AFD 307 Links and Notes - Part 3: Understanding Rail Price Wars

- In contrast with the popular agitation in the West (Grange Movement) over excessively high prices for rail freight shipments, the situation in the East was one of uneven/discriminatory pricing and prices that were actually too low to support operational costs or other financial needs
- Railroads were the 2nd largest industry in the United States after the Civil War (only behind agriculture) and a massive boom in construction of tens of thousands of miles of track (funded with government subsidies and private speculator investments) led to overbuilding that collapsed 115 railroad companies over the course of the Panic of 1873 https://en.wikipedia.org/wiki/Panic_of_1873 But we're going to be talking this week about a very narrow geographical area of US railroads in the period just a couple of years before the Panic of 1873 and somewhat after.
- Munn v. Illinois (1876) and the Granger Movement
    - US Supreme Court ruled [https://en.wikipedia.org/wiki/Munn_v._Illinois] in favor of the state of Illinois (which was being lobbied by the Granger farmer lobby) that states have the power to set maximum rates for storage and shipping of goods on privately owned common carriers and de facto "utilities." (Munn & Scott was a grain storage company.) This decision was in force until the 1886 Wabash Railroad decision reversed it and led to the creation of the Interstate Commerce Commission, as we noted in our last episode; it's outside our scope here, especially because by 1886, the oil industry had moved on to new regions beyond Pennsylvania, which was on the way out as *the* oil producing hub. [https://en.wikipedia.org/wiki/Wabash,_St._Louis_%26_Pacific_Railway_Co._v._Illinois] However, these rate maximums under Munn v. Illinois were a greater concern to the railroads west of Chicago than to the railroads east of Chicago where they had the opposite problem of rates being too low. **But it is critical to understand that the rates were only low for shippers receiving rebates (discussed last week), usually due to huge volume, which helps explain why the general public remained angry about high shipping rates, despite railroads losing money!** https://www.encyclopedia.com/social-sciences-and-law/political-science-and-government/us-government/freight-rates
    - While the Grangers had a significant political and policy effect all over the country, including in the East, which is why you might have read about them in an AP US History course or similar, they fall outside of the sphere of our discussion of the railroads in the context of the early oil industry in Pennsylvania and the outside refineries and crude shipping lines. https://en.wikipedia.org/wiki/National_Grange_of_the_Order_of_Patrons_of_Husbandry
- Railroads in Receivership - How to drive down rates even further:
    - *railroads or other carriers in impaired financial condition [could] cause and exaggerate the effects of the rate-cutting contests. These latter carriers were usually bankrupt and had no interest charges to pay. They were not earning enough to pay these charges or dividends on capital stock. Freed of the burden of such charges, they were able to reduce rates in the hope of attracting traffic from their solvent rivals, which were meeting interest charges and sometimes paying dividends. They had little to lose and much to gain either through increasing their traffic and gross earnings or forcing their more vulnerable*

competitors to yield and divide traffic or earnings.
https://www.encyclopedia.com/social-sciences-and-law/political-science-and-government/us-government/freight-rates
    - As noted below, carriers like the Erie Railroad went bankrupt multiple times during this period
- "The Road of the Century" by Alvin F. Harlow (1947) on the New York Central
    - In 1867, two public pressure groups emerged with a hostility toward railroads
        - "The National Anti-Monopoly Cheap Freight Railway League" - Lorenzo Sherwood proposed "the creation of seven double-track railroad systems, covering 4,000 miles, at a cost of $200,000,000, over which any company or individual might operate cars, just by paying tolls" (this isn't a particularly good or helpful idea but even to the 21st century some holdouts advocate for it)
        - National Grange of the Order of Patrons of Husbandry (aka The Granger Movement) - see above
    - There's a section beginning on p.284 discussing "ruinously intense" (286) price undercutting among railroads around the time of the oil rush in Pennsylvania
        - Harlow cites the Tarbell book we've been focusing on in the previous episodes - quoting "any big producer or refiner could bully a freight agent into a special rate"
        - Rockefeller himself told Congress: "A public rate was made and collected by the railroads, but so far as my knowledge extends, seldom retained in full; a portion was repaid [to] the shipper as a rebate. By this method the real rate of freight which any shipper paid was not known by his competitors nor by other railroads, the amount being a matter of bargain with the carrying companies."
        - Muckraker George W. Alger in McClure's Magazine (1904) criticized the railroads but also outlined the problem with their situation: "The railroads were fighting for a chance to live. They were interstate railroads, and there was no federal legislation of any kind governing them. They could not agree among themselves as to rates, and competition among them was ruinously intense. They needed control by law, and there was no law on the federal statute books which governed them. Such state laws as there were did not apply to interstate commerce, were weak and insufficient. They must do something. They had millions of dollars invested in their rights of way, in their tracks and rolling stock. They had to do business, carry on this enormous oil traffic, even at a loss. Not one of them was willing to move its business out of the Oil Regions like a disappointed grocery or a discouraged saloon. But with cut-throat competition, they could make no money. What could they do? The Oil Trust furnished the answer… Where there is an economic condition which absolutely requires a law and the state fails to provide it, somebody else will. The schemers for an oil monopoly furnished that law." (Note from Bill: Remember, due to the common law status as common carriers, the railroads could not really refuse business even if they wanted to, and they didn't really want to because they had already sunk so much capital into rail service to the vicinity of the oil regions prior to the discovery of oil.)

        - A passenger fare rate war broke out between New York Central and Pennsylvania in 1875 and lasted to at least 1877, resulting in both of them not really making money off the 1876 Centennial Exposition traffic to and from Philadelphia because they were charging such low prices
        - In 1877, which is also when a massive railroad strike broke out, which we will discuss in a different future episode, William H. [Billy] Vanderbilt (taking over from his recently deceased father, the Commodore) made a division of shipping arrangement with competing railroads, writing to publicly defend the cartel in the Chicago Times (June 1878): *"The great commercial, financial, agricultural and industrial interests of the country are all injured by such competition as has heretofore prevailed, with its attendant uncertainties, by such a check as would secure fair profits… What the people want is certainty and moderate prices for freight. The object of all pooling arrangements is to bring about this result… If any other scheme will work better, then I am in favor of that. High rates in the future are utterly impossible. The people are safe from extortionate charges. Stability of prices, fair rates for transportation, equitable dealings with shippers and general prosperity can be had only through some understanding embraced in what is generally styled a pool."* Two key pieces of context: 1) This pool to split freight business in the region came 3 years after the efforts of Empire Transportation Company and Rockefeller to negotiate proportional shares of oil traffic in the region between the 3 major railroad groups. [See previous episode; this is not mentioned in the book here.] 2) There was also immense price competition coming from the Erie Canal and Great Lakes shipping, who had managed to push down the price to move a bushel of corn from Chicago to New York City to a mere 7.5 cents.
        - In the 1880s (next chapter, pp.307-312), the New York Central was also forced to buy the brand-new "Nickel Plate" railroad because it was constructed literally parallel to their recently acquired Lake Shore subsidiary, as basically intentionally built as a very expensive hostage-taking. (It opened with fatally poor finances, as essentially a huge confidence scheme from the start, but they knew they could either force the Central to buy it to prevent competition with a railroad in receivership charging rock-bottom rates or sell it to Jay Gould as a rival railroad, with both outcomes meaning a huge cash-out for the leadership.) Two of the leaders of this scheme were the future Governor of Ohio Charles Foster and the future Ohio US Senator Calvin S. Brice.
    - Railroads like the New York Central and Pennsylvania began running postal cars for the US Postal Service at a revenue loss (especially being on the hook for maintenance costs), especially compared to private express delivery services who also shipped with them. (pp.294-295)
- "Erie Lackawanna: Death of an American Railroad, 1938-1992" by H. Roger Grant (1994)
    - The first chapter (about pre-1938 Erie) discusses the severe debt problems facing the railroad (which was the worst of many struggling railroads), preventing them from making meaningful investments in upgrading or expanding their infrastructure (pp. 10-11) - an early form of zombie corporation - and multiple

bankruptcies starting in 1859 did not alleviate the problem because the poor reputation made it difficult to obtain good financing (pp.4-7) - by the end of the 19th century, the lines were in poor shape which meant slower trips, and they were forced to undertake a long comprehensive rebuilding in the early 20th century before WW1, at great financial precarity (pp.8-9)

    - In the late 19th century, the Erie tried to use money-losing passenger rail service as a way of building brand loyalty (p.8) among businessmen who might arrange to ship revenue-generating freight over the Erie lines. They actually had notably bad passenger service so this was a bad plan. (Side note: This was a model that remain bizarrely popular among American railroads until the creation of Amtrak by the federal government during the Nixon Administration to try to publicly maintain passenger rail service that private railroads were finally ready to jettison.)
    - One other tieback to the Pennsylvania Oil Rush: Erie Railroad eventually came to be controlled by the billionaire Van Sweringen Brothers, real estate tycoons & rail financiers in Cleveland who were born a couple decades after their father had worked as an engineer in the northwestern Pennsylvania oilfields. They were pioneers of much of American suburban planning concepts in the pre-Levittown era. (Bad!) They were also extremely skilled at using holding companies after WW1 to evade Interstate Commerce Commission oversight of mergers, where they became very clever about manipulating debt loads and stock shares to control management of the railroads in their portfolios in a way that would probably impress private-equity raiders today. [see also: https://en.wikipedia.org/wiki/Van_Sweringen_brothers]
- “The Pennsylvania Railroad Company 1846-1946” (the railroad’s official centennial history of itself):
    - Chapter XV glosses over the oil business and the rate wars, simply stating “The development of the oil traffic and the railroads which handled it is a story told elsewhere” and “There is no need to go into detail about the rate cutting that took place, or the system of rebates and drawbacks...” while trying to minimize the PRR’s involvement in the rebate schemes or Rockefeller’s conspiracies (which makes sense for an official corporate history!)
    - However Chapter XVII goes into depth more:
        - *The first mention of a rate war for the traffic of the West* [note from Bill: anything west of the Atlantic seaboard but especially traffic from Chicago or St Louis] *occurs in the Pennsylvania’s Annual Report for the year 1858. This reference states: “The effect of the unwise competition for the carrying trade between the East and West, which prevailed for a time during the past year, induced the officers of the New York Central, New York and Erie, Baltimore and Ohio, and Pennsylvania Railroad Companies, to meet in convention for the purpose of agreeing upon remunerative rates, abolishing injudicious practices, and effecting a harmony of purpose conducive to the mutual advantage of the railway interest and the public. An arrangement was agreed upon which took effect on the first of October last, and the advantages thus far resulting from this compact seem to demonstrate the propriety of its continuance.” The same report also points out, however, that sharper competition than ever before is in the offing with the ‘enlarged New York Canal and its*

numerous steamers. This new competition was apparently effective in destroying the harmony of purpose among the railroads, for the report of the next year remarks that while the traffic of the road has increased, earnings from freight have not kept pace in consequence of the competition between the New York Central Railroad and the transporters on the Erie Canal. On another page, however, we come to what, over a considerable period of years, was the more important consideration in the battle between the trunk lines, which was joined in vigorously by the seaboard cities which they served. "It has been the policy of your Board to seek an increase of traffic for the road by securing freights destined to every part of the world, in all cases where they believed they could add to the profits of the shareholders, while they have with equal care sought to protect the manufacturing and commercial interests of Philadelphia, whose means have been so liberally embarked in the enterprise, by such differences in her favor in the rates of freight, as are due to the shorter distance it is to be transported to and from the West. More than this could scarcely be asked of the company, and more, if demanded, would not be permitted by the competing lines transportation between the East and West. During the past year the New York Central Railroad, in an unreasonable (if sincere) effort to bring the rates to and from New York to the same level with those of Philadelphia and Baltimore, sacrificed hundreds of thousands of dollars to herself and rivals, without attaining her object, beyond temporarily destroying the uniformity of these differences in rates." In other words, the Pennsylvania was attempting as it had since its line was completed, to maintain a rate differential on the competitive western traffic in favor of Philadelphia as against New York, and the Baltimore and Ohio was attempting to keep below both of them in its rates to and from Baltimore, both arguing that such differentials had a sound basis in the relative distances between those ports and the interior. This seemed a sensible argument, and there was another one which went with it, one of great practical importance, as concerning import and export traffic. Ocean rates from Philadelphia to Europe were higher than from New York, and from Baltimore still higher. Therefore, if wheat shipped to England via Philadelphia were to bring its owner the same profit as if it had been shipped by New York, the rail rate from farm to Philadelphia would have to be low enough to offset the higher ocean rate from Philadelphia to Liverpool. All this was fine, except that New York would have none of it. Her merchants and shippers claimed that her advantage in ocean rates was not caused by distance, but by various natural advantages, as well as by the superior facilities supplied by man, and, to a considerable extent this was true. Another important truth was that New York had got her first great advantage over her rival ports by reason of cheap transportation on the Erie Canal as compared with the overland routes, and thus was particularly loath to accept an equalization of the rail ocean rates via all ports. The battle lapsed during the Civil War, when all the trunk lines had all the traffic they could handle, but broke out in increased vigor when the war traffic ceased. The fact was that railway mileage had increased much faster than even the rapid growth of the

West had required, and there was a considerable excess of carrying capacity which was a constant temptation to rate cutting on some pretext or other. (Note from Bill: The antebellum rate war ended with the boom in wartime traffic.)

- Chapter XXII: *In 1867, the rate wars broke out again. The annual report for that year describes how the Erie and the New York Central attempted to break up "the through traffic arrangements of this company" by large reductions in their freight charges, and how the Pennsylvania met the challenge with still greater reductions, which resulted in a large increase in its tonnage. It appears that the others finally begged for mercy and the rates were restored, but "the effort increased the prestige of this company by bringing it shorter lines and better facilities more prominently into public notice". In 1870, it is noted that freight revenue decreased, in spite of an increase in tonnage, which "is mainly accounted for by the reduction of freight charges– without any legitimate object– during the past summer and autumn by the New York lines, to a point much below cost of transportation". Apparently from 1871 through 1873 there was traffic enough for all the roads without attempting to steal each other's business.*
- Chapter XXVI: New President of the Erie railroad - H. J. Jewett - tried to solve the rate war through agreements with the presidents of New York Central and Pennsylvania and smaller Western railroads. Elimination of rebating and establishment of a commission that would make “such moderate rates as would be reasonable and just to the public and give in the future equal and uniform rates to every shipper”. However, Baltimore and Ohio didn’t send a commissioner, and Grand Trunk of Canada was in receivership and had nothing to lose by continuing to slash rates. Also, New York public believed that New York Central had “sold out” to other roads, so there was resentment.
    - The commissioners weren’t able to control Grand Trunk, whose rates caused traffic to divert to Boston. In 1875,Boston to Chicago rates were 50% lower than from New York. In response, New York Central cut rates up to 60%, escalating another rate war.
    - IN April 1876, passenger fare between Boston and Chicago dropped from 25.85 to 14.00. Freight rate on ag products from Chicago to New York fell from 50 cents per hundred to 18 cents. The westward rate of 2.8 mills per ton-mile was less than half the Pennsylvania’s average cost.
    - Col. Albert Fink brought in in 1877 to pool railroad revenues. He had successfully done this in the South as vice-president of Louisville and Nashville railroad. This pool included about 30 railroad and steamboat lines and he had administered its affairs as commissioner. Formation of pool of westbound traffic from New York: 33% each to Central and Erie, 25% to Penn, and 9 to B&O.
    - Fink also pooled eastbound traffic in 1879.
    - Public was suspicious of this pooling, but it did keep the lines from destroying themselves
- Chapter XXVII: As stated last week, Standard Oil had great influence over Pennsylvania, collecting portion of rates from independent shippers. All the oil was shipped in cars owned by Empire Transportation Company, which was independent of the railroad although they worked in cooperation.

- American Transfer Company, secretly owned by Standard Oil, started aggressively building pipelines. In response, Empire acquired two refineries, one in Philadelphia and one in New York. Rockefeller protested that a public transportation company shouldn't also own refineries, as they would favor their own refineries (that's rich coming from Rockefeller).
- In 1877, Rockefeller refused to ship on Pennsylvania unless Empire gave up its refineries. Pennsylvania refused to bow, and lost 65% of oil traffic overnight. Empire wanted to rally independent refiners against Standard, but another rate war broke out which undermined their efforts.
- That summer, Pennsylvania could no longer afford to stand by Empire, and bought out their cars and plant. Standard Oil bought their pipelines and "thereafter had producers, transporters, and independent refiners largely at its mercy".
- New pooling agreement set up by Standard. 63% of traffic was to go to New York, with Pennsylvania conceded ⅓. Of the remaining 37% going to Philadelphia and Baltimore, Pennsylvania would have 26/37ths. Standard guaranteed Pennsylvania 2 million barrels per year and the Pennsylvania would pay a 10% commission on all the traffic Standard controlled. This arrangement remained in place until pipelines replaced railroads.