



DEREGULATION OF RAILROADS

By Ted Volskay

BACKGROUND

In 1870, a practice referred to as “pooling” occurred on a large scale among competing railroads as a means to enforce rate and fare agreements. Competing railroads agreed to the division of rail traffic and receipts at stipulated ratios. Arrangements for the division of rail traffic and receipts were referred to as “traffic pools” and “money pools,” respectively. By the late 1880s, strong public opposition to pooling and other monopolistic practices by industry led to passage of the Interstate Commerce Act of 1887.¹ Section 5 of the Interstate Commerce Act states:

That it shall be unlawful for any common carrier subject to the provisions of this act to enter into any contract, agreement, or combination with any other common carrier or carriers for the pooling of freight of different and competing railroads, or to divide between them the aggregate or net proceeds of the earnings of such railroads or any portion thereof...

In addition, the Act required that railroad rates be "reasonable and just" and that railroads publicize shipping rates, prohibited short/long haul fare discrimination, and created the Interstate Commerce Commission to hear complaints against the railroads and enforced laws against unfair practices.

By the 1920s, railroads faced significant financial challenges that could be attributed to federal regulations. Regulations at that time required railroads to service low density, unprofitable lines and to set minimum rates.² Transport of high volume products on major routes was effectively subsidizing unprofitable transport of low volume products on less traveled routes. Consequently, regulatory mandates, forcing railroads into inflexible rate structures and to maintain excess rail capacity, prevented firms from responding to external disturbances such as a recession, a change in interest rates, or large and unanticipated changes in prices.³ In addition, regulatory inflexibility rendered the rail industry vulnerable to competitors, including barge transport and the developing truck freight industry.

Direct and indirect consequences of regulations at that time resulted in railroad companies having little incentive to invest in innovative technologies to improve operational efficiency. For example, large railroad companies would benefit from the use of cars with significantly higher hauling capacities. To offset the increased cost of specialized freight cars, the railroad would need to lower rates for the intended customer to induce a higher volume of rail traffic. However, the Interstate Commerce Commission usually opposed the new rate, presumably to protect smaller rail carriers that could not or would not invest in the new and more expensive high-capacity rail cars.⁴

The cost of union labor also contributed to the financial stress on railroads. An unintended consequence of regulations during this period was the strengthening rail industry labor unions. Industries, like the railroad industry, were dominated by a few large companies, and regulations limited the entry of potential railroad competitors. This benefitted railroad labor unions because the unit cost (per worker) to organize employees was low, and the bargaining power of labor is leveraged when a large proportion of an industry workforce is unionized. In addition, union labor benefitted from regulations that allowed rail carriers to pass wage increases to the consumer.⁵

Labor unions also contributed to railroad industry inefficiencies. Railroad unions negotiated work rules that defined appropriate crew sizes, which typically included a conductor, two or more brakemen and, sometimes, a fireman. Labor inefficiencies occurred when rail carriers made the conversion from steam-powered to diesel-powered locomotives. That change required fewer crew members, but railroads were bound by union work rules to maintain the crew size. Similarly, the union and the rail industry agreed that the “work day” would be based upon mileage covered. Investments in improvements to increase train speed did not result in the anticipated profit potential for the rail industry because faster trains allowed union employees to work multiple shifts. This increased earnings without markedly increasing the number of hours worked each week.⁶

Privatization Case Study: Deregulation of Rail Freight Operations

Governmental Level: Federal

Primary Privatization Mechanism: Deregulation

Almost a century of regulating the railroad industry produced shipping rates that were incapable of responding to market changes, such as the emergence of the interstate highway system during the Eisenhower administration and growing competition from the trucking industry. Passage of the Railroad Revitalization and Regulatory Reform Act in 1976 and the Staggers Rail Act in 1980 provided the flexibility to allow rail pricing to respond to the marketplace, abandon unprofitable routes, and consolidate operations.⁷ More importantly, deregulation has put the U.S. rail freight industry on a more secure financial footing.

Since deregulation, rail carriers have been given the latitude to negotiate rates.⁸ Railroads are now able to negotiate rates directly with shippers, and the rail companies can tailor their capacity and services to the customer’s production and inventory policies.⁹ In addition, railroads are now able to abandon unprofitable routes and consolidate their operations.¹⁰ One result of this has been a substantial increase in the number of smaller low-cost, non-union, railroads that bought less profitable railroad tracks from the larger railroads. Surprisingly, the actual competition generated by the market has become more intense compared to level of competition prior to deregulation.¹¹

Deregulation of the rail industry also allowed the railroads to adopt labor-saving information technologies, which made it possible to automate traffic control such as signaling, car management, dispatching and tracking.¹² Use of labor-saving technologies led to the elimination of the caboose (last car on a freight train that had a kitchen and sleeping facilities for crew members) and associated crew members.¹³ This resulted in an overall decline in the railroad workforce of approximately 52 percent from 1973 (pre-deregulation) to 1996. Despite the loss of

railroad jobs and the introduction of smaller, nonunionized railroad companies, overall union membership in the rail industry workforce declined by only 9 percent, and the adjusted weekly earnings of rail workers remained about the same over the same 23-year period.¹⁴

External shocks to the economy, such as a change in interest rates, or fluctuations in the price of petroleum as well as deregulation of the trucking industry, have prompted the deregulated rail freight industry to improve customer service and operational efficiency, and rely heavily on innovation. The expanded use of intermodal operations, double stack rail cars, and computerized systems to track trains and manage railroad capacity has led to lower costs for shippers and higher profitability for rail interests.¹⁵

Things to Consider

- Although there was competition among railroads, the rail freight business was a virtual monopoly in certain parts of the United States prior to passage of the Interstate Commerce Act in 1887.
- Prior to passage of the Interstate Commerce Act in 1887, barge traffic along major river routes provided the only meaningful competition for bulk transport of freight outside the rail industry.
- Development of bulk transport by truck since the 1930s has provided more competition in the freight transport industry.
- The Interstate Commerce Commission initially was tasked with the authority to regulate railroads and was given the authority to regulate the trucking industry in 1935 following passage of the Motor Carrier Act.
- Competition between the rail and trucking industries became more significant after passage of the Federal-Aid Highway Act in 1956 and development of the interstate highway system by the Eisenhower administration.
- Rail and truck freight transport industries were both “deregulated” by 1980. However, passenger rail traffic is dominated by Amtrak, a government owned corporation.
- Railroad unions have remained relatively strong compared to the trucking and airline industries since they were deregulated. This is attributed to the oligopolistic nature of the rail freight business.¹⁶

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Produced by the Privatization of Government Services, Assets and Functions Study, 2011

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ENDNOTES

¹ Emory R. Johnson and Thurman W. Van Metre (1918). "[Chapter XVIII. Pools and Traffic Associations](#)". *Principles of Railroad Transportation*. New York: D. Appleton. pp. 292-307. Not available online

² James Peoples. "Deregulation and the Labor Market," *Journal of Economic Perspectives*, Volume 12, Number 3, pp. 111-130, (summer) 1998. Journal access limited to American Economic Assoc. members

³ Clifford Winston (1998). "U.S. Industry Adjustment to Economic Deregulation," *Journal of Economic Perspectives*, Volume 12, Number 3, pp. 89-110, (summer) 1998. Journal access limited to American Economic Assoc. members

⁴ Clifford Winston (2005). "The Success of the Staggers Rail Act of 1980," AEI-Brookings Joint Center for Regulatory Studies, Related Publication 05-24, October 2005.
http://www.brookings.edu/~media/Files/rc/papers/2005/10_railact_winston/10_railact_winston.pdf

⁵ See endnote 2.

⁶ See endnote 2.

⁷ See endnote 2. William W. Wilson, Wesley W. Wilson, and Won W. Koo. "Modal Competition in Grain Transport," *Journal of Transportation Economics and Policy*, September 1988. <http://www.jstor.org/pss/20052857>

⁸ See endnote 2.

⁹ See endnote 3.

¹⁰ See endnote 2.

¹¹ See endnote 3.

¹² See endnote 2.

¹³ See endnote 4.

¹⁴ See endnote 2.

¹⁵ See endnote 4.

¹⁶ See endnote 2.