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Competition at Work:  
Railroads vs. Monopoly  
in the U.S. Shipping Industry (p. 3)

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## *In This Issue*

“People of the same trade seldom meet together . . . but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices,” warned Adam Smith, more than 200 years ago, in his book *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776, vol. 1, bk. 1, chap. 10). In this issue of the *Quarterly Review*, Thomas J. Holmes and James A. Schmitz, Jr., offer a case study of the benefits to the public when “people of the same trade”—here, long-distance transportation—must give up their “conspiracy” and compete. In a new study, “Competition at Work: Railroads vs. Monopoly in the U.S. Shipping Industry” (p. 3), Holmes and Schmitz demonstrate that in this industry, increased competition lowered the prices that the public faced and, in fact, did much more. It also lifted the artificial barriers imposed by monopolists on technological innovations in the industry and so improved productive as well as allocative efficiency.

– Until Robert W. Fogel’s work in 1964, U.S. economic historians saw railroads as 19th century engines of growth. Railroads were seen as a key force behind the Industrial Revolution in the United States because this new form of transportation both connected the country’s major markets and created new ones. Before Fogel’s work, however, no one had attempted to measure just how much this new form of transportation contributed to U.S. economic growth. Fogel did this and came to a surprising conclusion. If railroads had not been developed, he found, then the nation’s rate of economic growth around the turn of the century would not have been much different than it actually was.

In 1993, Fogel was awarded the Nobel Prize in Economic Sciences for this and subsequent work, and his view has become conventional wisdom. It has done so partly because Fogel has provided a compelling defense of his result and partly because no one has yet managed to overturn it. Here Holmes and Schmitz take a new look at railroads and the U.S. long-distance transportation industry in the 19th and early 20th centuries. While these researchers may not quantitatively overturn Fogel’s result, they do seriously challenge it.

Holmes and Schmitz question a key assumption that Fogel made in order to come to his conclusion, the assumption that before railroads were

developed, the U.S. long-distance transportation industry was competitive. If Fogel's assumption is true, then his conclusion seems hard to refute. But if the assumption is not true, if the industry that railroads were entering was instead monopolistic, then the economic impact of the competition from railroads is likely to have been much greater than Fogel estimated.

This is what Holmes and Schmitz find. They make a compelling case that in the 19th and early 20th centuries, the industry providing most of the long-distance transportation in the United States—the shipping industry—was monopolistic. After presenting detailed evidence that a great potential for monopoly existed in this industry, Holmes and Schmitz show that the prices charged for water transportation were well above competitive prices and the ways of working in the industry were hampered by unions with the power to impose and hang onto inefficient technologies. Holmes and Schmitz then argue that the introduction of competition from railroads greatly weakened this monopoly and so greatly benefited the public. The price of water transportation dropped, and groups with monopoly power in the industry dropped some inefficient technologies in order to better compete with railroads.

Holmes and Schmitz do not attempt here to recalculate Fogel's quantitative estimate of the overall benefits that railroads provided to U.S. economic growth. They leave that for future work. From the work they have done here, though, it is clear that their future estimate is likely to be far greater than that of the conventional wisdom.

Arthur J. Rolnick  
Editor