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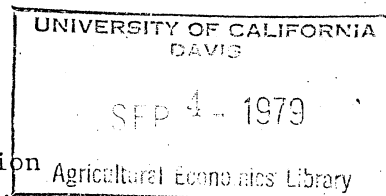
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Issues in Freight Transportation Regulation

By W. R. Kriebel and C. Phillip Baumel*

For the past decade, some economists and, more recently, some politicians have taken the position that economic regulation of freight transportation should be reduced or eliminated. They suggest that removing regulated motor carriers from economic controls by the Interstate Commerce Commission will encourage new entrants into the industry, lower freight rates, and improve service to shippers. The railroad industry and the U.S. Department of Transportation are advocating significant reductions in the economic regulation of railroad freight transportation. They argue that the railroad industry suffers from overcapacity, that it is unable to respond to price initiatives of exempt motor and barge carriers of agricultural commodities, and that ICC regulations interfere with efficient management of rail operations.

Railroad regulation developed in the 1950's-60's, when shipper allegations of unreasonably high rail rates, rebates, rate and service discrimination, and railroad pools led to agitation by farmers and merchants in the Granger territory for state laws to regulate railroads. Passed in 10 states, these laws permitted rail rates to be established by state regulatory commissions or by state legislatures and prohibited

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long haul-short haul discrimination. In 1886, the United States Supreme Court held that a state could not control rates on interstate traffic. A year later the Interstate Commerce Act established the Interstate Commerce Commission.

In 1917, the Car Service Act authorized the ICC to establish reasonable rail car service rules and to deal with car service emergencies. The Transportation Act of 1920 authorized the ICC to control railroad extensions and abandonments.

In the 1920's and early 1930's, the trucking industry became overcrowded with small uneconomic units unable to satisfy the minimum standards of safety, service, or financial responsibility. Concurrently, shippers and communities found that motor carriers provided the transport service that accommodated the changing needs of the economy, including door-to-door freight service and reduced inventories. To assure that public demand for essential transportation service would be met, as well as to provide for a financially viable and stable motor carrier industry, Congress amended the IC Act in 1935, bringing most types of interstate, for-hire motor carriers under economic regulation. The philosophy of federal regulation was to create an orderly marketplace, without discrimination because of size or location, and to provide a common carrier system available to all shippers.

A special concession was granted to agriculture in the Motor Carrier Act of 1935. Carriers hauling certain raw, unmanufactured agricultural commodities were exempted from both entry and rate regulations. Justification was based largely on the nature of the movement of these commodities. They often are perishable and seasonal, and they

require a large number of vehicles during an often short harvest season, thus not lending themselves to the common carriers of general merchandise over regular routes, or to the specialized carriers whose operations are not seasonal.

Against this historical background, does agriculture or anyone else still need economic regulation of freight transport, and if so, for what purposes and on what scale? This paper discusses the major issues of freight transportation regulation; carrier entry and exit, pricing, quality of service, and regulation of carrier operations.

Entry and Exit

The law requires that new or additional intercity motor common carrier operating authority must be or will be required by the public. A certificate is granted when the ICC finds the applicant to be fit, willing, and able to properly perform the proposed service. The motor common carrier is legally obligated to accept all shipments of commodities it is authorized to haul and to serve all customers without discrimination.

Supporters of reduced motor carrier regulation claim that the difficulty of obtaining ICC operating authority might have prevented the development of an adequate number of firms, resulting in rates that are higher than they would have been under a deregulated system. Currently granting over 95 percent of the applications it receives (U.S. Interstate Commerce Commission, May, 1979), the ICC has fundamentally revised the interpretation and application of the statutory language by giving more weight to shipper support and market competition factors. According to the 1978 Annual Report of the ICC (U.S. Interstate Commerce

Commission, 1978), over three-fourths of the 16,800 regulated motor carriers were small, usually family-owned businesses with annual gross revenues of \$500,000 or less.

Regulated motor carriers say the ICC is now ignoring the traditional criteria that have formed the basis for disposition of applications for common carrier authority as stated in the Pan American Bus Lines case (U.S. Interstate Commerce Commission, 1936). The present wholesale granting of truckload authority by the Commission is given as evidence that, essentially, entry has already been deregulated. In a routine case in 1978, Liberty Trucking Company, Extension, General Commodities, the ICC decided to shift the burden of proof to the opposing carriers and to define the burden in a way that severely restricts existing carriers' ability to oppose such applications (U.S. Interstate Commerce Commission, MCC, 1978). The industry contends that if such action is appropriate, which it does not believe, then the ICC must seek Congressional action and not merely toss aside the concept of entry regulation.

The regulated carrier industry would amend the criteria for issuance of operating authorities to include adequacy of service, ability and willingness of existing carriers to meet shipper needs, plus the energy effect on existing carriers of granting new certificates. The industry also advocates consideration of a reasonable broadening of commodity and route restrictions. The motor carrier industry would also redefine private carriage to permit intercorporate hauling for wholly owned subsidiaries and affiliates (U.S. Congress, 1979).

Proposals have been made to expand the list of exempt agricultural

commodities to include farm input items and foodstuffs. Proponents argue that regulated carriers are not interested in the short-distance movements of fertilizer, feed, chemicals, and other agricultural supplies. This forces some agribusiness firms into the trucking business. Adding these items to the exempt list would, they claim, enable unregulated truckers to backhaul them. Proposals have also been made to expand the right of agricultural cooperatives to haul nonmember regulated freight.

The regulated carriers counter that to expand the exempt agricultural commodities list would allow those whose present business is agricultural hauling to enter the common carrier market in a pick-and-choose manner as well as increase fuel consumption and empty miles. They claim the marketplace would be seriously disrupted, accurate and public market information on freight rates and carrier services would no longer be assured for shippers, the carriers would suffer financially, and the marketplace would become less, not more, competitive.

Empty backhaul mileage primarily arises from the inherent regional traffic imbalances and the need for specialized equipment. The ICC has estimated empty mileage for regular route motor common carriers to be 7 percent (Glaskowsky, O'Neil, and Hudson). It is difficult to fill one empty backhaul without creating another. Eliminating ICC entry regulations would not appreciably increase the amount of traffic.

The railroad industry and the U.S. Department of Transportation (U.S. Senate, 1979) advocate eliminating ICC controls on branch rail line abandonment and on railroad mergers and consolidations. The railroad industry contends that continued operation and maintenance of thousands of miles of light density branch lines result in large oper-

ating losses. Much of this track would require large amounts of capital to be upgraded to handle the 100-ton rail cars. The industry contends that the losses would be magnified if they were forced to maintain and upgrade these tracks. Moreover, they state that because the present ICC abandonment procedures are lengthy and costly, only the most obvious cases for abandonment are brought before the ICC.

Shippers and communities located on branch rail lines argue that the loss of the branch lines would substantially increase costs and probably make it impossible for farmers to market their products and receive production inputs. They claim that the poor condition of many branch lines is due to railroad neglect and that, with good service and track maintenance, the branch lines could be profitable. They further maintain that rail abandonment would threaten the very existence of their communities and add to the energy problem.

Railroad companies indicate that many branch lines are energy inefficient because of circuitry, stop and start operations, and low traffic volume. They claim through trains and unit trains are more energy-efficient than branch line operations. While they concede rail abandonment will increase fuel consumption by trucks hauling the product further to nearby mainlines or upgraded branch lines, the fuel savings on the energy-efficient mainline operations will more than offset the additional fuel consumption by trucks and will actually reduce total fuel consumption. Moreover, the railroad industry maintains that research has shown that communities located on abandoned branch lines have not declined and many have continued to prosper.

Pricing

As part of their public service obligation, the regulated motor and rail carriers must charge rates that are reasonable and not unjustly discriminatory. They are required to disclose rates publicly. Shippers and receivers contend that knowledge of what transportation rates will be next week, next month, and six months from now is important to a small business owner who must often compete in the same market with a large organization but does not have the staff resources to gather and analyze rate information. With no discounts, all users--large and small--pay the same prices for similar services.

The law provides legal antitrust immunity for collective rate-making conducted through tariff bureaus (U.S. Congress, 1948). Both carriers and shippers cooperate in the filing of proposed changes to existing tariffs, subject to approval or disapproval by the ICC. Rate-making procedures are designed to insure that extreme changes cannot easily be made. Proposals for general rate increases are reviewed by the ICC, which can, on its own motion or upon the complaint of any shipper or interested party, decide to suspend the new rate until it determines whether it is reasonable or inflationary.

Proponents of increased price flexibility claim that open price competition will yield lower rates and improve efficiency. The current ratesetting process is said to reduce the incentive for carriers to improve productivity and hold down costs. Rates based on the cost of providing the services, instead of artificial rough-system averages, are viewed as the cornerstones of future transport policy.

The regulated motor carrier industry position is that open entry

and freedom to negotiate all rates would create destructive competition in the industry. Entry of new firms would undoubtedly take place in the truckload market. The amount of truck traffic, however, would not expand as rapidly as trucking capacity, leading to severe rate competition on truckload movements, with revenues failing to cover total costs for many carriers. The next phase would be financial difficulty of the local carrier and rate increases or termination of high-cost less-than-truckload service. It is said there would be chronic overcapacity, a high turnover of trucking firms, reduced financial and operating reliability, and greater difficulty in tracing shipments and in collecting lost or damaged freight. The industry maintains that the process of collective ratemaking is absolutely essential to the maintenance of a stable, cost-effective, fuel-efficient freight transportation system. Shipper groups also endorse collective ratemaking as the only practical way to make sense out of the hundreds of thousands of rates on items to be transported to some 60,000 communities throughout the United States.

The motor carrier industry's legislative proposal for regulatory improvement calls for creation of a zone of reasonableness, including a no-suspend zone of 7 percent (decrease or increase) annually, for a 5-year period.

The railroad industry cites its continued low earnings to support its request for rate flexibility designed to meet competition, to take prompt advantage of innovation, and to market rail services aggressively. The average return on investment in the railroad industry in 1978 was 1.6 percent; 7 railroad companies lost money, and no major railroad had more than a 9 percent return on investment (Association of American

Railroads). The major changes in rail pricing regulation proposed by the railroad industry include:

1. Ability to establish rates by contract without review by the ICC. The purpose of the contracts would be to provide a more precise definition of the transport needs of the shipper, to base the rate more on costs of the movement, and to define more precisely the shipper and carrier risks and requirements. These contract rates would be filed with the ICC or another government agency.
2. Ability to publish seasonal and peak demand rates without notice. The Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) provides for seasonal and peak demand rates with a 30-day notice of publication or cancellation.
3. Ability to quickly change the division of rates among railroad companies to reflect changes in costs.
4. Ability to establish general rate increases to provide protection against inflation.
5. Ability to continue joint rate requirements among railroad companies.

Supporters of continued ICC controls over railroad rates point out that the 4R Act provides for establishment of both seasonal and demand-sensitive rates and that the railroad industry has failed to use this price flexibility. The railroad industry counters that this flexibility is of limited value because of the 30-day notice requirement for publishing or canceling the rates. Exempt commodity truckers and barges have no such requirement. This enables exempt carriers to charge high

rates during peak periods and to quickly reduce rates to hold traffic during periods when the volume of traffic declines. Moreover, the major seasonal rate proposal arising from the 4R Act is in protracted litigation, which will likely be settled by the U.S. Supreme Court (U.S. Interstate Commerce Commission, 8th Cir. 1978).

Shippers supporting regulation of railroad rates cite the need for stable rail rates as a prerequisite to product pricing. They are fearful that the contract rate provision would favor the large rail user over the small rail user. The railroad industry replies that many agricultural shippers have adjusted successfully to the rate fluctuations of exempt truck and barge carriers and have continuously increased the volume of their products shipped by these modes.

Transportation is a major spatial determinant. The rail rate structure, for example, has influenced industrial locations and relocations. The cost, quality, and availability of transportation is critical to the competitive position of agricultural industries in different regions. Rail users in some regions allege that they still face both rate and service discrimination by railroad companies. Whether these rail users are really being "gouged" or whether they are simply paying the full cost (or even less than the full cost) of transporting their agricultural outputs and inputs, given their geographic and light density location, can only be answered with more refined analyses than are presently available. The important point is that some users think they are being overcharged and other users feel that less regulation of rail prices will recreate the potential for discrimination. Although these users are basically in favor of increasing the efficiency of the rail-

road industry, they indicate that they will support increased efficiency through less regulation or regulatory reform only if some assurance of protection is provided in terms of rates and/or service that both shippers and railroads can live with. Thus, protection of the so-called captive rail user is a major regulatory issue. While many people are convinced that some users are captive or potentially captive to railroad market power, there is little agreement of precisely what is a captive rail user or what protection should be provided to the captive user under alternative levels of reduced rail regulation.

The railroad industry, while agreeing that some users may be captive to railroads, argue that railroad companies face intra- and inter-modal competition for the products they carry. Moreover, the products they carry face market competition from products produced in other regions. Thus, to raise rates to the point that would drive their producers out of business would, in the long run, lead to the further erosion of traffic from the railroads. They would clearly be better off hauling products at a rate that would generate traffic on their lines. Thus, one potential type of captive-user protection would be to provide a guaranteed rail car supply to captive rail users.

A little noticed issue related to railroad rate flexibility is the commodity clause of the Interstate Commerce Act. This clause prohibits carriers from transporting property it owns except that used in the business of the carrier. Repeal of this clause would enable a shipper to sell products at the point of origin to the railroad company and buy them back at the destination at a price that could reflect a discriminatory freight rate.

Quality of Service

The regulated motor carrier industry believes that eliminating economic regulation would introduce uncertainties into the cost and availability of motor carrier service. Small businessmen would likely be faced with the prospect of ordering in larger quantities with less frequent service; thereby incurring increased storage facilities and carrying costs and higher total physical distribution costs.

The motor carrier industry believes that price and entry controls have helped to achieve economic and social objectives that free market forces could not always assure. Over time, large and small businesses have been able to locate with the assurance that there already existed, or would soon exist, timely and continuous truck services. Thus, accessibility to markets with certainty may be an implied economic and social benefit of transport regulation.

Although small, rural communities would continue to be served by trucks in the absence of regulation, the uncertain issue is whether these towns would be served adequately or at lower prices. If cross-subsidization exists under regulation, many small communities may discover that their transport costs have increased sharply after reduced regulation. The regulated interstate carriers believe the most profitable firms would compete only for freight in the high-volume traffic corridors. To the extent that marginal carriers survive, they would likely be left to serve the smaller towns and rural areas. If true, relaxing motor carrier entry requirements and permitting unregulated rates would eliminate the common carrier obligation to serve all who need and want service with reasonable dispatch and with adequate equip-

ment. They further argue that in the absence of regulation, overcapacity and inadequate revenues would lead to deterioration of safety standards, evasion of safety regulations, financial irresponsibility, and generally unsatisfactory service.

Regulation is blamed by critics for protecting the status quo, stifling new technology, and limiting the range of rate and service choices. The implication is that a significant number of shippers have been overcharged for current levels of service. If the common carrier system were more competitive and were to offer a diversity of services, then overall physical distribution would be improved and consumer prices would be lower.

The motor carrier industry contends that major test of the variety and quality of services offered by regulated motor carriers is the attitude of users of the service. Numerous shipper surveys show general satisfaction with motor carrier service and support the concept of regulation (Wagner; Constantin, Jerman, and Anderson).

Railroad companies cite the need for shortening the time required for ICC decisions on railroad mergers and consolidations. These mergers and consolidations are needed to reduce excess rail plant by providing for joint use of mainline track and switch yards. Moreover, they are needed to consolidate rail services. Individual railroad companies say it is difficult to control service quality on interline traffic in the absence of mergers and consolidations. The railroad industry argues that railroad mergers should be handled in the same manner as mergers of other industries. That is, if a merger is found to be anticompetitive, it is prevented. However, rail users and labor

leaders contend that additional mergers and consolidations would reduce or eliminate carrier competition and result in a reduction of jobs and increased rail abandonment.

Control of Carrier Operations

In addition to its control over pricing, entry, and exit, the ICC can influence regulated carrier operations. It can control rental rates on freight equipment charges for accessorial services, the way cars must be routed, the number of cars and locomotives assigned to specific commodities, the number of cars assigned to unit trains, which rail cars will be repaired, and the way cars shall be moved. For example, ICC Service Order 1304 required railroad companies to place a maximum of 20 percent of its covered hopper fleet in unit grain train service (U.S. Interstate Commerce Commission, March 1, 1978). The order was issued in 1978 because small grain shippers complained that a large share of the fleet was assigned to unit grain trains. Unit grain train shippers and railroad management argued that each unit grain train car will haul at least twice as much grain as a car in regular train service because of faster turnaround times. Therefore, if the objective is to increase the amount of grain transported, more--rather than fewer--cars should be assigned to unit grain trains. Service Order 1304, which was cancelled before the car shortage period ended, is a classic example of the issue of efficiency versus equity.

ICC Service Order 1309 requires railroads to place, remove, forward, clean, weigh, and if needed, repair cars within 24 hours (U.S. Interstate Commerce Commission, April 12, 1978). Railroad companies complained that it is impossible to comply with this order in all cases

because of missed connections, congested ports and terminals, plugged grain elevators, weather, and other uncontrollable events. As a result of the order, some cars are moved in the wrong direction, or moved from the origin point while still empty or from the destination while still loaded.

Car Service Order 1322 required that 70 percent of all covered hopper cars and 50 percent of all 40-foot box cars of 12 Midwest railroad companies must be placed in grain service (U.S. Interstate Commerce Commission, April 12, 1978). The intent was to help solve an acute grain car shortage. The Missouri Pacific Railroad Company generally uses most of its covered hopper fleet to haul fertilizers and other chemicals. Yet, this service order forced most of its hoppers into grain service. The service order was quickly changed after the ICC received vigorous protests from shippers of fertilizer, chemicals, cotton, and sugar that this service order was simply creating a car shortage for nongrain shippers.

The railroad industry argues that the diversity of traffic flow patterns, rail user requirements, and railroad operating practices makes it impossible to establish rigid car service orders applicable to all railroad companies and still maintain a viable efficient transportation system. Yet some rail users believe that the emergency car service orders are their only recourse to car availability during periods of rail car shortages.

In the current fuel crisis, the issuance of Special Order No. 9 by the Department of Energy was in essence a similar effort to resolve the problem (U.S. Department of Energy, May 15, 1979). This order

established the priority of middle distillate consumption by farmers and haulers of perishable food products. Other high fuel users, specifically the independent truck operators, found the regulation did not provide adequate fuel at an acceptable price level for their perceived needs, resulting in severe operational instability.

The ICC granted a special fuel surcharge to allow for expedited recovery of increased costs (ICC, June 26, 1979). This order, however, only applied to the independent operators who contract with regulated motor carriers. The carriers of exempt agricultural commodities do not have an institutional framework for such recourse.

Conclusion

The freight transportation regulatory system is currently under severe criticism. Many alternative solutions are being offered. There is much disagreement within the transport sector, the shipping public, the body politic, and indeed among economists about what should be done. The regulated motor carriers oppose major changes, while some exempt trucker groups favor major relaxation of entry and price controls. The railroad industry generally favors elimination of much of the railroad regulation; yet there is disagreement within the industry on the precise nature of the changes. Rail and motor carrier users are found on both sides of the issues. Small community leaders fear the effect of major changes in freight regulation on their towns.

Information on the likely impacts of major changes in the regulatory system is needed to help resolve these disagreements. A significant number of studies have been done on the impact of rail abandonment on shippers and communities. Little research is available on the

potential impacts of increased price flexibility of railroads and motor carriers, of relaxation of entry controls for the motor carrier industry, of rail mergers and consolidations, of ICC rail car service rules, and of other regulatory issues on various groups of shippers, carriers, and communities. Little has been done to define the extent to which groups of rail users are captive to the railroad industry. Much of the speculation on the impacts of relaxation of railroad regulation focuses on the impacts of large and small agricultural shippers. These discussions typically fail to define what is large and what is small, and they are often blurred as to who is the shipper. For example, is the grain farmer or the local elevator the shipper? This lack of information presents a unique opportunity to agricultural economists for research to help resolve the conflict on regulatory change.

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