Introduction

For several decades beginning in the 1860s the passenger train dominated American intercity passenger transportation and figured importantly in the evolving American economy. Beginning about 1910 the automobile challenged the passenger train’s dominance. Whether railroad managements responded inappropriately, or whether the automobile’s appeal proved irresistible, the automobile quickly triumphed, relegating the passenger train to unimportance and unprofitability. In this book I examine the automobile challenge and railroad management’s response to determine whether managements did their best to adapt the passenger train to the automobile age.

The examination focuses on the California operations of the Southern Pacific Company and the Atchison, Topeka & Santa Fe Railway. Both companies typified large American railroads during a period when California’s rapid automobile, population, and economic growth was presenting their managements with a business environment undergoing greater than average change. Because buses figured importantly in railroad passenger strategies after the mid-1920s, I also examine the development of the intercity bus industry in California and its relations with railroads.

In evaluating how well railroad managements adapted to changing passenger markets, I challenge three generally accepted tenets of business and railroad history. The most basic of these tenets views the history of business decision making as a rational process in which managements acted to earn maximum possible profits. When confronted with a changing market, they altered their products to meet new consumer desires at the lowest possible cost.

Under this paradigm the noted business historian Alfred D. Chandler, Jr., explains how railroad entrepreneurs created the modern business hierarchy in response to the unprecedented scope and complexity of early railroad trunk lines. The completion of interregional trunk lines in the 1840s challenged railroad leaders to coordinate the safe operation and maintenance of scores of trains on tracks spanning hundreds of miles. Railroad leaders also had to make financial sense of organizations offering diverse freight and passenger services taking in revenues and making expenditures at hundreds of geographically dispersed points. To meet these challenges railroad leaders pioneered the modern business bureaucracy, which separated professional managers from owners. Cost accounting figured promi-
nently in the new structure as the means by which top managers controlled their vast enterprises. By knowing the revenue and cost consequences of their actions and acting to maintain or increase profits, railroad managers could adapt their enterprises to changing conditions.¹ The elegance of this argument stimulated the recent synthesis on the rise of big business.²

Although they preceded the Chandler paradigm, several explanations for the decline of the American passenger train support it. George W. Hilton’s analysis of Amtrak explains the historic decline of the passenger train as the result of decreasing demand, to which railroad management responded reasonably well. However, the service and cost virtues of the automobile and airplane overwhelmed management’s best efforts. Railroad managements tried to make passenger trains more appealing to an increasingly auto-conscious public, while they did their best to improve the productivity of the technology. If management erred on the side of emotion, it was in sticking with passenger trains far too long. John R. Meyer’s and Clinton V. Oster, Jr.’s, recent analysis of airline deregulation also views rail passenger decline in this manner. They claim that railroad managers made a valiant attempt in the 1930s to lower costs and improve service with the introduction of streamliners. Despite such efforts, which Meyer and Oster claim succeeded for a while, trains in the post–World War II environment again became a high-cost mode of travel. By this time managements had exhausted the technological possibilities for economically improving passenger trains, which consequently were doomed.³

In challenging the view that railroad managers met the auto challenge by offering the most profitable service they could have, I side with the noted American business historian Thomas C. Cochran. Cochran explains business evolution by allowing for sometimes irrational managerial behavior. His analysis of railroad executive correspondence between 1845 and 1890 finds organizational change occurring more slowly and haphazardly than Chandler claims. Cochran gives more weight to institutional precedent, primarily from the military, as well as to a long period of trial and error in finding out what practices were and were not socially acceptable. He finds little evidence that railroad managers paid much attention to outside industry analysts promoting organizational and accounting innovation, and he reports that accounting information often misdirected management. Railroad entrepreneurs and managers had at best only vague ideas about the profitability consequences of their actions. They made major investments in order to relieve traffic congestion on lines and in terminals, to operate longer and heavier trains, or to open new territory before a competitor might. They had little interest in innovation. Drawing on the darker side of Weberian theory, Cochran sees weaknesses as well as strengths within rail-
road bureaucracies that sometimes prevented rational responses to changing business environments.  

Stephen Salsbury’s history of the collapse of the Penn Central lends considerable support to the Cochran view, as does James J. Flink’s recent history of the automobile in American life. My work also supports it. I argue that although railroad managers generally pursued the profit motive, they did not do so for much of their passenger operations. They ran many passenger trains as a self-imposed social obligation or to promote freight service, particularly on routes where they competed with other railroads. This sometimes led to questionable investments. The investment by one railroad in a bright new passenger train often compelled its competitor to similarly invest, even though the service was unprofitable by the railroad’s limited definition of profitability. Meanwhile the railroad neglected to invest in more promising passenger routes where freight competition was not significant.

I also argue that managers acted inappropriately because most of them misunderstood the costs of running trains. In his broadly based, sweeping history of the railways of England and Wales, the British historian Jack Simmons notes that as nearly as he could determine, Victorian railroad managers had no notion of the profitability of their various services. Simmons remarks that the subject, because of its obvious historical implications, warrants closer study. In this work I provide such a closer examination for the case of railroads in the United States, confirming and offering insight into Simmons’s conclusions.

In the American context, managers thought that most of their costs were fixed, meaning that costs did not increase much when managers added cars to already existing trains. This belief led to strategies for reducing the passenger deficit by eliminating local and branch line trains, which grossed little revenue. At the same time, managers improved heavy mainline trains, which grossed considerable revenue. Unfortunately such actions failed to improve the profitability of passenger service. I argue that this was because costs behaved differently than management believed. Rather than remaining fixed, costs went up significantly when management added cars to trains. Management’s cutting of little-used trains reduced costs while not significantly reducing revenues, but its improving of mainline trains added substantially to costs as well as to gross revenues. In many cases costs rose faster than revenues, causing passenger train profitability to decline and eventually go into the red at the end of the 1920s. Because costs behaved contrary to management beliefs, the passenger deficit increased rather than declined in the later 1930s as management succeeded in carrying much larger passenger volumes.
Another historical view of railroad decline, popularized by Albro Martin in *Enterprise Denied*, holds regulation responsible for the railroad industry’s chronic financial problems since about 1910. Martin argues that regulation stripped management of its prerogative to set freight and passenger rates in accordance with changing market conditions. Yielding to pressure from shippers, Congress transferred rate authority to the Interstate Commerce Commission between 1906 and 1910. Subsequently holding down rates in a period of inflation, the ICC caused rail profit margins to wither, discouraging investment in tracks, structures, and rolling stock and driving managerial talent from the industry. Martin blames shortsighted government policy for the decline of the American railroad industry.\(^7\)

Martin’s view could explain chronic passenger train unprofitability after the automobile severely cut into its markets. Because of unfair government treatment of the railroads, managements may have invested far less in their viable passenger markets than they would have in a free market environment. Underinvestment would have made passenger service less competitive with the auto. Once the auto began to reduce passenger train demand, regulation also may have prevented managements from adjusting passenger services to new markets by discontinuing money-losing trains or raising fares.

My examination of the passenger train’s decline in California supports some of these points but puts a new twist on them. Other points it contradicts. While government policy unfairly favored highways over railroads and hindered management’s ability to compete with the auto, I contend that railroad management, rather than government policy, must take the blame for this condition. Transportation users in California, particularly development interests, wanted more and cheaper service than private rail corporations could provide at a profit. This fundamental incompatibility of interests underlay the conflict between the American railroad industry and its users during the Progressive Era. It explains why business interests so enthusiastically promoted both railroad regulation and tax-supported highways, whose bureaucracies thought in terms of service to users rather than profits. Railroad managements bridled at the resulting inequity, but their desired remedy of a return to laissez-faire enthused no other interest group. The only other option for eliminating the inequity was to publicly finance railroads under the control of users. This option may have found wide support but for the vehement opposition of railroad managers. The United States’ seemingly irrational policy of favoring highways while regulating railroads thus resulted from the failure of railroad managers to appreciate the social context in which they operated, which was one in which users dominated transportation policy. Railroad management’s concession to this
realities by running some unprofitable services to benefit more important users proved ineffective.

I also argue that regulation interfered remarkably little in the day-to-day management of passenger service prior to World War II, and that self-destructive practices attributed to regulation came instead from within railroad management and resulted from management's attempts to appease users. The practice of subsidizing money-losing passenger service with freight revenues offers a good example. It is commonly assumed that regulatory bodies compelled railroads to finance money-losing passenger service with freight revenues. To the contrary, I argue that the ICC opposed this practice before and after World War I and prodded the railroads to improve their cost accounting so that they could recognize passenger subsidies when they occurred. The railroad industry fought the ICC every inch of the way on this issue, primarily because it did not want the ICC or shippers to have knowledge of its cost structure, which would have further eroded management's already weak political position. This is one reason why the railroad industry made so little progress in cost accounting.

In general the ICC also welcomed railroad efforts to experiment with passenger fares. It encouraged railroads to raise fares in 1920, and it allowed them to lower fares in the 1930s. As passenger service lost ever larger quantities of money, railroad managements failed to raise fares not because of pressure from the ICC, but because the market would not stand higher fares. In 1936, when the ICC forced the eastern railroads to lower fares against their will, gross revenues subsequently rose substantially, indicating that fares had been too high from the market's perspective. I argue that the cause of the passenger deficit was not a regulatory structure that refused to approve fare increases, but a passenger service that cost too much to operate in comparison to the fares that the public was willing to pay. Management failed in not confronting its high cost structure with strategies and investments oriented to reducing the cost per passenger mile.

I also show that the California Railroad Commission readily permitted railroads to discontinue money-losing passenger trains during the interwar period. In the many instances where California railroads knowingly operated unprofitable passenger service, I argue that they did so out of their sense of social obligation rather than fear of regulatory proceedings.

Finally, I challenge the conspiracy explanation for passenger train decline. Bradford Snell, an often-quoted critic of American transportation policy, charged in the early 1970s that the railroad industry increased its profits by getting rid of many successful passenger trains in the 1930s. It did this, he claimed, by conspiring with the Greyhound Corporation and General Motors to replace profitable trains with General Motors-built
buses. This move ultimately led disgusted passengers to abandon inferior buses in favor of autos. The railroad industry benefited from increased freight revenues associated with the construction of more autos, more than compensating for the loss of profitable passenger trains.8

In looking at rail and bus passenger practices in California, I examine the development of the largest and most profitable of the Greyhound operating subsidiaries, Pacific Greyhound Lines. After first forming its own bus subsidiary, the Southern Pacific Company actively participated in the formation of Pacific Greyhound Lines, of which it owned a 39 percent interest. I argue that the Southern Pacific and Pacific Greyhound Lines diverted no important passenger markets from rail to bus. On the contrary, Pacific Greyhound fare policy protected important rail markets during the early 1930s. The corporation’s astounding profitability during the 1930s came not from the few rail passengers who were diverted to buses, but from bus managers who strove to make it ever more efficient.

In short, I discount three widely held beliefs about the decline of the American passenger train. In their place I offer the following explanation. California’s development interests, whose economic and political power eclipsed that of the railroads by 1910, demanded plentiful and cheap intercity transportation. They did so because their prosperity depended on economic growth, which in turn depended on plentiful and cheap transportation, among other things. To achieve their transportation objectives, they resorted to railroad regulation and subsidized construction of transportation infrastructure, including ports, canals, and highways. By 1915 their efforts rendered the private provision of railroad passenger service in California not only unprofitable but increasingly unnecessary. In the new era (after 1910) of subsidized competition, railroad passenger service could survive only if railroad managers developed better passenger service at lower cost. Managers partly succeeded in doing this by eliminating rural passenger train services and by speeding up and improving the comfort of remaining trains. Their successes demonstrated that there was an automobile-era market for fast, comfortable, and low-priced trains linking the larger cities. However, their failures in other areas prevented such trains from developing as they could have. Managers failed to improve their infrastructure to keep up with the dramatic highway improvements that the California state government made. Even with government subsidies to roads, a market existed for improved rail routes in the most important corridors. Managers could have invested in rail improvements themselves, or they could have recognized the sentiment of the state’s business interests that transportation infrastructure should be publicly provided and subsidized. In the latter event, they could have attempted to broker deals whereby the rail infrastructure would
have been taken over by an arm of the government and improved. They attempted neither strategy, but chose instead to publicly decry subsidies to other forms of transportation, a move that interested no one other than railroad managers. Consequently, the new streamliners of the 1930s ran over rail alignments made obsolete by indirect routes. Managers also failed to price their trains appropriately during the 1920s, which alienated all but business travelers. In the 1930s they tried and partly regained nonbusiness travelers through ultra-low fares, but they lost money on the traffic because their costs were too high. Low cost operation did not figure in their objectives for designing their passenger service, partly because they failed to understand how passenger costs behaved.

I begin this chronicle by examining the conflict between California’s railroads and the development interests in the state. In chapter 1 I describe the interrelated development of the Southern Pacific and Santa Fe railroad lines and the development of the state between 1860 and 1910. I show the passenger train’s extraordinarily rapid growth, its profitability, its largely local nature, and its importance to the state prior to 1910. I demonstrate that railroad managements performed superbly in modernizing California’s transportation system in the decade prior to 1910, but I also show that railroad corporations were disliked by most business and development interests in the state. I examine why this was so and the consequences up to 1920: regulation and tax-supported competition.

Business hostility to the railroads and the not unrelated development of competition rapidly created a nasty environment for the passenger train. In chapter 2 I examine how the railroad managements reacted. I trace how they made decisions, look at their objectives for operating passenger services, and examine how they changed strategy between 1910 and 1920, including the two-year period of federal control of the railroads.

In chapter 3 I continue tracing the evolution of passenger strategy during the prosperous 1920s as passenger demand continued to decline. During this time the Santa Fe decided to quit most of its intrastate business, while the Southern Pacific decided to replace much of its local trains with its own buses.

The Southern Pacific’s bus initiatives at the end of the decade set the stage for the 1929 formation of Pacific Greyhound Lines, which became one of the two largest and most profitable bus systems in the United States during the 1930s. In chapter 4 I look at the formation of Pacific Greyhound Lines, its ownership and control, its management methods producing its large profits, and its relations with the Southern Pacific. In this chapter I lay the Snell thesis to rest.

While Pacific Greyhound Lines made large profits during the Depres-
sion, neither the Southern Pacific nor the Santa Fe did, despite passenger trends similar to those of the bus company. The railroads failed not for the want of trying bold initiatives, including streamliners, even lower fares, and a new statewide bus system to compete with Pacific Greyhound Lines. In chapter 5 I examine their initiatives and results, and in chapter 6 I evaluate what went wrong. In the evaluation I consider how railroad cost analysis changed since 1910, contributing to the financial difficulties of the 1930s. Finally, in the conclusion I tie the various threads together.