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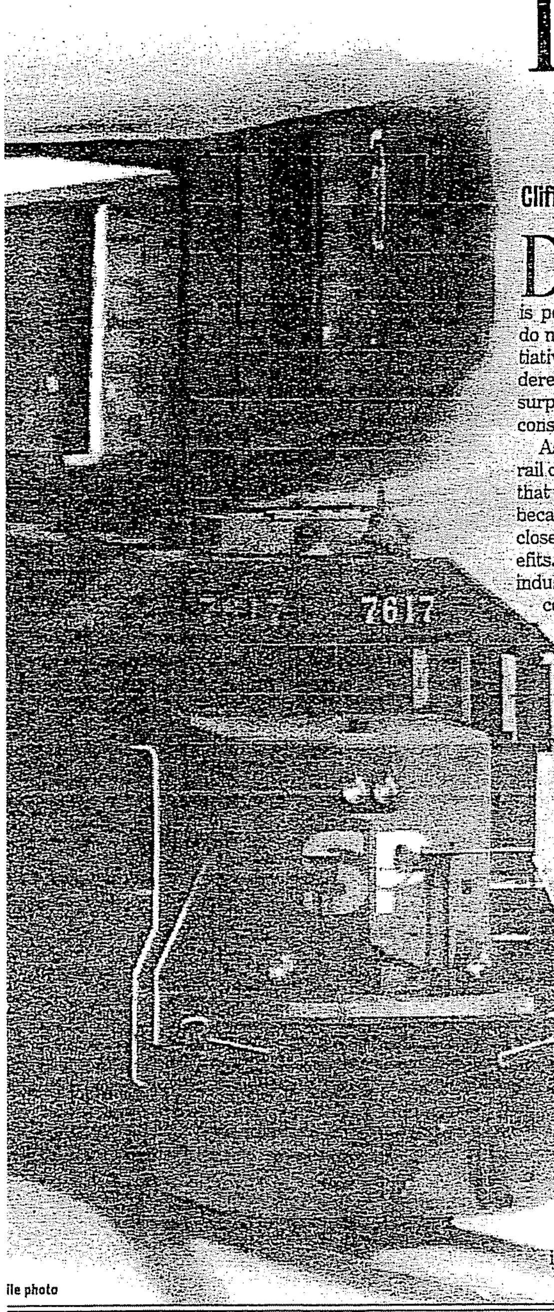
Deregulating the rails

A rare win-win for public policy



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Clifford Winston

Deregulation of U.S. industry has been such a controversial issue for the past few decades that it is perhaps understandable that people do not realize that one deregulatory initiative — the 1980 Staggers Act that deregulated the rail freight industry — surprisingly turned out to benefit both consumers and the industry.

As we appreciate the achievements of rail deregulation, it is useful to recognize that the policy succeeded, in large part, because it brought buyers and sellers closer together to achieve mutual benefits. In the process, the U.S. railroad industry has been revitalized and will contribute mightily to the efficiency of the nation's distribution system for the foreseeable future.

Until the 1950s, the railroads were the overwhelming mode of choice, transporting as much as 70 percent of the nation's intercity freight. But the growth of the intercity trucking industry, spurred by the development of the interstate highway system in the mid-1950s and the growing importance of such specialized forms of transportation as water and pipeline, caused the industry's profitability to fall as it began losing traffic to other modes.

The adverse effects of regulating the railroads, which began with the Interstate Commerce Act in 1887, also became apparent: Railroads were unable to respond effectively to their competition by adjusting rates; they were unable to shed unprofitable portions of track; and they were unable to consolidate and integrate their networks effectively to improve their service.

The railroads' financial problems culminated in the 1970s with the bankruptcies of several Northeastern and Midwestern railroads and with nearly every railroad earning a rate of return below that earned by the corporate sector as a whole.

Many industry observers feared that if the industry could not substantially increase its profits, it faced a real possibility of becoming nationalized. Thus, in 1980 Congress chose to deregulate the railroad industry in a direct, unambiguous fashion with the Staggers Rail Act, which allowed railroads to return to profitability by relying on the market.

Policy makers were concerned that railroads might charge some shippers exorbitant rates and, thus, rates for some commodities were subject to maximum rate guidelines that set out the conditions under which shippers could challenge a rate. The Surface Transportation Board was created and given the authority to arbitrate disputes.

Once deregulated, railroads took steps to improve financial performance. They negotiated contact rates that allowed them to tailor their services to shippers' preferences and that enabled both parties to share the resulting gains in productivity. For example, shippers who required service to and from a given destination would receive a reduced rate because they eliminated empty cars returning from the destination. Railroads also abandoned unprofitable track, cut costs by eliminating cabooses, made greater use of combined operations with trucks, stacked large cars and introduced entire trains for specific commodities and used computer information systems to track shipments and route cargo.

In short, the railroad industry that has evolved since deregulation is not the industry of our grandfathers. More importantly, the improvements in marketing, operations and technology were reflected in the bottom line. In the decade before deregulation, the industry's return on equity averaged less than 3 percent; during the 1990s the industry's return on equity averaged nearly 11 percent a year.

Surprisingly, deregulation has turned out to be a great boon for shippers and consumers. Intense competition from trucks and between railroads caused rail to pass on some of its cost savings to shippers in lower rates. In addition, shippers were able to reduce their inventories and lost cargo en route because rail improved their service times and reliability. Happily, consumers and the industry have benefited while rail's overall safety record has continued to improve.

Of course, not every shipper or every railroad has benefited equally from deregulation. Indeed, certain shippers have complained that rail rates are not always reasonable and that the Surface Transportation Board is not sufficiently responsive to their situation. Railroads respond that while their earnings have clearly improved since deregulation, their profits are still somewhat below the profits earned by the manufacturing sector as a whole.

Shippers and railroads would be better off if they were prodded to negotiate an end to the Surface Transportation Board and resolve their dispute by themselves. In such an environment, shippers and railroads could extend the benefits they have already achieved through contractual negotiations by achieving efficiencies as partners, instead of quibbling over a small pie as adversaries.

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