Testimony
of
James R. Young
Chairman, CEO, and President
Union Pacific Corporation
And Chairman
Association of American Railroads
1400 Douglas Street
Omaha, Nebraska 68179

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Freight and Passenger Rail: Present and Future Roles, Performance, Benefits, and Needs

Chairwoman Brown, Ranking Member Shuster, and Members of the Subcommittee, my name is Jim Young, and I am Chairman, CEO, and President of Union Pacific Corporation. I appreciate the opportunity to testify today on behalf of the rail industry. My testimony will be in two parts. The first will look at the role of the freight rail industry in the economy and the benefits associated with freight railroads. The second will discuss how we are faring in today's economy and the future needs of the freight railroads.

America's freight rail system provides the most efficient, cost-effective freight rail network in the world; it is vital to the economic health of U.S. industry, and it keeps American companies competitive in the world market. America's freight rail network is also the safest, most environmentally friendly, and energy efficient mode of surface transportation. Freight railroads are the backbone of the United State's transportation network, moving more than 41% of the freight ton miles. This is more than any other mode of transportation.

What does 41% of the freight ton miles mean? Let me give you a glance behind this number. Railroads move 70% of all automobiles produced in the U.S. We move 30% of the entire nation's grain harvest – enough wheat to provide every man, woman, and child a fresh loaf of bread six days a week. We move 70% of the coal in this country, which provides more than half the nation's electricity needs. During normal economic times, we move enough lumber to build almost three houses every minute of every day and enough cement to build 45 miles of new highway every day. Our intermodal business, which provides the door-to-door convenience of trucks with the long-haul economy of freight railroads, brings a vast array of products to U.S. consumers. Everything that we touch in our daily lives – from orange juice, to the clothes we wear, to toys, bicycles, computers, DVDs – all have had some part of their journey on a train. In fact, over the past 25 years, we have gone from moving 3 million trailers and containers a year to more than 12 million a year. We also carry steel, the wind turbines that create renewable electricity, and chemical products that are used to make the medicines we take, protect the water we drink, help grow the food we eat, and produce the products that make our lives more comfortable. In short, 41% of the freight ton miles mean just about anything that touches our lives.

Freight railroads also directly employ approximately 187,000 people, and the vast majority of these are union jobs. These are good U.S. jobs where the average total compensation is roughly $95,000. This makes freight railroads one of America's highest-paying industries. In addition, railroads and their employees pay for and are covered by the Railroad Retirement System, which provides benefits considerably more generous than Social Security. Roughly 550,000 retired railroad workers and family members receive more than $8 billion in retirement and survivor benefits each year.

In addition, all of the large, and the vast majority of smaller freight railroads, are privately owned. This means that we must build and maintain our own tracks and rights-of-way. We must also purchase the equipment that operates on these tracks as well as the signal control systems, and we do this with virtually no governmental assistance. (In fact, in 2007, we paid almost $600 million in state and local property taxes on this same infrastructure and equipment.) From 1980 through 2007, freight railroads invested approximately $420 billion in both operating expense and capital investment – more than 40 cents out of every revenue dollar – to maintain, renew, and expand track and equipment. This investment generates billions of dollars in economic activity to the rail supplier community through the purchase of locomotives, cars, steel, timber and concrete for ties, rock and aggregate for ballast, circuits for our train control and communications systems, and much, much more. In fact, we estimate that for every billion dollars in increased rail investment, 20,000 jobs are created.

So, as you can see, freight railroads play a vital role in the U.S. economy, but this is really only part of the story. An even more exciting story concerns the benefits we provide – and they are many.

First and foremost, we move all this freight safely. Nothing is more important to railroads than the safety of our employees, our customers, and the communities we serve, and our safety record is excellent. From 1980 to 2007, the last full year for which data is available, railroads have reduced the overall train accident rate by 71% and our employee casualties by 80%, with 2007 being a record year in terms of overall safety. Today, railroads have lower employee injury rates than other modes of transportation and most other major industry groups – including agriculture, construction, manufacturing, and even some types of retail activity.

As the nation's only privately funded transportation system operating a 140,000-mile network, railroads require vast amounts of private investment to meet the large capital demands necessary to support our infrastructure. In fact, the two largest railroads each spent more to operate, maintain and expand their infrastructure than did the State of New York on its highway system and almost as much as California. Other modes of transportation rely on government funding to support their infrastructure. Our ability to facilitate this private investment is a tremendous asset and benefit to our country. If we were not able to attract this investment, the government would have to find the billions of dollars necessary to fund our network in addition to those of our competitors (trucks and the inland waterways for barges), or alternatively would have to spend vastly more on highways to handle the business we carry, thereby forcing an even heavier burden on taxpayers.

Moreover, railroads are also a cost-effective mode of transportation. Based on revenue per ton mile, on average it cost 54% less (in inflation adjusted terms) to move freight by rail in 2007 than it did in 1981. These reductions have saved our economy countless billions of dollars over the years.

Then, of course, there are the major energy efficiency and environmental benefits rail offers. Railroads are more fuel efficient than other modes of transportation. On average, railroads are three times more fuel efficient than trucks, and our fuel efficiency is improving all the time. In 1980, railroads, on average, moved a ton of freight 235 miles per gallon of fuel. Today, that figure is 436 miles per gallon.

If just 10% of the freight that moves by highways moved by rail instead, our country's annual fuel savings would exceed one billion gallons. In addition, due to our fuel efficiency, freight that moves by rail instead of truck reduces greenhouse gas emissions by two-thirds or more per ton mile. In fact, the EPA estimates that for every ton-mile, the typical truck emits roughly three times more nitrogen oxides and particulates than a locomotive. The EPA also found that while railroads accounted for over 40% of the nation's freight ton miles, they produce only 9% of total transportation related nitrogen oxide emissions and 4% of transportation related particulate emissions.

Freight railroads also help reduce highway gridlock. A typical train takes the equivalent of several hundred trucks off the highways. Overcrowded highways act as an inefficiency tax that seriously constrains economic growth, and costs commuters days per year in lost time. Freight railroads help relieve this tax by reducing congestion, enhancing personal mobility, reducing the cost of maintaining existing roads and reducing the pressure to build costly new ones.

I would be remiss if I did not mention our relationship with passenger rail as a public benefit. Virtually all passenger rail operations outside the Northeast Corridor (including Amtrak) run on track owned by the freight railroads. We have a very healthy and robust relationship with passenger rail operators, and we often partner with them to take hundreds of thousands of commuters out of their cars and onto trains. The one thing we must guard against in these arrangements is to avoid robbing Peter to pay Paul. Taking rail capacity from freight to provide rail capacity for passengers is not the answer to America's urban congestion problems, as it will only shift thousands of trucks onto the highways. The real answer is to grow capacity for both freight and passenger. This concept was recognized in the recently passed Amtrak Reauthorization legislation, which provides additional funds for new capacity.

To sum up the freight railroads' benefits and role in the economy, when one considers the amount of freight we carry, our investment in American jobs and infrastructure, the safe and efficient manner in which we operate, and our benefits to energy consumption, the environment, and congestion relief, the industry provides enormous benefits to the country. When comparing those benefits to the total cost to shippers and taxpayers, we have the world's best, most cost-effective, environmentally friendly freight system in the world – one that keeps American industries competitive in the world marketplace.

Now, let me turn to how we are faring in today's tough economy and what the needs will be in the future.

To insure that this presentation is fully compliant with the antitrust laws, I think it would be appropriate for me to talk about how Union Pacific is faring in today's economy rather than talk about other railroads. Having said that, I fully believe the other Class I railroads share the same economic hurdles as do we.

Just last week we reported our earnings for the fourth quarter and full year of 2008. Frankly, we had a good year in 2008 as we reported record returns as well as record investments. However, we began to see the impact of the weakening economy in the second half of the year as rail traffic dropped sharply in the fall, and that weakness is clearly continuing into 2009. In the fourth quarter of 2008, our car loadings dropped 12%. So far in January, car loadings have dropped further, and we have not seen anything that makes us believe the first quarter of this year will bring anything different. The one piece of positive news has been the falling cost of fuel. Because we (Union Pacific) use 1.3 billion gallons of diesel fuel a year (41 gallons per second) to carry our customers' goods, the falling price of oil has benefited both our company and our customers in the form of lower fuel charges.

This year will clearly be a year that challenges our company, our customers, and our employees. During our peak periods, we have handled up to 205,000 car loads a week, and in 2006 and 2007 we averaged over 190,000 car loads per week for the entire year. Just last week, our car loads were below 150,000, and in prior weeks, the number was much lower. These are numbers we have not seen since the 1990s, and the reduction in car loadings cuts across every commodity group we carry. This drop in business translates into a reduction in earnings. With volumes running well below last year's levels, it is unlikely that we will be able to reach last year's First Quarter earnings of .85 cents per share.

How are we dealing with this reduction in car loadings and revenue? First, I am confident that the long-term fundamentals of our industry are sound. These reductions are a symptom of a worldwide decline in manufacturing and consumption. We clearly feel its effects as do our customers. We will act carefully to avoid making short-term decisions that could impact the strong, long-term opportunities we see for the future. Nevertheless, we will take aggressive steps to ensure we remain viable during this severe recession.

Today, we have unused assets all over the railroad. We have over 1,200 locomotives and 48,000 cars in storage. We expect these numbers to grow. These are assets we must maintain in place for the long-term and continue to absorb in our cost structure, notwithstanding the fact that they are not now producing revenue. We must also spend significant amounts of money to maintain our railroad. As you know, we are one of the most capital intensive industries in the country. We cannot afford – both from a safety standpoint and a customer service standpoint – to defer maintenance on our system, and we are not doing that. However, we will need to cut back on our capital for growth. We simply cannot afford to spend money we don't have to continue with our aggressive capital growth strategy. As I reported last week, our projected 2009 capital budget will be $2.8 billion. This is down from the past two years, which were both over $3 billion. Our reduction in spending also hurts the thousands of rail suppliers who support our industry as our orders shrink.

We are also implementing other forms of cost control across our system in an attempt to make sure the money we do spend is spent in an efficient manner. In fact, these cost containment efforts have lead to a significant reduction in our operating ratio, which is one of the things that helped us deal with the business reductions in 2008's fourth quarter and will continue to help us in 2009.

Unfortunately, we must also reduce the number of active employees. Over the last five years, we have hired over 27,000 people to accommodate growth and replace retired workers. Today, Union Pacific has roughly 3,150 employees out on furlough or in a part-time work program. I can tell you, as Chairman, that this is a very painful but necessary step to protect the rest of our workforce. However, the majority of those furloughed are in a program we call Alternative Work and Training Service (AWTS). Under this program, we guarantee an employee 8 days of paid service per month. This can be in the form of work or training. We usually designate the weekends as paid service days to cover weekend vacancies and to allow the employee to get another job during the week. We also continue to provide health care coverage and pay railroad retirement taxes for the employees in this program. We started AWTS as a mechanism to keep otherwise furloughed, well trained employees available to return to service when we see an uptick in demand.

Retaining excess assets (locomotives and cars) and ensuring a readily available pool of trained employees – while expensive – is a deliberate strategy that we have undertaken to insure the long-term health and responsiveness of our company. We want to be ready to meet increased demand for rail transportation should the economy respond to the stimulus proposals currently before Congress.

At this point it isn't at all clear what will happen throughout the remainder of 2009. However, one thing is certain – Union Pacific will be required to take the cost containment steps necessary to reflect economic reality. If the economy grows, we will make the much needed investments for the future. If not, we will contain spending, reduce costs, and reduce capital to reflect the weaker economy.

Earlier in my testimony, I described the role freight railroads play in the economy and the enormous public benefits we provide to society – both of which are significant. Today, we are in a major economic downturn, but we all know, from a historical perspective, this will not last forever. To capture all the benefits rail can provide to our economy and our society, the industry must continue to invest for the future.

A recent Department of Transportation study projects total freight transportation demand will increase 92% from 2002 to 2035, with an 88% increase in demand for rail service during that same time period. Other studies conclude the same thing. Moreover, a September 2007 study (The National Rail Freight Infrastructure Capacity and Investment Study) found that Class I railroads need $135 billion in investment to expand their network capacity by 2035 to keep pace with DOT's forecasted demand. This equates to over $4.5 billion annually for capacity expansion for the next 27 years. Several times that amount will also be needed to maintain and renew existing infrastructure. Today, on an annual basis, our industry is spending less than 40% of this amount for new infrastructure capacity. We all know that studies that project growth this far into the future may not be 100% accurate, but let's assume, for the sake of argument, these studies are off by 50%. We are still not now able to invest in infrastructure to the level the nation needs us to invest.

Another area that will bring huge costs to the rail industry is replacing existing assets that have come to the end of their useful life and replacing assets that are destroyed by natural events such as fire, floods, and earthquakes. Let me give you a few examples of these costs because they are staggering.

Union Pacific owns a bridge over the Mississippi River that is nearing the end of its useful life. This single bridge will cost hundreds of millions of dollars to replace. Last year, we started construction to replace another bridge in Boone, Iowa, that will ultimately cost over $50 million.

Because we operate outdoors, we are constantly battered by Mother Nature, and these costs can be astounding. For instance, in 2005, our Salt Lake City to Los Angeles line in Nevada was destroyed by a flood. The book value on that line at the time was $4 million. However, to rebuild the asset, it cost us $87 million. Similarly, a fire destroyed a bridge in Sacramento in

2007 whose book value was $0, yet we had to spend $14 million to replace it. Most recently, we had a mud slide on a line in Oregon that wiped out a significant portion of our railroad. The slide was as wide as a football field and the equivalent height of the Sears Tower. This took months to repair at a cost of over $100 million. All of this must be done using private dollars.

These are some big numbers associated with some big projects. Equally staggering are the day-to-day numbers. For example, Union Pacific wears out two miles of track every day – 365 days a year. At a cost of $450,000 to $600,000 per mile for replacement rail, this adds up very quickly. It costs on average $2.5 million per mile to build new track, and this figure does not include the cost of acquiring land or environmental issues that may need to be addressed.

These are the challenges we have before us, and we at Union Pacific are prepared to meet them head on. What can the government do to assist in this effort? While the government could be helpful in a number of areas, I will only make three recommendations today.

First, government must embrace policies that enhance the ability of the freight railroads to attract private investment dollars. As mentioned earlier, our ability to attract private investment in rail infrastructure literally frees up billions of dollars in public money that can be used to support other modes of transportation in this country. In fact, one could argue that the less we utilize rail in this country, the more the taxpayer must pay to subsidize other modes of transportation. We must be able to earn an adequate rate of return to attract private dollars. As returns improve to market levels, additional investment will follow.

Second, Congress should enact an investment tax credit for new rail capacity. We have endorsed a proposal that has been introduced in this Congress that would provide for a 25% investment tax credit for new rail construction that expands freight capacity. This credit will allow us to increase our return and make additional investments in rail – investments that are critical if we are going to meet the future, projected demands for rail transportation. In today's economic environment, where we must conserve our cash, this would enable us to spend more than we could otherwise. Moreover, it would have a stimulative effect on the economy.

According to U.S. Department of Commerce data, for every $1 of rail investment that would be stimulated by the tax incentive, $3 in total economic output would be generated.

Third, Congress should enact and fund programs that allow states to partner with freight railroads to move forward with projects that benefit both the freight railroad and the public. The best example of this type of project is the CREATE project in Chicago. This project will improve the fluidity of the freight railroads, enhance passenger rail service in the City, and reduce congestion on the highways. The freight railroads are willing to put up money consistent with the benefits we would receive, while the local, state, and federal governments put up the resources commensurate with the public benefits. These types of projects allow both sides – private and public – to develop and implement projects that would not otherwise move forward.

Madame Chairwoman and Members of the Committee, freight rail is vital to the overall health of our economy. We offer huge societal benefits that need to be maximized, and while we are currently dealing with the economic downturn, we have a great future. I look forward to working with you to fully develop a vibrant rail system in this country.