

The Penn Central Railroad Bailout Plan and Federal Reserve System, 1969-1970: Focusing on Loan Guarantees under the Defense Production Act

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The Penn Central Railroad was established in 1968 after the merger of the Pennsylvania Railroad and the New York Central Railroad. In June 1970, however, the company filed for re-organisation, which at that time was the largest corporate failure in U.S. history. The mainline railroads were subject to enduring regulation and protection by the Interstate Commerce Commission. Considering a request for aid from Penn Central, the Nixon administration launched a bailout programme under the Defense Production Act, which was passed during the Korean War. Nonetheless, it faced opposition from Congress and was unsuccessful in securing a loan guarantee from the Federal Reserve Bank. Some have argued that Penn Central's rescue was a precursor to 'too big to fail' or 'systemic risk' policies. This paper verifies these assertions by re-evaluating the events that led to the Penn Central Railroad bailout programme. First, the railroad's 'bankruptcy' was made possible by a unique historical context. Second, the Federal Reserve not only indirectly rescued operating companies by providing commercial bank loans to avoid a commercial paper market collapse but also considered the use of direct loans as fail-safe. Thus, the Penn Central Railroad bailout was a failure. Nevertheless, it was the catalyst for subsequent discussions of the bailouts of Lockheed (1971), Chrysler (1979), and even Continental Illinois Bank (1984).