The Conrail sale and the new robber barons

by Leif Johnson

As if epitomizing the public distaste for pouring tax money down bottomless sinkholes, Transportation Secretary Drew Lewis and Federal Railroad Administrator Robert W. Blanchette proposed in mid-April that the federal government sell Conrail to competing private railroads.

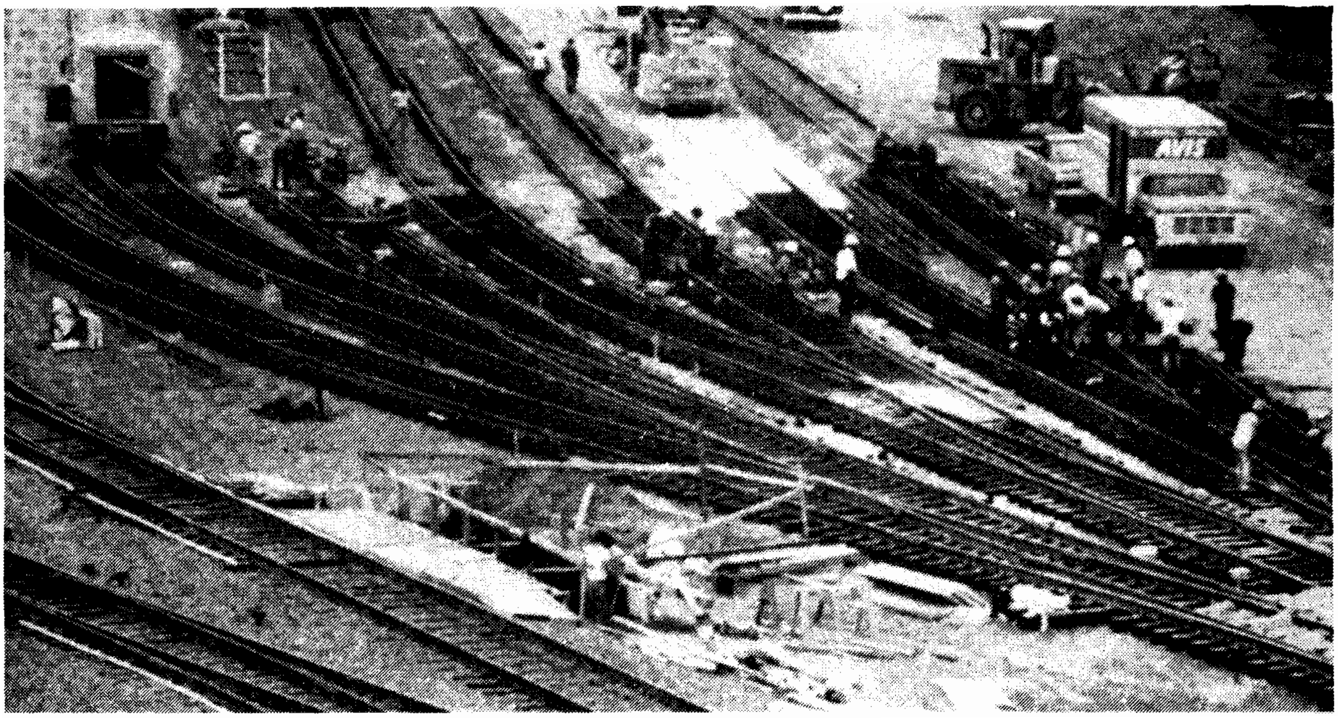
Conrail, the debris of six Northeastern railroads which was dumped on the federal government in 1976, has, despite assurances, failed to turn a profit. Conrail has absorbed $3.1 billion in its five years of life, and expects to ask Congress for an additional $604 million to $2.1 billion over the next four years.

Selling Conrail seems to many an ideal solution. The federal government would be relieved of additional subsidies; the labor costs negotiated into the 1976 Conrail package could be abrogated; and large-scale abandonments and work-rule changes could be effected with shippers and rail unions unable to use congressional leverage to block such measures.

Prevailing free-enterprise, antigovernment ideology favors the sale. As everyone knows, the government cannot continue to bail out failing private companies. Everyone also knows that rails are a marginal industry because the federal government has heavily subsidized alternate transportation modes while keeping a tight rein on rail rate increases. And featherbedding by rail craft unions is the major cause of the Eastern railroad bankruptcies.

The nodding of wise heads in consonance with the above press-fostered ideology should make any intelligent observer pause. Moreover, a little investigation would reveal the following realities:

- Almost uniformly throughout the nation, the rail companies have been reorganized into conglomerate corporate forms which re-establish the 19th-century trusts, functioning as overlapping corporate layers designed to draw off profits from the operating railroads and produce huge indirect federal subsidies to the conglomerate.
- The same banking houses, most notably the Harriman and Morgan interests, are the prime movers of this trust-building as they were a century ago when they were justly called "Robber Barons."
- The railroads continue to be highly profitable, largely due to the land granted them by the federal government, much of which they continue to hold contrary to the conditions of the congressionally mandated grant. The conglomerate form was created to separate the railroad from the land and derivative mineral profits, maintaining a rail loss to shelter profits accruing to the parent holding company.
- The purpose of trustification and cartelization of the rail system is to use transportation, together with banking, to absorb the profitability of the U.S. economy and thereby assume control over it.
- Rail labor productivity has risen 50 percent faster than manufacturing productivity in the postwar period. Railroads today run 55 percent more freight tonnage



Conrail maintenance has not kept pace with high freight ton-mileage.

than in 1950 with only one-third as many employees.

• Conrail, like its predecessor, was not meant to succeed. Its intentional sustained losses were designed to facilitate large-scale abandonments of industrial lines while forcing precedent-setting concessions from the rail workers.

Conrail is the paradigm of how the railroads are now being used. If Lewis and Blanchette seriously wish to sell the railroad, who would buy it? Its competitors, of course: the Norfolk & Western, the Chessie System, Missouri-Pacific, and Illinois Central Gulf, with various smaller companies like the Providence & Worcester, Detroit, Toledo & Ironton, or the Grand Trunk Western taking smaller chunks.

With the exception of Western railroads such as the Missouri-Pacific, virtually every one of Conrail's competitors is either a former subsidiary or controlled railroad of the former Pennsylvania or New York Central railroad. The subsidiaries were split off prior to the 1968 merger or prior to the creation of Conrail. In one case, a prospective buyer, the Providence & Worcester had been an inactive lease holder of the New Haven & Penn Central for nearly a hundred years before it resurfaced as a profit-making railroad.

After Conrail was effected, the previously created competition drained traffic heavily from the truncated and ruined Conrail lines. This drain was facilitated by the 1973 Regional Rail Reorganization Act, which allowed the competing lines trackage and terminal rights over Conrail facilities, giving the competitors through-lines that were formerly exclusively the Pennsylvania's or New York Central's. Further irrational abandonments of Penn Central trackage and poor service drove still more traffic to formerly owned or controlled competitors.

One of the present contenders for Conrail's choice lines is the Norfolk & Western, a former subsidiary of the Pennsylvania. This railroad was spun off on Interstate Commerce Commission (ICC) orders in 1968 as a condition for the Central and Pennsylvania merger. The ICC specifically stated that it ordered the spinoff to create competition with the new Penn Central.

In 1968 the N&W acquired the formerly Pennsylvania controlled Wabash and the formerly New York Central controlled Nickel Plate Road, and was forced by the ICC to take the Erie Lackawanna and Delaware & Hudson. The N&W thereby tripled its size, providing heavy competition to the Penn Central. In 1975 it dumped the bankrupt Erie Lackwanna onto Conrail.

On May 2, 1974 Federal Judge John P. Fullam ruled that the Penn Central, Reading Central of New Jersey, and Lehigh Valley (Erie Lackawanna joined the year after) could not be reorganized or find buyers for their lines. Yet these are the same lines that Lewis and Blanchette are trying to sell today. What happened in the intervening seven years?

• Conrail spent \$2.8 billion of federal monies upgrading the main lines, of which \$1.9 billion went for track and roadbed and \$900 million to repair and purchase cars and locomotives. This sum represents the deferred maintenance from the Penn Central. Now the federal government proposes to sell these assets back to Penn Central's former subsidiaries just months after it paid the Penn Central Company, the former railroad's holding company, $2.1 billion for the nearly worthless Penn Central railroad.

• The Staggers Rail Decontrol Act of 1980, written by Conrail and moved by Conrail's congressman, James Florio, a Camden, New Jersey Democrat, was rushed through Congress. It abolishes the ICC, permits much more rapid abandonment, and allows highly flexible rate-making, including contracts negotiated with individual shippers. This contract system was the way in which the Robber Barons made discriminatory rates, favoring some and ruining most others.

• Coal hauling has become highly profitable; the rail holding companies own great quantities of cool and demand is up due to the Kissinger oil war in 1973 and the Carter administration energy policies.

• The Penn Central Comany was successfully spun off from wreckage of the railroad with an $8 billion profit over the course of the bankruptcy. This massive profit was largely due to the existence of the Penn Central Company, the railroad's holding company. The PCC successfully shielded the railroad's real estate, pipelines, and other assets from the bankruptcy court, while subsequently using over $1.5 billion carry forward tax losses of the railroad to shelter income from these properties. The Penn Central Company is today a fast-growing "postindustrial" conglomerate with assets of over $2 billion.

By creating a holding company, the railroad can transfer assets to that company, which is a nominally capitalized shell, producing subsequent tax losses for the railroad. The losses can be used either to demand higher rail rates or, by using a consolidated tax return for the conglomerate, to shelter income from other profitable operations.

The railroad can also transfer its stock to the holding company, which can then declare large dividends on the stock, even if the railroad is listed as losing money, as the Penn Central did in 1968 and 1969. This transfers large amounts of cash to the holding company, making the railroad appear unprofitable, and generating tax losses.

An ultimate step, but not necessarily one taken, is for the holding company to ultimately rid itself of the railroad, using the accumulated carry-forward tax losses for the legally remaining seven years. This was the ploy of the Penn Central and the Chicago & Northwestern. The latter sold its line to its own employees, but kept the tax losses for itself to shelter income from highly profitable operations of Northwest Chemco, a subsidiary of Northwest Industries, the parent holding company.

The greatest irony in this operation is that it allows use of the very large assets of the railroad to create "postindustrial" conglomerates which ultimately destroys the basic industry upon which the railroad depends for revenues. The new conglomerate, like the Penn Central Company, may create or buy consumer products, energy, real estate, financial services, insurance, leasing, and communications companies, some of which can be used to engage in exorbitant equipment, communications, or other leasing contracts with the railroad.

Figure 1

Ton-miles, employment and retirees

Year	Freight ton-miles (in millions)	Employees (thousands)	Productivity index 1950=100 (ton-miles/employees)	Retirees and dependents (thousands)	Employee/ beneficiary ratio
1950	591,550	1,421	100	461	3.08
1960	575,360	909	152	883	1.03
1965	697,878	753	223	990	.76
1970	764,809	566	325	1,068	.53
1975	754,252	494	367	1,113	.44
1976	794,059	496	385	1,117	.44
1977	826,292	501	396	1,121	.45
1978	858,105	491	420	1,116	.44
1979	913,669	503	436	1,107	.45
1980	918,621	480	460	1,098	.44

Source: Association of American Railroads, *1980 Yearbook*, Railroad Retirement Board, *Statistical Review*, 1980.

Inevitably, railroads that lose large portions of their most valuable assets to their holding companies become supplicants for rate increases at the ICC. With deregulation, however, the shipper rather than the ICC must prove that the railroad is asking for unreasonably high rates. It is beyond the resources of virtually any shipper to demonstrate that the railroad was asset-stripped by its holding company, even if the shipper could obtain railroad records or if the court would entertain such arguments.

Illegal lands

The new conglomerate form of the railroads is heavily based on land and mineral rights holdings. Few people today realize that the railroads, which were granted a total of 9.3 percent of all land in the United States, including nearly 20 percent of Texas and nearly a third of Florida, still hold much of that land or its mineral rights.

For example the Union Pacific Railroad's subsidiary holdings, several million acres of land and mineral rights, were transferred to its holding company and listed at a book value of $372 million. The Union Pacific Corporation's vice-president for finance estimated the worth of these lands at $662 million or 78 percent higher than book value. A 1976 congressional commitee estimated the 1971 value of those lands and rights at $975 million, or 162 percent above "book value," and the present value of that land is estimated at about $3 billion.

The Union Pacific Corporation, a Harriman company, estimates that it presently owns or controls 2 billion tons of coal, 1.25 trillion cubic feet of natural gas, and several billion barrels of oil and gas equivalent in the Overthrust Belt. Income from these properties accrues to the holding company, not the railroad.

At the end of 1976, the Southern Pacific Company held 3.7 million acres with 1.5 million additional acres of mineral rights; the Burlington Northern, whose antecedent Nortern Pacific received 40 million acres in grants, still holds 2.4 million acres with mineral rights on an additional 5 million acres.

Since most land was granted on condition that the railroad build its planned routes and sell the land within three to five years at set prices—usually $1.25 to $2.50 an acre—much of this land is held illegally. Although historically the federal government has initiated reversion proceedings against numerous railroads, no substantial action has been taken since the last depression.

Strategic Bombing Survey

The Feb. 26, 1975 U.S. Railway Association Final Report that created Conrail contained a 400-page, mile-by-mile breakdown of light-density trackage. The report claimed that if stretches of several miles can be found where no revenue or less than profitable revenue is generated, the track in question should be abandoned. Few of these abandonments applied to spur lines, but rather to branch lines that interconnected with other lines and generated traffic for main lines.

The effect of taking out hundreds of small portions of branch lines was to reduce the traffic on main-line routes by driving branch-line shippers to other railroads, highway, or water transport.

A former Penn Central engineer recalled the abandonment of a line that shipped several trainloads of coal a week to Indianapolis Power & Light. The abandon of a short section of track made rail access to the power plant so circuitous and costly that the power company was forced to haul the coal by truck. "The way they abandoned track was like if you took out the track in Ohio and still expected to run trains from St. Louis to New York," he recalled.

The abandoned lines were recommended for "trails, outdoor use, snowmobile runs, bike paths, nature preserves for many prarie plants which otherwise are extinct, or power lines and roadways."

The cost-benefit analysis method used was that of the Prudential Insurance Company Strategic Bombing Survey of the World War II Office of Strategic Services. The OSS found that disruption of the industrial production of Germany and Japan was much more effectively accomplished by attacking transportation links than by bombing the factories and population centers. With complete air superiority by the end of the war, Allied bombers could map and destroy transportation links to bring industrial production to a halt.

In the realm of financial warfare between financial and producer forces, the financial faction similarly finds that it is more efficient to surround the producer with insurmountable problems like environmentalist regulations, high capital costs and inadequate or exorbitantly priced transportation than to attempt a direct buyout of producers. The financiers appropriate the producers' profits, ultimately dooming further production.

What about rail labor?

Conrail's March 15 Labor Report to Congress claims that approximately $200 million must be given back in wage and rules concessions by Conrail employees each year through 1985 if the railroad is to survive. Conrail suggests a "limited duration" 18-month wage freeze, abolition of one week of vacation and two holidays, elimination of craft distinctions, and use of remote controlled locomotives. Conrail further demands the right to fire 10,000 employees without the payments stipulated under Title V of the 1973 Rail Reorganization Act.

To enforce these demands, the report says, "Conrail must be permitted to take a strike of significant duration without government intervention . . . or the government must be prepared to intervene at an appropriate time to determine the components of a contribution package for any union which is unwilling to negotiate such a wage package."

Consider what Conrail has demanded: abolition of the Federal Railway Labor Act and Title V of the 3R Act, and the right to provoke a strike whose consequence—regardless of the labor outcome—is permanent loss of a portion of shippers, thereby guaranteeing the ultimate demise of Conrail itself. Thus Conrail is carrying out a policy of intentional failure, effecting desired abandonments and selloffs while also using the system as a vehicle to abolish work rules and seniority rights, and substantially reduce rail wages as a precedent for the entire rail industry

Featherbedding?

Conrail's assertion that the workers must sacrifice is ironic in light of its own management policies. Conrail's operating labor force has gone from 90,612 in 1976 to 72,596 in 1980, and Conrail's freight labor expenses as a percent of freight revenues have dropped from 66 percent to 56 percent. The rail unions granted Conrail very substantial work-rule changes in 1976. Engineers and firemen negotiated the elimination of firemen on 90 percent of all runs; brakemen were phased out of many through runs; and seniority, crew-sharing, and deadhead time were heavily revised in the railroad's favor.

Despite Conrail's demand that Title V be abrogated, Conrail has fired engineers, incurring the Title V costs, while at the same time it has opened a training school for new engineers to replace the laid-off men.

While the number of road employees has decreased substantially, Conrail's management employment has increased from 6,997 in 1976 to 8,455 in 1979. As a result, freight tonnage per executive fell from 141,000 in 1976 to 117,000 in 1979. Many of the new executives were recent business-school graduates who, with only weeks of training, began replacing veteran dispatchers and yardmasters. Many new management men were then recycled into the Department of Transportation, Federal Emergency Management Agency, and other federal crisis-management groups assembled during the Carter administration.

Two-thirds of the nation's rail labor force has vanished since 1950. Yet with only one-third the number of rail workers in 1980, railroads are hauling 55 percent more ton-miles than they were in 1950. If labor productivity per ton-mile is indexed at 100 for 1950, productivity

Figure 2
Who contributes to railroad pensions

Year	Employer, employee and investment (millions of dollars)	Social Security and Treasury (millions of dollars)	Federal contribution
1950	$ 376	$ 0	0%
1951	378	95[1]	12.2%
1960	722	318	31.0%
1965	799	459	36.4%
1970	1,243	589	32.2%
1975	1,763[3]	1,010	36.4%
1976	1,798	1,489[2]	45.3%
1977	2,016	1,458	41.9%
1978	2,066	1,869	47.5%
1979	2,477	1,790	41.9%
1980	2,736	1,743	38.9%

Source: Railroad Retirement Board, *Statistical Review, 1980.*

Notes: 1. Legislation introduced by Senator Paul Douglas (D-Ill.) mandated the Social Security fund to pay the Retirement Fund the amount that railroad workers would have received if they had Social Security, resulting in payments of nearly $1.5 billion by 1980. This is the only private pension system in the nation to which the federal government contributes.

2. Under a formula worked out in collective bargaining the railroads agreed to contribute an extra 9.5% if the workers agreed to substantially lessen wage demands. However, the entire amount of the railroad pension contribution was granted back to the railroads in a dollar for dollar rate increase, resulting in substantial wage and tax savings for the railroads.

3. Beginning in this year, legislation was passed to mandate the Treasury to pay a flat sum yearly to maintain the financial solvency of the Railroad Retirement Fund. It began at $250 million yearly and will continue at $313 million yearly until 2000.

in 1980 is 460. The increase in rail productivity is approximately 50 percent greater than for manufacturing in general.

Remarkably, rail productivity continues to increase while national manufacturing productivity has stagnated since 1976. Between 1975 and 1980 rail productivity went from 367 to 460 (see Figure 1).

The railroad pensions

Rail companies are the only private companies whose pensions are subsidized by the federal government. By 1950 the railroads could foresee the effects of technological improvement, reorganization and abandonments on the size of its workforce and its consequences for the Railroad Retirement Fund. In 1951, Sen. Paul Douglas (D-Ill), passed legislation to swap payments with the Social Security fund; the railroads pay for each employed worker and the Social Security fund pays for each pension beneficiary.

With the drop in the ratio of employed rail worker to beneficiary from 3.01 in 1950 to 0.44 in 1980, the railroads have a bonanza from the Social Security funds now running nearly one and a half billion yearly (see Figure 2).

Yet by the mid-seventies, the fund was depleted and Congress accepted a further direct subsidy to the Retirement Fund of $250 million (later $315 million a year until 2000). It also allowed the railroads to receive a dollar-for-dollar rate increase on their 9.5 percent increase in Retirement Fund contributions. However, the railroads had already negotiated a wage-pension tradeoff with the unions in 1975 that resulted in the railroads receiving double compensation for their contributions.

The federal contribution has stabilized at $1.7 billion yearly, or about 40 percent of the payment, but congress will soon be asked for further subsidies. What would Congress say if the Teamsters asked it to pay 40 percent of its pensions?

Who is behind the railroads?

Standard history books draw colorful pictures of the Robber Barons whose watered stock, land sales, and exorbitant, discriminatory freight rates brought them huge windfalls until they were tamed by public outcry and government action.

The two leading families who were together said to control more than half the trackage in the United States were the Morgans and the Harrimans. It is precisely these two interests who today are most responsible for creating the new rail trusts—the conglomerates—and who pushed through deregulation of all transportation to return them to the bounteous days before the establishment of the ICC.

Conrail is a paradigm of Morgan-Harriman control. The former Pennsylvania Railroad was a Morgan-controlled road through Morgan director James M. Syms, chairman of the Pennsylvania Railroad's executive committee and also a director of the Wabash Railroad which went to the N&W and the Detroit, Toledo & Ironton, a Conrail prospecive purchaser.

Another Morgan-Pennsylvania director was John T. Dorrance, chairman of the Campbell Soup Company of Camden, New Jersey. Paul Gorman, president of the Penn Central after the merger, is also on Campbell's board and that of the Prudential Life Insurance Company which ran the 1944 Strategic Bombing Survey.

The New York Central was a Harriman-Morgan company controlled through the Perkins family which connected Chase Manhattan bank, the Morgan banks, and their own First National City Bank, now known as Citicorp, the bank's holding company. These people flow into the Penn Central board after the 1968 merger.

The agencies that subsequently planned the reorganization of the Penn Central into Conrail were also Morgan-Harriman controlled, as is Conrail today. The U.S. Railway Association was run by Samuel P. Payne, former president of Morgan Stanley and Company. Conrail is run through director Joseph W. Barr, former head of American Security and Trust, a company on whose board sits R. L. Ireland III, the ubiquitous guardian of Harriman interests, particularly after the death of Roland Harriman.

Conrail's new chairman, L. Stanley Crane, was formerly of the Southern Railroad, another Harriman company, on whose board sits R. L. Ireland III. Reciprocally, Crane sits on the board of American Security.

In this context, some additional light is cast on advocacy of the Conrail sale from Transportation Secretary Lewis and Federal Railroad Administrator Blanchett: Lewis was a former trustee of the bankrupt Reading Railroad, which followed a holding company route into Conrail identical to the Penn Central's.

Blanchette was the general counsel who shaped the New Haven bankruptcy and merger with the Penn Central, for which he then became general counsel. After the bankruptcy, Blanchette become chairman of trustees of the Penn Central and its chief executive officer. When Conrail absorbed the rail properties, Blanchette moved to the holding company, Penn Central Company, to manage its miraculous emergence from bankruptcy. As Blanchette's official biography indicates, "he has more than a decade of first-hand knowledge of railroad affairs."

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