LEGISLATIVE VS. ADMINISTRATIVE DEREGULATION: THE INTERSTATE COMMERCE COMMISSION AND THE RAILROADS

Richard D. Stone
Towson State University

ABSTRACT

Unilateral administrative deregulation of the railroads largely preceded the Staggers Act of 1980. This paper analyzes the causes of this administrative deregulation and the forces involved in the process by which the ICC voluntarily gave up much of its power over the activities of the railroads.

INTRODUCTION

After well over a decade of attempts to pass deregulation legislation, railroads were largely deregulated by the end of 1980. The legislation which officially "accomplished" the lessening of economic regulation was the Staggers Act of 1980. However, this act was proceeded by several actions of the Interstate Commerce Commission, the body which regulates the railroads, and which, in effect, unilaterally greatly decreased regulation prior to 1980. Administrative deregulation, which preceded any legislative directive, is the subject of this paper, which will first trace the roots of regulation, then consider the forces which pushed for deregulation, and finally discuss the process by which administrative deregulation accomplished what proposed legislation could not.

A BRIEF HISTORY OF RAILROAD REGULATION

All regulation of the railroads was imposed by legislation, rather than administration. This was necessary at the beginning because without an institution in place, there was no possibility of regulation. Another reason for the legislative, rather than the administrative, imposition of regulation is that it is much more difficult for an institution to assume than it is to abdicate authority, as will be seen.

The first federal regulation of the railroads, and indeed the first federal transportation regulation, came after several less than successful attempts to regulate by various states. There have been many interpretations of how federal regulation came to be. Conventional wisdom has usually given much credit to pressure by the consumers, in particular the farmers and populists (Benson 1955; Buck 1913; Hicks 1931). Another view (Eastman 1940; Kolko 1965) maintains that railroads themselves pushed for and actually wrote the first railroad regulation because it was preferable to the piecemeal state regulations that were then in place.

Sorting out the rationale for early rail regulation is beyond the scope of this paper. For whatever reasons or reasons, the Act to Regulate Commerce (later known as the Interstate Commerce Act) was passed and signed into law in 1887. This act, in five sections listed several prohibitions and admonitions outlawing discrimination. It also created a five member Interstate Commerce Commission (ICC) to oversee and enforce the provisions of the act. The commission, however, was given no power to impose sanctions, so that every finding of an infraction had to go to the courts for enforcement.

The courts were much more friendly to the railroads than to the commission, and many of the ICC's decisions were overturned. Not until the presidency of Theodore Roosevelt was the ICC strengthened by amendments to the Interstate Commerce Act in the form of the Elkins Act of 1903, the Hepburn Act of 1906, and the Mann-Elkins Act of 1910, were the loopholes in the original act closed and the ICC given the power to regulate the railroads.

After World War I the railroads, which had been nationalized during the war, were returned to their private owners along with further regulation and restriction on managerial discretion. The aforementioned Hepburn Act of 1906 had imposed ICC control over maximum rates. This type of regulation is common for monopolies. The Transportation Act of 1920, however, sought to protect the railroads from themselves by imposing control over minimum rates, i.e. it gave the ICC power to impose a limit on how low the rates could go. By controlling the upper and lower limits on rates, the ICC could, in effect, set the actual rate to be charged. This would not have been controversial in a true monopoly situation, but competition to the railroads was increasing in the form of the motor carriers (trucking companies) which, bolstered by their performance during the War, grow quickly in the 1920's. Competition also was increasing from domestic barge lines.

For the next better than half century, the railroads struggled along against unregulated or less regulated competition, and changing economic conditions. The situation was made worse by the aftereffects of the railroads' own policies of overbuilding in the 19th century. The fact is that it was very profitable to build railroads, due to the governmental land grants and enthusiastic public subscription to stock offerings. Once built, however, it was not as profitable to operate all the little branch lines that produced little traffic. These lines were very susceptible to motor carrier competition for small shipments.

Rather than deregulate the railroads now that there was some competition, the government saw fit to regulate the other modes. Motor carriers were regulated under the Motor Carrier Act of 1935. Domestic water was regulated by the Transportation Act of 1940, and airlines were regulated under the Civil Aeronautics Act of 1938. However, regulating the competing modes, while making life somewhat easier for the railroads, did not level the playing field completely. Railroads were still more highly regulated than the other modes in terms of what was controlled by the ICC. In addition, each of the other competing modes had loopholes which left certain commodities and/or shipments unregulated. This is particularly true of water carriers, but was also true of the carriage of certain products (such as fresh fruits and vegetables), which should have been natural for railroads to carry. The railroads lost this traffic due to exemptions which placed the carriage by truck of these outside the jurisdiction of the regulatory body.

After the Second World War the railroads' financial situation continued to deteriorate with the suburbanization of the country and the diffusion of the population, situations ready made for the proliferation of the private automobile and the trucking industry. This situation was particularly acute in the Northeast, where traditional manufacturing was leaving the region. The federal government studied the situation and passed the Transportation Act of 1958, which contained provisions to assist the railroads, but failed to stop the flood of red ink.

It was during the late 1950's that the movement for transportation deregulation first became fashionable. The movement began primarily with academics (principally economists) who were taking note of the ineffectualness of legislation passed to help the railroads within the framework of existing regulation.

CALLS FOR DEREGULATION

Meyer, Peck, Stenason, and Zwick (1959) published the first study by economists recommending lessened regulation for the transportation industry. They concluded that transportation had grown and prospered less than other industries because it was overregulated. Competition had grown in the years since regulation was instituted and could efficiently replace regulation. James C. Nelson (1959) blamed the condition of the railroads on governmental policies. He recommended, among other things, relaxed regulation and government neutrality in treating the various modes.

George W. Hilton (1969) stated that the ICC was a cartel whose purpose was to prevent price cutting by the use of "umbrella ratemaking" in order to hold up rates artificially. Anne F. Friedlaender

(1969) concluded that ICC regulatory policies had resulted in the inefficient allocation of freight traffic, excess capacity, and the stifling of innovation.

Louis M. Kohlmeier (1969) criticized all federal agencies that economically regulated business because they tended to protect the interests of the regulated industries more than those of the public. By minimizing competition, the agencies cost the public money. Donahue and Hille (1971) attacked the misallocation of resources due to regulation that they saw as costing consumers and taxpayers millions of dollars. They, like Hilton, zeroed in on "umbrella ratemaking" which held up rates to artificially high levels, which in turn produced excess capacity, duplication of facilities, subsidized commodity movements, and financial problems for the carriers.

Ari and Olive Hoogenboom (1976) accused the ICC of being too susceptible to political pressure, or in the absence of such pressure on many issues, heavily influenced by the carriers. Its case-by-case approach helped to maintain the status quo and avoid the development of any consistent transportation policy.

The more popular and businesses presses began to pick up the attack. Robert C. Fellmeth (1970), under the auspices of a Ralph Nader group wrote the The Interstate Commerce Omission, which more specifically attacked the ICC than regulation generally. It singled out the commissioners personally as well as their policies.

Dan Cordtz (1971) wrote in Fortune that the regulatory apparatus had failed to keep pace with technological and economic change. He concluded that minor changes in structure or personnel would not be sufficient to correct the situation.

Parts of the federal government were also critical of the regulatory procedures. The Landis Report (1960) to President-elect John F. Kennedy criticized the federal regulatory agencies for slow and costly procedures, piecemeal solutions, and weak personnel. Congress also issued the Doyle Report (1961) of the Senate Transportation Study Group which stated that regulation was being used to preserve the status quo rather than to help create a dynamic transportation system that would serve the economy and national defense.

President John F. Kennedy presented the first ever Transportation Message to Congress on April 5, 1962. Contained in the message were criticisms of regulation and a call for more competition. Lyndon Johnson delivered his transportation message in 1966. Although both presidents declared transportation to be on their list of priorities, no legislation affecting regulation was passed. However, in 1966 the Department of Transportation was created. Beginning in 1971, DOT began to criticize the regulatory structure and to submit legislation to make changes in it.

In the years leading up to 1976, legislation was passed dealing with the railroads. These included the creation of Amtrak to take over passenger service, and the Regional Rail Reorganization (3R) Act which provided financial help for the railroads of the northeast. Nothing, however, was passed in the way of changing the regulatory structure.

Although there was increasing pressure from various sources for decreasing or eliminating the economic regulation of transportation, there were other forces which voiced the opposing view. The Interstate Commerce Commission (1975) was vehement in defending what it saw as its role in protecting the consumers who could not follow rate changes and needed help in processing service complaints. The commission stated that reductions in transportation regulation would be disruptive to the economy and ultimately costly to the consumer. The motor carrier industry, anxious to prevent a large influx of competitors that would result from lessened regulation, backed the ICC in favoring the status quo. The Teamsters Union, in an unusual alliance with the employers of its members, also feared increased competition that might employ nonunion drivers.

The Railroad Revitalization and Regulatory Reform 4R) Act was signed into law on February 5, 1976. The major thrust of the act was to provide for the creation of the Consolidated Rail Corporation (Conrail) to take over 6 bankrupt northeastern railroads. However, the act contained two other provisions relating to lessening regulation of the railroads. The first was expected to go a long way toward providing ratemaking freedom for the railroads, but, as events turned out, did not. The second was largely overlooked by analysts at the time of the passage of the 4R Act, but was the basis for administrative deregulation.

The first provision was contained in Title II of the act and came to be known as the "yo-yo" clause. It stated that rates that were equal to or greater than the variable cost of providing a service could not be found to be unjust or unreasonable on the grounds that they were too low. On the other hand, no rate could be found to be unjust or unreasonable on the grounds that it was too high unless the ICC found that the carriers had market dominance over the traffic in question. The method for determining market dominance was to be decided by the ICC. Railroads were to be able to increase or decrease rates by as much as 7 percent from the rate in effect at the beginning of the year.

The second provision was also contained in Title II as Section 207, Subsection (b). It stated that the ICC could exempt any rail traffic from regulation if it deemed that the regulation served little or no useful public purpose and was a burden on a persons or classes of persons or on interstate or foreign commerce.

ADMINISTRATIVE DEREGULATION

As mentioned above, at the time of the passage of the 4R Act there was considerable excitement among those interested in the domestic transportation industry. The act was the first piece of legislation that had proposed lessened, rather than increased, regulation as a move toward solving the problems of the railroads. However, implementation of the provisions was left to the ICC, which had a natural interest in maintaining its power. Therefore, analysts at the time ignored the second provision which required the commission to actively deregulate. The "yo-yo" clause, on the other hand was a directive and was expected to be used by the railroads quite extensively.

As required, the ICC set the guidelines for defining market dominance. The guidelines stated that market dominance would exist whenever the railroad involved had carried 70 percent or more of the traffic the preceding year, or the rate exceeded the variable cost of providing the service by 60 percent or more, or the affected shipper(s) had a substantial investment in rail related equipment or facilities (Interstate Commerce Commission 1978). These conditions covered almost all existing rail traffic and thereby excluded the "yo-yo" clause from use in almost all cases. The "yo-yo" clause expired in 1978, was reinstated by another act which also contained the fatal market dominance provisions, and eventually was made moot by succeeding events without ever having the effect predicted for it at the time of its passage.

Legalization of Contract Rates

Almost immediately after the restrictive market dominance rules were set, the ICC, on November 9, 1978, legalized rail contract rates under certain conditions (Interstate Commerce Commission 1980). The commission had previously held that rail contract rates were in violation of the Interstate Commerce Act. Indeed, all for-hire rail carriage had been common carriage with published rates since the passage of the Act to Regulate Commerce in 1887.

There were restrictions placed on the use of contract rates, however. Once a rate had been negotiated it would be published and other carriers would be allowed to use it. Moreover, contract rates were to be reviewed by the ICC on a case-by-case basis.

The use of contract rates did not soar immediately and the commission became concerned. It established a contract advisory service on May 12, 1980 to help shippers and railroads develop contract rates (Interstate Commerce Commission 1981). This action was quite incredible considering the ICC's past propensity for hanging on to every shred of its power. Here was a case of the commission creating a means for lessening rail regulation and then going so far as to create an advisory service to encourage the use of the instrument.

In the succeeding years the use of contract rates has increased and the ICC has continually attempted to lessen the restrictions on the use of contract rates, even to include confidentiality.

Deregulation of Produce

Rail carriage of fresh produce had been regulated, along with all other commodities, since the passage of the Act to Regulate Commerce in 1887. However, motor carriage of produce had never been regulated, having been made exempt by the Motor Carrier Act of 1935 which first regulated trucking. This gave motor carriers a great advantage in winning the traffic as they could quickly change rates to follow the market. As might be expected, the percentage of the produce traffic carried by the railroads decreased as the motor carrier industry grew.

In April 1978 the Southern Pacific Railroad, petitioned the ICC for an exemption to the Interstate Commerce Act for shipment of agricultural commodities on its own and affiliated lines. The ICC agreed to explore the possibility of deregulating rail carriage of produce, but instead of limiting its investigation to the petitioning lines, it studied the deregulation of produce for all railroads. Late in 1978, the commission did end federal regulation of the carriage of fresh fruits and vegetables carried by rail (Interstate Commerce Commission 1980). The railroads started to compete for this carriage almost immediately. Their percentage of this traffic has increased slowly, due in large part to the fact that they did not have much refrigerated equipment on hand initially.

The deregulation of fresh produce was a complete deregulation, unlike the legalization of contract rates. However, it should be pointed out that it did not affect nearly as much of the rail traffic as the contract rate action did. However, a more important point is that the ICC again took the initiative to lessen regulation by extending the exemption to all railroads even though railroads as a whole had not asked for it.

Other Administrative Deregulation

In succeeding years the ICC has lessened the reins of regulation in several ways. By 1980 the ICC had relinquished much of its control over car service rules and per diem payments. These terms refer to many different rules which placed restrictions and rules on the movement, distribution, and supply of rail cars as well as the amount one railroad had to pay another for the use of its rail cars. The commission opted for letting the market be a larger determining factor in the supply of rail cars and the cost of using them.

In the 1978-80 time period, the commission made several procedural changes which expedited procedures. On January 15, 1978, the ICC adopted new rules to speed up decisions in railroad merger cases (Interstate Commerce Commission 1979). On December 27 of the same year the commission issued a General Policy Statement on mergers which outlined the criteria to be used in making decisions on rail mergers. It, in effect, specified which types of mergers were most likely to be approved (Interstate Commerce Commission 1980). In 1980, the commission removed traffic protection restrictions on mergers. These restrictions had previously been included to protect competitors of the proposed merged railroad (Interstate Commerce Commission 1981).

Abandonment of service has always been much more controversial for the railroads than for other modes because once a rail line is abandoned the service is unlikely to ever be reinstated. In other modes, the public rights-of-way still exist and the possibility of another carrier picking up the service is always possible. Therefore, the procedure for abandonment had been a long and arduous one, complete with public hearings. The 4R Act had directed the ICC to place time limits on reaching a final decision in abandonment cases. The ICC, during this period, simplified, clarified, and speeded up the proceedings (Interstate Commerce Commission 1981).

In 1979 and 1980 the ICC made efforts to simplify rate tariffs and tariff filing procedures. New procedures reducing the filing requirements for rate increases were instituted in 1980 (Interstate Commerce Commission 1980, 1981). While changes in procedures might not be strictly classified as deregulation, they are examples of lessening the bureaucracy and streamlined procedures are indications of lessened control.

The passage of the Staggers Rail Act in late 1980 codified lessened regulation. Pundits have remarked that the legislation was necessary to catch up with the reality of the situation. Since the passage of this act, the ICC has deregulated boxcar traffic, trailer on flatcar (TOFC or piggyback), ownership of carriers in other modes, trackage rights agreements (arrangements for the use of track of a railroad by other railroads), and export coal, as well as continuing expedite and clarify abandonment and merger proceedings. All these actions, however, because they were taken after new directives were in place due to the Staggers Act, are not as astonishing as those between the years 1978-1980. It is of interest now to consider why the ICC took the actions it did after 90 years of maximizing its power.

ADMINISTRATION DEREGULATION AND JIMMY CARTER

The ICC's actions of the late 1970's were engineered by President Carter. There are two questions which might be asked at this point. First, why was Carter so interested in the deregulation of transportation? And second, how was Carter successful in lessening regulation when the 4 presidents preceding him had not been.

James Earl Carter was the first candidate for president to run as an "outsider." Now, it is almost a cliche for every candidate to be anti-establishment, even incumbents, but in 1976, this was a fairly new idea. In the aftermath of the Watergate Scandal, being an outsider and anti-big government was an asset upon which Jimmy Carter capitalized.

Carter, as governor of Georgia, had abolished many state agencies and introduced zero based budgeting. He had looked to market, rather than government, solution to many problems. This perspective set him apart from other Democrats. Carter also considered himself to be pro-consumer. He saw deregulation as encouraging competition which could lead to lower prices for consumers. During the campaign Carter frequently spoke out for transportation deregulation, and had planks to that effect inserted into the party platform (Eizenstat 1987).

The short answer to the second question is administrative deregulation. A more detailed answer involves a look at the people who were involved in decision-making at the Interstate Commerce Commission. On July 30, 1976, there were ten commissioners and one vacancy. Four had been appointed by Nixon, three by Johnson, two by Ford, and one by Eisenhower (in his first term). Five were Republicans, four were Democrats, and one was Independent (Interstate Commerce Commission 1976). By the end of 1977 there were only seven commissioners. This number decreased to six in 1978, increased to seven the next year, and decreased to six again by the end of September 1980. These six were evenly divided between Republicans and Democrats, but more important is the fact that Carter had appointed four of them (i.e. two-thirds). There was no legislation reducing the size of the ICC or the number of commissioners until 1982, well after Carter had left the White House. The reduction was a result of Carter's refusal to appoint the full complement of commissioners (Interstate Commerce

Commission 1981).

Interstate Commerce Commission appointments have not been a top priority with most presidents. Carter, however, deliberately appointed people according to the criterion that they be sympathetic to deregulation. They were encouraged to deregulate within their mandates (Eizenstat 1987). First, air regulation was tackled. More people could relate to air transportation than to other modes, because airlines carry people primarily, rather than freight. After the airlines were administratively deregulated, the administration concentrated on motor carriers. This was a more difficult undertaking because there was great opposition from the American Trucking Association and the Teamsters Union. Administratively lessening regulation of the rail industry was relatively easy due to the fact that the carriers favored deregulation.

One of Carter's key appointments in the undertaking of administrative deregulation was A. Daniel O'Neal, Jr. to the chairmanship of the ICC. O'Neal had been a Nixon appointee and had been on the commission since July 1973. Initially O'Neal had been a supporter of the ongoing ICC policies, but had become critical of the institutional inertia and a supporter of regulatory reform. He was appointed chairman in April 1977 and served until the end of 1979. As chairman, he had great influence on the changes in philosophy and procedures during his tenure. The chairman influences the commission because he or she sets the agenda and budget, and appoints bureau directors (Kahn 1987). Darius W. Gaskins succeeded O'Neal as chairman. He implemented many new policies by changing staff and putting new people in key areas. Those who did not go along with the changes were ousted and many old regulators took early retirement. It was a traumatic time at the ICC (Anderson 1987).

Replacing the key staff people, as described in the preceding paragraph was aided by the 1978 passage of the Civil Service Reform Act. This act, among other things created a Senior Executive Service and a new procedure for selecting, developing, and managing top-level federal executives. Its purpose was to reinstate a merit system, but in allowing the president to appoint the top staff people, it politicalized these positions (Selzer 1987).

In addition to the changes in personnel at the top staff levels, the commissioners began to make more decisions for themselves instead of relying primarily on staff recommendations as had been the practice. The staff is the corporate memory of the ICC. Commissioners come and go and serve relatively short terms compared to the staffers so that consistent philosophy has been the responsibility of the ongoing staff. This was an unusual time for the commissioners to take more responsibility in light of the fact that there were fewer commissioners and they might reasonably been expected to be too busy.

CONCLUSION

Presidents Reagan and Bush have used the idea of administrative deregulation in many areas and it is sometimes difficult to remember that this tool was first initiated by Jimmy Carter. One further question might be in order. Why did no president before Carter think of "packing" a regulatory commission with deregulators to administratively deregulate. There is no easy answer to this question. Perhaps, because regulation was instituted legislatively, none of them thought of deregulating any other way.

REFERENCES

Anderson, John M. 1987. Vice President, A. T. Kearney, Inc. Interview by author, 20 March. Alexandria, VA. (Former chief of the Cost Analysis Section, ICC)

Banks, Robert L. 1987. President, R. L. Banks & Associates, Inc. Interview by author, 19 March. Washington, DC.

Benson, Lee. 1955. Merchants, Farmers, & Railroads: Railroad Regulation and New York Politics, 1850-1887. Cambridge, MA: Harvard University Press.

Buck, Solon Justus. 1913. The Granger Movement: A Study of Agricultural Organization and Its Political, Economic and Social Manifestations, 1870-1880. Cambridge, MA: Harvard University Press.

Cordtz, Dan. 1971. "It's Time To Unload The Regulators." Fortune (July): 64-67, 143-145.

Donahue, Edward J. and Stanley J. Hille. 1971. "National Transportation Policy and the Regulatory Agencies." MSU Business Topics (Spring): 67-75.

Doyle Report. (1961). U.S. Congress. Senate. Committee on Commerce. Special Study Group on Transportation Policies in the United States. National Transportation Policy. 87th Cong., 1st Sess. Report No. 445.

Eastman, Joseph B. 1940. "The Adjustment of Rates Between Competing Forms of Transportation." I.C.C. Practioners' Journal (January): 190-194.

Eizenstat, Stuart E. 1987. Powell, Goldstein, Frazer & Murphy. Interview by author 18 March. Washington, DC. (Chief Issues Analyst in 1976 Carter campaign; domestic policy advisor to President Carter)

Fellmeth, Robert C. 1970. The Interstate Commerce Omission: The Public Interest and the ICC. New York: Grossman.

Friedlaender, Ann F. 1969. The Dilemma of Freight Transportation Regulation. Washington: Brookings Institution.

Hicks, John Donald. 1931. The Populist Revolt. Minneapolis, MN: University of Minnesota Press.

Hilton, George W. 1969. The Transportation Act of 1958: A Decade of Experience. Bloomington, IN: Indiana University Press.

Hoogenboom, Ari and Olive Hoogenboom. 1976. A History of the ICC: From Panacea to Palliative. New York: Norton and Company.

Interstate Commerce Commission. 1975. 89th Annual Report to Congress of the Interstate Commerce Commission for the Fiscal year Ending June 30, 1975. Washington, DC: GPO.

________________. 1976. 90th Annual Report to Congress of the Interstate Commerce Commission for the Fiscal Year Ending June 30, 1976. Washington, DC: GPO.

________________. 1978. 91st Annual Report to Congress of the Interstate Commerce Commission for the Fiscal Year Ending September 30, 1977. Washington, DC: GPO.

________________. 1979. 92nd Annual Report to Congress of the Interstate Commerce Commission for the Fiscal Year Ending September 30, 1978. Washington, DC: GPO.

________________. 1980. 93rd Annual Report to Congress of the Interstate Commerce Commission for the Fiscal Year Ending September 30, 1979. Washington, DC: GPO.

________________. 1981. 94th Annual Report to Congress of the Interstate Commerce Commission for the Fiscal Year Ending September 30, 1980. Washington, DC: GPO.

Kahn, Fritz R. 1987. Verner, Liipfert, Bernhard, McPherson and Hand. Interview by author, 19 March. Washington, DC. (General counsel, ICC, August 1970 to January 1976)

Kohlmeier, Louis M. 1969 The Regulators: Watchdog Agencies and the Public Interest. New York: Harper and Row.

Kolko, Gabriel. 1965. Railroads and Regulation, 1877-1916. Princeton, NJ: Princeton University Press.

Landis Report. 1960. U.S. Congress. Senate. Committee of the Judiciary. Subcommittee on Administrative Practice and Procedure. Report on Regulatory Agencies to the President-Elect. 86th Cong., 2d Sess.

Meyer, John R., Merton J. Peck, John Stenason, and Charles Zwick. 1959. The Economics of Competition in the Transportation Industries. Cambridge, MA: Harvard University Press.

Selzer, Leslie. 1987. Bureau of Accounts, Interstate Commerce Commission. Interview by author. 16 March. Washington, DC.