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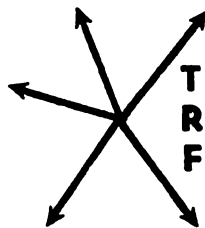
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TRANSPORTATION RESEARCH FORUM

Public Ownership of Rail Rights of Way, Public Financing, Private Sector Operations, and the Public Interest

by J. David Stein*

AN APPROPRIATE public policy towards the transportation industry as a whole remains an apparently elusive goal, though the first steps towards its formulation can be seen in former Secretary Coleman's "Statement of National Transportation Policy"¹ issued in September 1975, and updated in part in the extensive document issued in the waning days of the Coleman administration at DOT under the title "National Transportation: Trends and Choices."² Neither of these documents received the full public discussion due the subject material, though in part this might be attributed to Secretary Coleman's own perceptions of the issue, which ran counter to much of the conventional wisdom in the transportation field and also in the increasing level of hostility against Secretary Coleman created by the negotiations leading to the Rail Revitalization and Regulatory Reform Act of 1975 and his continued criticism of AMTRAK. Certainly, the result was to have the issue left for future development and resolution, with Congress taking a major role in establishing the National Transportation Policy Study Commission under the 1976 Federal Aid Highway Act.³

Although the National Commission is now gearing up to begin its work, with its report due in December 1978, and a new administration has come into office showing a decidedly more activist intent, little can be said to have changed over the past few years in terms of actually creating a policy which successive Administrations and Congresses can use for guidance in transportation programs.

Many studies have been carried out or are in process at this time within DOT, mandated by the "4R Act," which begin to deal with parts of this complex problem from the perspective of the needs of one industry, the railroads. It is with this aspect of the problem that this paper will attempt to raise certain specific issues and provide what is hoped to be a solution to one of the more glaring problems of railroading in the last quarter of the 20th century America.

*Transportation Director, New England Regional Commission.

COMPETITION, CAPITAL REQUIREMENTS AND RAILROAD MAINTENANCE

Most analysts seem to agree that one of the major difficulties which has faced the rail industry since the end of World War II has been the growth of the highway system under various federal programs, most notably the Interstate Highway Program established under the Federal Aid Highway Act of 1956.⁴ The growth of a vast network of highways financed through tax levies, albeit on users, has enabled the growth of the modern trucking industry to its present proportions. Trucking, given the flexibility of the system, and the growing dispersion of industry throughout the nation, has grown from relatively modest 6.5% (measured in ton-miles) of the national total in 1945 to about 21.3% in 1975.⁵ The rails, on the other hand, have seen their share drop from 67.2% to 36.8% in the same period.⁶ These figures, measured in ton-miles, however, disguise a major factor in what might otherwise appear to be the creation of a "balanced system" out of a near monopoly. Measured in revenue, the figures give an entirely different perspective. The same study shows that between 1968 and 1974, trucking revenues rose from \$16.9 billion to \$48.8 billion, an increase of 187.5%, while rail revenues rose from \$8.9 billion to \$16.9 billion, an increase of only 89.1%.⁷ The conclusion is that trucking has not only gained its share of ton-miles, but has succeeded in proving superior in moving the commodities which pay better rates (manufactured goods), while leaving the rails with the heavy or the bulk items like grain and coal which do not earn equivalently on a per ton-mile basis. Thus, the rails, to move more than one and a half times the freight, had to do so on a third of the revenue in 1974/5. This clearly speaks well for the efficiency of rail as a bulk carrier (and as a long-haul carrier), but also indicates the tremendous disparity in earnings. When tracing the problems of maintenance of rail lines, this figure becomes central to the understanding of the reasons for "deferred maintenance," particularly in the East, as will be examined later. A sim-

ilar question arises in analyzing the relative performance of rail and waterway traffic, but as this is confined to a relatively smaller spectrum of commodities and moves, it will not be examined here.

The cause of this change in relative earning capacity between the trucking and rail industries has had many factors, not all quantifiable, but each contributing. As mentioned above, the construction of the highway system, particularly beginning with the interstate system in 1956, has been a major cause. Another major contributor has been the collection of housing programs which developed since World War II (VA, FHA, etc.) which made it increasingly possible for families on modest incomes to acquire suburban single family homes. The shift of population away from the more concentrated urban core areas to low density suburbs was also accompanied by a shift in the locations of jobs. New industrial plants began to favor suburban locations with convenient highway access and low land costs, and were actively wooed by suburban municipalities anxious to lessen the tax burden on families who needed the schools and services which could be paid for by industrial taxes. Other factors were the tax provisions in the federal and state income tax which provided for accelerated depreciation for much new construction, making it increasingly profitable to build on new sites rather than to maintain older properties. Finally, among the major factors to be identified were state and municipal property tax policies which made farming on the urban fringes more and more unprofitable through taxation based on "highest and best use" rather than on actual use, and which therefore precipitated a rapid turnover of land from farming to housing and industry as the cities and towns expanded almost leapfrog beyond their 19th century boundaries.

All of the factors cited above have contributed, if not caused the decentralization of manufacturing. Trucks are ideal for making deliveries and picking up the products from such locations, able to operate more flexibly both in terms of scheduling and for handling the specific types of commodities received and produced. In fact, many industrial parks and factory complexes built since World War II did not even bother to provide rail access — it was not necessary for production, and the availability of a large number of competing truck lines kept the rates within reason, thereby obviating the need for rails entirely.

If the policies of government have made such great changes in the ability of the rails to compete successfully

against other modes, the rails too have been a cause. Seeing that the new product mix that was being manufactured in the nation was increasingly susceptible to movement by truck, due either to its fragility or to the high costs of inventory, the rails have withdrawn from these markets and have increasingly concentrated on the bulk markets where their advantage was clearer and the competition less. This concentration has led to the development of larger and heavier cars for moving greater quantities of goods, bigger locomotives for moving more of the larger cars, longer trains, and even the unit train concept. Each of these was seen at the time as a great step towards making the best of the inherent efficiencies of rail in moving large volumes over long distances at low cost. These rail-borne products, however, are also the so-called "low rated" commodities — (the transportation charges per ton-mile tend to be much lower than for industrial products), and hence, despite the great volumes (with attendant damage to track and equipment), the share of rail earnings has dropped considerably, as shown above. This whole set of changes in rail earnings and operations has led to a growing cost squeeze on railroads as they attempted to maintain their profitability. While there is considerable variation among the carriers with regard to the success they have had in keeping up their profits, all, without exception, have found the need to tighten their budgets to meet their needs from available revenues. This has resulted not only in salutary improvements, such as better scheduling of work, both in operations and maintenance, better control of costs, and a clearer view of the actual needs of the carriers, but also, and less fortunately, to reductions below reasonable levels on many necessary items, most notably, track and equipment maintenance. Not all carriers have been placed in this position, but most have begun, to some degree, to defer maintenance, and for many carriers, the effect of continued deferral was catastrophic. Not only did the deferral fail to prevent bankruptcies, but worse, it increased costs of operation through slower trains, more accidents, and higher costs to replace damaged track and equipment on inefficient "spot maintenance" programs rather than through the "normal" cycled maintenance needed to keep up the track structure.

The costs of deferred maintenance are extremely difficult to pin down. Many estimates have been made, but the definitions vary depending on the purpose of the estimate, and hence there is no good figure. Deferred maintenance can

be best defined as the difference between "normalized maintenance levels" and the work actually done, but the savings made from this calculation are not equal to the costs actually bringing the track back up to the level which would have been achieved through normalized maintenance, due to the acceleration of damage through prolonged neglect and the differing engineering practices between maintenance and rehabilitation. Further, there is the awkward question of "deferred capital improvements" i.e. new construction, which would have taken place given the needed resources, and which would have changed the maintenance needs to some degree with the changes in plant. Nonetheless, certain estimates can be used for purposes of assessing the general level of need, and as a guide to the types of funding requirements which will fall on the railroads as they attempt to return to normal levels of maintenance and improvements. One of the best known figures is the so-called "X-305" list, developed by the carriers for the Interstate Commerce Commission in response to the requirements of Ex Parte 305, a rate adjustment case which required the carriers to set aside the increased earnings from this adjustment for the purpose of maintenance only. While many waivers have been in fact granted from this requirement, and it has largely failed to achieve its stated goal, the estimates show a figure of \$2.4 billion for deferred maintenance, and \$2.1 billion⁸ for deferred capital improvements on track and structures. Other estimates, from various sources put the figures in the range of \$5 to \$20 billion nationwide. These are very large figures when compared with the current revenues of railroads, now standing at \$17-18 billion per year, of which only about 15% is available for maintenance and construction. However, they should also be seen in the context of federal and state transportation expenditures on highways, which amounted to some \$25 billion in 1973.⁹ Thus, the total of all deferred maintenance and capital improvements, which would amount to a multi-year program, are in the same order of magnitude as the annual public investment in highways, streets and roads. Normalized maintenance needed to maintain a rehabilitated and modernized system is estimated at about \$3.6 billion,¹⁰ compared with an annual current expenditure rate of some \$2.4 billion.¹¹ Certainly, the deficit as measured this way is not large compared to either federal (\$5-6 billion) or state (\$17-18 billion) annual outlays for highway construction and maintenance.

Yet, it is clear from recent history,

that this deficit is still there, and is perhaps still growing, despite the tremendous revitalization program now being undertaken on the former bankrupts serving the East and Midwest. National policy still fails to deal with the causes of the deficit in a manner which will assure that it is eliminated. The reorganization acts of 1973 and 1975, which set the planning and implementation of the "Conrail" reorganization still viewed the problem as one of management, and the final program as implemented was based on the assumption that ultimately private railroading could be profitable, and the underlying causes of the decline were not severe enough to require rethinking the role of the railroads and their methods of financing.

THE 3R ACT AND THE 4R ACT

The basic premise of these acts (the Regional Rail Reorganization Act of 1973 and the Rail Revitalization and Regulatory Reform Act of 1975, P.L. 93-236, P.L. 94-210) is that, with limited exceptions, railroading is inherently profitable in the US, and that good management, selective mergers, and loans were the solution to the problems that had led to the bankruptcies of the Penn Central, the Erie Lackawanna, the Boston and Maine, the Central of New Jersey, the Reading, the Ann Arbor, the Lehigh and Hudson River, and the Lehigh Valley railroads in the early 1970's, and later that of the Rock Island. Certainly, there is much to be said for operational improvements, and reduction of unneeded services. Yet the basic philosophy was that of restructuring the company, pruning the "light density lines" out of the system, and lending the funds needed to rehabilitate the track and equipment. The United States Railway Association (USRA), established to plan for the merger, produced two major reports, the Preliminary System Plan,¹² and the Final System Plan,¹³ which elaborated in great detail the causes of the bankruptcies, including those outlined above, and then proceeded to project viable operations resulting from restructuring operations, elimination of light density lines, and management improvements. It is ironic that this was much the program proposed by Penn Central in 1973, and which calculated that the savings from branch-line reduction were in the order of \$15-20 million per year out of total losses of over \$200 million per year, or about 10% of the total losses. None of the causes noted above — subsidized trucking competition, sprawl, taxation policies, etc., were addressed by the plan or its enabling legislation. Only the

variable of management received any real attention.

It is much too early to predict the ultimate outcome of this reorganization, nor of the success of the financial programs which were established for non-bankrupt carriers under the 4R Act. Certainly the early results of Conrail are encouraging, showing better levels of deficit reduction than had been predicted by USRA. However, it is also possible to attribute this to a new level of enthusiasm brought about by budgets which matched needs for the first time in many years, new management, and the fear that failure would be the prelude to outright nationalization of the Conrail system. While some may argue that nationalization has already occurred effectively, that charter of Conrail is clearly that of a for-profit private enterprise carrier, and its success will be measured in its ability to repay the \$2.1 billion in loans from USRA. This is not expected until the early part of the 21st Century¹⁴ and it would be impossible to predict on the basis of figures covering less than a full year of operations. Yet the failure to treat with the economic causes of the decline of the bankrupts merged into Conrail certainly makes it difficult to feel that success is assured. Many planners will privately concede that they are pessimistic about Conrail's long term viability under the present conditions, and many would argue that the loans would never be repaid, thus leaving the carrier essentially in the ownership of the U.S. Government.¹⁵

PUBLIC OWNERSHIP OF RIGHTS OF WAY

The concept of public ownership is not new. While most other nations have completely nationalized their rail systems, the U.S. remains one of the few examples of private enterprise railroading. Unfortunately, this does not seem to have been an effective approach, at least for many carriers in recent years, and much thought has gone into preparing alternative solutions. The railroads were nationalized in the U.S. during World War I, and returned to private ownership afterwards. A number of states and municipalities have acquired rail lines, mostly for passenger service, though freight is also carried on many of these. The Alaska Railroad is owned by the U.S. government, which is also the operator. Several states, most notably Vermont, have acquired railroad lines which are then leased to private operators. The Cincinnati, New Orleans and Texas Pacific Railway is owned by the City of Cincinnati and leased to the Southern Railroad.

One of the first serious proposals to place all rights-of-way in public ownership was made by William Grotz, former president of the Western Maryland, in the early 1950's, and again in the late 1960's. With the bankruptcy of the Penn Central, numerous bills were introduced into Congress for either partial or total public assumption of ownership of the rights-of-way by Senators McGovern, Humphrey, Weicker, and others, all premised on the need for a national rail network of mainlines serving major population and industrial centers. A similar bill was filed in the House of Representatives by then Congressman Brock Adams. None of these bills achieved much serious consideration at the time from the rail industry. Nor was the proposal to place the facilities of Conrail in public ownership much more successful.¹⁶ The so-called "Con-Fac" (Consolidated Facilities Corporation) proposed by USRA as an alternative strategy was quickly discarded as being both uneconomic and against administration policy. Its economic liabilities included the requirement to be a for profit corporation, which would have required lease payments at least as great as normal maintenance and rehabilitation costs.

"Con-Fac" did however receive some attention in the industry and from some of the states directly concerned with the planning process which was in the process of determining the best structure for Conrail. The Union Pacific Railroad made a major analysis of "Con-Fac,"¹⁷ and concluded that it was unworkable due to interference in private operations, unclear jurisdiction over train movements and maintenance, coordination of maintenance workers employed by the federal government with operations of private companies, etc., etc. The administration, particularly DOT Secretary William Coleman, strongly opposed "Con-Fac." It was never developed further, nor was it ever really considered as an alternative.

THE NEW ENGLAND PROPOSAL

In early 1974, the six New England states, acting through the New England Regional Commission, began a major planning study to determine the extent of rail service necessary for the economic health of their region. This effort quickly became dominated by the simultaneous need to follow and react to USRA's developing proposal for Conrail. New England found that it had to deal with two separate classes of bankrupt carriers, the Penn Central, destined for merger into Conrail, and the Boston and Maine, which had elected to attempt a

more traditional reorganization under Section 77 of the Bankruptcy Act. Other carriers in the region, though still profitable, were showing symptoms of declining earnings, particularly maintenance deferral, and, as noted above, Vermont had already had to acquire the major lines serving that state, the Vermont Railroad and the St. Johnsbury and Lamoille County Railroad.

The analysis developed for the Commission and the states showed that traffic projections did not warrant an optimistic view of the long term prospects of profitability, and that in fact, traffic would grow only slowly if at all on most lines.¹⁸ Further, it was shown that the economic health of the region, despite the rather bleak future for railroading as a whole, was highly dependent on the existence of railroad service. Fully 24% of all jobs in the entire six-state area were shown to be dependent on rail service to some degree for their existence,¹⁹ of which almost half (11.0% of total regional employment)²⁰ was directly dependent, and the other half (13.1%) was induced or indirectly dependent on rail service. Termination of all rail service was estimated to eliminate 6.7% of all the regions' jobs.²¹ This figure, developed at the time when New England was already in a serious recession, if not actual depression, with unemployment already over 10% in all states, was felt to indicate a situation that would be totally unacceptable to the states, and contingency plans were requested by the Commission to keep rail service going should a shut down occur. (Penn Central was at the time losing about \$1 million per day, financed through grants from USRA under the section 211 program for service continuation, and it was apparent that Congress was becoming less and less willing to make available such large sums without guarantees that they would do more than simply prevent service cessation.)

Using the experience of Vermont as a guide, and following on the idea of ConFac as developed by USRA in the Preliminary System Plan, the New England group began to develop a new model for public ownership to be applied nationally. The reasoning was that, with the recent bankruptcy of the Rock Island, it was clear that the problem of deferred maintenance had extended well beyond the original 17-state Conrail region, and that other carriers, particularly in the Midwest, would require a program not greatly different from that appropriate to the New England carriers and Conrail. After some preliminary analysis, and the preparation of an outline of the elements of such a plan, the Commission authorized the

development of legislation to be submitted to Congress. This legislation was to accomplish the following objectives:

1. Public acquisition of rail rights-of-way and other fixed facilities.
2. Public maintenance of the rights-of-way and rehabilitation of presently deteriorated facilities.
3. Leases to operating carriers to provide service over present routes with user charges.
4. Establishment of a trust fund to finance rehabilitation and ongoing maintenance.
5. An energy tax credit for use of fuel efficient modes.
6. A program to increase productivity of rail labor.
7. Reform of the process of regulation of the transportation industry to increase flexibility in competition and service.

The Resolution called for the establishment of a National Rail Transportation Policy, and was adopted by a vote of 6-1.²²

Working together, the members of the Rail Study Group (consisting of representatives of the six states, the Commission staff and consultants) developed the bill during the spring months of 1975, and submitted it to the Commission for approval on July 24, 1975. It was endorsed by a vote of 5-0 with one abstention by the State Members, and was then transmitted to the New England Congressional and Senatorial delegations for introduction. It was introduced in the Senate on October 2, 1975 as S.2459, and in the House as H.R. 10077 on October 10, 1975, with virtually the entire New England Delegation sponsoring the bill in each house. Hearings were held in October 1975 by the Senate Commerce Committee, Subcommittee on Surface Transportation, as part of the review of what was to become the 4R Act.²³

While the New England proposal was not reported out as a bill, it did spur Congress to require, under Section 901 of the 4R Act a review by DOT of alternative strategies for providing federal funding to the nation's railroads, including a full review of public ownership of rights-of-way. This review is still ongoing at the time of writing.

THE RAIL REHABILITATION ACT OF 1975 (S. 2459, H.R. 10077)

The program proposed by the New England bill is extremely simple in concept, though it attacked directly many of the traditional assumptions about the role of the public in resolving the rail crisis.

First of all, the bill acknowledged explicitly the need for federal subsidy of the rail industry to overcome years of neglect and deferred maintenance. It was felt that this was the best means of achieving the balance in public support for all modes, and made it clear that it was in the public interest to provide such subsidies to all modes as a means of enhancing the economic health of the nation and all its carriers. Second, the bill spoke directly to the need for long term commitments for funding rail maintenance on an ongoing basis, not only to repair the damage done by competition from trucking on public highways, but to turn around the fortunes of the carriers and to make them profitable and therefore able to go to the private market for capital for improvements to their operating equipment, modernization of operations, and equipment replacement. The bill, in simple outline, contained the following provisions:

1. Railroads would be offered the option of donating their fixed plant (right of way, transportation related structures, signal systems, etc.) in return for public assumption of financial support for maintenance and rehabilitation with long term leases (continually extended) to those properties turned over to the public.
2. The public would provide, through tax monies, the funds to purchase all the materials needed for maintenance, while the railroads would be responsible for hiring and managing the maintenance and construction forces from their own resources. Existing labor contracts would remain in force, and new ones would be negotiated as at present.
3. A national planning program would be initiated which would define the level of service and maintenance required on each line, which standards would reflect the national needs as defined by the DOT, the states, localities, shippers and the carriers. Emphasis would be placed on inclusion rather than abandonment.
4. Carriers would be allowed to join at any time after enactment. The planning process would begin immediately, but would not be a precondition to accepting lines. Lines not included would be returned to the carrier for disposal. Carriers would be required, however, to turn over all properties simultaneously, rather than to simply donate those lines which showed the least viability.
5. Once standards had been set (though they were subject to periodic revision), it would be the legal

responsibility of the railroads to maintain all lines to the standards set, or to their existing condition if lower than the standard. Failure to do so would subject the carrier to a penalty equal to the cost of rehabilitation to standard, to be imposed at the time the carrier joined the program.

6. Coordination, merger, consolidation and other joint use programs would be encouraged. Facilitation would come through the ability to buy and sell leases, rather than having to sell properties subject to bonded mortgages, and user charges would contain an incentive for joint use.
7. Carriers would be assessed a small, non-compensatory user fee. This fee would be readjusted (uniformly, nationwide) as the program succeeded in its objectives of rehabilitation and the carriers paid off their debt on the properties donated. A goal of 6-8% return on investment (after payment for bond retirement) was set as the basis for the level of the user charge.

It is the contention of the framers of the program that it avoids all the problems enunciated in conjunction with previous proposals (the best list of these is found in the Union Pacific publication cited above),²⁴ and that it in fact achieved its objectives at a minimum cost to the public, and the carriers, and with the least amount of confusion or difficulty. A short list of the strengths of the program includes the following:

- It is voluntary. Funds would be expended for improvements, and would not go to paying off bondholders, who would be taken care of by the carriers.
- It is comprehensive. All lines would be included (with limited and specified exceptions), and any line not included could be picked up by a state or other public agency.
- Railroads maintain control. They would continue to employ the maintenance workers, and would maintain full control over both operations and maintenance work, thereby eliminating problems of coordination and safety.
- It establishes standards. The planning process would establish standards for maintenance, and the railroads would be bound by their leases to adhere to the standards or face penalties.
- There is no direct subsidy. Labor remains the responsibility of the carriers, and there is no loss in incentive to keep costs under control.
- There is no pretense. Public funds are invested only in public properties. The subsidy is open and equitable, and comparable with other modes.

— Carriers are protected. The terms of the lease would protect the carrier from intrusions, and would guarantee long-term stability. It would also help rationalize the system.

— Deferral of maintenance would be halted. Properties acquired would be maintained, and those of carriers not in the system would be required to be kept to standards, or a penalty would be assessed.

— Bondholders would not be hurt. The lease would provide adequate compensation to the bondholders, but would not pay them off out of the public funds.

As may be seen, other than the emotional issue of private ownership of the rights-of-way, the entire program leaves a maximum of control in the hands of the carriers with safeguards provided to the public only as necessary to protect its investment in the properties acquired. This would result in not only a more healthy industry, but would have the added advantage of making best use of existing investments in highly valuable transportation facilities and operations, operations which are becoming increasingly valuable as the U.S. moves towards a serious program of conservation of fuel resources, attempting at the same time to preserve and improve the quality of life for all citizens.

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