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The Relevance of the Common Carrier Under Modern Economic Conditions

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Common carriage in the United States today is a patchwork of competition and monopoly. There is enough competition in transportation so that monopoly power, even in the absence of regulation, could not be overweening. At the same time, competition is not so complete that all monopoly power has been effectively checked. In short, the transportation business is neither more nor less competitive than many other unregulated industries. There are, however, significant features which set transportation apart from other businesses in this regard. Such competition as there is in surface transportation is generated largely by disparate sets of firms each of which has distinctly different propensities to compete. Where the railroads occupy the supply side of a market by themselves, competition is practically nonexistent. Where the truckers or water carriers can enter a market and follow their natural impulses, competition is practically perfect.

The basic policy decision regarding the economic organization of the transportation business was made by the Congress some thirty years ago. At that time Congress had several options. One was to utilize the competitive forces of the trucking industry to contain railroad monopoly. This would have emphasized the capabilities of the private sector of the economy to achieve satisfactory resource allocation. Another was to continue to concentrate decision-making power in its own hands and in the Interstate Commerce Commission. It is evident that Congress chose the latter course and in so doing created a class of common carriers (the truckers) having few of the intrinsic characteristics of common carriage as defined in the common law.[1] The question, which has been debated over and over again in the years since, is why Congress chose that alternative and seems to adhere to it so strongly.

The reason most often urged by economists and others is that the regulated transportation industries comprise a cartel whose interest lies on the side of moderating competition, and which is willing to accede to regulation for that purpose. This is undoubtedly an adequate explanation for the support given by much of the trucking industry to regulation. The railroads, too, are not disposed to open wide the gates to uncontrolled competition. But this rationale does not explain the resistance voiced by many interests to a shift toward less regulated transportation. The "preservation of the common carrier system" draws wide support and was even alluded to favorably in the President's transportation message,[2] which in general suggested that more competition would be desirable. It is evident that some benefits flow from the regulation of common carriage which would not be present in a more competitive milieu. What those benefits are and how universally they pervade the economy needs to be considered carefully before changes in public policy are made.

The primary purpose of this paper is to explore the hypothesis that public policy toward transportation has evolved largely to encourage a system in which costs of transportation have been socialized. That is to say, a public policy which has led to a system in which charges for transportation (rates) are intended to be related to ability to pay and not to long-run marginal costs. The exploration can best be done by considering the mechanism by which socialization has been accomplished as well as by inquiring into the objectives of public policy. If our hypothesis is correct, it is apparent that the value-of-service rate structure has served in a limited way as a device of income

[1] A perusal of the history of the common law regarding carriers will show that much of the legal doctrine in this field was an outgrowth of problems of what we now call imperfect competition.

[2] "For some seventy-five years, common carriage was developed by the intention of Congress and the requirements of the public as the core of our transport system. This pattern of commerce is changing—the common carrier is declining in status and stature with the consequent growth of the private and exempt carrier. To a large extent this change is attributable to the failure of federal policies and regulation to adjust the needs of the shipping and consuming public; to a large extent it is attributable to the fact that the burdens of regulation are handicapping the certified common carrier in his efforts to meet his unregulated competition. Whatever the cause, the common carrier with his obligation to serve all shippers—large or small—on certain routes at known tariffs and without any discrimination performs an essential function that should not be extinguished."

redistribution not unlike the federal income tax. We shall begin by considering briefly the economics of the problem.

For many years, value-of-service ratemaking has been regarded as a phenomenon of price discrimination. In conjunction with the economics of decreasing-cost industries, it has been given a status of economic respectability which perhaps has inhibited inquiry into its uses for public policy purposes.

The use of price discrimination as a businessman's technique to maximize profit has, of course, never turned on the resolution of any doctrinal conflict over its economic merits. Long before economists and lawmakers concerned themselves with the problem of rail monopoly, rail management had adopted value-of-service as a precept of ratemaking. No doubt the prospects of monopoly return were enhanced by the susceptibility of rail transportation to systematic price discrimination. This, in turn, may have induced the investment of greater amounts of private capital in rail plant than would have been forthcoming had discrimination not been feasible (or lawful). Perhaps demand and supply relationships in the period following the Civil War were such that discrimination was essential to induce new investment or to allow a return on existing plant, or both.

Initially, the bulk of railroad traffic was local and regional. Interregional traffic, for which demand at that time was quite elastic, did not occupy much capacity and could be handled at very little additional cost. Perhaps the revenues it produced made possible some reduction in local rates. This was the claim made in Congressional hearings and debate on the proposed long- and short-haul clause of the Interstate Commerce Act, where it was argued that uniform distance rates would kill off long-haul transport and force increases in local rates.[3]

[3] "Mr. Brown: Probably not more than 1/10th of the freight carried is through freight over some of the long competing lines. The company cannot afford to charge the other 9/10th of its freight at the rates charged for the through freight, as it cannot do so and pay necessary expenses, and if it is prohibited from carrying 1/10th or more of its freight long distances in competition with long through lines, it prevents those who are located far in the interior from reaching coast cities at all with their produce, and takes away from the company the small amount of clear money it realizes on such freight" (17 *Congressional Record*, p. 3830, 1886).

"Mr. Brown: Now, Mr. President, with the provision of the bill to which I have referred [long- and short-haul clause], and especially with the amendment of the Senator from West Virginia, enacted into a law and strictly carried out, it is impossible for the railroads of this country to transact the business of the country. If they attempt it they will either be driven into bankruptcy or a large part of the best territory of the United States will be driven from market and be unable to reach either Eastern cities or foreign markets with their produce. In other words, the railroads must put their local freight so low that they cannot pay fixed expenses and run, or they must put the through business at so high a figure as to prohibit the

Perhaps Congress gave tacit approval to rate discrimination to encourage the continued flow of new capital to the railroads or to assure full utilization of sunk capital.[4] Moreover, in its first annual report the ICC acknowledged both the existence and the merit of value-of-service rates.[5] That position was perhaps wise in view of the Supreme Court's imminent holding that regulated firms had to be afforded the opportunity to earn a fair return on the fair value of invested capital.[6]

As practiced by the railroads, discrimination assumed two basic forms: discrimination based on the different commodities tendered for shipment and discrimination as between persons and places originating shipments of competitive commodities. It was clear from the very beginning of Congressional inquiry into the practices of the railroads that Congress was much more sensitive to the latter form of discrimination.[7] Debate on the act of 1887 centered largely on the

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shipment of produce for a longer distance than five or six hundred miles" (*ibid.*, p. 3828).

"Mr. Cullom: . . . the rigid enforcement of the law as now amended will result substantially in making a mileage act, so that the nearer a party lives to the seaboard the cheaper will he get his transportation. It will result, in my opinion, in destroying much of the commerce of this country" (*ibid.*, p. 4229).

[4] "Mr. Stanford: For this reason rates are oftentimes below the average cost of transportation, and freight of a low value in the market is often moved at less than average cost. Low rates, if they pay anything above the direct expenses consequent upon movement, aid to sustain the railroads and the better enable them to move the traffic at non-competing points. Railroad companies cannot ignore the various circumstances that establish competition, much of which depends on the geographical conditions of the country. The shipper for a short distance has not been charged more, but the shipper for a long distance is charged less because the carriers cannot help themselves" (*ibid.*, p. 3827).

[5] "The public interest is best served when the rates are so apportioned as to encourage the largest practicable exchange of products between different sections of our country and with foreign countries; and this can only be done by making value an important consideration, and by placing upon the higher classes of freight some share of the burden that on a relatively equal apportionment, if service alone were considered, would fall upon those of less value. With this method of arranging tariffs little fault is found, and perhaps none at all by persons who consider the subject from the standpoint of public interest. Indeed, in the complaints thus far made to the Commission little fault has been found with the principles on which tariffs for the transportation of freight are professedly arranged, while applications of those principles in particular cases have been complained of frequently and very earnestly." *First Annual Report of the Interstate Commerce Commission*, Washington, D.C., 1887, p. 36.

[6] Smythe *v.* Ames, 169 US 466 (1898).

[7] "Shippers are willing that the railroads shall receive fair and remunerative rates; they do not complain so much of the rates as they do of the unfairness of discriminations that give one section advantages over another section, one town over another town, and one set of manufacturers over other manufacturers; that makes lands in one locality worth more than in another locality less eligibly situated with

discriminatory practices which affected competitive relationships between persons and regions,[8] and the act as adopted dealt in part with the problems occasioned by that kind of discrimination.[9] It is important to note that the act of 1887 did not provide for the complete elimination of either form of discrimination. The propriety of commodity discrimination apparently was recognized[10] and, as mentioned above, some discrimination between long- and short-haul freight was tacitly approved.

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reference to the markets. And they especially complain to see carloads of the same kind of freight passing their doors from more distant points to the same markets at less cost than they pay for transporting the same class of freight to the same market a less distance" (17 *Congressional Record,* p. 3554, 1886).

[8] One Senator summarized the complaints against the railroads in this way:

". . . I realize that there have been great wrongs, and I will enumerate some of the complaints which the people make against the railroad companies of the country as they have been summed up by the committee in its report:

The complaints against the railroad system of the United States expressed to the committee are based upon the following charges:

1. That the local rates are unreasonably high compared with through rates.
2. That both local and through rates are unreasonably high at noncompeting points, either from the absence of competition or in consequence of pooling agreements that restrict its operation.
3. That rates are established without apparent regard to actual cost of the service performed, and are based largely on 'what the traffic will bear.'
4. That unjustifiable discriminations are constantly made between individuals in the rates charged for like service under similar circumstances.
7. That the effect of the prevailing policy of railroad management is, by an elaborate system of secret special rates, rebates, drawbacks, and concessions, to foster monopoly, to enrich favored shippers, and to prevent free competition in many lines of trade in which the item of transportation is an important factor.
8. That such favoritism and secrecy introduce an element of uncertainty into legitimate business that greatly retards the development of our industries and commerce.
16. That the capitalization and bonded indebtedness of the roads largely exceed the actual cost of their construction or their present value, and that unreasonable rates are charged in an effort to pay dividends on watered stock and interest on bonds improperly issued.
18. That the management of the railroad business is extravagant and wasteful, and that a needless tax is imposed upon the shipping and traveling public by the unnecessary expenditure of large sums in the maintenance of a costly force of agents engaged in a reckless strife for competitive business" (17 *Congressional Record,* p. 3869, 1886).

[9] See 24 Stat. 379, 380 (1887), 49 USC, Secs. 2 and 3 and amendments thereto.

[10] This was made explicit by the Mann-Elkins Act of 1910. See 35 Stat. 60 (1910), 49 USC Sec. 1(6). This provision makes it the duty of regulated carriers to establish, observe, and enforce just and reasonable classifications. This recognition of the classification principle amounts to recognition of the practice of class rate discrimination. In a recent case the Commission argued that Sec. 1(6) makes classification and class (value-of-service) rates a mandatory not permissive principle of ratemaking. This argument was rejected by a three-judge District Court (see N.Y., N.H., and H.R.R. Co. *v.* U.S., 32 *U.S. Law Week* (p. 2081, U.S. District Court, Conn., Civil Action 9229, 7/23/63).

Clearly regional considerations were involved. Benefits from both forms of discrimination ran largely to the South and West, and Congressmen from those regions, though strong supporters of the act, would not have wished regulation to deprive their constituents of the benefits.

In the years between the Civil War and World War I, the economy of the West was largely undeveloped and the demand for transportation was probably quite elastic. Reduced rates on western produce were probably in the railroad's interest. It is doubtful that the Interstate Commerce Act was supposed to limit the railroads' power to continue discrimination in such cases. This is not to say, however, that the carriers and the Commission were of one mind as to how the railroads might utilize their power. Although the Commission did not act to eliminate all forms of discrimination, it did begin to develop standards covering the amount and kind of discrimination permissible. The basic rule articulated by the Commission in this early period was that no rate should be more than what the service was reasonably worth—worth being measured by some criterion other than what the traffic would bear.[11] In applying this stricture, though staying within the bounds of Smythe *v.* Ames, the Commission tended to limit rate increases on agricultural products and raw materials while being less restrictive in the treatment of proposed increases on manufactured goods.[12] That policy might have reflected a Congressional disposition to resist rail rate increases which might have slowed the rate of growth of the extractive industries in the West.

The modern history of rail ratemaking began with economic changes ushered in by World War I. By 1920 the demand for rail transportation probably had increased, relative to existing plant, so that nondiscriminating pricing might have been required without danger of crippling the railroads financially.[13] The war had greatly expanded the flow of interregional traffic and induced firms to make locational commitments in areas distant from many markets. Changes on the supply side of transportation had also taken place. Rail plant and

[11] See R. R. Commission of Nevada *v.* So. Pac. Co. 19 ICC 238, 249 (1910); and Advances in Rates—Western Case 20 ICC 307, 349–351, 354–357 (1911).

[12] See I. L. Sharfman (*The Interstate Commerce Commission*, Vol. III B, New York, 1936, pp. 45–83), discussing the 5 Per Cent Case of 1914 and the Rate Advance Case of 1915. In the former case, the Commission allowed eastern railroads to increase most rates by 5 per cent; in the latter case western roads were denied increases on raw materials and agricultural products. See also 31 ICC 351 (1914), and 35 ICC 497 (1915).

[13] An optimistic view of the railroads' future is expressed by W. Z. Ripley, *Main Street and Wall Street*, Boston, 1927, Chap. VIII.

capacity had diminished as a result of extensive deterioration during the war years. This allowed the railroads some flexibility of supply, in the sense that a reinvestment program could have been geared to revenues from a less discriminatory (or nondiscriminating) rate structure. Of course, a move to lessen the pattern of discrimination in rail rates might have slowed the rate of investment in rail plant in the 1920's and might have curtailed rail service to some shippers. The latter development probably would have resulted in higher rates on the movement of products of the extractive industries and less extensive service to and from areas that generated low volumes of traffic. It is doubtful that Congress would have favored such a development. Higher rates on agricultural products might have been absorbed by the farmer owing to inelasticity in the supply of such commodities. That would have worsened the already depressed state of agriculture and agricultural land values, a condition which history has demonstrated to be unpalatable to Congress.

Whatever possibilities of reducing discrimination might have resulted from expansion of demand for transportation, shifts in the location of economic activity, and diminution of rail plant can only be surmised. In the postwar period Congress clearly favored the preservation of the value-of-service rate structure.

The Transportation Act of 1920 established fair return on fair value as the rule of ratemaking to be followed by the ICC.[14] In 1924 the Supreme Court expunged any notion that full cost was the upper limit for measuring the reasonableness of any individual rate.[15] So interpreted, the act of 1920 imposed no cost ceiling on particular rates. Given the assurance that public policy condoned discrimination, the railroads tailored their investment programs accordingly. The ICC cooperated by not discouraging rail plant expansion, partly because its powers respecting such matters are limited, but also because Congress clearly favored the expansion of transportation facilities.

We do not mean to assert that there may not have been (and perhaps still are) rigidities in rail plant which called for some measure of discrimination in rail pricing. The point here is merely that the lessening of discrimination was not espoused by Congress or the Commission as an objective of public policy. Succeeding developments in the 1920's made it clear that other objectives were desired.

The railroads interpreted the act of 1920 as giving them freedom to maximize wherever possible, subject to the fair return constraint.

[14] 41 Stat. 488 (1920); as subsequently amended 49 USC 15 (a).
[15] Dayton-Goose Creek Ry. *v.* U.S., 263 US 456 (1924).

Pursuing this premise, they attempted to level up the generally depressed eastbound rates on the products of agriculture and the extractive industries. Western roads, particularly, found that the opportunities to increase revenues lay largely in the business of carrying raw materials and agricultural products, commodities which traditionally had moved at low rates. Increases in these rates were also justified by changes in rail-cost relationships. It is virtually certain that the balance of transcontinental rail traffic shifted from westbound to eastbound, so that car shortages occurred in the West and empty cars moved westward. Responding to these conditions the railroads began to level up the rates on eastbound movements.

The Commission began to balk at these efforts of the carriers to alter historic rate relationships which had existed practically from the inception of regulation. It reiterated its position that no rate should exceed what the service is reasonably worth, and in the 1920's it began to hold down or even require reductions in rates on various eastbound movements.[16] Thus, the Commission rejected the railroads' contention that the rule of ratemaking should be interpreted to allow the railroads full latitude as to the most efficient use of the discriminating rate structure, subject only to the fair-return ceiling.

That action was significant, since it revealed the Commission's view of its role in rate cases. In spite of the apparent primacy of the fair-return criterion in ratemaking, it is clear that the Commission would not allow the railroads to set rates in a way which would disturb important regional relationships. These conflicts between the carriers and the Commission appear to be inevitable consequences of demand pricing. Rates based on ability to pay, whether determined by the Commission or by the carriers, must look to both the immediate and the ultimate effect of the rate. It is clear that the two can be quite different, that the Commission and the carriers may evaluate them differently, and that such differences can reflect the economic impact of the rate. Even so, disagreements between Commission and carrier can be interpreted simply as differences in time preference (that is, the period over which revenues are maximized), and as evidence that the Commission is really only serving the long-run interest of the carriers. This interpretation ignores the fact that, while value-of-service rates may look to the maximizing of revenues and service, they are not "neutral" to the economy. Demand pricing clearly must gauge the effect of a rate on the firm or industry to which the rate applies. In

[16] See 68 ICC 676 (1922); 113 ICC 3 (1926); and Sharfman, *The Interstate Commerce Commission*, pp. 160–161.

that sense, the Commission must decide which sector or segment of the economy is likely to grow, or decline, as a result of change in transportation charges. It may appear, however, that the Commission has gone further in estimating the revenue consequences of a rate to the point of deciding which industries should receive the benefit of favorable rates. If such is the case, the conflicts between the carriers and the Commission are not similar to those between the manager and the members of the cartel as to the way to maximize the returns to the cartel; they are instead conflicts between an economic planner and the firms subject to its control as to how these firms are to provide service consistent with the plan. There is ample evidence to support the proposition that the Commission has been authorized to perform such a function.

Perhaps the first legislative directive to the Commission to undertake economic planning because of the impact of transportation rates came in 1925. Depressed conditions in agriculture had persisted in the years immediately following World War I. These conditions stimulated Congress to give the Commission explicit instructions regarding its role in rate cases. Western Congressmen urged the adoption of a joint resolution which would specify that agriculture, "the basic industry of the country," [17] should be afforded favorable treatment in rail ratemaking. The proposal provoked long and acrimonious debate, but finally emerged in modified form as the Hoch-Smith Resolution.[18] It gave explicit guidance to the Commission to regulate rates so that ". . . the conditions which at any time prevail in our several industries should be considered insofar as it is legally possible to do so, to the end that commodities may freely move." [19]

[17] 68th Cong., 1st sess., S. Rept. 313, "Declaring Agriculture to be the Basic Industry of the Country, and For Other Purposes," Mar. 28, 1924. Mr. Smith from the Committee on Interstate and Foreign Commerce: "This joint resolution is for the purpose of declaring the policy of the Congress as to freight rates on agricultural products and directing the Interstate Commerce Commission to carry this policy into effect.

"Congress having declared to the ICC the power to make rates, it was thought unwise to attempt to dictate any specific rate, but to direct the Commission that in the exercise of its ratemaking power the products of agriculture should carry the lowest rate in the rate structure. This is because the products of agriculture are the prime essentials in the economic structure of organized society. These products are produced under circumstances that do not permit the producer to pass the charges incident to their marketing to the consumer.

"The agriculturist pays the freight upon what he buys and sells. It seems, therefore, but just that provision should be made to make this burden as light as possible, especially upon the things he produces."

[18] 43 Stat. 801 (1925); 49 USC Sec. 55.

[19] *Ibid.*

Furthermore, the resolution authorized and directed the Commission to make a thorough investigation of the rate structure to determine to what extent:

> ... existing rates and charges may be unjust, unreasonable, unjustly discriminatory, or unduly preferential, thereby imposing undue burdens, or giving undue advantage as between the various localities and parts of the country, the various classes of traffic, and the various classes and kinds of commodities, and to make, in accordance with law, such changes, adjustments, and redistribution of rates and charges as may be found necessary to correct any defects so found to exist. In making any such change, adjustment, or redistribution the Commission shall give due regard, among other factors, to the general and comparative levels in market value of the various classes and kinds of commodities as indicated over a reasonable period of years to a natural and proper development of the country as a whole, and to the maintenance of an adequate system of transportation.[20]

The resolution gave particular emphasis to agriculture:

> In view of the existing depression in agriculture, the Commission is hereby directed to effect with the least practicable delay such lawful changes in the rate structure of the country as will promote the freedom of movement by common carriers of the products of agriculture affected by that depression, including livestock, at the lowest possible lawful rates compatible with the maintenance of adequate transportation service.[21]

The Hoch-Smith Resolution is the first and only explicit legislative sanction of value-of-service ratemaking. Taken literally, the resolution seems to require the Commission to adhere to the discriminatory rate structure which had been characteristic of rail pricing. At the very least, the resolution stiffened the Commission's resolve to protect the value-of-service rate structure and the historic preference in the rates afforded to agriculture. In attempting to carry out the Congressional mandate, the Commission even sought to widen the spectrum of rates in order to afford greater concessions to shippers of agricultural products.[22] When that threatened to reduce the revenues of the carriers, they appealed to the courts for relief, contending that the rule of ratemaking of 1920 made the revenue needs of the railroads the prime consideration in rate cases and that Hoch-Smith had not altered that rule. The case ultimately reached the Supreme Court where the railroads carried the day. The court held that the resolution had made

[20] 43 Stat. 801 (1925); 49 USC Sec. 55.
[21] *Ibid.*
[22] See, generally, Sharfman, *The Interstate Commerce Commission*, pp. 740–744.

no change in the law regarding ratemaking but had merely made explicit the legality of value of service as a ratemaking principle.[23] The Court's decision in the Ann Arbor case nullified some rate reductions which the Commission had imposed, and affirmed the contention that the rule of ratemaking of 1920 had not been altered by the resolution. The court found that the resolution expressed certain hoped-for objectives which the Commission should seek to achieve but within the limits of the law, including the rule of fair return on fair value.[24]

Certain language used in the Ann Arbor opinion gives the impression that the Court did not view the Hoch-Smith Resolution as having affected any change in the law,[25] and that view has been adopted by numerous commentators.[26] A closer reading of the case shows that it is true only in part. As interpreted by the court, the resolution had not changed the rule of ratemaking of 1920. Fair return on fair value was still the overriding requirement of that rule. Nor did the resolution make lawful anything that was not lawful prior to its adoption, value of service having been an established principle of ratemaking since the very inception of regulation. The resolution did, however, make one very significant change in the law and in the relationship between Congress and the Commission. The resolution was an assertion of the legislative power to establish standards in ratemaking and in so doing diminish the independence of the Commission in that regard.[27] The resolution also made explicit that value-of-service ratemaking was not

[23] Ann Arbor Ry. Co. *v.* U.S. 281 U.S. 658 (1930).

[24] *Ibid.*, 658, 669. This view is supported by the statements of both sponsors of the resolution in the debate on it: "Mr. Smith: It is simply a direction to the Interstate Commerce Commission that whenever there is a depression in any of the basic industries of the United States, as there has been in agriculture, the Commission should take cognizance thereof, and regulate the rates so as to facilitate the movement of the products of that industry (65 *Congressional Record*, p. 8336, 1924).

"Mr, Hoch: . . . and there is no provision here and no requirement or expectation that any rate which is not compensatory shall be levied" (*ibid.*; p. 11026).

[25] Ann Arbor Ry. Co. *v.* U.S., p. 668.

[26] See D. P. Locklin, *The Economics of Transportation*, 5th ed., Homewood, Ill., 1960, pp. 239–241.

[27] Sharfman has criticized the Hoch-Smith Resolution as fundamentally wrong and in breach of the principle of the independent status of the Commission (Sharfman, *The Interstate Commerce Commission*, pp. 469–472). He characterizes the resolution as "an attempt to override the judgment of the Commission . . . and to recognize the special demands of dissatisfied litigants and their supporters through the exertion of political power" (p. 470).

The authors of this paper do not hold a similar view regarding the propriety of such uses of political power. In our view, public policy is in large part an expression of political power and as such need not conform to the value system of economics or any other discipline in order to remain in the realm of propriety.

only permissible but was required, insofar as that principle is consistent with other aspects of the law. The rule of ratemaking has since been changed by Congress[28] and the federal courts have largely abandoned the rule of Smythe *v.* Ames.[29] The Hoch-Smith Resolution stands unaltered and its directives are still a viable part of the ratemaking law.[30]

When Congress elected to adhere to value-of-service ratemaking in the 1920's this perhaps prevented shifting to a less discriminatory rate structure. We have indicated above that the Commission might well have brought about such a change without any danger of disabling the carriers financially. By forestalling that development, the Congress effectively postponed a re-evaluation of the efficacy of value-of-service rates for another two decades.

The depression of the 1930's came close on the heels of a significant expansion of rail plant and railroad debt obligations. The high level of plant capacity and fixed charges built up in the 1920's was not appropriate to the demand conditions of the depression years. The imminent financial collapse of many carriers made necessary endeavors to secure revenues from every source possible. Presumably, the continuance of discrimination in rates could have enhanced the earnings of the railroads in that era. However, the difficulties of the railroads were not solely a product of the depression. Truck transportation had developed into a serious competitor during the twenties and had diverted much traffic from the rails. The bulk of the traffic that shifted from rail to highway was high-value, high-rated manufactured goods, the "cream of the transportation business." The existence of effective competition on a fairly wide scale made difficult the maintenance and manipulation of the value-of-service rate structure in aid of the financial plight of the railroads. The roads thus had to look to traffic in which truck competition was less effective as a possible source of new revenue.

The traffic which offered the greatest promise for increased revenue was agricultural products. The inelasticities of supply in these goods were probably of such an order that increases in freight rates would not have reduced substantially the volume of shipment, and the increased cost would have been absorbed largely by the farmer, at least in the short run. Proposed increases in these rates met with immediate

[28] 48 Stat. 220 (1933); subsequently amended 49 USC Sec. 15 (a)(2).

[29] F. P. C. *v.* Natural Gas Pipeline Co., 315 US 575 (1942), and F. P. C. *v.* Hope Natural Gas Co., 320 US 591 (1944).

[30] Apparently the Commission has held to this view. See 248 ICC 545, 611 (1942); 300 ICC 633, 686 (1957); cited by Locklin *The Economics of Transportation*, p. 421.

opposition. The Congress found intolerable the prospect of freight-rate increases which would worsen the economic disaster facing agriculture. As a palliative measure the Congress repealed the rule of ratemaking of 1920 by an amendment to the Interstate Commerce Act.[31] The amended rule directed the Commission to regulate rates, so that traffic would move freely at the "lowest charges consistent with the cost of providing service."[32] The revenue needs of the carriers were to be considered to the extent necessary to assure the maintenance of adequate transportation service. Fair return on fair value was abandoned as the prime objective of ratemaking. Under the new rule, the public need for cheap and adequate transportation was the prime consideration and the revenue need of the carriers was a subsidiary factor to be considered insofar as necessary to achieve the prime objective of public service. The amendment revitalized the Hoch-Smith Resolution which the Commission then used frequently to justify its attempts to maintain wide disparities in the rate structure.[33]

The act of 1933 was but a stopgap measure. The railroads were in desperate need of more revenue. Increases at the top of the rate structure were largely barred by truck competition, while increases on lower-rated goods were resisted by the Commission in accord with the new ratemaking policy. If value-of-service rates and the preferential rates at the low end of the rate spectrum were to be preserved, additional steps had to be taken. In the Commission's view the key was regulation of truck transportation,[34] since the diversion of high-rated traffic to truck movement was depriving the railroads of the traffic which supported the value-of-service structure. Such regulation was effected in 1935 with the adoption of Part II of the Interstate Commerce Act.

The support for the act of 1935 came from a coalition of interests, including large truckers who desired some modification of price competition, shippers who favored rate stabilization, and public officials who advocated a "clean-up" of the trucking business. However, for many congressmen the important thing was to do something to help the railroads.[35] Predictions made on the floor of both houses that regulation would lead to higher truck rates were not seriously denied.[36] In line with that admission, and to appease those who feared increases

[31] 41 Stat. 488 (1933); as subsequently amended 49 USC Sec. 15 (a) (2).
[32] *Ibid.*
[33] See note 24.
[34] See "The Fifteen Per Cent Case of 1931," 178 ICC 539, 582 (1931).
[35] See 79 *Congressional Record*, pp. 12197, 12210, 12214 (1935).
[36] 79 *Congressional Record*, p. 12222 (1935).

on rates for agricultural commodities, movements of such commodities were exempted from regulation under Part II.[37]

Public regulation of truck transportation has not received much support from economists—and this is not surprising. Freed of regulation, the business of truck transportation would probably come as close to the model of pure competition as is possible in the real world. The regulation of this business has been described as a cartel arrangement joining the interests of railroads and truckers under a common manager, the ICC.[38] But perhaps truck regulation may be better explained in broader terms. For example, it is clear that if, by the act of 1935, Congress sought to help the railroads, it was not solely out of concern for their employees and owners. Help for the railroads meant preservation of the rail pricing system and retention of depressed rates on some commodities. Truck competition clearly threatened the viability of that price structure and, if allowed to persist, would have necessitated the increase of some rail rates. Control of truck competition through regulation may have held out the prospect of helping the railroads, and no doubt railroad lobbying aided in the passage of the Motor Carrier Act but, nevertheless, chief among the confluence of interests which brought about passage of the act was pressure from certain shippers and representatives of certain regions to retain the benefits of value-of-service rates.

The ICC did not misunderstand the significance of the Motor Carrier Act. It gave immediate approval to truck rates and classifications which were almost exact duplicates of rail rates and classifications. Moreover, in the early days of 1935, the Commission made use of the minimum rate power to level up truck rates.[39]

Water competition, however, continued to harass the railroads. In order to have greater freedom to cope with it, the railroads suggested to Congress that the long- and short-haul clause be repealed, but the Senate was not receptive. Instead, Senator Wheeler, Chairman of the Senate Interstate and Foreign Commerce Committee, proposed that Congress bring water transportation under regulation of the Interstate Commerce Commission.[40]

Perhaps as a result of Senator Wheeler's suggestion, the Transportation Act of 1940 began as a bill to bring all domestic water

[37] 49 Stat. 544 (1935); as subsequently amended 49 USC Sec. 303 (b) (4a), (5), (6).

[38] See S. P. Huntington, "The Marasmus of the Interstate Commerce Commission," 61 *Yale Law Journal* 465 (1952).

[39] See Fifth Class Rates Between Providence and Boston 2 MCC 530, 547–549 (1936); Rates Over Carpet City Trucking 4 MCC 589 (1938); Commodity Rates of Kolahoma and Texas Transfer Co. 6 MCC 259 (1936).

[40] 84 *Congressional Record*, 1939, pp. 5874, 5882, and 6149.

transportation, except the noncontiguous trades, under regulation by the ICC, including much that up to that point had not been regulated at all. The bill, debated through three sessions of Congress, encountered much opposition from water-minded Congressmen, especially from the South. In order to prevent selective rate cutting by the railroads which might harass the water carriers, Senator Miller of Arkansas and Congressman Wadsworth of New York introduced an amendment which would have forced the carriers to comply with some kind of cost floor for rates. The amendment stated:

> In order that the public at large may enjoy the benefit and economy afforded by each type of transportation the Commission shall permit each type of carrier or carriers to reduce rates so long as rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all the elements entering into the cost to the carrier or carriers for the service rendered. It shall be unlawful to establish rates for any type of transportation which shall not be compensatory, as herein defined, whether such rates are established to meet competition of other types of transportation or for other purposes.[41]

Initially, the amendment met little opposition. In the debate on it, Senator Wheeler suggested that the language in the last sentence of the amendment might have an adverse impact on some water carriers, particularly those operating on the Great Lakes. Consequently, the last sentence of the original amendment was deleted and in that form the amendment was passed by the Senate.[42]

An amendment identical with the Miller Amendment was introduced in the House by Congressman Wadsworth of New York.[43] It met substantial opposition at the outset, but was passed.[44] Then, despite initial agreement by both houses on the Miller-Wadsworth Amendment, the conference committee refused to report a bill containing it. In debate on the conference report, Congressman Wadsworth moved that the bill be resubmitted to conference and the House conferees be instructed to insist on adoption of the Wadsworth Amendment.[45] That motion was passed and the bill resubmitted to conference.[46] A second conference report was presented to the House and once again the Wadsworth Amendment was deleted.[47] Mr. Wadsworth moved to

[41] 84 *Congressional Record*, 1939, p. 6074.
[42] *Ibid.*
[43] *Ibid.*, p. 9878.
[44] *Ibid.*, p. 9977.
[45] *Ibid.*, p. 9962.
[46] *Ibid.*
[47] *Ibid.*, p. 10146.

resubmit the bill to conference with instructions that the Wadsworth Amendment be adopted.[48] That motion was defeated.[49]

Opposition to the Miller-Wadsworth Amendment developed during the prolonged debate, as individual Congressmen recognized that the adoption of the amendment could signal a profound change in transportation policy. Their remarks and declamations provide an exceptionally revealing record of Congressional opinion about the objectives of transportation regulation.[50] The gist of the controversy as it

[48] *Ibid.*, p. 10192.

[49] *Ibid.*, p. 10193.

[50] Mr. Wheeler: "If the Miller-Wadsworth Amendment should be adopted, it would make every railroad company in this country, if a question of rates was raised, increase its rates on every branchline railroad. Not only that, but the Wadsworth Amendment provides that the Commission is to permit a floor to be placed under rates. It must be compensatory and in addition it must cover all overhead and all allowances of costs, meaning overhead, including taxes. There is considerable freight in this country that is carried at a low level of freight rates on a narrow margin because of competitive conditions or because it would not move at a higher freight rate. Many agricultural commodities are in this category, as are passenger fares" (86 *Congressional Record*, p. 11290, 1940).

Mr. Lea: ". . . We have an average cost of freight in this country. Much of it is hauled below that cost. Much freight is above that average cost.

"The Wadsworth Amendment states that the Commission shall permit the freight to be placed at a certain elevation. It must be compensatory and, in addition to that it must cover overhead and all elements of cost. That means overhead, including taxes. Without including any return on the investment we have this situation. Assume that the figure 100 involves what the Wadsworth Amendment states shall be included, compensation, including overhead, and it would carry taxes. The statistics show that in this country the average cost of transportation would be less than 80 percent of the Wadsworth standard, that is, what is rated as transportation cost. The additional costs are necessary of course for overhead and taxes.

"There is much freight at the present time that is carried as low as 80, under 100, because of competitive conditions or because it will not move at a higher freight rate. Cheap freight—low-grade freight like grain, fertilizer, sand and gravel, and building materials—must move at the lower level on a narrow margin or they do not move at all. Therefore the effect of the Wadsworth Amendment would be to require this 100 percent instead of the 80-percent floor on which the freight-rate structure is founded.

"The effect of this amendment, if put into practical effect and enforced, would be to raise the freight rates on a large portion of the heavy commerce of the United States.

"The high-cost freight, the high-priced freight, makes possible the low-cost freight in the United States. For instance, here is a passing train. One car is loaded with building materials. The railroad hauls that at a very low margin. Next to that car is a carful of merchandise, dry goods. The car that is loaded with dry goods probably pays $200 for the trip, while the car loaded with building materials pays $100. The high price that is charged for the higher grade freight makes it possible for the railroad to make something for carrying the low-grade freight. It carries the low-grade freight at a very minimum of profit, but its income is something above what it would have been had it not carried that freight" (*ibid.*, p. 18178).

unfolded was that a shift to a system of rates based on cost would result in increased rates on the movement of raw materials and agricultural products, and that this would not be in accord with past policy that such commodities should move at rates as low as possible. The clarification of that issue probably explains the ultimate defeat of the Miller-Wadsworth Amendment.

The result of the ratemaking controversy in the debate on the Transportation Act of 1940 cannot be construed as other than Congressional approval of value-of-service rates. Moreover, the *Record* is persuasive that the opponents of the amendment were more concerned with the retention of low rates on some commodities than with improvement in the level of rail revenues.[51] However, the statement of national policy in the act of 1940 does embody Congressional recognition that the carriers must be compensated if service is to be continued, *viz.*, the emphasis on fostering sound economic conditions in transportation and the proscription of unfair and destructive competition.[52] The task of carrying out these policy directives has, of course, fallen on the ICC.

About the time of the debate on the act of 1940, the Commission was developing a uniform rate scale and uniform classification. If the Miller-Wadsworth Amendment had been adopted, the class rate case probably would not have been continued. In a sense the act of 1940 and the evolution of the class rate structure were mutually confirming, and after 1940 the Commission proceeded with its refinement of an intricate value-of-service structure of class rates.

In the post–World War II period, the Commission found itself administering an internal subsidy in both rail and truck transportation. Regulation of truck transportation may have moderated the inherently competitive nature of the industry. Nevertheless, competitive pressures, though blunted, still made themselves felt in service. This competition, which the Commission has difficulty in controlling, probably squeezed out at least some of the internal subsidy which otherwise might have lodged in the truck rate structure. But even so, shippers concerned about competitive rate relationships in large degree achieved the effect of subsidy by rate equalization, and did not give up a great deal (i.e., compared to subsidized shippers by rail), inasmuch as service competition often does little more than dissipate carrier revenue. In that sense, small-lot shippers in sparse traffic areas have been benefited by

[51] See footnote 50.
[52] 54 Stat. 899 (1940); 49 USC preceding Sec. 1.

regulation and the extended service encouraged under it. Without it, their competitive positions would be worsened.[53]

Although it is not likely that the proponents of the acts of 1935 and 1940 envisioned this result for trucking, the Commission apparently found in the statement of policy of the act of 1940 a basis for such a result. It is true that the supporters of ICC regulation of truck and water transportation had stressed the destructively competitive effects of these modes on rail transportation and rail rates.[54] Those who opposed the extension of regulation to the other modes expressed their fear that regulation by the ICC would mean that truck and barge rates would be held up to protect the railroads.[55]

Various provisions were included in the act to allay these fears. The statement of national policy refers to the preservation of the inherent advantages of each mode as a goal of regulation[56] and, in the revised rule of ratemaking, the Commission was admonished to consider the effect of proposed rates on the movement of traffic "by the carrier or carriers for which the rates are prescribed." The statement of policy also directs the Commission to "... provide for fair and impartial regulation of all modes ... ; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; ... all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail ..." [57] Considering this language and assurances made by Senator Wheeler that the act would require the

[53] See the letter to Hon. John Sparkman, Chairman, Select Committee on Small Business, United States Senate, from J. H. Fles, executive vice president of Associated Truck Lines, Inc., Grand Rapids, Michigan, July 1, 1957 (Printed in Trucking Mergers and Concentration Hearings Before the Select Committee on Small Business, United States Senate, 85th Cong., 1st sess., Washington, D.C., 1957, pp. 161–162).

"Relaxation of rate policy will also mean that the shipper in the small community will not be given the service and the freight rates offered to shippers located in dense areas shipping to other dense areas. If free entry of transportation were allowed with a relaxed rate policy on the part of State and Federal regulatory bodies, Associated would give up many small service communities immediately because they are costing us money. Under our grant of authority, we are forced to serve such areas, and part of the price level granted by the Commission makes it possible to do so. Thus the lowest possible rate for a given shipper is not necessarily good for the country. We know the Interstate Commerce Commission seeks the lowest possible uniform rates so that shippers can obtain reasonably low transportation costs without discrimination" (*sic*).

[54] This position was summarized by Senator Wheeler at the time he introduced the bill which ultimately became the act of 1940 (84 *Congressional Record,* 1939, pp. 5869, 5870, 5873, 5874).

[55] See statements by Senator Bailey and Congressman South, 84 *Congressional Record,* 1939, pp. 6134 and 9716.

[56] 54 Stat. 899 (1940); 49 USC preceding Sec. 1.

[57] *Ibid.*

Commission to treat all modes impartially,[58] it is not surprising that the Commission has protected the truck rate structure as well as the rail, and has permitted or required rates which allowed the expansion of truck and barge service.[59]

The task of administering the policy impartially to preserve the inherent advantages of each mode and to foster sound and economical transportation was obviously difficult. Preserving the value-of-service rate structure requires that some freight yield revenues substantially greater than the cost of service. If both truck and rail carriers are to provide subsidized service, each must have a share of high-rated freight. But the Commission's efforts to protect the value-of-service structure, while dividing the traffic between modes, began to have adverse effects on the railroads. As volume carriers, the railroads' prime competitive weapon is price. The truckers, on the other hand, rely primarily on their service advantages to attract business. To achieve a satisfactory division of traffic between modes, the rates for each mode must reflect a balance between cost and service factors. Such a balance is not easily struck. The Commission tended to hold to the existing pattern of rate relationships and to avoid selective rate changes. This tended to give an advantage to the truckers. Moreover, the Commission was apparently reluctant to yield to the rate-cutting inclinations of the railroads because of the potentially devastating effects it could have on the truckers. At reduced rail rates, the truckers could probably continue to compete with the railroads in dense traffic areas, but at reduced revenue levels. This, in turn, would tend to eliminate trucking service to small shippers and to areas of lesser traffic volume, which would force rate increases for such shippers or areas. Similarly, if the truckers attempted to lower their rates to meet rail rate reductions, the railroads might not experience a net increase in revenue on their truck competitive movements and this, in turn, could lead to rate increases on their nontruck competitive traffic, much of which is the heavy agricultural and raw materials movements on which low rates are desired. As a result, the Commission often found such proposed rate changes, either truck or rail, to be destructively competitive and in violation of national policy.[60]

[58] See 84 *Congressional Record*, p. 6073 (1939).

[59] Petroleum Products Inc., Illinois Territory, 280 ICC 681, 691 (1951). Petroleum Carriers Division *v.* A., T. & S.F. Ry. Co., 302 ICC 243 (1957) (rail-truck competition). Wire Rods, Galveston Tex. & Sterling Ill., 277 ICC 123 (1950). Aluminum Articles, Texas to Ill. and Iowa, 293 ICC 467, 472 (1954) (rail-barge competition).

[60] See Petroleum Products Inc., Illinois Territory, 280 ICC 681, 691 (1951). Sugar from Houston, Texas, 51 MCC 775, 781 (1950). Merchandise in Mixed Truckloads, East 62 MCC 699, 723 (1954); 63 MCC 453, 483 (1955): Petroleum Carriers Division *v.* A., T., & S.F. Ry. Co. 302 ICC 243, 254–255 (1951).

The Commission's attempts to resolve these problems have been further complicated in recent years. Much of the high-rated traffic over which the railroads and the truckers have squabbled has been slipping away from the common carrier system and moving instead by exempt carriage. Legitimate private carriage has increased greatly and, of course, opportunities for profit have induced a fringe of illegitimate operations in truck transportation. The Transportation Act of 1958 has also introduced another unsettling element into an already confused situation. The 1958 amendment to the rule of ratemaking instructed the Commission that: "Rates of carriers shall not be held up to a particular level to protect the traffic of any other mode of transportation . . ." [61] How this is to be reconciled with the statement of national policy in the act of 1940 is not clear. The one test of this provision by the Supreme Court came out of a Commission attempt to hold up rates on a piggyback movement in order to protect a water carrier. The Court reversed the Commission's order and stated that, in a case where a proposed rail rate was fully compensatory, the Commission could prevent the adoption of that rate only if it could demonstrate, with satisfactory evidence, that the rate change was prohibited by national transportation policy.[62] Thus, the Commission is faced with the task of balancing competing interests of various modes of common carriage, which are subject to increasing competition from unregulated carriage, while seeking guidance from potentially irreconcilable provisions in the law.

A solution to this problem may be found in proposed revisions of the law. However, shipper interests are not neutral in the struggle among the modes, and between common and unregulated carriage. Many stand to gain if the regulated structure should be altered so as to allow greater competition in ratemaking. Others stand to lose a great deal. Generally, large-lot shippers in less densely populated areas and shippers of raw materials are in the second situation.

The Commission, preoccupied with existing law and perhaps sensitive to the very large segments of the economy which benefit by it, has found that value-of-service rates cannot be retained without new regulation to restrain competition, and thus has recommended that the agricultural and bulk-shipment exemptions be repealed.[63] Thus,

[61] 72 Stat. 572 (1958); 49 USC Sec. 15 (a) (3).

[62] U.S. *v.* N.Y., N.H. & H.R.R. Co., 372 US 744 (1963).

[63] See statement and testimony of Commissioner Howard Freas before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce. (*Hearings on Problems of the Railroads.* Part 2, pp. 1830–1831, 1852–1857 [1958].)

it is evident that the Commission is persuaded that in order to check the drain on common carriage more restrictions must be placed on non-regulated carriage. Only in this way can a rate structure which contains massive elements of internal subsidy be sustained.

Political realities, however, make the prospects of such legislation remote. The geographic diffusion of the population and the diverse economic bases of many states and regions have diminished the political appeal of legislation to secure the low-cost movement of basic raw materials over long distances. Moreover, Americans generally have displayed a marked intolerance of efforts to interfere with their private and often free use of waterways and highways.

The Administration's proposals to admit greater competition in transportation would obviously chop down the size of the internal subsidy by reducing the degree of discrimination in rates. However, line-haul transportation by rail is still "naturally" monopolistic and will become more so with automation. Highway transportation may reach the point of such utter congestion that its provision will become a public utility function.[64] Even today, it is likely that for volume shipments there is a substantial spread between rail and highways costs, which would permit considerable discrimination to flourish.

Thus it is by no means certain that freer competition in transportation will eliminate monopolistic practices. On this score the program for less regulation has come under attack.

Continuance of regulation does not mean, however, that the full panoply of regulatory restraints should be retained. A decision to discard the discriminatory rate structure as a means of achieving public objectives might lead to more fruitful ways of blending private enterprise and public goals in transportation. The abandonment of price discrimination as a public policy should allow distinctions to be drawn between those elements of transportation service which are of a public utility nature and those which may be effectively controlled by market competition.

The provision of right of way, both rail and highway is, in the main, a public utility function as is, to a lesser extent, the provision of motive power. On the other hand, neither the public nor private costs of providing freight cars, trailers, or containers, and the provision of freight consolidation and routing service are so rigid that effective

[64] Our notion here is that there may be public costs associated with unlimited entry into the trucking business, which may call for at least some limitation of the number of firms allowed to operate trucks over the road. Whether this calls for continued rate regulation is doubtful—but a possibility.

competition in the supply of equipment and service is not possible.[65] These functions would be removed from the sphere of rate regulation if regulation were really to be focused on monopoly and not on the transfer of benefits from one portion of the economy to another. (Many of these services are already being performed by shippers themselves, and it would appear that this will continue in the future.) It is probable that a freeing up of large parts of the business of transportation would lead to the development of new ideas, techniques, and transport institutions.

This is not to say, however, that all discrimination can or will be eliminated from the structure of freight rates. In the past, public acceptance of discrimination among classes of goods and for certain movements favored some shippers and penalized others. For the future, we may expect public insistence on some measure of discrimination which will equalize the price of transport for similar movements, even though the costs of these movements may differ. Public support of a far-flung rail network, of mileage scales in rate structures, of a ubiquitous highway system, and of local-service airlines has provided evidence that there is general unwillingness to impose the full economic penalty on those who are unfavorably located. It is probably realistic to anticipate that this will continue. Transportation history indicates that the public's conception of what is fair and equitable transportation pricing is not based on the specifics of cost and demand. (The long-standing quarrel over the long- and short-haul problem is evidence of this.) Until technology overcomes differences in cost which are related to traffic density, climate, terrain, distance, etc., some measure of discrimination will likely be demanded by the public. If history is any guide, this discrimination will be accommodated, at least in part, through the price structure of regulated common carriers.

Conclusions

Clearly, the transportation system of the United States has been the means by which public policy has sought to promote the welfare of certain sectors of the economy. A dominant theme in regulation has

[65] For example, we can see how stripping away the nonpublic-utility elements from the rate structure would affect rates by examining rates under Plans III and IV piggyback. There, the rates are essentially mileage charges for locomotive power on rail rights of way. The lease costs of both trailers and flatcars are presently outside the scope of regulation. Whether they remain so will depend on the Commissions's decision in ex parte 230.

been the maintenance of low rates on basic raw materials produced in areas more or less remote from the major consuming markets. The effect of this policy on the distribution of income in the United States has undoubtedly been enormous though largely immeasurable. It may be surmised that in the extractive industries, many of which have tended to be competitive, one of the effects of value-of-service rates has been to increase land rent. Insofar as this has occurred in the less-densely populated areas of the country, the result has probably been a narrowing of the differences between the values of rural and urban land. At the other end of the rate spectrum, value-of-service rates have probably imposed a larger share of the transportation burden on shippers of high-rated commodities, mainly manufactured goods, and this may have tended to dilute the quasi-rents associated with the less than perfectly competitive nature of some manufacturing.

While this may describe the effect of the internal subsidy on rail rates, it has played a different role in truck transportation. Here, value-of-service rates have probably had a marked impact on the growth of towns and smaller cities off main rail routes and on the periphery of metropolitan areas. The existence of ubiquitous truck transportation may have contributed greatly to the industrial and population decentralization which has occurred in many metropolitan areas since World War II.

Whatever may have been the exact results of value-of-service pricing, they have not been the product of aimless legislation. There is a clear and relatively consistent pattern of legislative and administrative action regarding surface transportation. The preservation of discriminating rates administered by and through the regulated common carrier system has been the dominant policy underlying transportation regulation in the United States for many years. This policy has been pursued because of the legislative expectation that it could stimulate a pattern of resource allocation and economic development desired by many members of Congress. The desire to curb monopoly power in transportation has been of marginal significance to Congress throughout the past four decades. The evidence supporting these conclusions is scattered through the record of Congressional action on transportation matters. No other interpretation is so consistent with Commission policies. One must be impressed upon reading the *Congressional Record* that Congress is willing to "skin the cat" in a variety of ways.

The problem for Congress and the nation is that increasing competition in transportation has made the enforcement of value-of-service rates virtually impossible.[66] The "preservation of the common carrier system" in its present form has depended on a coalescence of interests which is gradually breaking down. The interests of the various carriers in continued regulation are obviously different. Similarly, shippers of freight are split into different camps because of the effects regulation has on them. That shippers are not neutral in the struggle between the different modes compounds the problem of resolving the split between the truckers and the rail carriers, and makes uncertain the prospect that regulation will be abandoned. Moreover, it is clear that transport markets are still pock-marked by important elements of monopoly.

The result of forces working in transportation today, such as private transportation, experimental rates which deflate the discriminatory structure, and shipper demands for specialized equipment, may denigrate the effect of regulation. Perhaps Congress would be wise to recast regulation with a recognition that, while its objectives may need change, some measure of its protections to the public must be retained.

COMMENT

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Because I wish to draw attention to a number of problems that cover a rather wide range of subjects it will not be possible to explore any of them in depth. I shall try, however, to make the nature of the issues

[66] It may be that, even without legislative action, the value-of-service concept will be laid to rest. The Federal District Court in New Haven, Conn., recently rendered an opinion on this subject which may be the harbinger of such a development. (See N.Y., N.H., and H. R.R. Co. *et al.* U.S. and ICC District Court (3 judge), Conn., Civil Action 9229, 7/23/63. Noted in 32 *U.S. Law Week*, p. 2081.)

The court struck down an ICC order which had found unlawful an all-freight rate plan proposed by the New Haven and competing roads. The Commission had found the proposed rates to violate the classification principle stated in Sec. 1(6) of the Commerce Act. The court rejected this interpretation. Judge Smith made this observation on the matter: "It would appear that the Commission here invokes Sec. 1(6) as a means of preserving a basis for the 'value of service' concept in rate-making . . . in a desire to hold fast to a past which has already slipped away beyond our reach.

"This 'value of service' principle was useful in the early years of the Interstate Commerce Act in requiring the more prosperous East to assist in the development of railroads and commercial and agricultural enterprises in the undeveloped West at a time when the existing railroads were powerful monopolies.

. . . .

The continued application of this principle is, however, contrary to the letter and spirit of the National Transportation Policy amendment to the Interstate Commerce Act, . . . which, as its legislative history makes clear, was intended to permit the railroads, no longer effective monopolies, to respond to competition by asserting whatever inherent advantages of cost and service they possessed."

clear, hopefully to force a recognition of their significance, and to encourage further discussion of them.

The Common Carrier in the Transport System

The common carrier system has never been universal in carriage for hire. Other enterprises have always participated extensively in transport. The obligations of common carriage are to serve all alike, at reasonable prices and without discrimination. That is to say, within the scope of their common carrier duties the firms cannot select their customers and they cannot include or exclude through the device of discriminatory pricing.

Whatever the reasons for the emergence and development of the common carrier concept, it is clear that with the rise of the railroad to its position of dominance, the idea of protecting the shipper from monopolistic exploitation became of paramount significance. With the failure of competition to play the role that it was assumed to be capable of under laissez-faire, and with the growth of regulation, the need for limiting competition among the railroads also became recognized. It should be noted, however, that common carriage by agencies other than railroads, water for example, was performed by competitive and nonregulated enterprises.

The development of transport regulation around the railroads, together with the accompanying comprehensive and detailed rules for common carriage under federal legislation, has resulted in an identification of the common carrier with regulation. This identification has led to the assumption that all common carriers must be regulated in the public utility mold and that entry must be restricted.

Railroad regulation came to encompass a detailed regulation of prices (rates) and also made the railroads total common carriers. Finally, in 1920, limitations were imposed on freedom of entry. In the legislation which followed 1920 these controls were extended to all common carriage in this country, except that firms engaged in common carriage by water, motor, and air were not restricted solely to that type of transport activity.

None of the foregoing conditions is essential to the status of the common carrier *per se*, and the idea of common carriage should not be identified with rate regulation and freedom of entry. If this is so, then it may be asked: what would be left of the common carrier if rate regulations were abandoned? Common carrier obligations to shippers would remain as under present law, and this seems to be the most pressing need. Appropriate authority and agencies for specifying and enforcing obligations would be retained; readiness to serve all alike would remain. These duties would relate to services rather than firms or enterprises, and would not necessarily preclude any carrier from engaging in noncommon carrier transport. Relaxation or even the abandonment of current regulation, therefore, would not necessarily result in the elimination or disappearance of the common carrier.

Freedom of Entry and the Common Carrier

Freedom of entry as a privilege to be extended to common carriers would have different effects depending on the mode of transport. For the railroads, freedom of entry in the form of new railroad lines and extensions into the territory of others, hardly seems to be feasible.

For air transport, it is complicated by the problems of subsidy and airmail payments. Restriction of entry, particularly in feeder or local service, is justified because of this. Restrictions on the operations of the trunk lines may possibly be supported on similar grounds. The administration of policy to date, however, does not seem to have encouraged outstanding efficiency, particularly on those lines where one has the greatest reason to expect it.

Freedom of entry in motor and water carriage involves somewhat different considerations than those which apply to the other two modes. The reasons for restricting entry as a means of limiting competition are not apparent. Freedom of entry for carriers in these agencies need not result in the abandonment of common carrier obligations. Certification of those wishing to serve as common carriers could be retained. Contract carriage could be restricted to certain types of service if it were so desired. Guarantee of being fit, willing, and able could be retained, as well as publication of and abidance by rates, notice of changes of rates and services, and permission to abandon. If customers want common carrier service it is difficult to believe that they will be unwilling to pay for it, or that they should be compelled to do so if they do not.

In short, not only is the competitive process completely compatible with the common carrier as such, it has existed in the past, and still does exist over an appreciable range of transportation.

Freedom of Entry and Intermodal Ownership

Freedom of entry means the freedom of undertakings to enter a particular line of transport without restrictions designed to protect the business of those already offering services.

This still leaves open the question, however, of who should be free to enter. Should the railroads be given a free hand to enter any of the other modes of transport? Should shipping companies be given a free hand to engage in domestic and overseas air transport? Should aircraft manufacturers be permitted to enter the air transport business, and the automobile manufacturers to enter the motor carrier for hire service? Complete or undefined freedom of entry would require an affirmative answer to these questions. A negative answer, however, would not necessarily imply a limitation on competition, but rather a limitation on who the new entrants or competitors might be.

Freedom of entry in this context raises two broad questions of public policy: (1) the theory of industrial organization compatible with a competitive private enterprise economy; and (2) the underlying theory of organization of a national transportation system geared to an economical utilization of resources devoted to transportation.

The implications of the first question cannot be developed here. Suffice it to say that the application of the antitrust laws to market dominance, diversification of corporate activities, and corporate agglomeration constitute areas of debate where opinions differ widely and consensus of opinion is notably difficult to obtain. There is obviously pretty general agreement, however, that some rules are necessary and that some limitations do have to be imposed, although the nature of these are vague and the lines of demarcation rather dimly perceptible.

The second question needs to be evaluated in the light of two major considerations in transport organization: (1) consolidation policy, particularly with regard to railroads; and (2) the policy to be followed on diversification or integration of the various modes or agencies.

The consolidation issue comes first, it seems to me, because views on diversification will be influenced in a vital way by the policy adopted for consolidation. The limitations on competition among railroads, which are the result of economic characteristics derived from the technology of this mode of transport, have given rise to the special issue of railroad consolidation. This focuses on the plan or policy to be followed that is consonant with private enterprise, competition, and an efficient transportation system. There are three possibilities: (1) the grouping of railroads so as to maintain very extensive competition; (2) a national, four-system plan, or something of that nature; and (3) regional consolidation, with each system enjoying extensive monopoly of rail transport in the area it serves. It is most likely that any form of consolidation that develops will have pronounced regional features with definite limitations on the geographic areas served by each railroad. Resolution, therefore, of the problem of consolidation must shape judgment on the appropriate policy regarding diversification, because of the inescapable blending of technological and regional monopoly with thoroughgoing and regionally unconstrained competition.

Diversification or integration relates to policy centering on the question of whether the formation of transportation companies should be permitted. We can therefore omit discussion of entry of one mode into another to supply ancillary services.

The desirability of new transportation companies must be considered in terms of their possible impact on competition, efficiency, and regulation. It is not readily apparent to me that the formation of such companies would of itself enhance competition in the rendering of transport services. I do not see how it could improve competition in motor, water, and air transport. Nor can I see any ready or necessary improvements in coordination; on the contrary, the possibility of the opposite is very real. Furthermore, if consolidation results in a few giant rail lines and a large amount of regional monopoly, extensive diversification would result in a highly oligopolistic transport structure, with a real threat of limitations on competition, and the dangers of "internal" subsidies. Second, economies of scale in rail transport have been the subject of some rather careful study recently. The results seem to indicate definite limitations on economical size. If this is so, it is difficult to see how diversification would do anything but aggravate the situation. Third, diversification and the formation of transportation companies would probably result in more rather than less regulation. This contradicts proposals favoring a reduction in public controls.

The Problem of Discrimination —Its New Relevance

The problem of discrimination is noteworthy in connection with this discussion because of its bearing on competition and regulation, and because of R. A. Nelson's rather extensive attention to it.

Discrimination in economic theory refers to price differentiation among homogeneous products resulting from a producer's ability to separate his markets. The applicability of the concept to multiproduct firms with nontraceable costs is anything but simple or clear. The railroads, in particular, have significant amounts of nontraceable costs. They are multiproduct firms, although we do not seem to have reached very clear agreement on what constitutes a unit of output nor how to designate the particular products.

Nevertheless, agreement on the fact that there are nontraceable costs means that the precise total cost of each of the various services cannot be derived. This in turn means that the market (or "value of service") must be used in the making of rates if efficient utilization of the resources is to be achieved.

It seems to me that there will be no discrimination in the economic sense as long as price differences represent the recovery of nontraceable costs, and there will be no "internal subsidy" as long as any rate completely covers the costs which are directly attributable and traceable to the services which are being rendered.