38. Transportation

Policymakers should

- end all federal transportation subsidies,
- repeal the Railway Labor Act of 1926 and the Railroad Retirement Act of 1934,
- privatize Amtrak,
- privatize the air traffic control system,
- eliminate all federal regulations that prevent airports from being privately owned or operated,
- repeal laws that prevent foreign airlines from flying domestic routes in the United States, and
- repeal the Jones Act.

Historically, the federal government regulated the U.S. transportation system with a heavy hand. Beginning in the 1950s, a series of academic studies showed that regulation protected incumbent firms rather than the public. The result was higher prices and poorer service.

Deregulation of the Airlines

Congress passed the Airline Deregulation Act in October 1978. This legislation eliminated federal control over routes by December 1981 and over fares by January 1983. The Civil Aeronautics Board, which directed much of federal regulation of air transportation, was abolished at the end of 1984. The new law authorized airlines to abandon routes but established an Essential Service Air Program to provide subsidies for service to small communities.

The effect of this legislation on the market value of the various airlines has been remarkable. Southwest has gone from virtually ''zero'' to a market capitalization of around $12 billion. On the other hand, United

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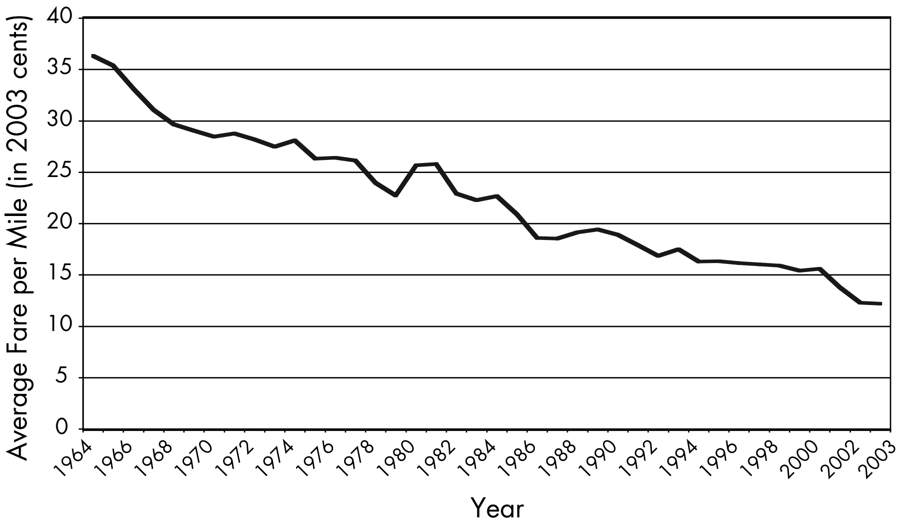
went from a market value in real terms of $2 billion to bankruptcy at the end of 2001.

The percentage of passengers traveling on discount fares has increased dramatically. In 1976, on long flights, only 27 percent of those flying in coach between major metropolitan areas managed to get a discount ticket; by 1983, 73 percent were getting special fares. Virtually all passengers today, except for a handful of business travelers, are paying less than the full coach fare. From 1977 to 2003, after adjusting for inflation, airfares fell some 53 percent. Figure 38.1 shows how the average fare has declined since the early 1970s. The Federal Trade Commission estimated in 1988 that, after adjusting for fuel costs, the flying public was paying 25 percent less because of deregulation. Steven Morrison, professor of economics at Northeastern University, calculated that deregulation produced a net benefit, in 2001 dollars, of about $15 billion, most of which was in the form of lower prices for consumers.

Lower fares have boosted load factors—from 49 percent in 1976 to 75 percent in the first half of 2004—which means that travelers are finding planes and airports far more crowded. Higher load factors, however, make

Figure 38.1
Airline Fares, 1964–2003



SOURCE: Air Transport Association, *Annual Passenger Prices (Yield),* http://www.airlines.org/econ/print.aspx?nid=1035.

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it possible for the airlines to make money at lower prices. Over the quarter of a century since deregulation, the number of passengers flying has roughly doubled while passenger-miles have nearly tripled, proving the success of deregulation.

Deregulation of Air Freight

While passenger airlines were receiving greater authority to compete, Federal Express was lobbying to open up freight air traffic. The Civil Aeronautics Board had granted it only a commuter license that limited FedEx to small aircraft, restricting its ability to compete. It wanted authorization to fly large aircraft to and from any state or city in the country. In 1976 the CAB recommended that air freight transportation be largely deregulated. With support for less federal control from other freight carriers and no visible opposition, President Jimmy Carter, in November 1977, signed H.R. 6010, which deregulated air freight transportation.

Although little attention has been paid to the abolition of air freight regulation, it has been hugely successful. Prior to deregulation, air freight had been growing around 11 percent per year. In the first year of decontrol, 1978, revenue ton-miles jumped by 26 percent. That early success helped build support for exempting passenger transportation from control.

Deregulation of Rail Freight

In the fall of 1980 Congress passed the Staggers Act to provide additional pricing and route abandonment freedoms to the railroad industry. The Staggers Act gave railroads the ability to set prices within wide limits. Rail lines could enter into contracts with shippers to carry goods at agreed-upon rates. Tariffs could not be considered unreasonable, even for ''captive'' shippers, unless they exceeded 180 percent of variable costs. To qualify as ''captive,'' shippers also had to prove that there was no effective competition, a provision designed to protect coal, chemical, and other bulk commodity shippers. Railroads were also given new authority to abandon routes.

The Interstate Commerce Commission was abolished and the Surface Transportation Board established on January 1, 1996, as an independent body housed within the U.S. Department of Transportation, with jurisdiction over certain surface transportation economic regulatory matters. Its authority is largely confined to railroad pricing and merger issues. This act also effectively deregulated intrastate controls on motor carriers, which had been blocking a fully competitive trucking industry.

The Staggers Act was highly beneficial for carriers as well as for shippers. The rail industry withstood well the sharp recession of 1981–82 and enjoyed record profit levels in 1983, notwithstanding a sharp drop in revenue per ton-mile. By 1988 railroad rates had fallen from 4.2 cents per ton-mile in the 1970s to 2.6 cents. After 1984 rail rates continued to fall, declining over the following 15 years by 45 percent. Competition and the Staggers Act have been a great success.

Deregulation of Trucking

Deregulation of the trucking industry, completed only in the 1990s, resulted in lower rates and better service to shippers. It also resulted in lower wages for truck drivers as the Teamsters Union lost power. The price of trucking licenses, which had been as much as millions of dollars, declined significantly to a few thousand dollars as the ICC made new licensing relatively simple and easy. Even though bankruptcies increased, the number of licensed trucking firms increased sharply in the first few years of deregulation.

Standard & Poor's found that the cost of shipping by truck had fallen by $40 billion from the era of regulation to 1988. Improved flexibility enabled business to operate on the basis of ''just-in-time delivery,'' thus reducing inventory costs. The Department of Transportation calculated that the outlays necessary to maintain inventories had plummeted in today's dollars by more than $100 billion.

Further Reform

Although great progress has been made in reducing regulation of transportation, further steps would improve the U.S. system. Currently, the motor carrier industry is subject to no economic controls; consequently there need be no change in policy.

Railroads are still subject to some price controls, limits on abandonment, and control over mergers. Rail passenger service, particularly Amtrak, has been a problem ever since it was established in the 1970s.

Government limits on air passenger transportation continue through cabatoge restrictions, federal administration of air traffic controllers, and government ownership of airports. Finally, as a result of the September

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11, 2001, attacks, security considerations have burgeoned, making air travel more time-consuming and perhaps safer.

Water transportation regulation and subsidies have not been a part of the regulatory reforms of the last 25 years and remain stubbornly resistant to change.

Rail Freight

Today, the rail industry remains the most closely supervised mode of transport with limits on abandonment; mergers; labor usage; ownership of other modes; and even, in certain situations, pricing. The Surface Transportation Board oversees the rail industry and administers the Staggers Act, under which the board must ensure that rates charged to ''captive shippers'' are fair.

Under federal law, the STB can exempt railroad traffic from rate regulation whenever it finds such control unnecessary to protect shippers from monopoly power or wherever the service is limited. Congress has legalized individual contracts between shippers and rail carriers, allowing competitive pricing. The Staggers Act authorizes railroads to price their services freely, unless a railroad possesses ''market dominance.'' Congress continues a prohibition on intermodal ownership and requires the maintenance of labor protection.

All rail mergers, for example, require STB approval; once given the green light, however, those mergers are relieved from challenge under the antitrust laws or under state and local legal barriers. Railroads face a stringent review by the STB that, in addition to general antitrust considerations, includes the effect on other carriers, the fixed charges that would arise, and the effect on employees. In particular, the board must provide protection in any consolidation for employees who might be adversely affected. That provision is very popular with rail labor unions; the industry views it as employment protection, which makes achieving significant savings from mergers difficult.

Under current law, railroads must seek STB permission to abandon lines, build new track, or sell any service. Because users and other interested parties employ the law to slow or even block change, which adds to costs, those rules should be repealed.

Federal law also enjoins the STB to regulate rates charged ''captive shippers''—those that can ship by only one line and enjoy no satisfactory alternative. Coal and grain companies have exploited this provision to gain lower rates. The markets for coal and grain are highly competitive,

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so the producers cannot sell their output at more than the market price. Consequently, a railroad that drives shipping costs up to the point where the cost of producing the coal or grain and then moving it exceeds the competitive price will find that it has no traffic. In other words, although the railroad has no direct competition, it, too, is constrained by the market.

If a coal company enjoys significantly lower costs because of a favorable location or a rich and easily exploited mine, it could reap higher profits than less favorably sited enterprises. However, if the mine has only one option for shipping its product, that is, a single railroad, the rail carrier will be able to secure much of that above-normal profit. In that case, the stockholders of the railroad will gain at the expense of the stockholders of the mining corporation. There exists no rationale for the government to intervene by favoring one company over another. The captive shipper clause must go.

Congress should also repeal the ban on railroads' owning trucking companies or certain water carriers. Federal regulations proscribe railroad ownership of trucking firms, although the STB and the ICC, in earlier decades, have granted many exceptions. From the time of building the Panama Canal, the Interstate Commerce Act has prohibited railroad possession of water carriers that ply that waterway. Early in the 20th century, the public believed that those huge companies needed the competition of water carriers to keep down transcontinental rates. Like the prohibition on ownership of water carriers, the ban on owning trucking firms stems from the unwarranted fear of railroad power. With the plethora of options available to shippers today, such rules are totally unnecessary. The restrictions simply limit the ability of railroads, trucking firms, and water carriers to offer the most efficient multimodal services.

The Staggers Act authorized railroads to negotiate contracts with shippers but only with government approval. In addition, all rates must be filed with the STB, and tariffs that are either ''too high'' or ''too low'' can be disallowed. Congress should repeal these vestigial regulatory powers. At best, they add to paperwork and to the cost of operation; at worst, they slow innovation and reduce competition.

Amtrak

Over 33 years, Amtrak has spent some $34 billion in an effort to turn itself into a self-sustaining enterprise.

Congress should face the facts: passenger rail transportation cannot be made profitable, except in a few corridors, such as between Washington and New York and perhaps Boston. That portion of the system can probably cover its operating costs but most likely will be unable to cover its capital costs. With a few minor exceptions, passenger rail is not profitable anywhere in the world; there is no reason to believe it can be made profitable here. The appropriate policy would be to auction off the assets of the current system, favoring investors who would attempt to continue some passenger service. It seems likely that the East Coast corridor between Washington and points north would survive, albeit with a lower paid workforce. If all union contracts and employees are kept, the system can survive only with taxpayers' funds.

Air Travel

Although airline deregulation has been a great success, the industry has been plagued with crowding; delays; and, on some routes, dominance of a single carrier. The causes lie in the failure to deregulate other essential features of the industry. The air traffic control system, in particular, remains a ward of the FAA. Government entities own virtually all airports. The federalization of airport security has added more government bureaucracy with no clear effect on security.

Air Traffic Control. The FAA runs the current air traffic control (ATC) system. Because the FAA is a government agency, annual congressional appropriations control its finances. Its rules follow normal bureaucratic practices with congressional committees looking over its actions. Moreover, the FAA must regulate itself—a major conflict of interest.

As a government agency, the FAA has been unable to bring on line quickly new technologies that would improve safety and reduce delays. While computer technology changes every year or two, the FAA's procurement processes require five to seven years to complete. It still has 1960-era mainframe computers, equipment that depends on vacuum tubes, and obsolete radars. As a consequence, equipment breaks down frequently and planes must be spaced farther apart than would be necessary with state-of-the-art computers and radars.

Congress has held numerous hearings and put great pressure on the FAA to modernize, but it has been unable to improve matters significantly. To create and maintain a modern system, air traffic control must be separated from the FAA. The Clinton administration recommended a government corporation to run the ATC system; but another government corporation, such as the post office or Amtrak, although it would probably be an improvement over the current arrangement, is not the solution.

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A number of other countries—Canada, the Czech Republic, Germany, Latvia, New Zealand, South Africa, Switzerland, Thailand, and the United Kingdom—have wrestled with this problem and have found that separating the ATC system from government oversight while maintaining government safety regulations works well.

Although no country has fully privatized its ATC system, Canada has created a private nonprofit corporation owned by the users. Its system has successfully reduced delays. The other freestanding ATC systems are at least partially government owned. Given the restrictions that the federal government puts on its government-owned corporations, such as Amtrak and the post office, it would be preferable to follow Canada's example by establishing a nonprofit corporation owned and controlled by airlines and other users of the ATC system.

Most ATC systems are funded through user fees. The problem that arises is what to charge general aviation. Because the FAA currently subsidizes general aviation, owners and pilots oppose any notion of a freestanding corporation dependent on user fees. Nevertheless, client pay is a good rule. Noncommercial general aviation pilots, who typically fly single-engine planes, should be charged only when they file a flight plan or land at an airport with a control tower. Commercial general aviation planes, such as corporate jets, should pay their share of the costs of the system.

Airline Cabotage. It is time for the United States to drop its restrictions on foreign ownership and operation of air carriers. Under current law, non-Americans can own no more than 25 percent of the voting stock of U.S. airlines. America has no similar restrictions on investment in steel, autos, or most other industries. There is no reason to make an exception for the airlines. Other private carriers should be free to invest in the United States. At the moment, several U.S. carriers are in financial difficulties. Purchase by a healthy foreign airline would make great sense, bringing new capital and new competition to the American market. Virgin Atlantic Airways, for example, is interested in building a low-cost U.S. carrier to feed its international service.

At the same time, the long-standing policy of negotiating ''open skies'' agreements with other governments should be based not on what U.S. carriers get out of the agreement but on the benefits to American travelers. Cathay Pacific, based in Hong Kong, could offer improved service and competition both in the domestic market and internationally. British Air

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might invest in US Air to provide nationwide connections to Europe. The introduction of such foreign carriers would strengthen competition in the American market, bringing additional benefits to travelers.

Airport Privatization. Because the Airport and Airways Trust Fund moneys have been available only to government-owned airports, private airports are ineligible for any of the funds that are raised from taxes on fuel and passengers. Because those airports eligible for grants are subject to federal appropriations, even state and local government-owned airports cannot plan and count on money from the trust fund. Repealing the federal taxes on aviation and allowing airports to impose their own fees, which could vary by time of day to reflect peak use, would give airports incentives to expand their capacity and introduce technologies that would reduce delays.

Maritime Policy

Unlike the regulations affecting other transportation sectors, maritime regulations and subsidies have been strikingly resistant to reform. A hodgepodge of conflicting and costly policies—subsidization, protectionism, regulation, and taxation—unnecessarily burdens the U.S.-flag fleet, forces U.S. customers to pay inflated prices, and curbs domestic and international trade. The list of rules and regulations governing shipping is too exhaustive to catalog here, but one thing is clear: shipping policies must be thoroughly reviewed and revamped. Congress should pay special attention to deregulation of ocean shipping and other trade- and consumer-oriented reforms.

In particular, Congress should repeal the Jones Act (sec. 27 of the Merchant Marine Act of 1920). The Jones Act prohibits shipping merchandise between U.S. ports ''in any other vessel than a vessel built in and documented under the laws of the United States and owned by persons who are citizens of the United States.'' The act essentially bars foreign shipping companies from competing with American companies. A 1993 International Trade Commission study showed that the loss of economic welfare attributable to America's cabotage restriction was some $3.1 billion per year. Because the Jones Act inflates prices, many businesses are encouraged to import goods rather than buy products manufactured in other parts of the United States.

The primary argument made in support of the Jones Act is that we need an all-American fleet on which to call in time of war. But during the Persian Gulf War, only 6 vessels of the 460 that shipped military

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supplies came from America's subsidized merchant fleet. Repealing the Jones Act would allow the domestic maritime industry to be more competitive and would enable American producers to take advantage of lower prices resulting from competition among domestic and foreign suppliers. Ships used in domestic commerce could be built in one country, manned by citizens of another, and flagged by still another. That would result in decreased shipping costs, with savings passed on to American consumers and the U.S. shipping industry. The price of shipping services, now restricted by the act, would decline by an estimated 25 percent.

Conclusion

Transportation is inherently competitive. Since elimination of most of the economic controls on trucking, railroads, and airlines, those industries have flourished. Although the performance of those sectors has improved greatly since the 1970s when the federal government controlled entry, rates, and routes, problems remain. The difficulties stem in part from the success of deregulation, which, for example, has democratized air travel while the infrastructure has remained in government hands. Decontrol has demonstrated that the market works much better free from government controls than with government oversight. We need to apply that lesson to the remaining problems and remove federal ownership and control from administration of air traffic control, the airports, and the security system.

The government should free the freight railroads from the remaining constraints on that industry. The government should recognize that passenger rail transport is never going to be profitable, especially when run by the government. Only the private sector can possibly run a profitable passenger train system and then only if free from government controls on labor and pricing. Unlike other transportation policies, maritime policy has been resistant to reform and should receive the immediate attention of reform-minded members of Congress.

Suggested Readings

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—Prepared by Peter Van Doren

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