INTRODUCTION

Transportation Economic Regulation in Practice

JOHN W. FISCHER

The author retired as a Specialist in Transportation Policy, Congressional Research Service, Library of Congress, Washington, D.C. For more than three decades, he researched transportation issues for members of Congress and its committees.

In this issue, "deregulation" refers to economic deregulation of transportation firms by the federal government. It does not refer to the elimination of safety, environmental, or other forms of oversight by federal and other governmental bodies.

The following articles acknowledge the 40th anniversary of the beginning of the end of economic regulation of transportation industries in the United States. Although moves to deregulate occurred before 1978, most transportation practitioners look to the passage and implementation of the Airline Deregulation Act of 1978 as the starting point. This legislation launched a concentrated effort to roll back nine decades of federal economic regulation of rail, truck, air, and other activities.

Retrospectively, this should have been an easy task—however, that was not the case. Federal regulation of the transportation sector was an embedded part of the American economy. When deregulation first was proposed, the aim was to modify and modernize regulation, not to eliminate it. Instead, over a relatively short period, much of what was a regulatory industry within an industry—including a significant federal bureaucracy—vanished. This is not to say that all regulation is gone, even today. Some economic regulation remains, but in comparison to the pre-1978 situation, it is minimal.

PHOTO: ATOMIC TACO, FLICKR

Amazon and other companies whose business models rely heavily on shipping and deliveries have flourished in a deregulated freight and transportation environment.

Generally, the reader of these articles will get the impression that deregulation has been a success—without it, today's economy might look very different. For example, it is hard to imagine an Amazon-like firm operating in an environment in which each of its shipping-related innovations was subject to challenge by competitors and federal review.

Some large companies, like Pan Am, struggled to adjust to less government oversight and eventually closed.

Photo: Icarus, Flickr

Deregulation did not occur instantly; nor did it occur without economic pain and dislocation. Many transportation firms adjusted to the new, deregulated environment, but many did not—such as Pan Am and Consolidated Freightways, one-time giants of the transportation world. Many other large and small firms, including those that were created because of deregulation, also have come and gone. In each case, the firm's assets and employees were dispensed with—often with serious consequences for workers and stockholders.

In the early years of deregulation, the pain of business failures resulted in serious calls for Congress to attempt reregulation. These efforts failed, primarily because the new economic freedoms offered to transportation industries unleashed forces of innovation and efficiency made a dramatic, effective case against such a policy retreat.

History of Deregulation

Federal economic regulation of transportation industries was an accepted feature of the U.S. economy for more than 80 years. Though transportation is the focus of this issue, economic regulation was employed extensively across a wide range of other economic sectors and often remains in place today.

As late as the early 1970s, students of transportation economics—the author included—were exposed to a large dose of regulatory economics. Two of the most popular textbooks of the time, Philip Locklin's *Economics of Transportation* and Dudley Pegrum's *Transportation: Economics and Public Policy*, prepared would-be transportation professionals for a career working in or interacting with a highly regulated industry (*1–2*). Considerable time was spent deciphering the rationale behind rate-making in surface transportation or fare setting in aviation, with additional time devoted to learning the language of regulatory policy, the underlying legal framework, and how that knowledge could be applied in a professional setting. Instructors often made it clear that, since federal regulatory policy was far from perfect, some efforts to reform economic regulation were desirable. Students would not have guessed that, a decade later, much of this education would be of limited use.

The so-called Granger Laws—passed by several Midwestern states in the mid-1800s to regulate the growing monopoly of railroads and discriminatory pricing by grain elevator companies—were ruled unconstitutional because controlling interstate commerce was deemed a function of the federal government.

Photo: Cloud D.C., Wikimedia

Origins

Although the ability of government to regulate economic and other activities has its origins in English common law, it is the Commerce Clause of the U.S. Constitution (Article 1, Section 8) that gives the federal government the sole right to regulate interstate commerce. For the first 100 years of the Republic, the Commerce Clause was invoked to control activities among the states, but economic regulation of transportation industries did not occur until passage of the Interstate Commerce Act of 1887 (*3*). This act gave the newly established Interstate Commerce Commission (ICC) the duty to regulate railroad rates and other business practices in certain circumstances.

ICC was a response to unsuccessful attempts to regulate railroads at the state level, particularly

Photo: Library of Congress

The Interstate Commerce Commission, 1913.

in the agricultural regions of the Midwest. The so-called Granger movement and resulting Granger Laws were meant to reign in what many at the time saw as the railroads' misuse of monopoly powers. The Supreme Court found the Granger Laws to be unconstitutional violations of the Commerce Clause, resulting in a push for congressional action that later became the Interstate Commerce Act.

ICC was charged with ensuring that railroads did not exercise monopoly powers by requiring that they provide and publish "just and reasonable rates"—rates that avoided discrimination and preferences among shippers, including adjustments to long- and short-haul rate inequities. Initially, ICC's broad investigatory powers were fairly toothless, but just after the turn of the 20th century, Congress enacted legislation that increased ICC's actual regulatory power.

In its decision making, ICC evaluated a host of factors: the cost and value of service, fully allocated costs, fully distributed costs, and more. Setting rates became a process. Rates were proposed and evaluated; frequently these were challenged by other interested parties. ICC also gained power over such railroad industry activities as acquisitions, mergers, and line abandonments.

Broadening Powers

For better or worse, ICC became the model for federal regulatory agencies. As new technologies blossomed into new industries, ICC gained new powers and new regulatory agencies were formed.

Calls emerged for the developing post–World War I trucking industry to be regulated in the same fashion as the rail industry. Although the decision to regulate the motor carrier industry was criticized then and since, Congress and the Roosevelt administration passed the Motor Carrier Act of 1935. This legislation included the trucking industry and the intercity bus industry in the ICC regulatory framework, albeit with features that differed in many ways from railroad regulation. Although nearly all railroads were common carriers—that is, they held their services open to all—the motor carrier industry consisted of common carriers, contract carriers, private carriers, and many intrastate carriers that were subject to state rather than ICC regulation.

In the early 1930s, the emerging airline industry experienced troubling times. Safety was a serious problem. Economic competition was intense, both within the industry and with its major competitor, passenger railroads. Federal airmail subsidies, which had kept the industry afloat economically, became inadequate.

In part to protect the aviation industry from itself, Congress and the Roosevelt administration enacted

A 1914 cartoon depicts ICC as Uncle Sam, towering over the now-weakened railroad companies with the ghost of former railroad president William Vanderbilt aghast.

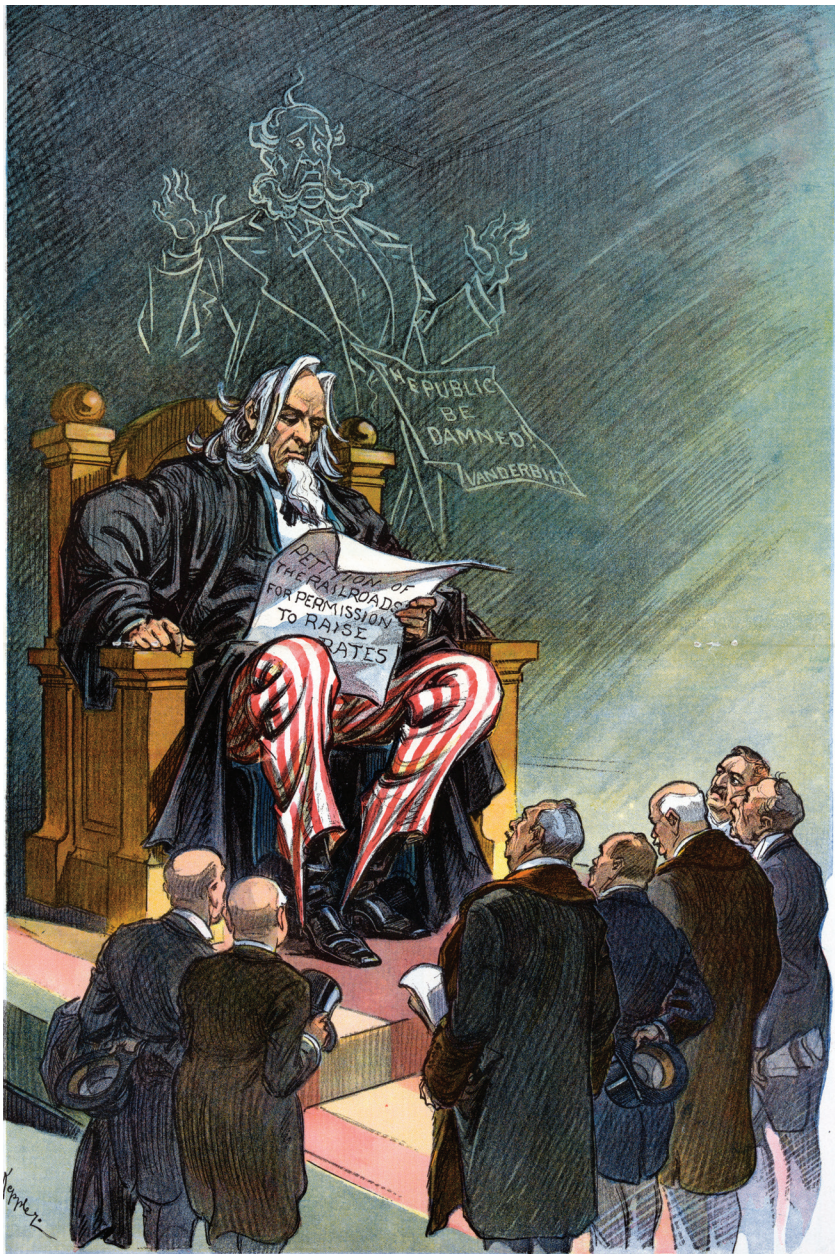


Photo: Library of Congress

Affected by the crippling economic depression of the 1930s, the young aviation industry could not be kept aloft by government airmail subsidies, which themselves were affected by scandals.

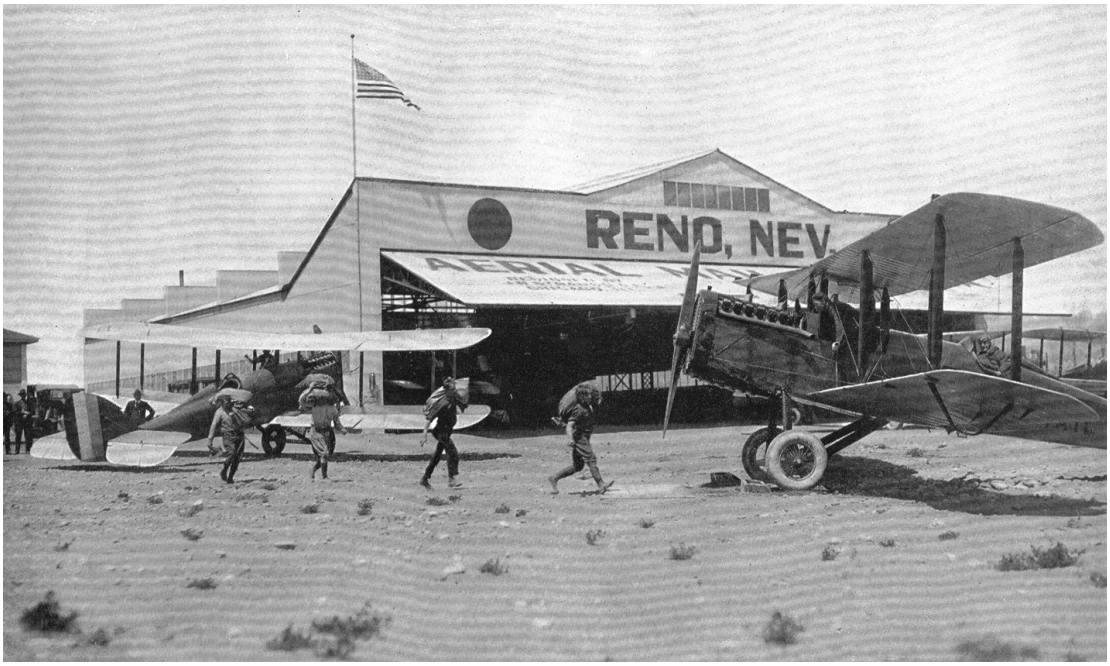


PHOTO: NATIONAL POST MUSEUM

the Civil Aeronautics Act of 1938. This legislation initially created an agency within the Department of Commerce that was responsible for all federal aviation activities—air traffic control, safety, economic regulation, and more.

In 1940, these functions were divided into the Civil Aeronautics Authority—the precursor to the Federal Aviation Administration (FAA)—and the Civil Aeronautics Board (CAB), which was responsible for a variety of activities, most prominently, economic regulation. Over time, CAB became the independent agency that it was in 1978.

Without the ability to control—and compete on—pricing in the regulated era, airlines wooed customers with luxury service.

PHOTO: FLYSAS.COM

Airline Regulation Evolves

CAB was organized along the lines of ICC but engaged in its regulatory activities in a very different way. CAB regulated airline routes, via city pair markets; airline fares; mergers; acquisitions; and, significantly, market entry. Despite some commonly held beliefs, CAB never regulated levels of service in markets, although it did require air service to markets in certain cases.

After World War II, CAB often was criticized for preventing the entry of new airlines into the air carrier market. In fact, no new carriers were allowed to enter the major airline market for almost 30 years; this was seen as a major barrier to enhanced competition. Because airlines could not compete on fares per se, they competed mostly on the basis of service—better food, nicer seats, and more. By the 1970s, considerable frustration with the high cost of air service in the United States became a major focus of the push toward deregulation.

Industry unto Itself

Regulation was an industry unto itself. Individuals could and did make a career out of regulation. The two major transportation regulatory agencies were themselves significant employers.

In 1975, for example, ICC had 2,115 employees and CAB had 728. Many lawyers, economists, analysts, and other professionals spent their careers filing traffic rate cases and other cases as part of the regulatory process (*4*); likewise, companies employed many individuals whose sole occupation was interacting with the regulatory agencies. For example, before 1978 United Airlines had a staff

of 150 dealing with regulatory matters; by 2002, the number had shrunk to a "half-dozen" (5).

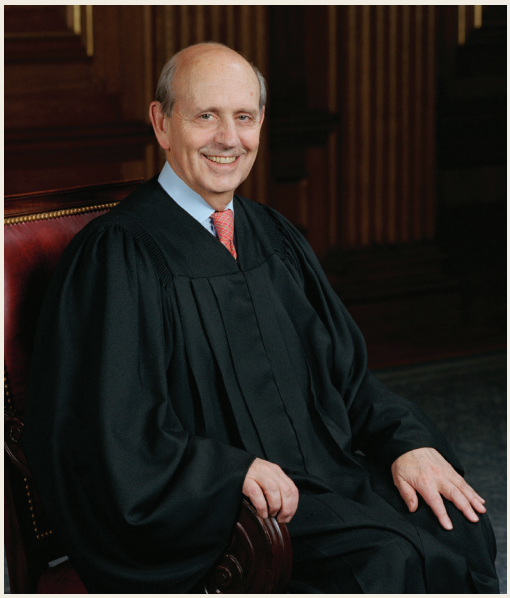
In retrospect, it is nothing short of amazing that an entrenched Washington bureaucracy and an associated private-sector industry essentially were eliminated over a relatively short period without far more controversy.

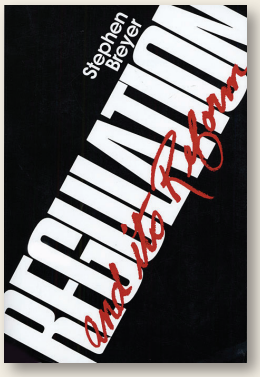
Long March to Deregulation

Deregulation was a process, not an event. Like the authors of the textbooks cited earlier, most proponents of reduced regulation did not seek full deregulation. Instead, they sought a framework that would allow industry more freedom to compete; in this view, such a framework would result in less need for regulation over time.

The Eisenhower administration held this view and President John F. Kennedy made such a process a centerpiece of his 1962 Message to Congress, "On the Transportation System of Our Nation" (2). In that message, Kennedy sought to move federal transportation policy away from what was viewed as a "chaotic patchwork of inconsistent and often obsolete legislation [that] has evolved from piecemeal development with the result that it has failed to keep pace with the changing structure" of industry (2). Although the message seemed to mark a real break with past practice and represented a great deal of work by the Kennedy administration, it did not result in any specific legislative action.

From this point, the maneuverings necessary to get to deregulation make for interesting reading, as do the personalities of those who drove deregulation from idea to law. Several presidents and members of congress from both parties played major roles in the





Justice Stephen Breyer's *Regulation and its Reform* presents a thorough survey of the full implications of government regulation—economic, legal, administrative, political—and addresses the complications of administering regulatory agencies. Examined are the regulatory areas of health and safety, environmental pollution, trucking, airlines, natural gas, public utilities, and telecommunications, along with such related topics as cost-of-service rate making, safety standards, antitrust, and property rights. See Chapter 16, in particular, for a discussion of the Kennedy hearings. The book is available from Harvard University Press at www.hup.harvard.edu/catalog.php?isbn=9780674753761.

Photo: Glen Wallace, Flickr

Like much of the transportation system in Europe, Network Rail, the owner and manager of most of the rail network in England, Scotland, and Wales, is heavily regulated by the government.

deregulation debate. Transportation industries; shippers; and labor, passenger, and other groups took various positions at different times in the decade leading up to 1978.

For example, all major U.S. airlines—with the notable exception of United Airlines—originally opposed deregulation. Labor was opposed to deregulation unless their specific transitional needs were met. Likewise, shippers in general favored deregulation based solely on their satisfaction or dissatisfaction with the existing environment.

According to Seely and Rose in their well-documented history of transportation in the 20th century, the move to deregulation featured heroes and, perhaps, villains (*6*). Some individuals likely receive too much credit for pursuing deregulation and others, such as President Gerald R. Ford and his administration, get too little. The outsize role of several individuals, however, is worth noting here in brief.

Enacting Reform

By holding a series of hearings on deregulation beginning in 1974, Senator Edward Kennedy, then chairman of the U.S. Senate Committee on the Judiciary, and his special counsel, now Supreme Court Justice Stephen Breyer, jump-started the move to deregulate the airline industry.

The hearings by Kennedy and Breyer received considerable national press coverage and revealed a confusing, inefficient CAB regulatory framework that satisfied no one completely. Enlisting the aid of academics and other subject experts from a variety of backgrounds, the hearings paved the way for needed reform of the regulatory system (*7*). Most importantly, Kennedy and his ever-expanding group of supporters from within Congress and outside—and from both liberal and conservative policy perspectives—turned deregulation into a significant national issue.

By 1978, the focus of Congress and of the Carter administration had turned entirely toward reform. The economist Alfred Kahn, a renowned expert on public utility regulation, was appointed CAB chairman and began moving the agency to administrative reform. Kahn—who came to be known as the father of deregulation—created a greatly eased administrative environment that had an immediate impact on airline fares and service, and a beneficial one from a consumer standpoint.

The legislative success of the Airline Deregulation Act fostered a climate for further deregulation. Members of Congress in both the House and the Senate took up the cause of deregulation of other transportation industries. In short order, the Motor Carrier Act of 1980 and the Staggers Rail Act of 1980 (named after Rep. Harley Staggers, then chairman of the U.S. House Committee on Interstate Commerce and Transportation) were passed, and the Bus Regulatory Reform Act of 1982 made deregulation more or less complete. Although additional legislation would follow to address residual deregulation, and although CAB and ICC would remain in existence until 1984 and 1995, respectively, more than 90 years of pervasive industry regulation had been undone in four.

Deregulation Today

These and other events of the last four decades have greatly diminished economic regulation of transportation within the United States. It is equally important to recognize, however, that transportation industries remain subject to a wide range of safety, labor, environmental, and other regulation, both at the federal and state levels. Likewise, in many ways international transportation is regulated economically or institutionally, though barriers in the aviation sector have loosened as other nations have adopted their own forms of deregulation.

Transportation technologies and practices do not stand still. As one article in this theme issue suggests, cities and states now are dealing with the possible need for regulation of transportation network companies like Uber and Lyft. Similarly, the FAA is considering regulatory requirements for the integration of unmanned aircraft systems, or drones, into the National Airspace System. Whether any of these actions will eventually include economic regulatory elements remains to be seen.

References

1. Locklin, D. P. *Economics of Transportation*, 7th ed. Richard D. Irwin, Inc., Homewood, Ill., 1972.
2. Pegrum, D. F. *Transportation: Economics and Public Policy*, 3rd ed. Richard D. Irwin, Inc., Homewood, Ill., 1973.
3. Interstate Commerce Act of 1887, Pub. L. No. 49-104, 24 Stat. 379 (1887).
4. *Statistical Abstract of the United States*. Bureau of the Census, U.S. Department of Commerce, 1976, p. 249.
5. Railroads adapted better to deregulation than airline industry, analysts say. *Chicago Tribune*. December 23, 2002.
6. Rose, M. H., B. E. Seely, and P. F. Barrett. *The Best Transportation System in the World: Railroads, Trucks, Airlines, and American Public Policy in the Twentieth Century*. Ohio State University Press, Columbus, Ohio, 2006.
7. Breyer, S. *Regulation and Its Reform*. Harvard University Press, Cambridge, Mass., 1982.

NOTE: The *TR News* Editorial Board thanks John Fischer, emeritus member of the TRB Standing Committee on Aviation Economics and Forecasting, for his work in assembling and developing this issue.