

Motor-Carrier Rate Regulation: A Case Study in Cartel Control

W. DAVID MAXWELL,
School of Business Administration
Tulane University, New Orleans, La.

The need is noted for a common analytical description of the transportation industry to provide a common basis for discussions of transportation policy. The purpose of the present paper is to provide such a basis for motor-carrier rate regulation.

The natural economic characteristics of motor trucking are those of a highly competitive industry. Rate regulations (together with control of entry) have prevented these natural economic characteristics from dictating the development of a large part of motor trucking. Under such regulation the economic characteristics of motor trucking are those of what an economist would call price-fixing cartels. The ICC functions in the regulating of rates as an overseer of the cartels into which the railroads and a large portion of motor trucking are organized.

The analytical description of rate regulation as typical of cartel control is substantiated by a study of 176 motor-carrier rate cases. The cases are classified and a description of each class, its relative frequency of occurrence, and the rationale of the ICC are presented.

It is argued that the regulation of motor-carrier rates can best be understood as a case study in cartel control. Economic theory suggests a widely-applicable rationale that can be used to describe rate regulation and the form of pricing characteristic of motor trucking.

• TO THE ECONOMIST the area of motor-carrier rate regulation is apt to appear, under superficial scrutiny, a completely amorphous morass of incredible complexity, self contradiction and other species of illogic cloaked in unfamiliar jargon. Regulation appears to be sought for regulation's sake and there seems to be no economic rationale for the tortuous twisting and turning evident in the deliberations of the Interstate Commerce Commission (ICC).

There is an economic rationale present, however, in motor-carrier rate regulation—a rationale the clear understanding of which by economists and transportation experts would go far toward the provision of a common basis for discussions of policy recommendations. One of the major reasons for conflicting policy recommendations in the area of transporta-

tion is the lack of a common analytical description of the transportation industry. The relatively low academic standing accorded transportation as an area of study is attributable in large part to this same deficiency.

This paper seeks to make explicit the economic rationale pursued by the ICC in regulating motor-carrier rates. Specifically abjured are policy recommendations. The paper is designed to provide a better understanding of what the situation is with respect to one aspect of transportation. What should be done about the situation is a separate question, but one which can hardly be intelligently discussed without the prerequisite of a well-defined common concept of the circumstances which the proposals seek to alter.

The economic terminology which is used herein has for many, unfortunately,

ethical or normative connotations. No such connotations are intended. The terms employed have, relatively, specific meanings in economics and their usage does not necessarily imply that the practices and structures which they describe are regarded by the author as desirable or undesirable.

ECONOMIC CHARACTERISTICS OF MOTOR TRUCKING

The natural economic characteristics of motor trucking are those of a highly competitive industry. Capital requirements for entry are small; there are few, if any, significant economies of scale, and the ability of individual firms to pursue profit opportunities arising in widely-separated geographical areas is almost unparalleled. These natural economic characteristics have not, however, dictated the pattern of the industry's development. A large portion of the industry has been subjected to rigid control of entry. It is extremely difficult for new firms to enter this segment of the industry except as replacements for existing firms (as purchasers of "operating authority"), and the market served by the typical firm is tightly circumscribed in terms of the products that may be transported and/or the area that may be served.

Despite the control of entry the number of motor-carrier firms is still large, so that in the absence of further control the industry might be uncomfortably competitive. The object of rate regulation is to decrease the likelihood of such an occurrence. Encouraged by the regulatory authorities, and exempted by the Reed-Bulwinkle Act from prosecution for violation of the anti-trust laws, the motor carriers are organized regionally and by type of operating authority into rate bureaus and conferences one of whose major functions is to fix the prices charged by member firms for transport services. A large segment of motor trucking is organized into what the economist would characterize as price-fixing cartels, entry into which is rigidly controlled by control of entry into the industry.

The ICC functions as the overseer and

coordinator of the motor-carrier cartels. It is hampered in this role by several interrelated factors. For one thing, not all motor carriers are equally subject to its jurisdiction. Firms which are content to transport agricultural and other exempt commodities may escape almost entirely any control of entry or pricing. Firms transporting their own products are also relatively free from economic regulation (these firms are not completely free from economic regulation in that the products which they may transport are restricted). Among the firms subject to economic regulation some classes (by operating authority) are subject to greater control over their pricing than others.¹ Another factor arises from what the economist might characterize as naturally disparate estimates of price elasticity of demand for transport services. In controlling a cartel a major difficulty may be that individual cartel members view (though probably in other terms) the elasticity of the demand for the products or services they sell as greater than the elasticity of demand as seen by the cartel head. As a consequence there exists a continuing temptation to individual firms to undercut the price established by the cartel members collectively. In turn, an agency overseeing a collection of cartels could be expected to face the same problem in getting individual cartels to agree upon and abide by a given set of prices. It is to be expected that if prices are established which appear most profitable to the overseer they will appear too high to the individual cartels, and if set in accord with an individual cartel's estimate of demand elasticity they will appear too high to the individual

¹ By law the Commission may regulate only the minimum rates of contract carriers. This "deficiency" is compensated for by subjecting the latter to more stringent control by other means. Contract-carrier regulation has as its purpose the protection of the common carrier (See, e.g., *Contracts of Contract Carriers 1* MCC 628). Classified as "common" carriers (hence subject to greater rate regulation) are carriers that transport only one commodity between two points or serve only a couple of shippers. Contract carriers are not accorded the same protection against common carriers that the latter receive from the former (e.g., *Quality Milk Service, Inc.*, 64 MCC 5; *Subler Transfer, Inc.*, *Extension-Rochelle*, 64 MCC 486, and *Worm Extension-Ainsworth and Johnson*, 32 MCC 641). The statement could be substantiated further very easily.

cartel member. Thus, a major problem of the ICC in regulating the rates of motor carriers is to prevent individual cartels or individual carriers from lowering their rates and thus threatening the solidarity of the cartels and the effectiveness of their coordination.

Still another element of discord is added by the relationship of the motor carriers to the railroads. The railroads comprise yet another cartel under the supervision of the ICC, though this cartel is perhaps more tractable than the motor carriers—at least insofar as internal solidarity is concerned. Natural barriers to entry exist in that initial capital requirements are large. The firms are relatively large in size and few in number and do not exhibit to an equal degree the mobility and flexibility of motor carriers. As a result the Commission need not devote a major portion of its energy to controlling entry or helping to maintain cartel solidarity. What does constitute a major problem, however, is the maintenance of a peaceful relationship between the railroad cartel and the motor-carrier cartels. Here again there is a tendency for the Commission to view (in other terms) the elasticity of the demand for transport as of lesser elasticity than as seen by either type of cartel separately. One of the complicating facets of the relationship between the motor carriers and the railroads is that the exempt motor carriers appear to constitute a greater threat to the railroads than to their fellow (non-exempt) motor carriers. Safely protected from the exempt carriers, the regulated motor carriers (of, at least, the more-favored type, that is, the relatively large common carrier of general commodities) seem to suffer little from exempt-carrier inroads. To the railroad (a common carrier in the classic sense), however, the exempt carrier appears as a direct competitor for important tonnage.²

The economic characteristics of the regulated portion of motor trucking (as modified by that regulation) are thus those of a group of price-fixing cartels presided over by the Commission. The characteristics of the system of pricing likely to be employed is deducible from the economic characteristics and the realization that the customers served by motor trucks may be easily segregated into distinct customer groups possessing differing elasticities of demand for motor-carrier services. Customers may be distinguished by geographical location, by weight of shipment, by the product they wish transported, and by other means. Rate differentials may be then established by what an economist would call "three-degree" price discrimination and in transportation would be less precisely termed the "value-of-service" principle.

Motor-carrier rate regulation may thus be described as a body of regulation designed to promote (in the terminology of economics) collusion and discrimination in pricing in and among the cartels into which the motor carriers subject to such regulation are organized and between these cartels and the railroads. Collusion exists when producers have some influence over price but do not influence price independently. Discrimination exists when the prices of goods or services are disproportionate to the marginal costs of providing the goods or services. The public interest is generally viewed by the "regulatory" authorities as synonymous with the financial condition of the (usually common) carriers and there is little indication in motor-carrier rate regulation that the regulatory authorities view as an important goal the minimization of the cost to society of moving things from one place to another.

MOTOR-CARRIER RATE CASES

The above description of the economic characteristics of motor trucking and the pricing of the industry's services is supported by an examination of the decisions of the ICC in motor-carrier rate cases,

² The Commission makes no attempt to insure service by motor carriers which the carriers do not wish to perform, even when their franchises include the commodities or points involved (See e.g., U.S. Congress, Senate, Select Committee on Small Business, *I.C.C. Administration of the Motor Carrier Act* (Washington: U.S. G.P.O., 1956, pp. 308-309).

TABLE 1
TYPE AND DISPOSITION OF ALL MOTOR-CARRIER
RATE CASES¹

Case		Granted or	Denied or
Type	Number ²	Complaint	Complaint
		Sustained	Dismissed
Suspended carrier-pro-			
posed rate changes	135	43	92
Rate reductions ³ . . .	133	42	91
Rate increases	2	1	1
Complaints against the			
level of existing			
rates	9	2	7
Commission-initiated rate			
investigations	12	7	5
Cases involving pick-up,			
delivery, distribu-			
tion, and like			
charges	7	3	4
Cases involving product			
classification	13	6	7
Total	176	61	115

¹ Source: Interstate Commerce Commission, *Motor Carrier Cases*, Vols. 63-64.

² Cases disposed of in a single hearing are ordinarily treated as a unit and listed under the title cases. But where a different disposition is made of some rates than that of others or where more than one of the above major headings is treated in a single hearing (e.g., a proposed rate reduction and a complaint against the existing rate by a party other than the proponent) such actions are treated as separate cases.

³ Includes one nominal increase which by its lowered minimum and the reactions of all parties involved was clearly, in effect, a rate decrease.

although this is by no means the only supporting evidence.

Table 1 gives some idea of the types of rate cases confronting the Commission and their disposition during the course of a year. Only cases in which decisions were printed in full were examined. The classification of cases posed numerous difficulties. The element of judgment involved is not, however, so large as to affect significantly the distributions or the generalizations drawn therefrom.

Rate Reductions

Of the 176 such cases, 135 arose because some carrier association or shipper objected to a proposed rate change. Of the 135 proposed rate changes to which there were objections 133 were proposed rate reductions. There are several reasons for the preponderance of cases involving rate reductions. For one thing, rate increases are usually general increases applying to all motor-carrier cartels in a given area of the country and to all commodities transported. As a result, after

every general increase there is a backwash of proposed rate reductions as individual cartels or carriers attempt to reduce the rates on particular commodities the elasticity of demand for transport of which is too high to warrant the increase.

Another reason for the preponderance of challenged rate reductions is that it is through such challenges that cartel solidarity is maintained. Any individual carrier may decline to follow the tariff of his cartel, but his departure from the tariff may be challenged if he seeks to lower his rate. Such challenges usually result in the suspension of the proposed reduction for at least (and in many cases more than) seven months pending a ruling on its lawfulness by the ICC. Literally anyone or any group may protest the reduction without the necessity of proving that they will be adversely affected. The carrier proposing the rate reduction must show that what he proposes to do is lawful, and he must be prepared to do so several times if need be.

In the face of the downward pressure upon the rate structure the Commission yields ground reluctantly. Of the 133 suspended rate reductions 42 were permitted to go into effect (Table 1). The two major criteria employed by the Commission are whether or not the reduction is necessary to meet competition and whether or not the existing "competitive relationship" between carriers will be affected by the rate decrease. A reduced rate is approved if it meets the criteria. It is refused if it does not meet the criteria, or if it has not been shown by the proponent of the reduction that it does meet the criteria.

A finding that a competitive necessity exists for the rate reduction may result if (because of a previous rail rate decrease or for other reasons) the Commission is convinced that the motor-carrier rate exceeds the rail rate by such an amount that the motor carrier is precluded from a "fair opportunity to compete" for the traffic. The railroad ordinarily pleads that the rate disparity is necessary because of the inherent advantages of motor trucks over railroads. If other carriers have not been participating

in the traffic for which the rate reduction is sought or if for other reasons the Commission does not think that the present division of traffic between carriers will be affected by the rate reduction or does not think that the rate reduction is apt to lead to retaliatory reductions, it may find that a competitive necessity exists.

A finding that no competitive necessity exists, or has not been shown to exist, will ordinarily occur if the Commission thinks that the present share of the motor carrier is not unjust, or has not been shown to be unjust. The Commission will often state that the present share of the motor truck in the traffic has not been placed in evidence, or it may simply state that the motor carrier is presently participating in the traffic despite the lower rail rate. Approval of a rate reduction does not necessarily require, however, the evidence the absence of which is cited as a ground for disapproval. If there is a history of previous rate decreases or if for other reasons the Commission has fears for the stability of the rate structure the reduction will ordinarily be denied.

The carrier requesting the rate reduction may plead competitive necessity because of actual or potential competition from private carriers. If such carriers already exist, the proponent of the reduced rate must show that a substantial amount of his custom has been lost to the private carrier. The Commission can then weigh this loss against the potential damage to the rate structure that might ensue if the reduction is granted. If the private carriage has not materialized but is only threatened, an interesting game follows. Essentially, the task of the Commission in such a situation is to try to find out whether the shipper, the carrier, or both, are bluffing. If the Commission thinks that they are not bluffing it will, *ceteris paribus*, grant the reduction. If there is a good chance that they are bluffing the Commission will state that private carriage is not, or has not been shown to be, a sufficiently strong probability, and that it has not been shown that private carriers can transport the commodity in question more cheaply (although the Commission does not require such a

showing when it thinks the carrier and shipper are not bluffing).

If other motor carriers are participating in the traffic at the rate which the one carrier is seeking to reduce, this constitutes evidence that no competitive necessity for the rate reduction exists.

The issue of the compensatory nature of a rate is largely spurious. If the reduced rate is found to be a competitive necessity it is not apt to be found non-compensatory. The meaning of "compensatory" is by no means clear. At times the Commission implies that to be compensatory a rate must cover fully allocated costs plus a reasonable profit, but at other times the Commission makes it clear that to be compensatory a rate must take into consideration the "value-of-service" principle.³ Similarly, the Commission usually says that round-trip mileage must be used in determining the compensatory nature of the rate, but sometimes says that it cannot be assumed that the return trip will be empty.⁴

In approving a rate reduction the Commission may cite comparisons of the prospective revenue against some measure of the carrier's over-all costs (normally the "system average" costs of the carrier or of the larger carriers in the area), or comparisons of the revenue to be yielded at the lower rate to the average revenue on all traffic or on other specific commodities. Similarly, the Commission may cite favorably comparisons of the proposed rate with rates on other commodities or on the same commodity between other points. On the other hand, in finding that a proposed reduced rate is not, or has not been shown to be, compensatory the Commission may, truthfully enough, note that comparisons utilizing system average costs are of small value because such costs are computed by lumping together truckload and less than truckload traffic of all kinds. For similar reasons comparisons of the revenue to be

³ *Rugs and Carpeting from Virginia to Cleveland, Ohio*, 64 MCC 435, and *Coffee from San Francisco to Utah*, 64 MCC 261.

⁴ *Fresh Meats from Louisville to New York and Pennsylvania*, 63 MCC 143, and *Fabrics from Georgia and North Carolina to Oklahoma and Texas*, 63 MCC 430.

yielded to the average revenue on all traffic may be rejected. Comparison with the revenues or rates on other commodities may be rejected for failure to prove that the transportation characteristics are the same as those of the commodity for which the reduction is sought (though approval of a rate reduction may be granted without such proof). The cost data submitted by the proponent are often found deficient for many other reasons, thus preventing a determination of the compensatory nature of the rate—although a reduced rate may be approved even though no cost data are submitted. To cap the inconsistency, system-average costs (approvingly cited in cases in which rate reductions are granted and held of little value in many cases in which rate reductions are denied) are sometimes used by the Commission as evidence that the proposed rate would not be compensatory. Thus the compensatory nature of a proposed rate depends, in the main, upon whether or not the Commission—on other grounds—wishes to accept or reject that rate.

Of much more importance than overt references to it indicate is whether or not the proposed rate reduction would disturb the "existing competitive relationship" between carriers on the stability of the rate structure. Where the carrier proposing the reduction is the only carrier participating in the traffic the existing competitive relationship will normally be considered to be unaffected. Where several carriers are participating in the traffic and there is a likelihood of retaliatory rate reductions, disruption of the existing competitive relationship is of primary concern. Complicating the issue are those cases in which, by the principle that the carriers involved should have "an equal opportunity to share in the traffic," the Commission may wish to grant the reduction but may fear that doing so would endanger the stability of the rate structure. Where a rate reduction would disturb the existing competitive relationship the Commission may or may not decide that there exists a competitive necessity for the reduction, but in such cases the proposed rate is quite likely to

be found non-compensatory, or not shown to be compensatory.

In the context of the preceding section most of the inconsistency in the Commission's treatment of proposed rate reductions is readily resolved. A rate reduction may be approved when the status quo will not be affected materially or when necessary to counterbalance a disturbance and thus restore the status quo. It then follows that the proposed rate is compensatory. A rate reduction must be denied when the status quo is threatened and it then follows that the proposed rate is not, or is not shown to be, compensatory.

Rate Increases

As indicated by Table 1, suspended rate increases are of infrequent occurrence. There were only two such increases among the cases studied, while in the same period there were 133 suspended proposed rate reductions. Neither of the two cases is typical of rate increases. Rate increases ordinarily occur as blanket increases for all motor carriers in a given area of the country. One of the two cases referred to a proposed rate increase by a single carrier and the other by carriers of a specialized type organized into a single nationwide cartel.

Indicative of the Commission's primary concern with the financial condition of the carriers (and at least secondary concern with society's transport cost) is the fact that volumes 60 through 64 of *Motor Carrier Cases* contain no instance in which a general rate increase was denied in toto (including the cases disposed of without printed report).

Relative to the ponderous machinery set in motion by challenged rate reductions the grounds for justifying a proposed general rate increase are fantastically simple. Essentially they consist of statements that the costs of operation have been rising and that the operating ratio (the ratio of revenue to expenses for some past period) for the "average" carrier is considerably above 93. In some cases the rate increase is permitted to become effective while under investiga-

tion, and shippers who object to an increased rate on their commodity are told that they may bring a maladjustment to the Commission's attention later (when the burden of proof will be on the shipper). The use of the operating ratio has occasioned qualms among the Commission itself. Little is implied about changes in motor-carrier profitability in what is occurring to operating ratios. Operating ratios may increase while net profits are rising, and attempts to minimize the operating ratio involve sacrificing some profits.

Minimizing the operating ratio logically implies that production is halted where marginal cost equals the product of the ratio of total cost to total revenue and marginal revenue. Minimizing the operating ratio (when less than one) means thus the loss of some profit needlessly and avoidable under-utilization of capacity.

Complaints Against Existing Rates

As indicated by Table 1, there were nine cases (not including Commission-initiated investigations) in which the level of existing rates was contested; seven of these cases resulted in favorable findings concerning the existing rates. The paucity of such cases relative to the number of challenged rate charges, and the preponderance of favorable findings, are due primarily to the fact that the burden of proof in such cases is upon the protestant.

A shipper may complain that an existing rate is too high or a competing carrier may complain that an existing rate is too low. If the shipper is the complaining party he usually assails the rate on additional grounds such as the applicability of the rate, for proving that an existing rate is too high is a formidable task. If a competing carrier is complaining that an existing rate is too low this complaint is not so apt to embrace the additional charge that the rate is inapplicable. Of the four shipper complaints one was sustained (on the ground that similar commodities enjoyed a lower rate), as was one of the five competing-

carrier complaints. In the latter case the single motor carrier involved in the traffic was charging a non-compensatory rate below that of the railroad. Raising this rate to equality with the rail rate was precisely the adjustment necessary to render it compensatory.⁵

Commission-Initiated Rate Investigation

The Commission may institute rate investigations upon its own motion when it so desires. These rate investigations may be of any of the types indicated by the other categories of Table 1, and the fact that they are initiated by the Commission is their primary distinction. There are some indications from the limited number of cases studied, however, that these cases are apt to differ somewhat from the majority of the cases in the categories into which they would otherwise fall. For example, a Commission-sponsored investigation of an existing rate is more apt to result in an adverse finding with respect to the rate. Also, such cases frequently are concerned with questions of widespread interest to the industry (such as whether or not in general rate increases different percentage increases can be requested for different products, or what relationship all-commodity motor-carrier rates must bear to first-class or all-commodity rail rates).

Pick-up, Delivery, Distribution, and Similar Charges

Where the shipper performs a portion of the transportation involved he may be granted an allowance for having done so (for example, he may have carried the product to the terminal). Where the motor carrier performs some additional service not included in that for which the basic rate is levied, the shipper may be subjected to an additional charge. In instances in which a carrier is, in effect, proposing a rate reduction by offering a more complete service for the same

⁵ *New England Motor Rate Bureau, Inc., v. Anna Bradley, Doing Business as Bradley's Express*, 63 MCC 668.

charge, or by requesting a reduction in charges or an increased allowance to the shipper, other motor carriers and the railroad object. In the cases in which a rate increase is being, in effect, proposed, the shippers protest. By and large, the Commission's reactions are the same as they would be to overt proposed rate changes, and stability in this portion of the rate structure is sought no less than in others.

Product Classification

Like the rail classification system from which it originally sprang, the motor-carrier classification system is quite complex. As a consequence, questions sometimes arise concerning the applicability of the rates charged on particular commodities. Frequently, the importance of the value-of-service principle, or price discrimination, is evident in these cases. The use or function of a commodity is often a determinant of the proper rate to be applied to it though the cost of transporting it is unaffected. Similarly, a commodity which has undergone processing which affects its value but can have had little or no effect upon the cost of transporting it may be subjected to a higher rate, and different rates are often quoted for the same commodity in accordance with its value. In short, some of the classic determinants of the elasticity of derived demand are evident in the classification system, and changes in that elasticity occasion the reactions to be expected on the basis of the theory of price discrimination.

In cases involving product classification or the applicability of rates the Commission seems inclined to look at each

case, as it arises, in terms of the description in the tariff and the nature of the commodity. In such cases the burden of proof is not the obstacle that it is in other types of rate cases. Both parties (ordinarily the shipper and the motor carrier) appear to be on equal legal footing in that the Commission does not appear to favor either, *a priori*. Nor do the over-all objectives of the Commission appear to figure strongly in these cases. Despite the fact that the shipper invariably argues for that classification yielding the lower rate, the Commission does not appear to view the shipper complaints as it does other downward pressures upon the rate structure.

CONCLUSIONS

The regulation of motor-carrier rates can be best understood as a case study in cartel control. Basically the ICC functions, in the area of rate regulation, as the overseer of the price-fixing cartels into which railroads and a large portion of motor carriers are organized. As economic theory suggests of such market structures as those in which regulated motor carriers operate, price discrimination (in its economic sense) is a dominant characteristic of the type of pricing employed. Such a characterization of the industry and its form of pricing does not necessarily argue for or against the type of regulation which has made this characterization an accurate one. A better knowledge of the economic characteristics of the industry and what follows therefrom would, however, vastly improve most discussions of regulatory policy.