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THE COST OF EXCESS RAIL-LINE CAPACITY: IMPLICATIONS FOR THE GREAT PLAINS

The railroad network in the United States is truly a product of the "horse and buggy" era, with branch lines extending into virtually every community in the nation. The principal lines were all completed by 1890, and, while total mileage continued to increase until 1916, the rate of growth slowed perceptibly during the quarter-century prior to World War I.¹ Since 1916, rail line has declined from slightly over 250,000 miles to slightly under 200,000 miles at present.² Despite the revolution in domestic transportation wrought by the automobile and the airplane, railroad mileage today is approximately the same as it was in 1900.

The 20 percent decline in railroad mileage seems modest indeed when compared to the 60 percent decline in real investment in rail facilities and the 70 percent decline in employment in the last 60 years.³ The declining investment per mile of line has taken its toll in the form of progressively deteriorating rights of way. At the present time a significant fraction of rail line is under "slow orders" as a result of its poor condition.⁴

EXCESS RAIL CAPACITY AND ITS COST

As might be expected, the advent of intermodal competition (provided by trucks, buses, private automobiles, and airplanes) had far different effects upon rail lines operating over direct routes between major population centers and those short, stub-end lines serving small communities in lightly populated areas. The disparities are great, indeed. The most heavily utilized 20 percent of existing route miles account for 67 percent of all freight traffic. On the other hand, 33 percent of the least utilized mileage generates only 1 percent of the traffic. Thus, traffic on the more heavily utilized one-fifth of the rail network is more than 100 times as great as on the least utilized one-third.⁵

Of all the sources of waste and inefficiency which beset the railroad industry, including poor freight car utilization, inflexible

rates, outmoded work rules, and excess line capacity, the last named is certainly the most costly. Thus, Keeler has estimated that, with optimal traffic density on U.S. rail lines, the existing volume of traffic could be accomplished with 40,000 to 50,000 miles of line, one-fourth to one-fifth the present mileage.⁶

On the basis of 1969 traffic levels rail mileage and prices, Keeler estimated the "welfare" loss (increased costs to railroads plus the net loss to consumers from rail rates in excess of long-run marginal costs) at up to \$3.5 billion per year.⁷ This represents more than 30 percent of railroad operating expenses, fixed charges, and an implicit return of 8 percent on stockholders' equity for 1969.⁸

No doubt the foregoing estimate constitutes an upper limit, and demand would justify, that is, cover the cost of, the continued operation of some lines at sub-optimum density even though they incurred more than minimum achievable costs in the process.⁹ As a consequence, while the Keeler estimate may involve more than a little upward bias, abandonment of much existing line would assuredly produce savings of a significant magnitude.

SUBSIDIZATION OF EXCESS RAIL-LINE CAPACITY

Sixty years ago, when railroads transported more than 80 percent of the nation's freight, they were able to engage in numerous money-losing activities through a process of internal subsidization. The primary form of such subsidization was "value of service" pricing in which high-value goods, being less sensitive to transport costs than low-value goods, were charged relatively higher rates than bulky, low-value goods.

In the ensuing decades, truck competition undermined the historic system of value of service pricing. High-value goods were the ones most easily diverted to highway carriers because the greater reliability, faster delivery, and smaller shipment sizes which characterized truck transport were far more important to shippers of high-value than low-value goods.

While truck competition tended to reduce the extent of internal subsidization in railroad rate

(Continued on page 2)

¹ U.S. Bureau of the Census, *Historical Statistics of the United States* (Washington, D.C.: 1960), p. 429.

² *Yearbook of Railroad Facts, 1978 Edition* (Washington, D.C.: Association of American Railroads, 1978), p. 46.

³ *Historical Statistics of the United States*, pp. 117, 433, and 437; *Yearbook of Railroad Facts, 1978 Edition*, pp. 55 and 58; and U.S. Department of Commerce, *Statistical Abstract of the United States, 1977* (Washington, D.C.: 1977), p. 472.

⁴ U.S. Department of Transportation, *A Prospectus for Change in the Freight Railroad Industry* (Washington, D.C.: October, 1978), p. 25.

⁵ U.S. Department of Transportation, *Preliminary Standards, Classification, and Designation of Lines of Class I Railroads in the United States*, Vol. I (Washington, D.C.: August 3, 1976), p. 6.

⁶ Theodore E. Keeler, *On the Economic Impact of Freight Regulation* (St. Louis: Center for the Study of American Business, Washington University, November, 1976), p. 24.

⁷ *Ibid.*, p. 23.

⁸ *Statistics of Railroads of Class I in the United States, Years 1967 to 1977* (Washington, D.C.: Association of American Railroads, September, 1978), pp. 1 and 2.

⁹ Theodore E. Keeler, "Railroad Costs, Returns to Scale, and Excess Capacity," *Review of Economics and Statistics* (May, 1974), p. 21.

(Continued from page 1) structures, it by no means eliminated it. As recent as two decades ago, carload rail traffic subsidized less-than-carload-lot (LCL) traffic, freight traffic subsidized passenger traffic, and main lines subsidized branch lines. Ultimately, railroads withdrew from the transport of LCL freight, and, when annual deficits from passenger operations exceeded \$200 million per year in the late 1960s, Congress passed the Rail Passenger Service Act of 1970 to relieve railroads of this particular millstone.

There remains, today, the largest and most serious source of railroad inefficiency and waste, excess line capacity. At the same time, railroad investors, the last source of any substantial internal subsidization, have been exploited to the virtual limit. With rates of return below 4 percent in each and every year since 1955¹⁰ and with current rates of return between 1 and 2 percent, investors have been withdrawing private capital from the industry, leaving it to the taxpayers to forestall such extensive deterioration of the railroad plant as to invite the termination of much rail transport in the United States.

In the interests of all who are concerned with the vitality of the railroad industry—shippers, receivers, employees, investors, and the public at large—it is time to take a close look at national policy vis-a-vis rail-line abandonment. Such careful scrutiny is certainly long overdue.

NATIONAL RAIL-LINE ABANDONMENT POLICY

Ever since the passage of the Transportation Act of 1920, the Interstate Commerce Commission (ICC) has exercised the authority to approve or disapprove rail-line abandonment. Thus, railroads lack the freedom which other businesses enjoy to modify or terminate particular activities on their own initiative. As long as railroads enjoyed a dominant, almost exclusive, position in domestic transportation, such a "duty of service" obligation was not without its merits. Unfortunately, however, the greatly altered competitive circumstances in recent years did not lead Congress to modify very quickly its historic policy.

While the Railroad Revitalization and Regulatory Reform Act of 1976 outlined more precisely the procedures to be followed by the ICC in abandonment proceedings, shipper and community protests can still render the process so cumbersome, time consuming, and costly and the outcome so uncertain as to retard unduly the reduction of excess capacity in the rail system.¹¹ The proposed Railroad Deregulation Act of 1979 would greatly facilitate abandonment by prohibiting the ICC from denying a request where the revenues generated by the line were insufficient to cover the costs of rendering service on the line, including a reasonable return on carrier investment. It seems unlikely that any less forthright and unequivocal directive will compel the ICC to agree very readily to the abandonment of any substantial portion of existing excess rail-line capacity.

EFFECT OF RAIL-LINE ABANDONMENT ON SHIPPERS

It might appear that a shipper located on a line potentially subject to abandonment is being asked to acquiesce to the loss of the line for the benefit of shippers on the remaining lines. That is not the case. A shipper located on a line destined for abandon-

ment should consider not merely the additional cost which he may incur in a longer initial truck haul but also the potential reduction in rail rates which he may enjoy from that point to final destination. After all, it is total transport cost to the final destination which determines net returns to the seller and not just the cost of the initial portion of that trip.

It was just this issue which was investigated in several studies in Iowa and Nebraska. Specifically, research efforts in both states were aimed at discovering the effect of alternate grain storage and transportation systems on the net revenues of shippers, elevator operators, and carriers. The Iowa study of six and one-half counties in the Fort Dodge area concluded that the grain distribution system yielding the greatest net revenue to the area, that is, gross revenue from the sale of grain minus all relevant transportation and storage costs, would require the abandonment of 73 percent of the existing rail lines and the operation of 115-car unit trains between six subterminals and Gulf ports.¹² Of the eleven alternatives considered in the Iowa study, the one yielding the lowest net revenue was the "traditional single-car system operating on 100 percent of the 1971 rail-line system."¹³ The best alternative would have generated over nine million dollars per year, or the equivalent of 7.8 cents per bushel, more than the single-car system operating over all existing lines.¹⁴ A more recent study of 71 branch lines located throughout the state revealed that the abandonment of 63 of these lines and the upgrading of the remaining eight, together with the institution of 85-car unit trains to Gulf ports, would confer a net gain of \$42 million on the system as a whole.¹⁵

A study of the potential impact of branch-line abandonment in six contiguous southcentral Nebraska counties yielded results similar to the Iowa research. Three alternatives were considered: (1) maintain all existing lines, (2) upgrade all lines to the extent necessary to accommodate covered hopper cars in multicar shipments, and (3) abandon 25 percent of the existing lines and improve the quality of the remaining lines sufficiently to support unit-train operations.¹⁶ The branch-line abandonment option with the transportation of a substantial percentage of grain in unit-train lots from seven subterminals was calculated as yielding \$668,000 more annually than the traditional single-car system and \$1.2 million more than upgrading all existing lines.¹⁷

¹²C. Phillip Baumel, Thomas P. Drinka, Dennis R. Lifferth, and John J. Miller, *An Economic Analysis of Alternative Grain Handling Systems* (Springfield, Virginia: National Technical Information Service, November, 1973), p. 118. The maintenance of 27 percent of the 1971 rail lines was the smallest network considered in the study.

¹³*Ibid.*, p. 119.

¹⁴*Ibid.*, p. 123.

¹⁵C. Phillip Baumel, John J. Miller, and Thomas P. Drinka, *An Economic Analysis of Upgrading Rail Branch Lines: A Study of 71 Lines in Iowa, Executive Summary* (Washington, D.C.: U.S. Department of Transportation, March, 1976), p. 13.

¹⁶Dale G. Anderson, Floyd D. Gaibler, and Mary Berglund, *Economic Impact on Railroad Branch-Line Abandonments: Results of a Southcentral Nebraska Case Study* (Lincoln: Agricultural Experiment Station, University of Nebraska-Lincoln, September, 1976), pp. 9-10.

¹⁷*Ibid.*, p. 19.

¹⁰*Yearbook of Railroad Facts*, various years.

¹¹*A Prospectus for Change*, pp. 127-128.

A supplementary study of fertilizer distribution in the same six-county Nebraska area endeavored to determine whether the introduction of a major import into the analysis would modify the conclusions in any way. The addition of fertilizer transportation merely tended to strengthen the case for abandonment of the low-density lines by increasing the net gain from abandonment over continuation of the present rail system or upgrading all branch lines to accommodate multicar shipments.¹⁸

While grain growers might gain from lower rail costs and rates, how about grain elevators located on abandoned rail lines? The Iowa study concluded that the unit-train-six-subterminal solution would not lead to the disappearance of any existing grain elevator and that the typical country elevator facing loss of a railroad would experience less than a 1 percent diminution in its level of earnings.¹⁹ The Nebraska study, again, reached similar conclusions. While elevators on abandoned lines would be by-passed, other than during harvest season, in favor of direct farm to subterminal shipments, all would continue to operate, at least in the short run, albeit at somewhat lower annual volumes.²⁰ An Illinois study which compared the growth rates of elevators which had lost rail service with those that had not found that, even though elevators on abandoned lines might not grow as rapidly, they nonetheless continued to increase their volume of grain receipts and their capital investment.²¹ A comparison of Minnesota elevators which lost rail service between 1969 and 1975 with those that had not found that storage capacity of the non-rail elevators increased by a larger percentage than the capacity of the elevators which continued to enjoy rail service.²² Finally, while a Missouri study suggested that some of the elevators on abandoned lines would become redundant from a combination of abandonment and unit-train operations, the adverse effect on such elevators appeared to be as much or more a function of reduced multicar rates to subterminals as to higher costs of trucking grain.²³

DISTRIBUTION OF THE GAINS OF RAIL NETWORK RATIONALIZATION

While studies of rail-line abandonment tend to conclude that the benefits of reduced rail capacity exceed the costs, they are

¹⁸Mary Berglund and Dale G. Anderson, "Impact of Branch-Line Abandonment on Costs and Structure of Fertilizer Distribution," *Proceedings*, Eighth Annual Meeting, Transportation Research Forum (Oxford, Indiana: Richard B. Cross, 1977), pp. 465-466.

¹⁹Baumel et al., *Alternative Grain Handling Systems*, pp. 121-242.

²⁰Anderson et al., p. 24.

²¹A. R. Bunker and L. D. Hill, "Impact of Rail Abandonment on Agricultural Production and Associated Grain Marketing and Fertilizer Supply Firms," *Illinois Agricultural Economics*, January, 1975, pp. 17-18.

²²H. Barry Spraggins, "Rationalization of Rail Line Abandonment Policy in the Midwest under the Railroad Revitalization and Regulatory Reform Act of 1976," *Transportation Journal*, Fall, 1978, p. 13.

²³Daniel Salomone, David E. Mosher, and Joseph C. Headley, *Economic Impact of Alternate Grain Transportation Systems: A Northwest Missouri Case Study* (Columbia, Missouri: unpublished manuscript, Agricultural Experiment Station, University of Missouri, Columbia, December, 1976), pp. 63-64.

frequently silent on the distribution of the gains.²⁴ In view of the low rates of return which have characterized the railroad industry for a number of decades, it would be reasonable to conclude that the long-run financial viability of the railroad industry would require the capture of a portion of the benefits by the railroads themselves. Nevertheless, if only one-fifth of the \$3.5 billion of potential savings from railroad rationalization had been added to net railway operating income in 1969, they would have achieved a rate of return unequaled since 1929.

The same Railroad Deregulation Act of 1979 which would greatly facilitate rail-line abandonment also contains a provision which would eliminate all maximum rate regulation after a five-year period. Is it not possible that in the absence of such limitations, the railroads would be able to divert to themselves the great bulk of the savings from line-capacity reductions? Such a possibility should certainly be recognized. The very substantial economies of large-scale operation, the high ratio of fixed to variable costs, the fixed route structure, the limited number of railroads operating between all origin-destination pairs, the very high barriers to the entry of new railroads, and the long history of inter-railroad collusion in rate making all militate against effective competition among the railroads. While the intermodal competition of highway carriers tends to be effective for some commodities and some hauls, it is likely to be inadequate for low-value goods moving substantial distances, the precise circumstances confronting the bulk of agricultural exports from the Great Plains.

On the other hand, it would be a grave error to perpetuate the kind of maximum rate regulation which the ICC has historically imposed on the railroad industry. An inflexible system of rate regulation requiring publication and lengthy advance notice of rate changes and paying scant heed to inter-locational imbalances in traffic has added to the waste and inefficiency of rail transport. As a consequence, the only kind of maximum rate regulation that recommends itself is regulation which limits rail discrimination against shippers for whom intermodal competition is inadequate. While antidiscrimination provisions have been a part of the Interstate Commerce Act since 1887 and while the proposed Railroad Deregulation Act of 1979 continues such a provision, the requirement that the shippers compete with one another renders it useless as a protection for shippers of low-value goods moving substantial distances. Until this oversight is corrected there is inadequate assurance that agricultural shippers in the Great Plains states will be important beneficiaries of railroad rationalization.

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²⁴An exception is Linwood A. Hoffman, Steve C. Bermingham, and Lowell D. Hill, "The Impact of Unit Trains on Corn Price Relationships at Country Elevators: Two Case Studies," *Illinois Agricultural Economics*, July, 1976, pp. 12-13.

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Review and Outlook

Real output in Nebraska increased in May, with the physical volume index for the state recording a gain of 1.5 percent. The April-to-May increase was the third consecutive month-to-month increase in the index and produced an index value which was 46.7 percent above the 1967 base-period level. On a May-to-May basis, the index is up 3.6 percent above the previous year level.

The May increase in economic activity was broadly based, with five of the six major sectors recording gains. For the second consecutive month, agriculture led all sectors with a substantial 9.3 percent increase. Higher prices for grains and livestock during May of 1979 were largely responsible for the index increase.

The nonagriculture sector of the economy showed a more

modest 0.4 percent increase above the previous month's level. Construction recorded a 0.5 percent increase; manufacturing showed a decline of 0.4 percent, the only sector to decline; distributive trade recorded a 0.6 percent increase; and the government sector recorded a similar 0.6 percent increase in May over April levels.

The Nebraska economy has improved for three consecutive months, March through May, but still remains below its peak recorded in December of 1978. The current economic expansion is now in its fifth year for both the Nebraska economy and the U.S. economy. Available national data support the contention that the level of economic activity has peaked and is now turning down. Within recent days, announcements (Continued on page 5)

Notes for Tables 1 and 2: (1) The "distributive" indicator represents a composite of wholesale and retail trade; transportation, communication and utilities; finance, insurance, and real estate; and selected services. (2) The "physical volume" indicator and its components represent the dollar volume indicator and its components adjusted for price changes using appropriate price indexes—see Table 5, page 5.

ECONOMIC INDICATORS: NEBRASKA AND UNITED STATES

| 1. CHANGE FROM PREVIOUS YEAR | | | | |
|------------------------------|--|-------|---|-------|
| May, 1979 | Current Month as Percent of Same Month Previous Year | | 1979 Year to Date as Percent of 1978 Year to Date | |
| | Nebraska | U.S. | Nebraska | U.S. |
| Indicator | Nebraska | U.S. | Nebraska | U.S. |
| Dollar Volume | 115.4 | 112.3 | 113.5 | 113.6 |
| Agricultural | 140.3 | 118.5 | 123.7 | 126.4 |
| Nonagricultural | 111.8 | 112.1 | 112.0 | 113.2 |
| Construction | 102.6 | 108.4 | 103.2 | 114.7 |
| Manufacturing | 117.5 | 116.8 | 118.5 | 117.3 |
| Distributive | 112.3 | 111.0 | 112.4 | 112.3 |
| Government | 104.5 | 107.6 | 103.5 | 107.5 |
| Physical Volume | 103.6 | 101.5 | 101.6 | 103.0 |
| Agricultural | 119.1 | 103.6 | 98.2 | 104.5 |
| Nonagricultural | 101.5 | 101.4 | 102.1 | 102.9 |
| Construction | 90.1 | 95.2 | 90.4 | 100.5 |
| Manufacturing | 106.1 | 105.3 | 107.0 | 106.3 |
| Distributive | 101.4 | 100.3 | 102.0 | 102.0 |
| Government | 99.3 | 100.3 | 99.5 | 100.6 |

| 2. CHANGE FROM 1967 | | |
|---------------------|-------------------------|-------|
| Indicator | Percent of 1967 Average | |
| | Nebraska | U.S. |
| Dollar Volume | 324.6 | 296.0 |
| Agricultural | 333.2 | 309.9 |
| Nonagricultural | 323.0 | 295.5 |
| Construction | 336.8 | 276.1 |
| Manufacturing | 362.3 | 292.6 |
| Distributive | 318.5 | 303.1 |
| Government | 280.8 | 278.0 |
| Physical Volume | 146.7 | 136.2 |
| Agricultural | 136.0 | 129.7 |
| Nonagricultural | 148.6 | 136.4 |
| Construction | 128.1 | 105.0 |
| Manufacturing | 159.4 | 130.3 |
| Distributive | 148.8 | 141.6 |
| Government | 139.9 | 141.3 |

3. NET TAXABLE RETAIL SALES OF NEBRASKA REGIONS AND CITIES (Adjusted for Price Changes)

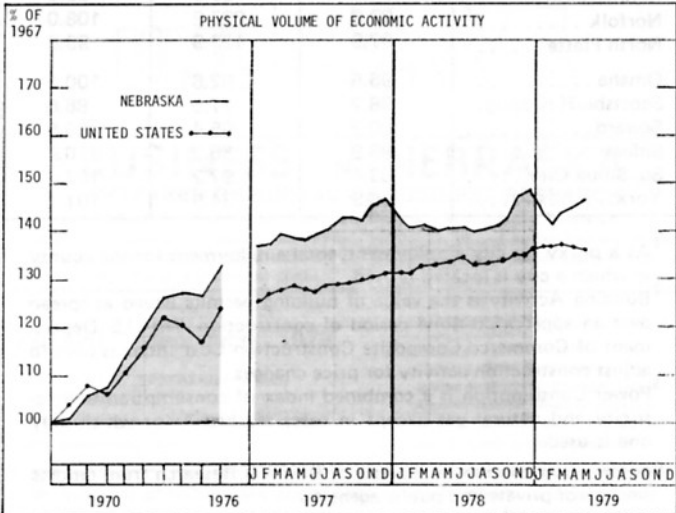
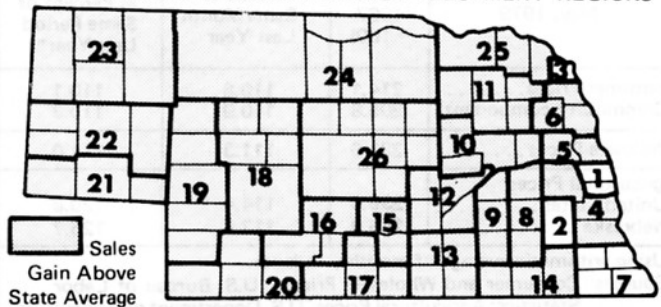
| Region Number ¹ and City | City Sales ² | Sales in Region ² | |
|-------------------------------------|-----------------------------------|-----------------------------------|---|
| | May, 1979 as percent of May, 1978 | May, 1979 as percent of May, 1978 | Year to date '79 as percent of Year to date '78 |
| <i>The State</i> | 104.3 | 103.5 | 103.1 |
| 1 Omaha | 105.3 | 102.7 | 97.8 |
| Bellevue | 94.4 | | |
| 2 Lincoln | 106.6 | 104.8 | 103.1 |
| 3 So. Sioux City | 99.3 | 98.1 | 97.0 |
| 4 Nebraska City | 93.3 | 100.5 | 107.5 |
| 5 Fremont | 99.2 | 99.5 | 105.5 |
| Blair | 115.7 | | |
| 6 West Point | 105.4 | 107.8 | 110.5 |
| 7 Falls City | 107.0 | 100.8 | 102.5 |
| 8 Seward | 103.7 | 105.7 | 103.7 |
| 9 York | 104.0 | 110.0 | 112.9 |
| 10 Columbus | 108.2 | 106.7 | 109.6 |
| 11 Norfolk | 108.1 | 106.1 | 107.6 |
| 12 Grand Island | 104.0 | 101.7 | 109.8 |
| 13 Hastings | 97.0 | 98.2 | 103.4 |
| 14 Beatrice | 114.7 | 108.3 | 107.9 |
| Fairbury | 98.6 | | |
| 15 Kearney | 104.6 | 104.8 | 108.3 |
| 16 Lexington | 111.2 | 107.6 | 111.4 |
| 17 Holdrege | 108.1 | 107.6 | 111.2 |
| 18 North Platte | 109.7 | 107.8 | 109.4 |
| 19 Ogallala | 115.2 | 108.7 | 108.6 |
| 20 McCook | 103.8 | 102.2 | 107.1 |
| 21 Sidney | 98.4 | 101.9 | 105.3 |
| Kimball | 103.4 | | |
| 22 Scottsbluff /Gering | 115.9 | 112.8 | 108.0 |
| 23 Alliance | 108.2 | 104.4 | 106.6 |
| Chadron | 108.6 | | |
| 24 O'Neill | 104.0 | 104.8 | 116.9 |
| 25 Hartington | 109.1 | 104.1 | 107.3 |
| 26 Broken Bow | 115.3 | 102.3 | 112.7 |

¹ See region map below.

² Sales on which sales taxes are collected by retailers located in the state. Region totals include motor vehicle sales; city totals exclude motor vehicle sales.

Compiled from data provided by Nebraska Department of Revenue.

1979 YEAR TO DATE AS PERCENT OF 1978 YEAR TO DATE IN NEBRASKA'S PLANNING AND DEVELOPMENT REGIONS



(Continued from page 4) indicating a buildup of manufacturers' inventories, a decrease in shipments of major appliances, lagging new car sales, and other negative economic news seem to support the belief that the U.S. economy has entered into a recession. The Bureau's physical volume index for the United States (see chart, page 4) seems to confirm the fact that the U.S. economy has reached a plateau.

While the national economy presents a picture of considerable weakness, the Nebraska economy continues to make solid gains. Total retail sales rebounded in May after a brief dip in April, 1979. Total retail sales in the state, before adjustments for price changes, were up 14.2 percent in May, 1979, compared with year-earlier levels. Retail sales were up 23 percent on a dollar volume basis since January, 1979, an indication of the economic well-being of the state.

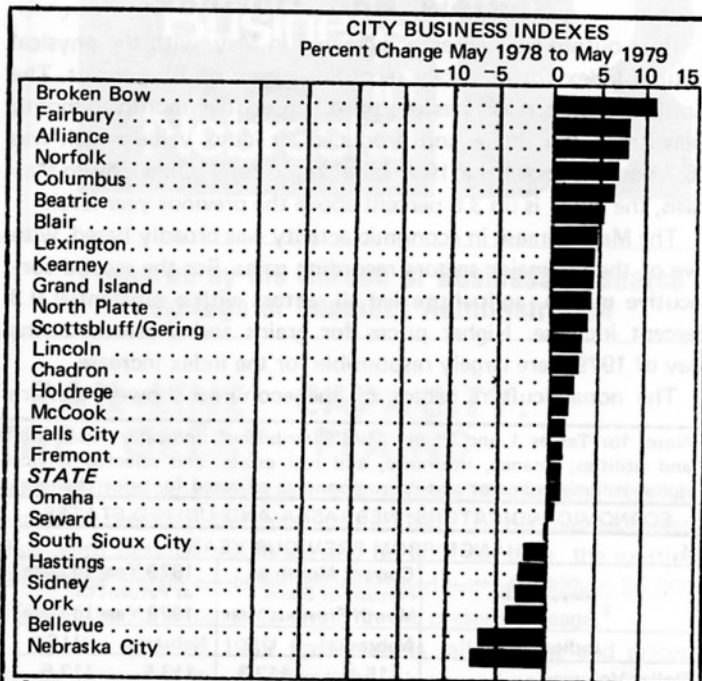
Motor vehicle sales in the state declined in May from April's level, but were still ahead of the May, 1978, level by nearly 9 percent on a dollar volume basis. Despite fuel problems, motor vehicle sales are up on a year-to-date basis over their 1978 level.

After adjustments for price increases, May, 1979, total retail sales were 3.5 percent above May, 1978. On a May-to-May basis, twenty-three of the state's twenty-six planning and development regions recorded a real increase in retail sales. Sixteen of the regions recorded increases in excess of the state average.

The cumulative total for the first five months of 1979, compared with a similar year-earlier period, indicates a real retail sales gain of 3.1 percent. Twenty-three of the state's twenty-six planning and development regions recorded an increase in real retail sales equal to or in excess of the state average on the year-to-date basis. Real retail sales in the metropolitan Omaha area continue to lag the state average. For the first five months of 1979, compared with the same period in 1978, real retail sales in the metropolitan Omaha area are below the 1978 level. Increases of 10 percent or more in real retail sales during the first five months of 1979 compared with the year-earlier period were recorded in the following regions (listed with their major trading centers): Region 6, West Point; Region 9, York; Region 16, Lexington; Region 17, Holdrege; Region 24, O'Neill; and Region 26, Broken Bow.

The strong increase recorded in the state's economy in May was reflected in the city business indices as nineteen of the twenty-six reporting cities registered gains in May, 1979, relative to a year previous. The strong retail sales picture across the state was responsible for much of this increase. Broken Bow posted the largest gain in economic activity, with an increase of 11.5 percent over the year-earlier level. Other communities with year-to-year increases in excess of 5 percent included Fairbury, Alliance, Norfolk, Columbus, and Beatrice.

D. E. P.



Source: Table 3 (page 4) and Table 4 below.

4. MAY CITY BUSINESS INDICATORS

| The State and Its Trading Centers | Percent of Same Month a Year Ago | | |
|-----------------------------------|----------------------------------|--------------------------------|--------------------------------|
| | Employment ¹ | Building Activity ² | Power Consumption ³ |
| <i>The State</i> | 100.6 | 87.3 | 99.2 |
| Alliance | 130.7 | 17.2 | 98.5 |
| Beatrice | 101.3 | 68.8 | 103.0 |
| Bellevue | 96.5 | 48.2 | 102.9* |
| Blair | 97.1 | 95.3 | 100.2 |
| Broken Bow | 101.7 | 161.2 | 126.1 |
| Chadron | 94.9 | 149.5 | 94.9 |
| Columbus | 101.0 | 167.9 | 102.8 |
| Fairbury | 102.0 | 566.2 | 101.7* |
| Falls City | 97.1 | 81.2 | 106.4 |
| Fremont | 104.9 | 83.2 | 104.5* |
| Grand Island | 106.0 | 92.3 | 106.1 |
| Hastings | 104.7 | 46.3 | NA |
| Holdrege | 97.9 | 171.0 | 73.6 |
| Kearney | 108.2 | 92.1 | 96.9 |
| Lexington | 98.6 | 123.2 | 96.9 |
| Lincoln | 100.9 | 105.9 | 97.2 |
| McCook | 98.3 | 172.6 | 85.9 |
| Nebraska City | 97.4 | 50.9 | 92.0 |
| Norfolk | 97.8 | 227.2 | 108.0 |
| North Platte | 97.9 | 123.9 | 99.8 |
| Omaha | 96.5 | 92.6 | 100.3 |
| Scottsbluff/Gering .. | 98.2 | 77.5 | 86.6 |
| Seward | 100.2 | 95.4 | 85.5 |
| Sidney | 96.9 | 56.2 | 110.9 |
| So. Sioux City | 93.4 | 97.2 | 107.4 |
| York | 96.3 | 34.5 | 101.1 |

¹ As a proxy for city employment, total employment for the county in which a city is located is used.

² Building Activity is the value of building permits issued as spread over an appropriate time period of construction. The U.S. Department of Commerce Composite Construction Cost Index is used to adjust construction activity for price changes.

³ Power Consumption is a combined index of consumption of electricity and natural gas except in cases marked * for which only one is used.

Source: Compilation by Bureau of Business Research from reports of private and public agencies.

5. PRICE INDEXES

| May, 1979 | Index (1967 = 100) | Percent of Same Month Last Year | Year to Date as Percent of Same Period Last Year* |
|---------------------------|--------------------|---------------------------------|---|
| Consumer Prices | 214.1 | 110.8 | 110.1 |
| Commodity component | 205.8 | 110.9 | 110.3 |
| Wholesale Prices | 231.6 | 111.3 | 111.0 |
| Agricultural Prices | | | |
| United States | 239.0 | 114.4 | 120.8 |
| Nebraska | 245.0 | 117.8 | 125.7 |

*Using arithmetic average of monthly indexes.
Sources: Consumer and Wholesale Prices: U.S. Bureau of Labor Statistics; Agricultural Prices: U.S. Department of Agriculture.

THE DEVELOPING RECESSION

There is little doubt that the United States is now in a recession. Entry into the recession will probably be dated as occurring during the second quarter of 1979, and it is an open question as to how long and severe it will be. Events during the first and second quarters of 1979 and especially since April have pushed the economy to stagnation and now decline.

Inflation and especially the sharp rise in the price of petroleum is acting like a tax increase, taking purchasing power from consumers and reducing real consumption levels. Consumers have less real income to spend on goods and services as a result of inflation and the lagging rate of increase in personal income. Consequently, they will be unable to maintain purchases of real goods and services at a level equivalent to 1978. Shipments of major appliances are off over 10 percent and reflect consumer sentiment and the declining real income. This recession seems to have developed because of exceptionally sharp price increases.

Moving out of the recession may prove difficult. Inflating the economy by increasing government spending and/or tax relief, traditional anti-recession tools, is unlikely to end the recession and is more likely to contribute toward inflation.

The current recession seems an opportune time to consider some major structural reforms which will prevent its recurrence. Consideration might be given to a major tax cut along the lines proposed by the Kemp-Roth plan. Less regulation of certain industries, transportation for instance, may reduce the rate of inflation by reducing prices or slowing the rate of increase.

Reducing the rate of inflation might be achieved by stimulating

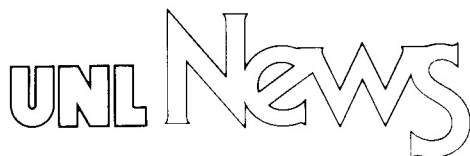
capital formation. Consideration could be given to some form of tax exemption from interest earned from individual savings accounts. Historically, a savings account has been an almost certain way of losing purchasing power as inflation eats away at capital. Consumers have become increasingly skeptical of holding liquid assets and have attempted to convert these assets into goods and commodities with a chance of appreciating in price. This only contributes to inflation as people scramble for control of resources. Some form of exemption for savings accounts from taxation may be a desirable means to stimulate capital formation and reduce the rate of inflation as well.

Nebraska may escape the recession with only minor dislocations. Personal income during the first quarter of 1979 declined by less than \$200 million to \$12.027 billion from \$12.203 billion, fourth quarter, 1978 (see Table 1). This decline in personal income reflects a decrease in farm income well below the first quarter of 1979 and a sharp increase in personal income in the second quarter is anticipated. Wage and salary disbursements continue to increase quarter after quarter and no industry shows a decline in income other than agriculture. The recession could lower the rate of increase in personal income and may adversely impact wage and salary increases in Nebraska, but if grain and livestock prices hold, the recession should be mild in the state. The effects of the recession in Nebraska will be manifested in higher unemployment rates, intolerably high inflation rates, and high interest rates. In other words, stagflation.

D. E. P.

| Table 1 | | | | | |
|--|---------------|---------------|---------------|---------------|---------------|
| NEBRASKA PERSONAL INCOME | | | | | |
| SELECTED QUARTERS 1977, 1978, 1979 | | | | | |
| (billions of dollars) | | | | | |
| | <u>1977:1</u> | <u>1977:4</u> | <u>1978:1</u> | <u>1978:4</u> | <u>1979:1</u> |
| Personal Income | 9.982 | 11.026 | 11.048 | 12.203 | 12.027 |
| Percentage Increase (1st Quarter to 1st Quarter) | | | +10.7% | | +10.5% |

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