The original documents are located in Box C19, folder "Presidential Handwriting, 4/24/1975 (1)" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

THE PRESIDENT HAS SEEN...

THE WHITE HOUSE

WASHINGTON

April 24, 1975

ECONOMIC AND ENERGY MEETING
April 25, 1975
11:00 a.m.
Cabinet Room

From: L. William Seidman LWS

I. PURPOSE

A. To consider the Administration response to the farm bill.

B. To consider proposed Administration legislation designed to assist the railroads.

II. BACKGROUND, PARTICIPANTS, AND PRESS PLAN

A. Background: Congress has just passed H.R. 4296 which would increase target prices and loan rates for wheat, corn, and cotton. A memorandum on alternative Administration responses is attached at Tab A. A memorandum on proposed Administration legislation designed to help the railroads is attached at Tab B.

B. Participants: The Vice President, Rogers C.B. Morton, Earl L. Butz, William T. Coleman, Edward H. Levi, John T. Dunlop, James T. Lynn, L. William Seidman, Alan Greenspan, Arthur F. Burns, Frank G. Zarb, Stephen S. Gardner, James M. Cannon, Donald Rumsfeld, Richard L. Dunham, John O. Marsh

C. Press Plan: White House Press Corps Photo Opportunity.

III. AGENDA

A. Energy Conservation Commercial

Frank G. Zarb will report on a commercial which has been developed to help stimulate and encourage energy conservation.

B. Farm Bill Alternatives

Secretary Butz will review alternative responses to the farm bill.

C. Railroads

James Cannon will review proposed legislation designed to assist the railroads.

A

THE WHITE HOUSE

WASHINGTON

April 24, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: FARM BILL ALTERNATIVES

Background

Early in 1973 the Nixon Administration proposed to the Congress that Federal programs relating to wheat, feed grains, and cotton be limited to providing loans at rates ($ per unit of production) well below current and anticipated market prices. This would have allowed the market to operate with minimum Government interference and yet preclude exceptionally low prices. The proposed programs were to replace older programs under which producers were paid to restrict production.

During the period of consideration, market prices moved up quickly and the outlook was one of continued high demand for food. The Congress rejected that approach and substituted a program embodying loans and target prices. The loan levels were to perform essentially the same function as proposed by the Executive Branch. All of the producer's production would be eligible for loans. The target prices were designed to provide incentives to producers to meet the projected increased demand for food. Only those producers with an acreage allotment (based upon planting history) would receive such payments and only to the extent of the normal production on their allotment.

The Executive Branch originally resisted this approach since it meant continued Federal involvement. Objections centered on the high target prices over the life of the bill and the "escalator" provision which would have increased target prices each year in line with increases in the index of prices paid by farmers for production items including interest, taxes, and wages.

The target price concept eventually was accepted by the Executive Branch and a bill agreed upon in the summer of 1973. The "escalator" was modified to provide adjustments for increased yields to apply only to 1976 and subsequent crops (not the 1975 crop) and the target prices were lowered. Meanwhile, domestic prices rose well above projected target prices largely because of a worldwide economic boom, a fall off in world agricultural production, and increased U.S. exports (partly due to devaluation of the dollar).

The impact of these events on producers was initially favorable. Government surpluses overhanging the market were eliminated. Export demand surged. Farm product prices rose dramatically.

Spiraling agricultural prices focused attention on the value of grain reserves as a cushion against supply shortages. This was a major issue at the World Food Conference in Rome. The U.S. Government is in the process of developing a policy with respect to the appropriate level of food security and how the burden should be shared. Currently, importers, facing favorable supply prospects, have shown little interest in accumulating grain stocks. An increase in Federal support through price guarantees would increase the risk of the Federal Government acquiring stocks and thus reduce the interest of other nations in sharing the burden of carrying reserves.

The supply/demand situation today is vastly changed from a year ago. Farm prices are retreating from their former high levels, with some prices (wheat, soybeans, cattle) having fallen precipitiously.

Meanwhile, production costs are at record levels since current target prices and loan rates were established in 1973. Production costs, as measured by the index of prices, an "average" of farm costs paid for production items, has increased 16 percent since 1973. This index, the escalator defined in the 1973 Act, will be applied to the 1976 and 1977 crops. However, costs of producing grain have risen much more steeply than "average" farm costs since large quantities of fuel and fertilizer are required relative to other inputs. Details for a couple of grain producing areas are shown in the table below:

Wheat, Kansas, E. Central	Unit	1973	1975	Increase $	Increase %
Variable costs	$/bu.	0.57	1.05	0.48	84
Total costs:					
excluding land	$/bu.	0.95	1.54	0.59	62
including land	$/bu.	1.59	2.50	0.91	57

Corn, N. Indiana	Unit	1973	1975	Increase $	%
Variable costs	$/bu.	0.48	0.81	0.33	69
Total costs:					
excluding land	$/bu.	0.72	1.12	0.40	56
including land	$/bu.	1.15	1.79	0.64	56

Producers, particularly livestock, in 1975 are facing a cut in income for the second year in a row.

Year	Gross Farm Income	Production Expenses	Realized Net Income
	(Billions of $)		
1970	58.6	44.6	14.0
1971	60.6	47.6	13.0
1972	69.9	52.4	17.5
1973	97.0	64.7	32.2
1974	102.0	74.8	27.2
1975 est.	94-98	75-77	19-21

The enrolled Farm Bill, H.R. 4296, is the congressional answer to the current situation. It would increase prices as follows:

	Unit	Target Price Current Law	Target Price H.R. 4296	Loan Rate Current Law	Loan Rate H.R. 4296
Wheat	$/bu.	2.05	3.10	1.37	2.50
Corn	$/bu.	1.38	2.25	1.10	1.87
Cotton	$/bu.	.38	.45	.34	.38
Soybeans	$/bu.	--	--	--	3.94

The following is the vote tabulation on the bill:

	House For	House Against	Senate For	Senate Against
Original bill.........	229	162	57	25
Conference bill.......	248	166	Voice approval	

The House vote on the Conference bill was 28 votes short of the number needed to override a veto.

Issue: What, if anything, should the Administration do, if H.R. 4296 is vetoed.

Since it is unlikely that any action would have a significant impact on this year's production, alternative actions should be viewed largely in terms of their impact on (1) the votes to override a veto; (2) 1976 outlays; (3) future years' production, prices and budget outlays; (4) the likelihood that Congress, in an election year, will attempt to raise supports even higher.

Option 1: Do nothing beyond vetoing the bill.

This would leave the loan levels at the minimum specified by the 1973 Act. Target prices would be unchanged with the escalator applied to the 1976 and 1977 crops.

Pros

1. Additional incentives to increase production are not needed (at least in 1975). The acreage farmers intend to plant will, given normal weather, exceed market demands and add to stocks. A very large winter wheat crop already seems assured.

2. Any increase in loan levels will add to 1976 budget outlays.

3. An increase in Federal support through price guarantees would increase the risk of the Federal Government acquiring stocks and thus lessen the interest of other nations in sharing the burden of carrying reserves.

4. Farmers could protect themselves by using the futures market.

Cons

1. The Administration could appear insensitive to the cost/price squeeze faced by farmers, especially since the Government has asked for all-out production.

2. Could lead to further legislative efforts, to pass a farm bill for 1975, or, although unlikely, to a veto override.

3. Loan rates could be raised moderately without significant economic consequences, since prices are expected to average higher than any loan levels that would be selected, and since, under such circumstances, the loans would be repaid.

Option 2: Increase loan levels to a point unlikely to result in the CCC accumulating quantities of wheat and feed grains.

The wheat loan rate would be raised from $1.37 to $1.75 ($2.50 in the bill), and corn from $1.10 to $1.50 ($1.87 in the bill).

Pros

1. Would cover most producer's total costs of production, excluding land, by a wide margin.

2. Could offset pressures to override a Presidential veto.

3. Narrows spread between wheat and corn prices and makes wheat more competitive in feed markets during times of large surplus.

Cons

1. Would increase 1976 budget outlays by about $75 million.

2. Continues a pattern of the Administration acting when Congress passes unacceptable bills.

3. Adds to degree of indexation in the economy making control of inflation more difficult.

Option 3: Raise the loan rates to levels the Secretary of Agriculture believes are the minimum acceptable to congressional representatives of wheat and feed grain producers.

This would raise the wheat loan from $1.37 to $2.00 (compared to $2.50 in the bill and $1.75 in Option 2) and corn from $1.10 to $1.50 (compared to $1.87 in the bill but same as Option 2).

<u>Pros</u>

1. Would give wheat producers substantial protection since the levels would significantly exceed production costs, excluding land.

2. Could offset pressures to override a Presidential veto.

<u>Cons</u>

1. Would increase 1976 budget outlays by about $90 million.

2. Increases risk of expanded use of loan program and higher budget outlays, especially if export demand weakens.

3. Widens spread between wheat and corn prices, and makes wheat uncompetitive in feed market during time of large surplus.

<u>Option 4</u>: Propose legislation applying the escalator to the 1975 crop target prices for wheat and feed grains.

Wheat would be increased from $2.05 to $2.51 ($3.10 in bill). Corn would be increased from $1.38 to $1.68 ($2.25 in bill). Cotton would not be increased since targets are already above market prices.

<u>Pros</u>

1. Would be in harmony with the spirit of the 1973 Act since it would capture most of the bulge in production costs as measured by the production cost index.

2. The target prices for grains would be well below the market price anticipate <u>if</u> exports continue at a high level.

<u>Cons</u>

1. Would appear to discriminate against cotton producers.

2. Conflicts with past Administration policy not to negotiate higher target prices.

3. Increases the risk of target prices exceeding future market prices.

4. Will reopen the issue to legislative logrolling.

5. Would add $40 million to outlays for disaster payments (tied to the target price).

Option 5: Propose legislation increasing target prices to the level of market prices anticipated for 1975 crops, assuming low exports.

Wheat would be increased from $2.05 to $2.50 ($3.10 in bill). Corn would be increased from $1.38 to $2.00 ($2.25 in bill). Cotton would not change.

Pros

1. With target prices tied to minimum market expectations, the likelihood of deficiency payments for wheat would be reduced.

2. Producers would be protected to the low end of Government price expectations.

Cons

1. Would increase 1976 budget outlays by about $60 million.

2. Budget exposure would be further increased for 1977 and 1978 when market prices are expected to fall.

3. Would appear to discriminate against cotton producers.

Decision

Option 1 WR? Do nothing beyond vetoing the bill. Supported by Treasury, CEA, OMB, CIEP, Marsh

Option 2 ______ Increase loan levels to a point unlikely to result in the CCC accumulating quantities of wheat and feed grains.

Option 3 ______ Raise the loan rates to levels the Secretary of Agriculture believes are the minimum acceptable to congressional representatives of wheat and feed grain producers.
Supported by USDA, Domestic Council

Option 4 ______ Propose legislation applying the escalator to the 1975 crop target prices for wheat and feed grains.

Option 5 ______ Propose legislation increasing target prices to the level of makret prices anticipated for 1975 crops, assuming low exports.

CIEP recommends a veto on the farm bill and leaving the loan rates unchanged on economic grounds but making clear in a veto message our commitment to a strong export oriented, open market policy.

I agree

OMB wishes to qualify their vote for Option 1 with the following statement. On the single economic merits, OMB recommends the bill be vetoed and that no changes be proposed in target prices or loan rates. However, in coming to a decision as to what course to follow, assuming a veto, OMB believes careful thought should be given to the following considerations:

Assuming that the Farm Bill is vetoed, and that the veto is sustained, the followup question must be: What action is the Congress then likely to take? If, as we suspect, the Congress chooses to try again, then we need to assess the likelihood of the Congress being able to pass a new bill that is "veto-proof" because its sponsors lower the target price increases sufficiently to shift the necessary votes to their side.

If the Administration shows no movement in connection with successfully sustaining a veto on the first bill we could be putting ourselves in a position of opposition to <u>any</u> increases; a position which we probably cannot sustain.

This line of reasoning suggests that we may want to at least <u>consider</u> the possibility of advocating an increase in target prices and loan rates; say to levels consistent with the change in production costs since the current law was enacted in 1973. If this kind of approach could be coupled with an agreement from the Committees to enact these changes as part of a <u>three year</u> bill, we would be protected against even greater increases in 1976.

B

THE WHITE HOUSE

WASHINGTON

DECISION

April 24, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON Jim AND BILL SEIDMAN LWS

SUBJECT: RAILROADS (EMERGENCY RAILROAD REVITALIZATION ACT)

I. PURPOSE

At your economic meeting tomorrow, Secretary Coleman will seek your decisions on proposed administration legislation designed to help the railroads.

The general issues are:

- Should you submit railroad legislation limited to

  1) regulatory reform; and,
  2) $2 billion in loan guarantee;

  Or, should all or any of the following be included

  A) ICC by-pass authority;
  B) interest subsidy;
  C) additional $1.2 billion in emergency aid?

- What additional legislation and programs will be required to solve the overall railroad problem?

II. BACKGROUND

The Nation's economy depends on a functioning U. S. railroad system. Unfortunately, over one-half of the trackage in the country is unfit for high-speed operations and accidents and derailments have nearly doubled since 1967.

Eight Northeast and Midwest railroads are bankrupt (including the Penn Central), the so-called Granger roads in the Plains States are in precarious condition; average rates of return are extremely low; and, we have just had the largest quarterly deficit in rail history.

This very serious financial condition has led to a nationwide deferred maintenance problem which will cost between $5 and $10 billion to remedy.

Current and proposed Federal activity is concentrated in four general areas:

- efforts to help the bankrupt railroads of the Northeast and Midwest through the Regional Rail Reorganization Act of 1973;
- financial assistance for all railroads to buy rolling stock and to improve the roadbeds and other capital investments (through direct grants and loan guarantees);
- regulatory reform; and,
- emergency programs of grants and loans for specific railroads (including those in bankruptcy) to overcome the current unemployment, energy and cash flow problems.

There is a strong sense in Congress that something needs to be done to help the railroads, but that there is a danger that the government will end up pouring massive Federal funds into the railroads without solving the problems.

See Tab A for additional background information and Congressional situation.

III. ISSUES AND ALTERNATIVES

You are committed to sending Congress your Railroad Revitalization and Energy Transportation Act consisting of regulatory reform and $2 billion for loan guarantees.

Secretary Coleman has asked you to add interest subsidy, ICC by-pass authority and $1.2 billion in additional aid (which he calls the "Emergency Railroad Rehabilitation Program").

One of the reasons for decision now is that hearings begin on the railroad rehabilitation issue in the Senate Commerce Committee on May 1.

In addition to this proposed program, other very significant railroad issues will be coming to you for decision. For example:

- the financial problems of the utilities may require some form of government refinancing and additional railroad aid may be required in the energy independence context.

- many in Congress want to attack our current unemployment problem by creating railroad jobs with Federal grants.

See Tab B for a memorandum from Secretary Coleman on the issues presented, and a paper from CEA.

The following are the specific decisions required at this time:

FIRST ISSUE - <u>Should an Interest Subsidy be Added to the Loan Guarantee Program?</u>

Secretary Coleman recommends that an interest subsidy be included as a component of the $2 billion loan program. This added financial incentive might also enable railroads who are in such bad financial condition that they cannot apply for a loan without a loan subsidy to take advantage of the program. Under this proposal, the Secretary could agree to pay up to one-half of the interest costs on the loans. This program would cost up to $80 million a year for each of the 20 years.

ALTERNATIVES

1. Propose an interest subsidy program as a part of the $2 billion loan guarantee proposal.

   Pro: Would create a highly leveraged program which, when tied to the ICC by-pass provision, permits the Executive wide latitude in restructuring the railroads of loan applicants.

   Con: There are other Federal loan guarantee programs which have proponents arguing for interest subsidy. It could be argued that this is a new spending program.

2. Permit some form of interest payment, or deferred payment, under an existing mechanism but avoid a direct interest subsidy. (This could involve the Secretary allowing railroads to finance their loan under the Federal Financing Bank or defer interest payments in the initial years.)

   Pro: This essentially accomplishes the objectives of the proposal by Secretary Coleman for interest subsidy without the obvious precedent of an interest subsidy program.

   Con: This alternative for direct interest subsidy would likely be perceived as such among the special interest groups who would argue for equal treatment for their loan guarantee programs.

3. Provide no interest subsidy but state that we recognize that some railroads will have a problem participating under the loans and that we will study the issue and propose remedial legislation, if required.

   Pro: Avoids all the problems of interest subsidy and candidly admits that additional Federal action will likely be required.

   Con: Results in the Congress taking the initiative and, therefore, may result in a worse bill than the Secretary's proposal.

<u>DECISIONS</u>

1. Propose an interest subsidy program as a part of the $2 billion loan guarantee proposal.

   Approve ___________ Disapprove ___________

2. Permit some form of an indirect interest payment but avoid a direct interest subsidy.

   Approve ___________ Disapprove ___________

3. Provide no interest subsidy but recognize the problem and leave options open for a possible later proposal involving an interest subsidy.

   Approve ___________ Disapprove ___________

SECOND ISSUE - Additional (not in your FY 76 budget) Railroad Aid to Provide Emergency Rehabilitation.

Secretary Coleman has recommended a $1.2 billion, 15-month program to help stabilize the deteriorating rail roadbed, as well as generate employment in productive tasks. The proposal involves additional loan guarantees and direct grants.

All railroads would be eligible to participate.

The program is in addition to the $2 billion loan guarantee program described above.

No one questions the need for additional Federal support for the railroads beyond the $2 billion loan guarantee, regulatory reform and efforts to salvage the bankrupt railroads in the Northeast and Midwest. The issue is whether this new program proposal is the proper response at this time and in this form.

We do not have any firm analysis on the extent to which the railroad problem is impacting our energy objectives. Therefore, we do not have a firm recommendation at this time on the extent to which the Federal Government should assist the railroads primarily for energy reasons.

ALTERNATIVES

1. Include additional funding (approximately $1.2 billion) over and above the $2 billion loan guarantee.

   Pro: This will help prevent deterioration of the railroad roadbeds and make your railroad bill a major new initiative.

   It will tend to preempt other legislation being proposed in Congress to link the railroad and unemployment problems by providing emergency grants for railroad jobs.

Con: We should not send up legislation beyond that to which we are already committed until we have a better understanding of the total railroad problem and its relationship to other railroad initiatives.

Such a grant program will not really help unemployment in the short term.

There are difficult issues involved in giving taxpayers' funds to solvent railroads.

There would be potential labor problems depending on whether force account or contract labor is used.

2. If you decide in favor of the new Railroad Rehabilitation Program, the only way to justify it under your "no new spending program" decision is by relating it to energy.

   A way of explaining the impact of this on your "no new spending" decision would be to state that the $1.2 billion will be offset against funds you have asked the Congress to rescind from the Highway Trust Fund.

   Accordingly, if you decide to go with the new program, it can be explained as having energy impact and is thus an energy exception.

3. Provide up to $600 million in grants within the $2 billion funding level already established.

   This is the amount of grants in the Senate's Emergency Employment Appropriation Act, reported out of Committee on April 22. Would leave $1.4 billion in loan guarantees.

   Use of grants would be restricted to bankrupt railroads and a limited number of special purposes designated by the Secretary (e.g., as incentive for merger or joint use of track).

   Pro: Would have same basic benefits as Alternative 1 (prevent deterioration, preempt other legislation), while avoiding some of the drawbacks. For example, it would pinpoint the assistance where needed most -- on bankrupts. Avoids most of the problem of giving taxpayers' funds to solvent railroads. There is already a precedent for funding bankrupt lines.

Con: It could be argued that the $600 million in grants would violate your policy of no new spending programs.

DECISIONS

1. Include additional funding (approximately $1.2 billion) over and above the $2 billion loan guarantee.

   Approve __________ Disapprove __________

2. If you approve number 1 above, justify the program addition by relating it to "energy independence."

   Approve __________ Disapprove __________

3. Provide up to $600 million of program grants within the $2 billion loan program.

   Approve __________ Disapprove __________

Some of your advisers believe that the railroad issue must be considered in total and that an intensive examination of alternative approaches such as the controlled transfer system discussed briefly in Tab B should first be completed.

THIRD ISSUE - <u>"By-Pass" or Reform Existing ICC Authority Over Railroad Restructuring When Federal Financial Assistance Is Offered</u>.

There is general agreement within the Executive Branch that the railroads are in serious need of restructuring to eliminate excess capacity. The problem is the cumbersome regulatory procedures administered by the ICC. Efforts to restructure through merger or various cooperative agreements in the past have failed, in part, due to the length of time involved in getting ICC approval.

The Secretary of Transportation proposes that the ICC be "bypassed" wherever a railroad restructuring proposal approved by the DOT also requires federal financial assistance. Thus, the Secretary would impose a restructuring plan (merger or other cooperative agreement) as a condition to his grant of a loan guarantee or interest subsidy and the ICC would have little or no authority to approve or disapprove such restructuring plan. Instead, the approval procedures would be moved, by legislation to the DOT which would conduct appropriate, but more expeditious, hearings.

Secretary Coleman feels strongly that the impetus for restructuring reform needs additional Federal financial assistance such as the "interest subsidy" discussed elsewhere.

The ICC would retain authority in all railroad restructuring that did not require Federal financial assistance.

The Attorney General raises these issues:

1. Should the Secretary of Transportation, who creates a railroad restructuring plan as a condition of a loan guarantee or interest subsidy, also have the authority to resolve all third party (shippers, competitors, public representatives) complaints about that plan.

2. He states that basic questions ("not mechanical details") have not been resolved as to how regulatory action can be expedited and still protect the legitimate interests of third parties in an expedited hearing procedure with fast judicial review.

3. Finally, he strongly states that before any legislation is sent to the Hill, decisions must be made on which he wishes to be heard, as to the appropriate relationship between the Secretary and the Attorney General. Specifically, what type of consultation or concurrence from the Attorney General will be required? He states that, at the least, the Attorney General must be required to give specific reasons in writing to backup his advice <u>or</u> consent.

All your advisers agree that your railroad legislation should not be submitted without proposals for effective reform of the ICC or for bypassing the ICC.

The legislative office believes there may be a better chance to drastically reform the ICC with a "super" new hearing panel than to give ICC control over railroad restructuring (where Federally financed) to DOT.

The Counsel's office agrees that <u>existing</u> ICC procedures must be bypassed as a condition for granting loan guarantees or interest subsidies and that the Secretary of Transportation should have the authority to "trigger" the bypass procedures but believes that both the Attorney General and the Secretary must clarify their positions before a decision can be made as to whether the bypass should be to:

(i) the DOT;
(ii) an expedited "super" ICC hearing panel; or
(iii) a separate agency.

<u>Decision #1</u>

The Secretary of Transportation should be given the authority to condition, where appropriate, loan guarantees and interest subsidies (if authorized) upon the successful completion of a railroad restructuring plan (e.g. a merger).

Pro: all the reasons set forth above which suggest that such inducements are necessary to preserve a privately operated rail system.

Con: the use of federal financial assistance to foster mergers between privately owned companies is anti-competitive and bad public policy.

Favor: DOT, OMB, Domestic Council, and Counsel's Office.

Oppose: No one

HRF APPROVE _______DISAPPROVE

<u>Decision #2</u>

The railroad legislation should not be submitted to the Hill until an administrative plan has been formulated giving the Secretary of Transportation the authority to "trigger" either a bypass of the ICC or the use of an expedited newly created regulatory process.

All your advisers agree that such a plan must be formulated except the Attorney General who reserves judgment, and Secretary Coleman insists that the "plan" be formulated within one week.

It is unanimously recommended that you direct the formation of a drafting committee with representatives of your Counsel's Office, DOT, the Attorney General, OMB and the Domestic Council to submit such a plan for your approval no later than May 4.

HRF APPROVE _______DISAPPROVE

A

BACKGROUND

1. Condition of the Railroads and Statement of the Problem

The American railroads are essential to the nation's economy and are in danger of collapsing. Most freight is transported by the railroads (38% of ton-miles transported) and many basic products and commodities rely nearly exclusively on the railroads. For example, they transport 70% of the coal produced, utilizing 81% of the nation's mainline tracks.

Over one-half of the trackage in the country is unfit for highspeed operations. For safety reasons, trains are operating under Federal "slow orders" on nearly 50% of their tracks and at speed under 10 miles per hour for 20% of the tracks. Accidents and derailments have nearly doubled since 1967. Because of inefficient equipment and operating methods, a typical freight car moves loaded only 23 days a year.

The railroads are in very poor financial condition. Eight Northeast and Midwest railroads are bankrupt (including Penn Central), the so-called Granger roads in the Plains States are in precarious financial condition; average, industry-wide rates of return are 3% or less; and, they just had the largest quarterly deficit in rail history. Among the principal factors that have caused this dismal financial condition are:

A) Outdated government regulation,
B) Archaic work rules,
C) Government subsidies to competing modes (such as barges and motor carriers).

These difficulties have resulted in the critical problem of redundant rail facilities and excess competition. The magnitude of this problem is most clearly demonstrated by the severe physical deterioration in the rail industry. Recently, expenditures on track maintenance have fallen short of the amount needed by $1 billion per year.

This has led to a deferred maintenance problem which will cost between $5 - 10 billion to remedy. There is widespread sentiment in the rail industry and Congress that the Federal government should pay for a major part of this expense. The deferred maintenance problem is concentrated mostly in the Northeast and Granger states. Thus, a sound solution to the Northeast bankruptcy problem should go a long way toward achieving a nationwide solution.

2. Current Situation

Based on the history of government involvement in the railroad problem over the last several years, it is perhaps easiest to view the current situation in four categories of existing or proposed Federal involvement:

A) Efforts to help the seven bankrupt railroads in the Northeast and Midwest -- through the Rail Reorganizational Act of 1973 and the attempts to create Conrail;

B) Financial assistance for all railroads to buy rolling stock and to improve the roadbeds and other capital investments (through direct grants and loan guarantees);

C) Regulatory reform; and,

D) Emergency programs of grants and loans for specific railroads (including those in bankruptcy) to overcome the current unemployment, energy and cash flow problems.

These efforts and this memorandum do not consider the Federal involvement in rail passenger service. Essentially, AMTRAK and the Federal efforts to upgrade the Northeast corridor are being dealt with separately.

Briefly, the following is a snapshot of where we are in each of the above categories.

-- Bankrupt Railroads. For the past year, the U. S. Railway Association (USRA) has been designing a new rail system for the Northeast, to be owned and run by a new private corporation, the Consolidated Rail Corporation (ConRail). Two months ago, USRA published its preliminary plan, indicating that ConRail would require $3 billion in Federal financing and would be federally controlled for at least 10 years. The Administration is aiming to develop a position on this plan by early May. An interagency task group has been established by the Economic Policy Board, under Secretary Coleman's leadership, to explore various alternatives to USRA's plan. This should result in an Administration legislative proposal, including both financing provisions and technical amendments to the Regional Rail Reorganization Act. USRA will submit its final plan to Congress by July 26.

-- Capital Assistance. There have been a host of proposals ranging from Federal purchase of the railroad rights-of-way to modest loans for the railroads designed to permit all the railroads to upgrade their capital plants. The Administration approach has been to offer $2 billion loan guarantee program which we attached to our regulatory reform proposal several years ago. These loans would be used by any U. S. railroad wherever located and regardless of their financial condition.

-- Regulatory Reform. The proposed bill will: permit increased pricing flexibility; expedite rate-making procedures; outlaw anti-competitive rate bureau practices; and improve the procedures for dealing with interstate rail rates. In addition, the bill will outlaw discriminatory taxation of the rail industry.

-- Emergency Programs. Most of the one-shot emergency railroad programs have been designed to cope with the unemployment problem. There are a host of specific proposals before Congress, including a $700 million railroad employment proposal that has been agreed to by the senior members of the Senate Appropriations Committee. Most of these bills are ad hoc and provide grants and loans to be used by the railroads as a means of putting more track maintenance people to work. They are not designed to deal comprehensively with the overall railroad problem and it is not clear how they fit into other pieces of the solution.

3. Congressional Response

As indicated in the foregoing section, Congress is groping with the overall railroad problem. There is a strong sense in Congress that something needs to be done and that there is a great danger that the government will end up pouring massive Federal funds into the railroads without satisfactory protection of its investment or ever coming to grips with the root causes of the railroad problem. The range of solutions which have been suggested cover the whole spectrum from nationalization to doing nothing. For example, Senators Hartke and Weicker have introduced legislation to nationalize the railroads rights-of-way and Senator Randolph has submitted a bill to provide $ billion to upgrade the tracks.

Senate Appropriations Committee has included $700M for Railroad Improvement and Employment in the $6B Emergency Unemployment Supplemental which will be reported out of committee April 23. The Senate Commerce Committee is expected to have authorization hearings on the rail improvement proposal the week of May 1 and Senate action is expected by mid May. Similar rapid action by the House is expected. Senators McClellan, Bayh, Randolph and Hartke strongly support the $700M proposed ($600M in grants and $100M in loans).

It is clear that Congress has not yet taken a look at the entire railroad problem comprehensively covering the near-term employment and cash flow problems along with the long-term bankruptcy and rights-of-way maintenance issues. More distressingly, there is a strong likelihood that Congress will pass ad hoc emergency grant and loan programs without the necessary regulatory reform.

B

THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

MEMORANDUM FOR THE PRESIDENT

SUBJECT: National Railroad Program

Last week, on April 11, I informed you of my concern for the desperate plight of the nation's railroads, the effect of that situation on the rest of the economy, and the pressures building in Congress for a solution -- even if that solution involved partial nationalization. I also proposed, in broad terms, a program for dealing with this situation. A copy of my April 11 memorandum to you is attached.

We need your decision at this time in two areas: (1) the rail regulatory modernization, financial aid and restructuring bill (Railroad Revitalization and Energy Transportation Act) is now ready to go except for two unresolved issues which are discussed in Part A; and (2) the Emergency Rail Rehabilitation Program, which is discussed in Part B.

I believe it important that we arrive at decisions in these two areas now so that we may immediately start on the road to solutions to the railroad problems and it is particularly important to introduce our regulatory bill (RRETA) to Congress at this optimum time. We understand that the Senate Commerce Committee is planning to hold hearings next week on an Emergency Railroad Rehabilitation Program. I believe the Administration should have a positive program initiative of its own to respond to the Congressional proposal. Otherwise, we will have to testify against a proposal which we believe has great merit.

While these deal with the overall railroad problem it is, of course, also essential that we deal with the Northeast rail restructuring problem. By the 26th of this month, the Economic Policy Board Task Group on Northeast Rail Restructuring, of which I am Chairman, will present you with its specific recommendations.

William T. Coleman, Jr.

Attachments

Railroad Revitalization and Energy Transportation Act (RRETA)

Background

The Railroad Revitalization and Energy Transportation Act has been designed to deal with two major parts of the railroad problem. The Act would modernize government regulations under which the railroads operate and would provide for consolidation and streamlining of the national rail system utilizing financial incentives and bypass of the ICC regulatory impediments to rail restructuring.

It is important to release the RRETA very soon because of the urgent need for regulatory modernization and financial assistance throughout the industry and particularly in the crisis-stricken Northeast, and because the timing for introduction in Congress is now optimum. The Surface Transportation Act (STA), which contained many of the proposals of the RRETA, passed the House overwhelmingly in December and we want to maintain the momentum it generated.

The RRETA, which we have been working on for several months, is now ready to be submitted to Congress except for two issues which remain unresolved. These two unresolved issues are the extent of railroad financial aid, and which Executive Branch agencies should control the restructuring process. This paper seeks your decision on these issues.

Issue A: Should there be an interest subsidy as part of the railroad financial aid package?

There is agreement within the Executive Branch that the RRETA should provide loan guarantees, under the control of the Secretary of Transportation, to railroads to finance rationalizing and streamlining facilities. It would allow financing at the low Federal Financing Bank rate and would allow flexible financing arrangements such as deferral of interest payments. The $2 billion loan guarantee authority in the bill is already a part of your budget proposals.

The financial aid proposal serves a twofold objective: (1) providing the railroads access to the private capital market for funds to rehabilitate and improve the essential portions of the national rail system, and (2) incorporating an incentive to the industry to consolidate and restructure duplicate trackage, yards, terminals, and other facilities, under the control of the Secretary of Transportation, to produce over time a viable and more efficient national rail system.

Option 1: Provides $2 billion in Federally guaranteed loans.

Option 2: Provides $2 billion in Federally guaranteed loans with provision that the Secretary could agree to pay up to half of the interest cost on the loans. For example, if the entire $2 billion were loaned out and the interest on government guaranteed loans were 8 percent, the Secretary of Transportation would be able to subsidize up to $80 million in annual interest payments.

Discussion

As a condition for granting a loan guarantee, the Secretary could require applicant railroads to enter into agreements for joint use of tracks, terminals, and other facilities and for purchase or sale of other assets and for mergers. To gain an interest subsidy the applicant railroads would be required to agree to perform restructuring specified by the Secretary. Such agreements would not be subject to ICC approval, but the Secretary would be required to hold a hearing before approving such an agreement. In addition, the Secretary could not approve an agreement unless it achieved the intended transportation objective in the least anticompetitive way.

It is realized that interest subsidies are not normally desired. However, in this case the interest subsidies would be directly tied to industry restructuring, would have large leverage on the amount of restructuring and modernization which could be stimulated, and in fact provide a key incentive for the restructuring. It is therefore believed that an exception should be made to the general rule against interest subsidies.

Reasons for choosing Option 2 are the following:

(1) Loan guarantees without incentive interest subsidies will not be used as extensively by the rail industry, and hence the restructuring objectives of the program would not be achieved to the extent we would like.

(2) Interest subsidy is the minimum assistance required to move toward a restructured national rail system and arrest the further financial decline of the industry which could lead to eventual nationalization of the entire system.

(3) An interest subsidy is needed to achieve the strong industry support we desire to achieve enactment of the entire bill, including the much needed regulatory modernization parts. Without the interest subsidy, the financial aid package may be described by railroad management and labor alike as inadequate to meet their needs.

The principal arguments against Option 2 are that it requires more Federal money and that it creates a new spending program. It conflicts with your policy that the Administration introduce no new spending programs at this time.

<u>Recommendation</u>

The Department of Transportation strongly recommends Option 2 because it would give the Secretary of Transportation the necessary tools to achieve the objectives of the program which Option 1, without the interest subsidy, would not do.

<u>Decision</u>

<u>Option 1:</u> Without interest subsidy ____________

<u>Option 2:</u> With interest subsidy ____________

Issue B: Should the Attorney General's concurrence be required on restructuring (such as agreements for joint use of tracks, terminals and other facilities, and purchase or sale of assets and mergers) carried out under the financial aid program?

At present the ICC approves restructuring and Department of Justice concurrence is not required. However, the ICC process is not flexible enough and has not permitted the needed restructuring. A prime example of the deficiency is the 12-year Rock Island merger case which is not yet finalized.

There is agreement within the Executive Branch that a bypass of the ICC is necessary in order to reach the objective of allowing and providing an incentive for necessary railroad restructuring. The Secretary would have authority to approve restructuring carried out under the financial aid program.

Option 1: Department of Justice concurrence (and approval) would be required.

Option 2: Consultation with the Department of Justice, but not approval of Department of Justice, would be required.

Discussion

Reasons for favoring Option 1 are that it is DOJ's job to oversee the competitive structure of American industries. They are the experts in antitrust matters, are impartial to all industries, and are best able to apply consistent antitrust policy to all industries. There should be no exception made to this for the rail industry.

Reasons for favoring Option 2 are that the competitive environment in the railroad industry must be restructured to achieve a long-run viable and efficient railroad system. DOJ's traditional attitude has been to resist almost all reductions in the number of competitors, or in the amount of competition, and this is simply not appropriate for the railroad industry at this time. The railroads are a special case and railroad restructuring should not be treated with the normal DOJ antitrust philosophy. Thus, requiring DOJ approval would reduce the flexibility required and add additional unnecessary delay in the restructuring process. DOJ approval of competitive restructuring is not now required in cases before the ICC and there is no reason to add it as we move the restructuring authority under loan agreements from the ICC to the Secretary of Transportation. In any event, if the Attorney General had a significant disagreement with the Secretary's decision in a major case, he could elevate the issue to the Cabinet level for ultimate decision.

Recommendation

The Department of Transportation recommends Option 2 because it provides the required flexibility to achieve the objectives of the program. It is our understanding that the Attorney General recommends Option 1.

Decision

Option 1: With DOJ concurrence required ______________

Option 2: With DOJ consultation, but approval by DOJ not required ______________

An Emergency Railroad Rehabilitation Program

The Need for a Program

We estimate that the railroad industry will have the largest quarterly deficit in rail history during the first quarter of this year. Net rail operating income which was $170 million during the first quarter of last year is estimated to show a loss of approximately $100 million for the industry this year.

This sharp drop-off in earnings comes after decades during which the rate-of-return on investment has been around 3%. Because of this chronically low rate-of-return, the industry has not been able, from either self-generated funds or outside funds, to put in place the required investment in new plant or equipment or even to maintain existing plant and equipment at acceptable standards. The deferred maintenance in the industry is presently estimated to range between $5.5 billion and $7.5 billion.

As a result of the sharp drop-off in earnings experienced during the current economic downturn, the industry has reduced its employment from 516,000 during the first quarter of 1974 to 495,000 this year. The railroads currently estimate that they will have 35,000 fewer maintenance-of-way employees this year during the height of the maintenance season as compared to last year. Maintenance-of-way is traditionally one of the first categories cut back in order to conserve cash. The end result of this cutback will be a further decline in the physical plant of the industry and its operating capability. This occurs in an industry whose physical plant is in dilapadated condition. Accidents and derailments have nearly doubled since 1967. We do not have precise measures nor can we project the effect of the industry, shippers, and safe operating conditions of the increase in deferred maintenance which will occur. However, with a further sharp increase in deferred maintenance, we may soon have an industry which does not meet the Nation's basic transportation requirements.

Current estimates are that 81% of mainline tracks are used to carry some portion of the 400 million tons of coal hauled by the railroad industry each year. If Project Independence goals are to be met by 1985, the railroad industry will need to almost double the amount of coal hauled. Actual ton miles of coal hauled by rail, however, could triple due to the change in origin from eastern coal to low sulpher western coal. The result would be that coal could move over approximately 90% of the railroad mainline network. Therefore, a healthy railroad industry is a key ingredient to meet our national objectives -- continued economic growth and energy independence. We firmly believe an emergency, remedial program is needed.

Description of the Program

We have developed a program which has the following objectives:

1. To provide temporary but immediate financial assistance to halt the deterioration in the physical plant of the industry -- the primary emphasis of the program would be to rehabilitate and maintain mainline routes and terminals;

2. To place a first priority in restoring the mainline routes and terminals which handle the predominant amount of coal and other energy resources; and

3. To create job opportunities in the industry for rehiring of furloughed railroad employees as well as new employees (there will also be an impact in the allied industries).

Generally, there is agreement within the Executive Branch that a program along these lines has great merit. This view is shared in the Congress, which appears to be moving rapidly to enacting such a program. The disagreement in the Executive Branch is on timing of submitting a proposal to the Congress and how to accommodate the program within the President's overall budget guidelines.

Funding and Timing of Options

The Department had originally proposed a $3 billion 27-month program or alternatively a $1.2 billion 15-month program. The programs were identical during the first 15 months. The $1.2 billion program -- unlike the $3 billion level -- assumes that no specific employment stimulus will be required during FY 1977. These proposals would have required an exception from the President's policy of initiating no specific spending programs which added to the $60 billion projected deficit.

In order to be more consistent with the President's budget policy, the following additional options have been developed:

1. Rescind existing highway program contract authority by approximately $1.2 billion from the approximate $9.1 billion currently deferred;

2. Reduce the currently planned highway program obligations by FY 1975 by $1.2 billion;

3. Develop a longer range mechanism of funding railroad projects out of the highway program levels; or

4. Delay submission of this program at this time pending development of a more comprehensive railroad package but submit the RRETA immediately.

<u>Option 1 - The Rescission of Existing Highway Contract Authority</u>

Currently, we have proposed that Congress defer ("impound") $9.1 billion of existing highway program contract authority. It is extremely unlikely that the Congress will concur in this, indeed the Senate is rapidly moving toward a resolution of disapproval. This would make the $9.1 billion available to the States immediately for obligation. This step could lead to obligation levels significantly over the President's $5.2 billion budget obligation level during FY 1976 and the $1.3 billion for the transition quarter. States are capable of obligating most of the $9.1 billion during FY 1976 and the transition quarter.

The rescission of $1.2 billion would reduce Federal expenditures during FY 1976 and the transition quarter by about $350 million, <u>assuming the Congress acts, as anticipated, to disapprove our proposed deferral</u>. This, however, does not fully offset the anticipated increase in Federal expenditures resulting from the Emergency Rail Rehabilitation Program which is expected to be about $500-$700 million during this period. However, the remaining budget impact of between $150 million and $350 million would be offset by reduced unemployment insurance expenditures ($150 million) and increased tax revenues ($100 million). Therefore, on a full cost and revenue basis, this option would have little or no budget impact.

This option would permit the Administration to take credit for meeting the critical needs of the railroad industry by reprogramming funds from lower priority highway programs. This option would put the burden on Congress to consider such a trade-off rather than simply adding additional amounts as the Commerce Committees are planning to do. It would run into definite political opposition, especially from the highway lobby.

This is the option recommended by the Department of Transportation.

<u>Option 2 - The Reduction of the Planned Level of Obligations for the Highway Program in FY 1976</u>

The FY 1976 budget proposes a $5.2 billion highway obligation level. The Administration could propose to reduce this by $1.2 billion to accommodate the new railroad program. This is a "real" option only if one assumes that the Congress will go along with the continued deferral of $9.1 billion of contract authority, a very unlikely situation from all of our Congressional readings. In that case, the reduced highway program would save $350 million in expenditures. Again, this alone does not fully offset the budget impact of the new rail program; however, the reduction in unemployment insurance and the increase in taxes would offset most, if not all, of the program costs.

On the negative side, this option suffers from the lack of credibility it will have in the Congress. We already face heavy criticism of the current highway program levels included in the budget. The $5.2 billion highway program proposed by the Administration for FY 1976 compares to $6.6 billion available in FY 1975 and $6.4 billion authorized for FY 1976. By comparison, if our highway deferral proposal is disapproved by Congress, then the States may well obligate $7.0-$7.5 billion. Therefore, the Department of Transportation does not consider this as a viable option.

Option 3 - Develop a Longer Range Program for Divesting Highway Funds for Rail Projects

The proposed Administration highway bill for this year includes a provision to make railroad facilities an eligible category of expenditures from the highway program. This provision could be made more attractive to the States by giving the Secretary authority to forgive State matching requirements as well as to provide additional highway fund allocations to States using highway funds for rail projects. This option is consistent with our efforts to expand the users of the Highway Trust Fund and giving States greater flexibility in making capital investment decisions.

On the other hand, we do not envision this as meeting the urgent and immediate needs of the railroad industry. The impact of this proposal would take time to implement. It leaves much of the discretion to States, who, no matter what the economic incentives, will need time to implement the program. The competition for State highway funds is so intense that few rail projects will be initiated even given strong economic incentives to initiate such projects. The Department of Transportation supports this proposal in concept except for some of the proposed incentives which we wish to examine more closely. However, the Department does not consider this an effective solution to the railroad industry's present needs.

Option 4 - Delay Submission of the Emergency Program but Submit RRETA Now

This Emergency Railroad Rehabilitation Program is seen as an interim and temporary measure. It is intended to set stage and complement the longer term financial assistance program being developed. Nevertheless, in the absence of the longer term program, the proposal makes a substantial commitment of resources.

OMB believes that a longer term proposal should be developed rapidly so that it is available prior to submittal of the final plan being prepared by the United States Railway Association for restructuring the bankrupt railroads in the Northeast and Midwest. In that context, OMB believes the overall commitment being made to railroads can be best assessed. The submission of the RRETA to Congress now, provided that it contained some attractive financing provisions, would allow the Administration to have at least one positive rail proposal before the Congress as it considers the Emergency Railroad Rehabilitation Program next week.

Recommendation

The Department of Transportation strongly recommends Option 1. Of the other options, the Secretary finds No. 4 as the only one with merit.

Decision

Option 1 -- With highway program rescission. ______

Option 2 -- But reduce highway program obligations. ______

Option 3 -- Develop longer term program. ______

Option 4 -- Delay submission of emergency program, but submit RRETA now. ______

THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

APR 11 1975

MEMORANDUM FOR THE PRESIDENT

SUBJECT: The Crisis of the Nation's Railroads

Mr. President, as your principal advisor on transportation matters, I feel compelled to convey to you my sense of the desperate plight of the Nation's railroads. The state of the rail industry today not only endangers any prospect of economic growth in this country but also imperils our important national objective of energy independence. There is a growing mood in Congress that the only answer to the crisis of the railroads is some form of nationalization. I believe that a private sector solution is possible -- if we move quickly. There is an urgent need for action. Therefore, I respectfully urge you to undertake a dramatic, coordinated program to revitalize the Nation's private enterprise railroad system.

The crisis of the American railroad industry presents this Administration not only with a grave problem but also with a great opportunity. If you can put into effect, Mr. President, a program to save the railroads, it will have an historic significance equal to that of any other endeavor upon the domestic scene. From a political standpoint, I believe it provides an unparallelled opportunity for the Administration to seize the initiative from Congress.

The Importance of the Railroad Industry

For more than a century the railroads have been the backbone of this Nation's transportation system. Even after years of decline, railroads still carry 38 percent of all freight (in ton miles), easily exceeding the 23 percent transported by motor carrier and the 16 percent moved via inland waterway. Railroads carry 70 percent of the automobiles produced in this country, 66 percent of the food, 78 percent of the lumber and wood, 60 percent of the chemicals, 60 percent of the primary metal products, and 71 percent of the pulp and paper. If the Nation is to realize its economic growth potential during the remainder of the twentieth century, the railroads must be in a condition to move quickly and safely significantly increased freight volumes.

Moreover, a healthy railroad industry is crucial to the energy needs of this country. The railroads must play the predominant role in supplying the Nation with coal during the remainder of this century. The railroad industry transports 70 percent of the coal produced in this country, a task involving approximately 81 percent of its mainline network. Your Project Independence, to make the Nation self-sufficient in energy, envisions a doubling of domestic coal production by 1985. To meet this goal, railroads will be required to double their coal-carrying capacity. Actual ton miles of coal carried by rail, however, must triple due to changes in origin from eastern coal to low-sulphur western coal. This would necessitate coal shipments over 90 percent of the railroad mainline network. Greatly improved railroad service is, therefore, essential to the development and use of coal for energy. In addition, rail transportation is the most energy efficient of all the modes, both freight and passenger. With regard to freight transportation, our research indicates that railways are significantly more energy efficient than trucks, their ubiquitous competitor, or airlines, and slightly more efficient than even barge movement. As for passenger service, our research indicates that railroads, when properly utilized, are substantially more energy efficient than either autos or airlines in moving passengers and are approached in efficiency only by intercity bus. In summation, a healthy, progressive, strengthened railroad system is absolutely essential to our national objective of energy independence.

The Problem Facing the Railroad Industry

Given the paramount importance of the railways in both the past and future of this country, it has been alarming for me, during my first month on the job, to discover the dilapidated state of the railroad industry. The facts are startling. Over one half of the present rail track in the country is unfit for high-speed operations. It is not uncommon for train operations on mainline tracks to be limited to speeds of 10 to 20 miles per hour. Accidents and derailments have nearly doubled since 1967. Because of outdated equipment and methods and the resultant inefficiency, a typical freight car moves loaded only 23 days a year. It is becoming increasingly apparent that the rail industry, as presently constituted, will be manifestly unable either to support the traffic our economy generates or to meet the challenge of increased coal carriage which energy independence demands.

For many years now the income generated by the American railroads has been insufficient to meet the requirements of plant maintenance and rehabilitation, and with rates of return of 3 percent or less, funds from outside sources are virtually unavailable. The deferred maintenance in the industry is now estimated to range as high as $7.5 billion. Although the problems of railroads are most severe in the Northeast and Midwest (where eight carriers are bankrupt), numerous other railroads, especially the so-called Granger roads that operate in the Plains states, are in precarious financial condition. The massive problems of the railroad industry are most recently aggravated by the largest quarterly deficit in rail history. Today the United States is confronted with the grim reality that a major breakdown of our rail freight system is a distinct possibility.

It is important that the underlying causes of the railroad problem be clearly understood. A great deal of the discussion on this subject is focused on the poor condition of mainline track and on the bankruptcies. These are symptoms but not the underlying causes of railroad difficulty. The principal factors underlying railroad difficulty are: (1) Redundant facilities and excess competition; (2) Outmoded regulation; (3) Archaic work rules; (4) Lack of capital to finance rehabilitation; and (5) Preferential treatment of other modes.

Perhaps the principal factor underlying railroad problems is the redundancy of plant and the excess competition which exists within the industry. This is especially true in the Northeast and Midwest and, as a result, these are the areas where railroad problems are the worst. There are simply more facilities of all types -- yards, mainline tracks, and branch lines -- than are required to provide economical and efficient service. In many instances, two or more railroads compete for traffic sufficient only for the survival of one carrier.

Secondly, slow and cumbersome regulatory procedures impede responses to competition and changes in market conditions and at times result in traffic being handled at non-compensatory rates. These procedures also have created a serious impediment to needed restructuring. Regulation that was necessary when it was enacted decades ago is simply unresponsive to today's needs. This inflexibility stemming from Interstate Commerce Commission procedures and rules is a major deterrent to railroad efficiency and viability. For instance, after 12 years, the attempt to restructure the Rock Island Railroad through merger with other carriers is still incomplete.

Third, the existing work rules in the industry are a major obstacle to achievement of economic potential in the railroad system. Archaic arrangements regarding the size of the crews that man trains and providing for crew payment on an illogical basis weigh heavily upon the industry and severely limit productivity.

Fourth, lack of capital and the resultant deferred maintenance has caused widespread deterioration of mainline track and other parts of the railroads' physical plant. Clearly there is a need to rehabilitate the essential portions of the industry's physical plant -- but that rehabilitation will be effective in revitalizing the railroads only if the burdens of redundant facilities, regulatory constraints, and costly work rules are also alleviated.

Finally, there has been, over the years, preferential treatment of the other transportation modes by the Federal Government. Only the railroads (with the exception of the pipeline companies) own their own rights-of-way and have to carry the fixed charges of ownership and maintenance of this extensive plant.

The Congressional Reaction

There is a great deal of pressure building in Congress for a solution to the railroad problem, and there is growing feeling on the Hill that the only answer lies in some form of nationalization. Faced with the prospect of continuing crises and the necessity of providing more and more Federal money, there is an understandable desire to ensure that the American public receives something in return for its heavy investment. In the absence of a constructive alternative, Congress may indeed turn to nationalization. Senators Hartke and Weicker have introduced legislation to nationalize the railroad rights-of-way, as has Senator Humphrey, and Brock Adams, a leading spokesman on rail matters in the House, has publicly stated that serious consideration should be given to such a proposal. Privately, many other Congressmen and Senators are saying that the only solution to rail industry problems lies in nationalization. In any event, Congress has already seized upon the obvious problem of deteriorating track and roadbed as an interim means of improving the railroad situation as well as an opportunity to take the political initiative. Senator Randolph intends to introduce a bill to provide for a $1 billion program for upgrading rail rights-of-way. Congressman Heinz and Senator Buckley have each introduced separate bills to spend $2.5 billion and $2.0 billion, respectively, to upgrade deteriorating trackage through employment programs.

It is highly unfortunate that Congress has been allowed to take the initiative on the railroads. It is even more unfortunate that some solutions receiving serious consideration in Congress are excessively expensive, inappropriate responses to the real problem, and bad for the country. The Congressional proposal of nationalization of the industry, or, at least, of the rights-of-way, would mean not only an injection of unnecessary Federal control into another area of our national life but also unnecessary rehabilitation and maintenance expenditures on excess railroad plant. Total physical rehabilitation of the existing rail system is not only prohibitively expensive but also undesirable. What is needed is a major rationalization of the rail facilities of the country and an elimination of redundant capacity through mergers and joint use of facilities. Only the components of a rationalized rail plant should be rehabilitated. Moreover, rehabilitation of track will be of little benefit to the railroads or to the Nation unless the other difficulties of the railroads can be overcome as well. A track rehabilitation program should only be commenced as a part of a broader program to overcome other industry problems such as regulatory restraints and work rules.

A Program to Rebuild the Railroad Industry

The Department of Transportation has a comprehensive program which I believe will assure the United States of a viable private enterprise rail system capable of meeting the commerce and energy needs of this country. Moreover, it provides the Administration with the means of seizing the political initiative. The program involves: (1) A consolidation and streamlining of the national rail system utilizing financial incentives and relief from impediments to rail mergers and joint use of facilities; (2) Removal of a number of outmoded and inequitable regulations on railroads; (3) As an important first step to nationwide rail consolidation, the forging of a successful conclusion to the current Northeastern rail restructuring process in a form consistent with the national program of consolidation; (4) Measures to reduce preferential treatment of competing modes and; (5) Recognition of the indispensability of rail passenger service in certain corridors and the public (and Congressional) demand for such service in other areas.

Implementation of the Program

The cost of rehabilitating even the streamlined rail plant that I have proposed will be high. On the other hand, I am keenly aware, Mr. President, of your dedication to fiscal responsibility. Therefore, the Department of Transportation has already developed two concrete legislative proposals which will not only take great strides in furthering the program I have outlined but also be consonant with your opposition to any new spending programs.

First, we have proposed a bill called the Rail Revitalization and Energy Transportation Act of 1975 to provide $2 billion in loan guarantees to railroads to finance the rationalization and streamlining facilities. The $2 billion in the bill is already a part of your budget proposals, and the proposal is awaiting White House approval. As a condition of receiving assistance, the Secretary of Transportation will be able to require railroads to enter into agreements for the joint use of tracks, terminals, and other facilities and to enter into agreements for mergers to further rationalize the rail system. The proposed bill also provides significant regulatory reform by amending the Interstate Commerce Act to permit increased pricing flexibility, to expedite rate-making procedures, to outlaw anti-competitive rate bureau practices, and to improve the procedures for dealing with intrastate rates.

Second, I have proposed a $1.2 billion Emergency Railroad Rehabilitation Program to attack forthwith the accelerating deterioration of the railroad physical plant. The proposal carries with it significant immediate benefits for employment in the country. The money for this bill could, as one alternative, come from rescinding $1.2 billion of the $9.1 billion for highways currently being impounded. As a result, it would not increase Federal funding authorizations but rather reallocate funds from lower priority to higher priority transportation programs. I believe that public reaction, except for the die-hard supporters of expanded highway programs, would be positive. This proposal also is awaiting White House approval. The primary emphasis of the proposal is to rehabilitate and maintain mainline routes and major terminals that will be included in any restructured and streamlined railroad system. This legislation will significantly assist the Nation's energy goals by giving priority to those projects which will aid in the movement of coal.

The financial assistance provided through the proposed Rail revitalization and Energy Transportation Act and the Emergency Railroad Rehabilitation Program, coupled with the regulatory reform contained in the former, will provide the foundation for a viable private enterprise railroad industry. Moreover, these two legislative proposals will announce the Administration's determination to deal with urgent national problems even while simultaneously maintaining a commitment to fiscal responsibility. At the least, the Emergency Railroad Rehabilitation option of using highway money would put pressure on Congress to consider trade-offs rather than add-ons to the budget as the means for financing the railroad programs it is considering.

In conclusion, Mr. President, I believe that the two legislative proposals I have outlined are important initial steps in constructing a comprehensive program to save the American railroads. Of course, it is also essential that we deal appropriately with the Northeast rail restructuring problem. By the 26th of this month, the Economic Policy Board Task Group on Northeast Rail Restructuring, of which I am Chairman, will present you with its specific recommendations.

SIGNED BY
WILLIAM T. COLEMAN, JR.

William T. Coleman, Jr.

EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20506

April 23, 1975

MEMORANDUM FOR ALAN GREENSPAN

FROM: James C. Miller III

SUBJECT: USRA's PSP and The Need for an Intensive Examination of an Alternative Approach

Background

On February 26, 1975, the United States Railway Association (USRA) issued its Preliminary System Plan (PSP) for restructuring the seven bankrupt railroads in the Midwest and Northeast region. Under the PSP, portions of the bankrupt system would be transferred to the Norfolk and Western (N&W) and Chessie system; the rest, minus some light density lines, would be consolidated into a government-sponsored ConRail system. Although ConRail is projected by USRA to generate positive net income by 1978, needed investments for rehabilitation will cause a negative cash flow for 12 to 14 years. USRA estimates that $3 billion in Federal government assistance will be needed during this period.

After hearing comments from the Administration, the ICC, and other interested parties, USRA will submit its Final System Plan (FSP) on July 26, 1975. Unless at least one House of Congress passes a resolution rejecting the FSP, it becomes effective on September 26, 1975. According to best information, USRA plans no significant modifications in the PSP.

This memorandum highlights the frailities of the PSP and recommends an intensive examination of controlled transfer of the bankrupt properties to solvent rail carriers prior to the Administration's adoption of a position on the PSP. The controlled transfer alternative has not been seriously considered, mainly because of alleged political infeasibility. The stakes, however, are high. The PSP is likely to involve much higher fiscal support than now envisioned and eventually produce a set of economic and political circumstances leading directly to the nationalization of the system. Controlled transfer appears to be the only viable alternative.

Major Defects of the PSP

1. Although the PSP calls for a competitive three-carrier system in the region, the amount of competitive service surviving under the PSP could be significantly less than exists today.

2. ConRail would not be viable:

   a) Projections of annual revenue increases of $200 million are unlikely to be realized because traffic growth and rate increases would not be forthcoming at assumed rates.

   b) Rehabilitation costs are underestimated; most analysts believe that the $3 billion estimate is overly optimistic.

   c) ConRail management is an unknown; it cannot be relied upon to bring about $100 million in cost reductions from increased efficiency, as USRA has assumed.

3. Given the current negative cash flow of $30-100 million, a likely result of the plan is the granting of an annual subsidy of $0.5 to $1.5 billion. In the end this would lead to Federal ownership, since ConRail would be obtaining its capital and part of its operating subsidy from the Federal budget.

The Preferred Alternative (Controlled Transfer)

1. The objective should be to merge the profitable parts of the Penn Central system with solvent lines in order to create a viable private sector transportation system characterized by a number of competing rail carriers. However, none of the research and policy analysis to date has addressed the problem of specifying those mergers which would secure these ends. (USRA rejected this alternative because it perceived (erroneously) little interest on the part of solvent carriers in purchasing portions of the region's rail system.)

2. There are, however, several promising options:

   a) Merger of the four western lines to Chicago and St. Louis with: (i) N&W, (ii) Chessie, (iii) "Pennsylvania", and (iv) "Central". By demerging the Penn Central and providing some subsidies for roadbed and capital improvements to the demerged parts, they could be made attractive.

b) Merger of the profitable links in the Penn Central and Erie Lakawanna into the N&W and Chessie. This leaves only two carriers, since ConRail would be left with the dregs of the Penn Central (50% of the trackage, at least).

c) Selling off anything anyone wants to buy. Some purchasers would be other lines, others would be new railroads.

3. Advantages and disadvantages:

a) The principles are correct:

(i) Each of the proposed mergers reduce the potential for governmental support and hidden subsidy;

(ii) Such mergers reduce the likelihood of outright nationalization of the region's rail system five year from now; and

(iii) The first option, along with deregulation, makes possible effective intermodal competition for bulk freight between regions of the country.

b) There are operational difficulties:

(i) None of these options have been thoroughly investigated and the time frame for a decision on this matter is extremely short. There has been considerable interest in controlled transfer by solvent Midwest, Western, and Southern lines, although this interest has been dampened by USRA's negative response. Work would have to be done by DOT, Treasury, OMB, and CEA to establish at least the basis for possible transactions before offering any of these options for inclusion in the FSP or proposing them directly to Congress.

(ii) There are political problems. ConRail would be left with the hopeless lines and the need to go to Congress for an annual subsidy. On the whole, this is less palatable to legislators than is the cross-subsidy implicit in the PSP.

THE WHITE HOUSE

WASHINGTON

April 25, 1975

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: BILL SEIDMAN

FROM: JERRY H. JONES

SUBJECT: Farm Bill Alternatives

Your memorandum to the President of April 24 on the above subject has been reviewed and Option 1 -- do nothing beyond vetoing the bill -- was approved.

Also the President made the following notation with regard to CIEP's recommendation on page 8:

-- I agree.

Please follow-up with the appropriate action.

Thank you.

cc: Don Rumsfeld

THE WHITE HOUSE

WASHINGTON

April 25, 1975

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: JIM CANNON
BILL SEIDMAN

FROM: JERRY H. JONES

SUBJECT: Railroads (Emergency Railroad Revitalization Act)

Your memorandum to the President of April 24 on the above subject has been reviewed and the following decisions were approved:

Decision #1 -- The Secretary of Transportation should be given the authority to condition, where appropriate, loan guarantees and interest subsidies (if authorized) upon successful completion of a railroad restructuring plan (e.g. a merger).

Decision #2 -- The railroad legislation should not be submitted to the Hill until an administrative plan has been formulated giving the Secretary of Transportation the authority to "trigger" either a bypass of the ICC or the use of an expedited newly created regulatory process.

It is unanimously recommended that you direct the formation of a drafting committee with representatives of your Counsel's Office, DOT, the Attorney General, OMB and the Domestic Council to submit such a plan for your approval no later than May 4.

Please follow-up with the appropriate action.

Thank you.

cc: Don Rumsfeld