loss (-) before interest, tax expenses, and extraordinary item	-277	-244	-61	165	468	598	742	854	958	1,060
Other expenses (note e)	-18	-27	-33	-64	-191	263	336	395	431	469
Net income (note f)	-295	-271	-94	101	277	335	406	459	527	591

a/The yearly financial statements are based on depreciation accounting, which uses the Generally Accepted Accounting Principles. If ICC Betterment Accounting procedures were used, most capital improvements to roadway and equipment would be expensed rather than capitalized. The effect would greatly increase the stated loss in the rehabilitation program's earlier years.

b/Includes operations for the period April 1, 1976, to December 31, 1976.

c/Includes operating loss subsidies.

d/Includes "other" revenues.

e/Includes interest, tax loss carryforward, and deferred taxes.

f/Does not include extraordinary item reduction of income tax expense from carryforward of prior years' operating losses.

Source: Restated USRA PSP Forecast.

Table II-2

FSP Projections: Capital Investment and Main Sources of Financing

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
	(millions of dollars)									
Capital Investment:										
Addition to road and facilities	617	308	393	438	487	483	520	558	599	646
Addition to transportation equipment	396	121	93	95	171	106	271	338	363	401
Total	1,013	439	486	533	658	589	791	896	962	1,047
Sources of funds (note a):										
Net income	-	-	-	101	277	335	406	459	527	591
Depreciation	38	65	83	102	126	151	178	213	252	295
Federal funds	696	605	427	295	-	-	-	-	-	-
Equipment obligations	-	-	47	47	137	85	216	272	290	321
Total	734	670	557	545	540	571	800	944	1,069	1,207

a/Funds are also used for additions to working capital, payment of dividends, and increasing other assets.

Source: Financial projections for FSP as implemented.

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