For many economic analysts, the problems currently plaguing our economy are bringing back memories of the stagflation of the 1970s. "Stagflation" is the term created to define the simultaneous conditions of inflation and stagnant business activity — usually characterized by increasing unemployment. It was that economic environment that gave rise to deregulation that continues to this day.

In the United States, regulation has traditionally followed a “rate of return” methodology, whereby regulators have determined the acceptable rate of return for a carrier to earn, which would cover costs and ensure a reasonable profit, sufficient to support reinvestment. The problem with this practice is that it creates a perverse incentive for a company to increase costs to drive up profit.

Recognizing an inflationary spiral, the government considered deregulation as a means of abating inflationary pressures. In 1977, President Carter named Alfred Kahn, a Cornell economics professor, the administrator of the Civil Aeronautics Board. Legend has it that Kahn told one airline official, “I really don’t know one plane from the other. To me, they’re all marginal costs with wings.”

Deregulation of aviation was followed by deregulation of other modes (rail, truck and ocean). The impact on transportation was immediate and dramatic. With the exception of railroads, new entrants quickly became major players. Although some were more flash-in-the-pan (i.e., People’s Express), many became industry leaders (i.e., J.B. Hunt).

The challenges for railroads and trucks operating in a deregulated market were exacerbated by the 1982 recession. Market dynamics quickly changed. Part of regulation’s purpose was to ensure adequate capacity for times of war and national emergency. However, adequate capacity for extreme traffic peaks means excess capacity most of the time. The granting of operating authority — a monopoly license — was the regulatory means to support this excess capacity.

Transport carriers realized they needed to balance supply and demand, while coping with legacy cost structures. Railroads did this by shedding non-core assets, renegotiating labor contracts and attracting volume growth. Two key commodities in this strategy were international intermodal and Powder River coal. With excess capacity, railroads could ignore the cost of infrastructure and price at marginal cost; however, as volume grew, excess capacity disappeared, and railroads needed to price at average cost — a higher threshold.

Today, we find ourselves in an extremely partisan situation. Many customers feel they are being gouged on pricing. Their arguments are based on how much their rates have risen over time. Wall Street’s embrace of the outlook for further “price improvement” by railroads adds fuel to the fire. The result is some parties calling for re-regulation, only this time regulating price — rather than profit.

Railroads feel they are being penalized for their success. Legacy contracts were a one-time phenomenon. The unique conditions that allowed such pricing no longer exist. Railroads invest a higher percentage of revenue than any other industry, and their returns on capital are not always sufficient.

Intermodal faces a precarious situation. Many customers resent the significant rate increases imposed after legacy contracts expired. However, their circumstances differ from those of bulk shippers who lead the charge against the railroads, and who like to claim that they pay a higher portion of fixed costs than intermodal customers.

Still, this is rational economics. Ramsey pricing maintains that customers with inelastic demand (i.e., bulk shippers) pay a higher markup over marginal costs than customers with more elastic demands (i.e., intermodal). This may seem unfair, but if a strict, formulaic price model were imposed (where all customers paid the same markup over marginal costs), customers with options would shift to another mode. Rather than have intermodal customers absorb some of the fixed cost, bulk shippers would have to absorb all the fixed costs — and their rates would rise even further.

The real challenge is infrastructure. Even in a duopoly, there can be competition for business — if sufficient capacity is available. It seems to me that inadequate investment and capacity is the common problem we should all be seeking to solve. Only then can the transportation system meet the needs of all stakeholders.

Ted Prince is president of Consolidated Chassis Management LLC. He can be contacted at (804) 754-2291, or at tprince@ccmpool.com.