Maury Klein

Competition and Regulation: The Railroad Model

In the following essay on the railroad industry, Maury Klein examines preconceptions and misunderstandings surrounding Americans' views of regulation and competition. He argues that the United States seems to want competition without losers and that, at least in the case of railroads, regulation has often tried to ensure this outcome without a real understanding of the economics of the industry.

Competition has survived in American culture by assuming as many forms and shapes as two centuries of theorists and practitioners could devise. Probably no concept except democracy has been more extolled or less understood by Americans than competition. For all that has been said about the subject, it remains a stranger in a strange land, a mutant whose meaning is still, like beauty, in the eye of the beholder.

The railroad offers valuable insights into the nature of competition and its alter ego, regulation, because it was the formative industry that shaped the American conception of both. We know the story of the rail experience by heart, so often has it been told, yet there are still gaps, even mysteries, that render our overall grasp unsatisfactory. Why is it, for example, that so few interpretative histories have been written about so well-trod a subject? Why is there no definitive general history of American railroads?[1]

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[1] Given the voluminous literature on railroads, it is remarkable how few general works treat the subject, let alone interpret it in broad terms. John F. Stover, *American Railroads* (Chicago, Ill., 1961) and *The Life and Decline of the American Railroad* (New York, 1970) are descriptive and largely repetitive of each other. Stewart H. Holbrook, *The Story of the American Railroads* (Garden City, N.Y., 1953) is a popular history. The most useful volumes remain Alfred D. Chandler, Jr., *The Railroads: The Nation's First Big Business* (New York,

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The answer may be that our understanding of the rail experience is less complete than we realize, and that one major area of weakness concerns the railroads' relationship to the roles played by competition and regulation in the economy. To explore this possibility, I want to sketch a historical model of this relationship and to discuss the state of confusion and contradiction that has long existed among those who have grappled with the problem.[2]

The model arranges railroad history into three periods: 1) the transition from competition to regulation, 1860–1920; 2) cartelization and the new competition, 1920–58; and 3) restructuring and deregulation, 1958-present. In many respects it confirms the old saw that history is just one damn thing after another. Like so much else, transportation systems did not arise by planned, rational means but through a process of accretion. As E. Porter Alexander aptly observed in 1887, "The prominent features of modern railway practice . . . have come about from necessity, not choice. . . . Like Topsy they are not creations but developments."[3]

The railroad emerged at a time when no serious competition existed among modes of transportation. By the Civil War or soon afterward it dominated the field, a position it held unchallenged for half a century. During this upward march the railroad played three distinct roles: it introduced transportation where none had existed before; it supplemented existing forms; and it replaced other inadequate or less efficient modes. Only in this last function did the railroad compete with other transportation methods. The true paradigm for competition as we know it arose not from these early intermodal clashes but from intramural strife among the carriers.[4]

During this first period certain baffling characteristics of the railroad emerged. Although defined early as a common carrier, the railroad was very much sui generis and its development, as Charles Francis Adams stresses, "little else than a constant succession of surprises." Much confusion and wasted energy resulted from the failure of Americans to grasp the unique aspects of railroads that made them poor

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1965), and the same author's broad synthesis in *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass., 1977), 122–87.

[2] For a useful discussion of why historians have been so slow to treat railroad history intelligently and comprehensively, see Albro Martin, "Light at the End of a Very Long Tunnel: The Railroads and the Historians," *Railroad History* (Autumn 1986): 15–33.

[3] E. Porter Alexander, *Railway Practice* (New York, 1887), 6.

[4] I am aware that competition existed in many areas between railroads and water carriers. The point here is that the most influential and decisive form of competition was between rival rail lines rather than intermodal competition.

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models for public policy dealing with competition, regulation, and most other issues. One perceptive critic of regulation, himself a former Interstate Commerce Commission (ICC) member, complained in 1936 that "At no time from the inception of the railroad industry has public thinking on the subject been clear."[5]

Foremost among these characteristics was the fact that the railroad discriminated. Many industries discriminate in some way, but the railroad had more types affecting more people more directly in more ways. Three distinct forms of discrimination arose early: geographic, classification, and individual. The first was inherent in the very nature of railroads, as it is in any form of transportation. The second was a logical response to difficult pricing problems, whereas the third resulted largely from pressures brought to bear by shippers and the railroads' own fierce scramble for traffic.

These discriminations provoked most of the public wrath against carriers that led to regulation. This wrath in turn derived largely from confusion over another characteristic of railroads: no one knew how to calculate costs in a manner that made them a meaningful basis for rates. Without any cost basis, rate structures had necessarily to evolve from experience, trial and error, and a witches' brew of internal needs and external pressures. They were called tariffs for good reason; if there was a model for how rates were made, it was the tariff system, where logic took a back seat to expediency, pressure, and self-interest. The result was a common carrier lacking rational means to calculate either its costs or its pricing structure, which made public defense of its rates lame and unconvincing.[6]

[5] Charles Francis Adams, Jr., *Railroads: Their Origin and Problems* (New York, 1888), 85, 185; "Transportation Developments in the United States," *Proceedings of the Academy of Political Science* 17 (Jan. 1937): 73–74.

[6] The literature on costs and pricing is extensive but diffuse. See, for example, Albert Fink's pioneering "Cost of Railroad Transportation" [extract from the Annual Report of the Louisville & Nashville Railroad] (Louisville, Ky., 1875); Emory R. Johnson and Thurman W. Van Metre, *Principles of Railroad Transportation* (New York, 1920), 337–51; Harry Gunnison Brown, *Transportation Rates and Their Regulation* (New York, 1921); Eliot Jones, *Principles of Railway Transportation* (New York, 1924), 71–90; Owen Ely, *Railway Rates and Cost of Service* (Boston, Mass., 1924); Winthrop Daniels, *The Price of Transportation Service* (New York, 1932); James C. Nelson, *Railroad Transportation and Public Policy* (Washington, D.C., 1959), 327–73; U.S. Senate, *National Transportation Policy*, Sen. Report No. 445, 57th Cong., 1st Sess. (Washington, D.C., 1961), 385–424 [hereafter cited as Doyle Report]; John R. Meyer et al., *The Economics of Competition in the Transportation Industries* (Cambridge, Mass., 1960); Theodore E. Keeler, *Railroads, Freight, and Public Policy* (Washington, D.C., 1983), 43–61. Historically, the pricing of rail service has been based on value of service rather than its cost.

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Still another characteristic compounded the problem of discrimination. Two different rate structures emerged: one based on local or noncompetitive traffic, the other on through or competitive traffic. The railroad exercised monopoly power over the first type but was at the mercy of competitive forces in the second type. From this duality arose vast confusion over the question of whether the railroad problem—and therefore the target of regulation—was one of monopoly or excess competition. This was further aggravated by a tendency to lump two very different conditions under the rubric of "monopoly": the domination of whole traffic routes by merging systems, and the domination that any line exercised over local shippers who lacked other outlets.

The rate structures that evolved were based on local rates with through rates figuring in effect as marginal income. Rail managers had no choice; given their lack of a cost basis, they had to peg prices to their most constant source of business if rates were to have any stability at all. Seen in this context, the decision to base rates on the value rather than on the cost of service was both logical and necessary. Unfortunately, it produced a classification system so complex that its inherent and artificial discriminations became yet another inviting target for critics.[7]

History then played some cruel tricks on rail managers. First, patterns of discrimination turned rate structures into a crazy quilt; then competition for traffic drove rates steadily downward. Triggered by rapid construction that brought more roads into common markets, and fueled by the hard times after 1873, this early brand of competition was so reckless and profligate that it aroused widespread public indignation.[8]

Perceptive rail managers realized that once rates were knocked down, shippers would clamor to keep them down. They were more right than they knew. The broadside attack on carriers denounced monopoly, excessive competition, and all forms of discrimination with

[7] The literature on rates, the classification system, and discriminations is too enormous to cite here. Virtually every work cited in this article has something to say on these subjects. For some standard introductions see Jones, *Principles of Railway Transportation*, 71–180; Walter Chadwick Noyes, *American Railroad Rates* (Boston, Mass., 1905); Ely, *Railway Rates and Cost of Service*, 1–80; Emory R. Johnson and Grover G. Huebner, *Railroad Traffic and Rates* (New York, 1911) 1: 331–492; Doyle Report, 385–443.

[8] The intensity of these early rate wars can best be appreciated by extensive browsing in such periodicals as the *Commercial and Financial Chronicle*, *Railroad Gazette*, *Financier* (later *Public*), and *Bradstreet's* for the 1870s and 1880s. Contemporary newspapers in New York and Chicago, as well as in other affected cities, also contain a wealth of detail on rate wars.

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equal vehemence. As the clash grew more politicized, a fateful reversal took place. The rhetoric of protest managed to gain acceptance for the argument that *all* rates should be based on competitive rates, which kept falling, rather than on local rates, which were denounced as "unnatural."[9]

Rail managers paid dearly for failing to establish the premise that local rates were the proper basis of the price structure, but once the issue moved into the political arena it is likely that their argument would have been ignored anyway. As a result the exception became the rule: local rates came to be viewed as artificial and competitive rates as "real." A. B. Stickney, a maverick rail president who strongly favored rate regulation, conceded nevertheless that the immediate effect of the Interstate Commerce Act was the lowering of some noncompetitive rates to competitive levels. He also noted tersely that "competition cannot reduce cost."[10]

The return of good times brought not peace but the equally bitter expansion battles of the 1880s, which broadened the theater of war and the scale of losses. As rates plunged inexorably downward despite repeated attempts by the carriers to stop the bloodletting through pools and other agreements, the public outcry forced government to intervene—first at the state level during the 1870s and then at the federal level in 1887. All sides were anxious to restore stability but disagreed widely on the source of disturbance. Federal regulation thus made a curious debut as a remedy for either excessive competition or monopoly, depending on whom you consult.[11]

Stickney believed the Interstate Commerce Act would fail to prevent unjust discrimination because it tried to preserve competition, which was in his view the source of discrimination. Alexander warned that laws against unjust discrimination amounted to "legislation against

[9] This conclusion is derived from reading thousands of pages of testimony scattered through state and federal hearings for the period 1870–1900. For two examples see the testimony in the proceedings cited in footnote 10.

[10] A. B. Stickney, *The Railway Problem* (St. Paul, Minn., 1891), 69, 143, 219, 223–24. For examples of this view of rates, see the testimony in [Hepburn Committee], *Proceedings of the Special Committee on Railroads . . .* (New York, 1897) and U.S. Senate, *Report of the Senate Select Committee on Interstate Commerce* (Washington, D.C., 1886).

[11] For accounts of these wars and attempts to stop them see Maury Klein, *The Great Richmond Terminal* (Charlottesville, Va., 1970), *The Life and Legacy of Jay Gould* (Baltimore, Md., 1986), and *Union Pacific: The Birth, 1862–1893* (New York, 1987); Julius Grodinsky, *The Iowa Pool* (Chicago, Ill., 1950) and *Transcontinental Railway Strategy, 1869–1893* (Philadelphia, Pa., 1962). There is no satisfactory account of the eastern rate wars or the trunk line pool. For a brief discussion see Albro Martin, "The Troubled Subject of Railroad Regulation in the Gilded Age—A Reappraisal," *Journal of American History* 61 (Sept. 1974): 353–59.

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the competition which produces it." Scholars have divided over the issue for a century. Some, like Richard Waters, argue that the act's purpose was "to curb unfair practices born of excess competition," whereas others, like James Nelson, label it an attempt to curb "excesses of rail monopoly power." George Hilton called it an effort to stabilize rail cartels. Still others have declared it a mixture of both.[12]

"From simple and coherent beginnings," observed Nelson, "transport regulation has grown very complex and detailed." He was wrong; the beginnings look anything but simple or coherent. It is hard to escape the conclusion that the ICC began life with several missions that were incompatible with each other or with the realities of railroad economics. It tried both to prevent monopoly by enforcing competition and to outlaw discrimination. As Stickney and others pointed out, however, a policy designed to preserve competition also perpetuated discriminations. By 1898 the ICC shared this belief; Adams got to the heart of it as early as 1870. The basis of the whole transportation problem, he declared, was that "*competition and the cheapest possible transportation are wholly incompatible.*"[13]

In characteristic fashion Americans wanted both. They harbored a long and deep hatred of monopoly, whether in royal, private, or public hands. As Thomas K. McCraw has noted, any policy favoring monopoly "bore a crushing burden of negative national prejudice." The result was a policy gridlock with roots deep in the national culture. The law banned discrimination but hedged its definition of the various forms and how they related to competition. It barred pools but left other forms of collective ratemaking in legal limbo. If the object was to stabilize or cartelize the industry, banning the most popular vehicle for carrier collusion seemed an odd way to go about it.[14]

Whatever the disease, the remedy proved ineffective. The competitive wars grew steadily worse until the depression after 1893 swallowed many of the roads in receivership. Once the depression had run its course, a new generation of rail giants led by E. H. Harriman

[12] Stickney, *Railway Problem*, 140; Alexander, *Railway Practice*, 59; Richard Hadley Waters, *Competition and Regulation* (Philadelphia, Pa., 1938), 97; Nelson, *Railroad Transportation*, 112; George W. Hilton, *The Transportation Act of 1958* (Bloomington, Ind., 1969), 4. For a survey of the literature on regulation see Thomas K. McCraw, "Regulation in America: A Review Article," *Business History Review* 49 (Summer 1975): 159–83.

[13] Nelson, *Railroad Transportation*, 112; Thomas K. McCraw, *Prophets of Regulation* (Cambridge, Mass., 1984), 9.

[14] McCraw, *Prophets of Regulation*, 10. The pooling issue and its alter ego, the long haul–short haul clause, are expertly discussed in Martin, "Troubled Subject of Railroad Regulation," 339–71.

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caught the rising crest of prosperity by overhauling the railroads into efficient modernized systems on a scale never before witnessed. Clearly a new era in railroad history had dawned. Determined not to repeat past mistakes, these leaders tried to rationalize competition in a variety of ways ranging from private understandings to mergers on a grand scale to interlocking directorates. This "community of interest," as it was popularly known, sprang from a vision of a few giant systems ruled by men who trusted each other and played the competitive game by shared rules.[15]

Ironically, the systems forged by Harriman and others in the 1900s came remarkably close to the railroad map that emerged in the 1970s, but the policy puzzle made the road between a long and tortuous one. Americans could not let go of the belief that competition was essential in the rail industry; as a result public policy down to 1918 consistently encouraged it. The new systems were denounced as a bald attempt at monopoly, and both the ICC and the courts attacked key mergers, most notably the Northern Securities Company and the Union Pacific–Southern Pacific combine. The Supreme Court applied the Sherman Act to the railroads in ways that made clear its determination to keep them competitive.[16]

Not everyone shared this view. "The benefits supposed to result from railroad competition," said former ICC chairman Martin Knapp, "I believe to be greatly exaggerated." A former pool official and ICC commissioner observed that "The phrase 'free competition' sounds well as a universal regulator, but it regulates by the knife. Unless the weapon in turn itself is held in check it is too dangerous an agency to be endured." The ICC itself argued that competition was wasteful, and noted in 1898 that while nearly every nation regulated rates, only the United States tried to enforce competition. In the next breath, however, it warned against the threat posed by the vast rail combinations forming to suppress competition.[17]

[15] Different aspects of this story are found in Albro Martin, *Enterprise Denied: Origins of the Decline of American Railroads, 1897–1917* (New York, 1971); Albro Martin, *James J. Hill and the Opening of the Northwest* (New York, 1976); George Kennan, *E. H. Harriman: A Biography*, 2 vols. (Boston, Mass., 1922); B. H. Meyer, *A History of the Northern Securities Cases* (Madison, Wisc., 1906); Maury Klein, *Union Pacific: The Rebirth, 1894–1969* (New York, 1990).

[16] The Northern Securities decisions are in 193 U.S. 197 and 197 U.S. 244. For the dissolution of the Union Pacific–Southern Pacific merger see *United States v. Union Pacific Railroad et al.*, 266 U.S. 61, 33 S. Ct. 53, and 57 L. Ed. 124.

[17] Gabriel Kolko, *Railroads and Regulation* (Princeton, N.J., 1965), 74, 87; "Transportation Development in the United States," 68–69. Kolko's version of the "capture" thesis of regulation has been pretty thoroughly demolished. See, for example, Richard H. K. Vietor,

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It is hard to read the reports of the ICC commissioners during these years and not sympathize with their frustration. A decade's experience had given them some good insights into the nature of the problems confronting them, but they could not get either carriers, shippers, or Congress to share their vision. Nor could they shake entirely free of the inherently contradictory belief that both combination and competition were dangerous. By the time their views had an impact on policy, the realities of the railroad problem had shifted ground.

While the Supreme Court upheld the banner of competition, the ICC gradually gained new powers from Congress until by 1910 it exerted full control over rates and therefore over much of rail competition. Between 1903 and 1916 power drained steadily from the carriers to the regulatory agencies. Then the unexpected occurred: American entry into the First World War led to the government's taking over the railroads. Regulation gave way to a form of domination that gave the roads better treatment than they had ever received. Once responsible for the roads' performance, the government could not help but view their problems in a more sympathetic light.[18]

The war's end forced Americans to confront directly the issue of what should be done with the carriers. By then the mood of the country had changed radically. Most of the prewar reform fervor had exhausted itself in the Crusade for Democracy, and the wartime experience had revealed certain undeniable advantages in a rail policy stressing cooperation under government supervision. From this chrysalis emerged a sharp reversal of regulatory policy embodied in the Transportation Act of 1920.

Instead of enforcing competition, the act sought to create a protected cartel under tight regulation. It permitted pooling of traffic and earnings. Mergers that had been attacked only a few years earlier were now actively encouraged so long as they conformed to a master plan that combined strong roads with weak ones. The object was to create a limited number of systems of equal strength that might com-

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"Businessmen and the Political Economy: The Railroad Rate Controversy of 1905," *Journal of American History* 64 (June 1977): 47–66, and McCraw, "Regulation in America," 164–66.

[18] The best and most lucid account of the prewar struggle between the carriers, the ICC, and the government is Martin, *Enterprise Denied*. See also K. Austin Kerr, *American Railroad Politics, 1914–1920: Rates, Wages, and Efficiency* (Pittsburgh, Pa., 1968); Kolko, *Rates and Regulation*; I. L. Sharfman, *The Interstate Commerce Commission: A Study in Administrative Law and Procedure* (New York, 1931–37), 5 vols. For the wartime experience see Kerr's book and Walker D. Hines, *War History of American Railroads* (New Haven, Conn., 1928).

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pete in healthy ways. As Ari and Olive Hoogenboom observed, "Consolidation became the panacea competition had been in the decades surrounding the turn of the century." Machinery was devised to guarantee roads a minimum return, and the ICC received power to fix minimum rates, decide questions of extensions and abandonments, and oversee the issuing of new securities.[19]

A new era dawned in which the transition from unbridled competition to regulated monopoly seemed on the threshold of completion. Many rail leaders, dazed by the rapid forced march through ever stricter regulation, government control, and an unfamiliar postwar world, welcomed the new structure of things, if only because they craved stability no less than the public did. With the ICC possessing virtually absolute control over rates, competition among railroads shifted from rates to service. Too late rail managers discovered that this brand of head butting could be very expensive and wasteful in its own fashion.

Unfortunately, the 1920 act came a generation too late. Its primary effect was less to blaze new trails than to institutionalize certain ironies. Seeking the best of all possible worlds, it decreed in effect that there should be competition without losers. The mechanism for preserving competition was to be the same one rail leaders had used earlier to eliminate it: a consolidation plan. Nothing better illustrates the confused thinking on the subject than the contradictory aims of this consolidation policy.[20]

"A major purpose of the transportation act," declared the ICC in a 1929 decision, was to preserve "substantially the whole transportation system." This was to be done by a "union of weak with strong lines" to ensure the survival of all. In other words, strong roads would be rewarded for their efficiency by being saddled with weak roads according to a master plan concocted not by them but by the ICC. And the final product was intended to be at bottom not monopoly but an updated brand of competition. "A greater amount of actual and effective competition in service," intoned the commission in a 1926 decision, "may be assured by a limited number of well-articulated systems than by a greater number of systems less complete."[21]

[19] Ari Hoogenboom and Olive Hoogenboom, *A History of the ICC: From Panacea to Palliative* (New York, 1976), 105. The literature on the Transportation Act of 1920 is voluminous. A full description of the act is in Sharfman, *Interstate Commerce Commission*, 1: 177–244.

[20] Details on the consolidation provisions of the 1920 act and their tortuous fate are in Sharfman, *Interstate Commerce Commission*, 3A: 385–501, and Hoogenboom and Hoogenboom, *ICC*, 105–10.

[21] Quoted in Sharfman, *Interstate Commerce Commission*, 3A: 432–33, 461.

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It seems not to have occurred to the architects of this policy that strong roads were strong and weak ones weak for reasons that went beyond their horoscope or hard luck. If rail managers had learned one lesson from the bitter expansion wars of the 1880s, it was the folly of eliminating unprofitable competitors by absorbing them. The best roads had worked hard to rid themselves of mileage that failed to pay its way; now Congress proposed to force more on them in large, unpalatable doses.

Small wonder that strong systems shunned the plan and shed no tears when the scheme collapsed in failure after a decade of futile efforts to enact it. Unfortunately, the 1920 act contained another poison pill in the form of the provision giving the ICC sweeping authority to approve extensions and abandonments. It also allowed the commission to compel carriers to construct new mileage in certain circumstances. On occasion the ICC permitted new construction of competitive track on the grounds that "competition, within reason, rather than monopoly, is in the public interest."[22]

On these questions as on so many others, the commission was a house divided. One commissioner, noting the emphasis placed by his colleagues on the role of competition in one key decision mandating construction of a new line, said bluntly that "The theory of competition as applied to railroads and a more or less dogmatic reliance upon it has been in my judgment the greatest single error in our national policy toward railroads." He was joined by a fellow commissioner who reminded his brethren that " 'Monopoly' is not necessarily synonymous with inadequacy. 'Competitive' facilities are not 'necessary' merely because they are 'competitive.' "[23]

No one could have predicted that in the long run the railroads would suffer more from being forced to maintain service—that is, not abandon mileage—than from being told when and where they could (or must) lay down new track. But history played another cruel trick on the carriers. The act of 1920 bound them in a straitjacket of regulation at precisely the time they fell victim to a technological revolution.

For seventy years railroads had dominated the transportation industry because no new forms had risen to challenge them. After 1920, however, several new modes appeared on the scene, and older ones like pipelines and water transport were reinvigorated. The automobile, truck, bus, and airplane all utilized the internal combustion engine and new lightweight alloys to gain significant competitive advantages

[22] Quoted in ibid., 3A: 358–59. For details on these provisions see ibid., 3A: 327–85.
[23] Quoted in ibid., 3A: 359.

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over railroads. Within a few years there emerged a vicious contest for business among modes of transport competing less with each other than with other modes.

The railroads and their regulators had put their house in order only to find that the action had moved outside. Suddenly the ground rules of regulation required a complete overhaul. Nothing in them even remotely anticipated the nature or dimensions of intermodal competition. How could they? Unlike law and custom, technological change is neither linear nor predictable. After enduring largely unchanged for a century, the structure of competition in the transport industry was revolutionized within a decade, and more change loomed on the horizon. Once the Depression intensified the scramble for traffic, the nation found itself gripped by yet another transportation crisis.

Two broad policy alternatives existed. Congress could loosen the regulatory straitjacket binding railroads, or it could try to fit the other modes with jackets of their own. Some carriers were itching to compete, not only by cutting rates but also by diversifying into other forms of transportation themselves. Contrary to their image as business fossils, many if not most major systems redefined themselves as transportation companies during these years, adding truck and bus service where the law allowed. Some, like the Union Pacific, contemplated buying airlines to make themselves into complete transportation firms. The obstacle always was whether regulation would permit it.[24]

Given the potency of competition as a cultural value, it may seem strange that this course was not chosen. But the times were all wrong for it. The Depression cast business in an ugly light, and to many people the proposed transportation companies raised the old specter of monopoly. Moreover, the New Deal administration, grappling with huge problems of unemployment and deflation, showed no interest in forms of competition that threatened to drive rates even lower, incur higher deficits, and ruin more firms. Coordination and control were the bywords of the new era. Some way had to be found for all modes to coexist under federal supervision with each one carrying the traffic best suited to it as efficiently and economically as possible.[25]

[24] This quest for diversity can be seen by glancing through issues of *Railway Age* for the interwar years. In 1926, for example, this trade journal began a section devoted to truck and bus activities undertaken by railroads. For the Union Pacific flirtation with air travel, see Klein, *Union Pacific*, 2: 320–26.

[25] For the mood of the 1930s see Earl Latham, *The Politics of Rail Coordination, 1933–1936* (Cambridge, Mass., 1959).

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After the usual exhaustive public debate fortified by a fresh generation of statistical input, policy followed a predictable course: the transport jumble was rationalized on familiar terms by bringing the new modes under regulatory strictures similar to those already in force for the railroads. A series of acts beginning with the Motor Carrier Act of 1935 and culminating with the Reed-Bulwinkle Act in 1948 applied to the new modes the old formula of regulatory cartels that suppressed competition and stabilized rates.[26]

The Transportation Act of 1940 became the cornerstone of this effort. It inserted a preamble into the Interstate Commerce Act defining the national transportation policy as the "fair and impartial regulation of all modes of transportation . . . to recognize and preserve the inherent advantages of each." The ICC was to pursue policies that created a transport system adequate to the needs of commerce, defense, the postal system, and "sound economic conditions" among the carriers. To fill this tall order, it had to protect each mode from competition in the form of rate cuts by other modes. The object became not only coordination but perpetuation of services.[27]

This was simply the traditional American approach of taming the unfamiliar by fitting it with familiar harness. The problem was that almost nothing in the rail model fit the other types of transport; in many cases regulation was not only ineffective but simply irrelevant. All railroads were regulated, but all private automobiles, most trucks, and 90 percent of inland water carriers were exempt. The railroads might be cartelized, but large sectors of other modes were not and could therefore exploit their competitive advantages. Instead of protecting the railroads, the heavy hand of regulation left them even more vulnerable to the new competition.[28]

The competitive environment had changed radically and in ways that hurt railroads the most. This became painfully clear when the Second World War with its blizzard of traffic ended, and rail traffic suffered a precipitous fall that confronted the nation in the late 1950s with the next round of the transportation problem. This deterioration of the railroads' competitive position was all the more shocking for having occurred during a period of relative prosperity. Trucks swept

[26] These acts are summarized briefly in Keeler, *Railroads, Freight, and Public Policy*, 26–43.

[27] Ibid., 136; *Railway Age*, 108: 851–54, 1043–45; 109: 371–73, 399–403; Keeler, *Railroads, Freight, and Public Policy*, 27.

[28] Doyle Report, 152–84; Nelson, *Railroad Transportation and Public Policy*, 111–45; Association of Railway Executives, "Declaration of Policy Deemed Necessary to the Continuance of Adequate Transportation Service to the Public," 20 Nov. 1930, copy in possession of Union Pacific Corporation.

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away much of the high-value freight traffic, and airplanes were fast scooping the long-haul passenger business. Even long-haul freight, the staple of rail earnings, was being nibbled away on several fronts.[29]

Slowly, grudgingly, the machinery of institutional change cranked up to meet a crisis that threatened to throw giant systems into ruin. The Weeks Committee among others discovered in 1955 what some industry people had been shouting since 1920: the railroads had long since ceased to be a monopoly threat and need not be clamped so rigidly in regulatory irons. Scholars and analysts edged gingerly onto the bandwagon, proclaiming that regulation in the transport industry was neither efficient nor economical. Where the generation of the 1930s had sought coordination and control, the new era emphasized cost efficiency—an objective better reached by a freer market than through tight regulation.[30]

The result was a gradual reversal of past policy beginning with the Transportation Act of 1958 and continuing with the formation of Amtrak in 1971, the 3R Act of 1973, the 4R Act of 1976, and the Staggers Act of 1980. Together these acts deregulated the railroads in a way that gave them a freedom of action they had not possessed since the nineteenth century. Apart from regaining control over most of their rates, they were able to shed at last the common carrier burdens that had required them to continue unprofitable operations. "Freed of its medieval shackles of common carrier service obligations," predicted one scholar, "the railroad industry should continue to play an important and profitable role in the U.S. economy for many years to come."[31]

By 1980 the railroads seemed to have come full circle in their *totentanz* with competition and regulation, and the trip had cost them dearly. Only a handful of once-proud systems remained; the rest had been swept into bankruptcy or into a new wave of mergers that buried their original identity forever. The reorganized industry was leaner and meaner, with most roads being creatures of holding companies formed to spin off nonrail assets that in many cases had become more valuable than the railroad itself. Some of these companies have even gone out of the railroad business, and many large roads have vanished, littering the countryside with old roadbeds that are fast assuming the status of burial mounds among cultists.[32]

[29] Nelson, *Railroad Transportation and Public Policy*, 3–110, 148–92; Doyle Report, 47–74.
[30] For a pivotal work in this transition see Meyer, *Economics of Competition*.
[31] Keeler, *Railroads, Freight, and Public Policy*, 147.
[32] There has been another interesting trend in recent years toward the creation of short-

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What does the experience of the railroads tell us about the American way of competition and regulation? Obviously it suggests that the usual time lag between policy and reality has grown steadily worse over the years. Regulatory policy, like old generals, seems doomed always to fight the last war, partly because in our system it takes so long to recognize new problems and then to build a consensus for change. At bottom regulation involves a quest for some viable equation reconciling economic efficiency, social justice, and political acceptability. The more complex regulatory mechanisms become, the more difficult it is to adjust them or get rid of them when necessary, let alone tie them to these objectives.

Since the pace of change wrought by new technology continues to gain speed, the gap between policy and reality widens daily despite all efforts to close it. In the modern world policy cannot possibly keep pace with change of all kinds. The renewed emphasis on deregulation in recent years may reflect a growing realization that the market mechanism, whatever its other shortcomings, provides faster and more accurate signals about changing realities.

Another obvious conclusion is that the railroads were unique in too many ways to be a useful model for regulating competition. More important, the slowness of Americans to grasp these aspects as unique helped to distort their larger understanding of what competition entailed in business. The railroad experience confounded one dubious set of preconceptions about competition, and in the process did much to create an even more dubious set of preconceptions. It led policy down wrong paths on which considerable time and energy were wasted for the return trip. This was probably unavoidable, given human fallibility, but it ought to caution us against any hasty application of regulatory machinery as a cure for problems.

In a broader sense the railroad experience reinforces a behavioral pattern common to our culture. The market mechanism seems to be popular so long as it produces good news. When it produces bad news, however, a clamor for restraint and regulation arises. Put another way, the true American obsession is with winning, not competing. We relish, even glorify, competition in the abstract until we come out losers from it—and historically we have often been poor losers.

This attitude extends well beyond athletics and business to wider forums of policy. There was a healthy dose of it in the bitter debate over Vietnam and in the current rage for Japan bashing, to suggest

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line roads operating over the better routes of abandoned larger systems. See, for example, *Providence Journal*, 7 Nov. 1988.

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but two examples. Our inability to accept that in competition we cannot always win, and indeed may have reached a point in world affairs where we will lose more often than we win because we cannot dominate as we once did, has had tragic consequences in the past and will likely have them in the future.

The flaw lies in a failure to understand competition as a process rather than an outcome—and least of all an outcome foreordained in our favor. "Competition," said Adams, "has been a great educator for railroad men. It has not only taught them how much they could do, but also how very cheaply they could do it." But the tuition has been high, and the need now is to find less costly ways of learning new lessons.[33]

[33] Adams, *Railroads: Their Origin and Problems*, 203.

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