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TO REGULATE OR NOT TO REGULATE?

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Abstract

There is a growing clamor for railroad deregulation. The arguments suggest competition will work, regulation is costly and a failure. Only the naive could believe two or three firms provide effective competition. Vested interests have kept regulations from working. Such political and economic power would keep competition from working. Heavy dependence on legalism keeps the transportation system from being effective.

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In recent years the trade press has been vociferously advocating deregulation of transportation. This approach has been especially strong with respect to U.S. railroads. The arguments are (1) competition will keep everyone in line, (2) regulation has not worked, (3) bureaucracy increases costs.

In May and June 1975, the White House sent forth a number of legislative proposals aimed at rail deregulation.

Competition. It is argued that truck, water, and air provides a type of competition that would assure "reasonable" rates and services. There may be some evidence that between major metropolitan areas such competition exists, but such evidence is not very convincing. In the hinterlands, there is even less conclusive evidence such competition exists. There is strong evidence to suggest that competition in an economy, such as the United States, characterized by dominant firms in every industry (excluding agriculture) does not work. Such dominant firms can control entry of competition. They can control pricing and production policies which restrict competition. Even in spite of regulation, they are able to control information so that customers are unaware of available alternatives. Both dominant firms and regulatory agencies have adopted and accepted delaying tactics that make it impossible for small firms to receive "justice".

Many firms hold firmly to the maxim "Competition is desirable for everyone else but me." They want even the limited information, that regulation provides, Few railroads and even fewer shippers would want to operate in a realm where they had no access or knowledge of competition price policies.

However, in many industries non price competition may be even more important than price competition. This is the current area where transportation can provide the selective services to favorite customers that can either permit a firm to stay in business or force it to bankruptcy. Rural America rail carriers achieve this by availability of cars, condition of cars, and distination of shipments, for example. Since price competition can be monitored it is easier to regulate, availability of service is more difficult to monitor. There are many cases that illustrate what could be expected if regulation were to pass out of the picture.

Those favoring deregulation are the same ones who are the strongest advocates of a legalistic approach to decision making, "If its not in the contract, its not my responsibility," No economy has successfully operated for any length of time under a strict legalistic approach such as many of the deregulators, by their actions, would suggest is the goal. This approach favors the firms that can lure the best lawyers, who can provide the needed legal delaying actions to force the plaintiffs out of business. Such an approach would further enhance a self-appointed, self-serving elite.

A legalistic approach is much concerned with precedent. A dynamic economy and society must be forward looking. A preoccupation with the past leaves too little time and resources to prepare for a rapidly changing future.

Competition in the regulated industries has been defined by the regulated and the regulators in a manner to suit their respective vested interests. The more widely accepted textbook definitions of competition have been ignored. The usual measures of market structures, market conduct, market performance would provide the basis for developing a regulation that would work.

Failure of Regulation. Regulation has not provided many of the benefits that could have accrued to such policies. This has been because there was only selective regulation and because the regulating agencies either were naive or did not have the integrity to make the hard decisions. Regulators have a general public responsibility, but too often they have close social, economic, and political ties with the regulated. Both the regulated and regulators have been concerned with settling small legal issues rather than with the major economic and social issues that are the problem. The Penn Central from the start of their merger illustrates this argument.

There are many examples in a large number of governmental agencies suggesting that regulations did not work but further study reveals the agencies were unwilling to adopt the policies needed to make regulation work. Often it is more important politically to indicate an effort is being made than to be in a position to indicate effectiveness (or ineffectiveness) of that effort.

Functions of Regulation

A review of regulatory history suggests three major functions desired by most such action: (1) protect consumer, (2) protect investor, and (3) provide necessary product or service. Generally, the nature of the industries involved were such that it had been demonstrated that the perpetuation of non regulation led to abuses that far outweighed the costs of regulation. If all firms in the economy were so small, they could not exert economic and political power and if no firms had monopoly rights because of unique access to limited resources, exclusive processes (i.e., patents, copyrights) etc., then regulation probably would not be necessary. But this situation does not exist.

Regulation suggests a recognition that "equitable" income distribution and "equitable" exploitation of resources are necessary ingredients for economic growth. The individual or firm concept of "equitable" in these two cases is much different than is the societal concept.

Additional Functions of Transportation System

Adam Smith spelled out the advantages of production specialization. Such activities permitted more efficient use of resources, increased per capita output and increased per capita real income.

One of the reasons U.S. economic growth was possible was that there were many available resources. Spatially their resources were spread over a vast area from the Atlantic to the Pacific and from the Gulf of Mexico to the Canadian border. To bring these resources together so the advantages of specialization could occur an effective transportation system was essential.

Under present conditions two of the essential U.S. products are coal and food. These are produced in dispersed areas. The current legislative proposals suggest the railroads can capriciously cut off service from rural areas with no regard for consequences to either that area or the U.S. economy.

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Transportation regulation must, ~~therefore~~, accept the added function of contribution to economic growth. A review of regulatory decisions suggests the regulatory agencies have not accepted this role as a major ingredient in their actions.

There are three ingredients to transportation contributions to economic growth: (1) quality of service, (2) cost of service, (3) social responsibility.

Quality of Service. Quality of service is concerned with adequacy of facilities to move product when needed. This implies sufficient rolling stock, motive power, and road bed capability to meet the needs. These facilities must also be such as to protect the product while it is in transit.

Quality of service also implies the potential users can be assured that service will be available when needed over time so they can make necessary long run investment decisions to use their available resources.

Cost of service. Cost of service (freight charges) can be developed either on the basis (1) of "What the traffic will bear" (demand) or

(2) cost of providing the service (supply). Neither the transportation agencies nor the regulatory agencies have followed a policy of developing data so either of these techniques or a combination could be effective.

There is a basis for differentiated pricing of transportation service. However, the railroads do not have the data to do this on a rational basis. Such rational differentiated pricing would require changes in philosophy and data analysis by both transportation firms and their regulatory agencies.

If transportation is to meet its economic growth responsibility, quality and cost of service must be treated in a manner to permit achievement of this goal.

Social responsibility. There is a recognition by many sectors of the economy that business, government, industry, labor, agriculture, etc., have responsibilities to society. These responsibilities cannot be met "legalistically". They represent that extra that individuals and institutions are willing to contribute in dedication and contributions to society to help provide a better world in which to live. Transportation firms (particularly railroads) by action suggest social responsibility does not apply to their activities. They indicate such activities, if they do not have a direct money payoff, should be assumed by other sectors of the economy.

Many regulatory agencies, since they are enamored with legalistic approaches, also fail to recognize social responsibility as an essential ingredient in their actions.

Regulation to Meet Responsibilities

Certain institutions in the U.S. economy have special responsibilities because of the nature of the services they provide. These services are essential to a highly industrialized society. If these institutions do not provide their primary service, the efficient functioning of the other sectors of the economy breakdown. Two examples of such industries are transportation and banking.

For these special industries the regulatory agencies must adopt policies, procedures, and guidelines that will recognize these added responsibilities. Their actions must consider not only the effect on the regulated industry and firms but also the impact on the overall economy.

A review of findings and decisions in too many cases suggest these regulatory agencies make decisions only on short-run firm balance sheet projections with little analysis of industry or economy short-run or long-run implications. Such a change in approach would, by definition, imply some major changes in approach to regulation and the types of information needed to make sound decisions.

There is need for increased emphasis on analysis of regulated changes to reflect how the change will effect the primary function of the regulated firm. For example, if the Interstate Commerce Commission had controlled the holding company activities of the railroad, many of the present U.S. railroad problems could have been avoided.

Standard economic theory provides a basis for understanding price theory. This suggests using standard definitions for fixed and variable costs as well as a recognition of elasticity of demand concepts, cross elasticity and demand substitution. A review of transportation accounting and reporting practices suggest economic price theory is not a viable man·gement tool used by either transportation firms or their regulatory agencies.

Apparently data on operations as accumulated by regulatory agencies and transportation firms are to be used for rate hearings, reporting, and historical analysis. These records may have been adequate for such purposes under the economic and institutional framework existing when developed. But any management tools for a dynamic economy must change to meet management needs of the future.

It is suggested price theory must become an integral part of transportation management and regulatory decision making.

Transportation firm management has the responsibilities to: (1) provide service, (2) protect investors, (3) protect consumers, (4) contribute to economic growth, (5) contribute to a better society. Because of the unique dependence of the total economy on transportation, the management has added responsibilities to the public that override responsibilities to investors.

Since World War I, railroad management has abdicated responsibilities to make decisions to meet the above criteria. They have been more concerned with ways to blame others for poor performance and with ways to legally divert resources from their primary function (providing transportation services) to other functions that showed promise for immediate short-run financial gain. The regulatory agency encouraged, both overtly and covertly, this approach to management. A review of the literature suggests railroad management is more interested in establishing who receives the greater subsidies than in providing transportation service.

Transportation management must be willing to plan for the future. The past may offer some guidelines but it cannot be a primary factor in making provisions for the future.

Regulation and the Future

Historically, transportation regulation has not been particularly successful. This has been partly because the regulatory agencies, courts, and legislative bodies have narrowly defined the function of regulation. They were more concerned with providing a show case to the public than with results. It is not so much that regulation is at fault as it is the methods of regulation are at fault.

There are many governmental agencies charged with different facets of transportation regulation and implementation. Although, the enabling legislation states the goal is to provide an effective efficient transportation system that will contribute to the economic needs of the economy and society, action suggests this wordage is to serve as a pallative to the public rather than as an essential guideline for their decision framework.

In rail transportation, there is the Interstate Commerce Commission, Rail Service Planning Office (ICC), U.S. Railway Association (and Conrail), and the U.S. Department of Transportation. There are many other federal and state governmental agencies also concerned with rail transportation, as well as water, truck, and air transportation. The actions of these various agencies suggest they are more concerned with protecting their own vested interests than with developing a sound transportation system.

Transportation is an important segment of an efficient distribution system. But transportation cannot be isolated from the other segments of this distribution system such as processing, warehousing, packaging, inventory management, and financing. Therefore, answers to transportation questions (this is what regulation should be concerned with) must be in the context of a total distribution system. The present regulatory schemata is concerned usually with answering a question, for example, for a specific firm operating in a specific area. Such piece meal approaches to complex problems can at best provide short-run answers. If the system is continued it can lead <u>only</u> to failure.

Before regulatory agencies can be effective in achieving their goals there is need for a sound national transportation system policy. This policy must be developed within the framework of transportation as an economic development tool. In too many cases attempts have been made to impose national policy standards developed by regulatory agencies, the regulated firms and other interested government agencies. Such national policies accumulate dust but contribute little to an effective set of guidelines for action.

This national transportation policy to be a viable document must include input from all sectors of the economy, must be specific enough to provide guidance and flexible enough to serve a dynamic economy.

Any policy statement so developed should be carefully monitored to determine why legislative, administrative, and regulatory actions do not implement the policy. In addition, there should be mandatory provision for evaluating and updating the policy at least once every five years.

Any transportation policy and the related regulatory bodies must be developed within a framework that looks to providing transportation needs of the future rather than building for a "glorious" past. It would be more fruitful to pursue policies concerned with developing a transportation system that works than to have such a preoccupation and fixation with deregulation which will hasten nationalization.

Summary

The clamor for railroad deregulation suggests that competition will assure reasonable service and rates and regulation is costly and not effective.

There is little evidence that industries with small number of firms have characteristics of competitive firms. Dominant firms have kept regulation from working and will be equally effective in keeping competition from working.

The insistence upon legalistic approaches assures success to those with the resources to delay and continue the case. Legal precedent provides little room for innovative approaches to the future.

Regulatory agencies and certain industries such as transportation have a unique responsibility to meet the needs of the general public.

Neither the regulators nor the regulated accept such a public and social responsibility.

Standard economic theory provides valuable tools for managerial decision making. These guidelines are ignored by the ICC and the railroads. Data is unavailable for rational decision making.

The absence of an accepted national transportation policy, the unwillingness to face the transportation issues that must be solved and an apparent concern with self interest rather than providing transportation has led to the failure of regulation.

Regulation could have worked if 20th century government and industry leadership had assumed leadership roles. The alternative to effective regulation is even worse than the experience with regulation and will hasten nationalization.

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