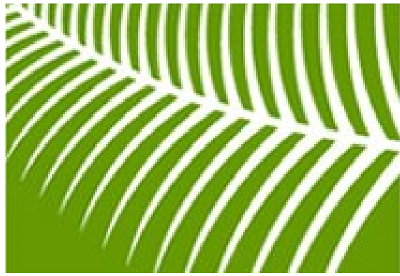

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*D. W. Brosnan**

Is Minimum Rate Regulation Necessary in the Public Interest

Minimum rate regulation is not necessary in the public interest. In fact minimum rate regulation in transportation violates every moral and economic right of the public to have the monetary savings and improved services which will result from more nearly equal competition among carriers, especially from common carriers competing with private carriers. Such regulation perpetuates waste and protects the inefficient. It contributes high profits to some business concerns at the expense of smaller businesses and the public. It discourages initiative and development. It substitutes the unqualified inexperience of regulators for that of responsible railroad management. Instead of protecting the public against discriminatory practices, it produces costly discrimination against the public welfare and interest.

For these and other reasons, an emphatic "NO!" is the only common-sense answer to the question which this panel is asked to discuss. Minimum rate regulation is most certainly *NOT* in the public interest.

Freight rates are only prices placed on transportation. Anything that keeps those prices unnecessarily high, as minimum rate regulation does, filches money from people's pockets, and abuses the public interest.

Competition lowers prices. The whole American economy is based on that fact. Competition reduces prices to consumers in the production and sale of automobiles, washing machines, clothing, food and all other products of a free-enterprise system. Competition will also reduce the prices of transportation, and it is high time that all common carriers be required to compete to save people money. There has been no real common-carrier competition for years and there can't be until these carriers are freed of the chains of minimum rate regulation.

Governmental studies have emphasized this repeatedly as common carriers, which are unnecessarily regulated in lowering their prices, have deteriorated in importance and strength to the point where there is a very critical threat to the future of common-carriage in this country. This unnecessary regulation is the root cause of the leaping growth of private carriage.

In 1955, for example, President Eisenhower's Cabinet Advisory Committee said that waste in transportation was costing the consuming public billions of dollars a year and adversely affecting all common carriers. The principal change recommended was that government should allow common carriers to price their services as low as they like, short of incurring an actual money loss. President Kennedy has been saying practically the same thing since he took office and has recommended to Congress that much greater rate-

**President, Southern Railway System*

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setting freedom be permitted, including the elimination of all minimum rate regulation on bulk and agricultural commodities. All Federal government agencies interested in transportation have supported this view, except the Interstate Commerce Commission which only exists to impose regulation on transportation.

Minimum rate regulation by the Interstate Commerce Commission began in 1920. It was intended to curtail the railroads' freedom to compete with other modes of transportation which were then in their infancy—first, waterway carriers and, later, highway carriers. Even the shadow of justification for minimum rates regulation has been lacking for many years. The "infants" are now full grown and more than able to fend for themselves.

The common-carrier barge lines, by their own reports, earn substantially more on their investments than do railroads. The common-carrier trucking industry gloats that its share of traffic has so greatly increased that its revenues for hauling freight now exceed those of the railroads.

The barge and truck industries are no longer weak, as these facts show, but they mew like helpless kittens when they are in the hearing rooms of Congress or appearing before the Interstate Commerce Commission to protest some rate reduction by a railroad. They plead for umbrella rates to shelter them from rail competition. All too frequently the regulatory umbrella is raised to protect their profits. This results in the public having to pay freight rates that are higher than necessary because the trucks and barges peg their largely unregulated charges just under rail rates.

These two strong and financially healthy modes—trucks and barges—are protected at the expense of the consumer who pays all freight bills in the end. The trucking and waterway industries do not now require the protection of minimum rate regulation. This means there is no longer any reason why the public should be penalized in the pocketbook while waiting for a regulatory body to approve a freight price reduction. For example, when Southern Railway tried to lower grain freight rates, it cost the people of the South $70 million or more in the delivered prices for grain they used during the 22 months of waiting before the reduction could lawfully be made. This is just one example of the cost to the public of outmoded and unnecessary regulation.

It is wrong to deny people the lower prices made possible by improved technology and managerial initiative, no matter what the mode of transportation. The public interest demands that competition replace regulation so there can be a stronger common-carrier transportation system in this country to serve that public interest adequately, efficiently and at the lowest prices that sound management and technological improvement can justify.

If there is to be a strong common-carrier system in our country's future, minimum rate regulation must be ended. Full competition, limited only by the requirement that it be nondiscriminatory, must be permitted for all common carriers. Prices and services must be those the public wants, not the high prices and restricted services that come from excessive and unneeded regulation. These artificially high prices and limited services are responsible for the continuing and mushrooming growth of private carriage of freight.

Loss of business to private and unregulated carriage has seriously weakened all common carriers—barge, truck and rail. It is also discriminatory against

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smaller business concerns in competing with larger businesses. Unlike larger businesses, the smaller businesses rarely have the money or the volume of business to justify the ownership of fleets of barges and trucks. The larger businesses profit from the manufacture and sale of their products and also from the transportation of those products. This transportation profit is made possible by artificially high common-carrier rates. The growth of private carriage can only be slowed and stopped by allowing common carriers to sell their services at prices that will take the profit out of private carriage.

All common carriers—truck, barge and rail—will benefit when competition is put to work to lower prices. It can only be put to work when we wake up to the fact that freedom cannot be regulated. There is no magic in the witch's brew of regulation; there is progress and benefit for all in the common sense of competition. The full fruits of this competition—lower prices and improved services—cannot be realized by the public under present-day regulation of minimum rates.

*Dudley F. Pegrum**

Limitations of time and space imposed by the chairman of the program committee prevent anything resembling a detailed examination of the many and complex issues raised by the topic assigned for this discussion. Only brief attention can be given to a few of what seem to be the critical economic issues of the problem.

I. Costs and the Pricing Process.

Probably the most critical issue in the problem of minimum rate regulation focuses on the appropriate relation of costs to the rates on traffic, which may be shared or transported by the different modes. Some take the position that rates for particular services must always reflect costs, others that there is no necessary relationship that will obtain at any particular time. These differences in viewpoint arise in part at least, from the complex nature of costs that characterize production in the real world.

Costs and Prices Under Competition. Under the assumptions of perfect competition costs always equal prices, marginal cost and average total cost per unit of output being equal to each other, and the same as price. All of the costs are directly identifiable with the products or services; costs and output of the individual firm are immediately adjustable to the prices it must accept as data. To the extent that the assumptions are valid for any particular situation these relationships will obtain. However, this so-called "static" model does not take the factors of time and traceability into consideration.

Costs and the Rate of Output. From the standpoint of the rate of output costs fall into the category of fixed and variable. Fixed costs are those which for a given plant and a given production period are unaffected by the rate of output. What particular items of a firm's costs are fixed depends upon the time period selected for the calculation. For output and price decisions the amount of these costs will be determined by those that are invariable for the

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time period during which changes cannot be made under existing practical or legal constraints.

In this connection it should be noted that fixed costs are always derived from those that have been incurred. When investment is being planned for future service none of the costs are fixed. For example, the estimated cost of moving grain in the "Big John" cars must include the investment in those cars if the decision to acquire them and move the grain in them is to be made on an economical basis. This cost is not incurred for the business as a whole, it is for this particular service and should not be incurred unless the rates for the services are designed to cover that cost. The investment does not become a fixed cost, i.e., a thing of the past, until it has been made. When it has been made, it is fixed for the particular service in question, and no other.

Variable costs constitute the second type of costs that are related to the rate of output. These are the costs that fluctuate directly with the rate, increasing in total as the output increases and decreasing as it decreases. These are the costs that are incurred during a given production period as a result of using up resources. For a given production period, or at the time the decision is made to incur costs, they constitute the controllable part of the costs of production and are the only relevant ones for output and price decisions.

Traceability of Costs. Costs must also be analyzed from the standpoint of their traceability to the various goods or services produced by a firm. Most enterprises turn out more than one product; that is, they are multi-product undertakings. When this is the case there will be costs which will be incurred specifically for each of the products or services, and therefore will be directly traceable to them. These are known as specific costs. The other costs are known as joint costs. They are not traceable to specific products or services because the production of one results in the production of another. Back haul in transportation is a familiar illustration. These nontraceable costs may be either fixed or variable, but in either case they cannot be assigned economically in any sense to anyone of the joint products. They belong to all of them together.

Cost and Decision Making. The total cost of each product of a multi-product firm can never be obtained logically. If a total cost is calculated it will be the result of arbitrary assignment of the nontraceable costs based on a formula or procedure that is not economically rational. Furthermore, fixed costs are what economists call non-economic costs. That is to say, they do not enter into rational calculation of costs for decision making for either output or prices. It follows that the average or fully-distributed cost for any product or service of a multi-product firm is an arbitrary figure, illogical and uneconomical as a basis for decision making. The costs that are relevant for decision making are those that are specific and variable for the service in question. The prices to be charged for the units of output should be those that will yield the maximum net revenue above those relevant costs. Not all the products or services can, or should, contribute proportionately to the fixed and the nontraceable costs. The contribution to or absorption of these costs will vary according to the relative demands for the different products or services.

II. Issues of Minimum Rate Regulation.

Objectives of Minimum Rate Regulation. The regulation of minimum rates

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has three principal objectives: (1) to prevent predatory practices, that is those that are undertaken for the purpose of driving out competitors or, because of their uneconomical nature have that effect; (2) to prevent special favoritism among shippers, commodities or places; (3) to protect competitors against competition from more efficient rivals. Minimum rate controls to achieve the first objective are designed to prevent the elimination of economical competition. To achieve the second they are designed to limit discriminatory rates arbitrarily imposed by the carrier to give special advantages to the favored services. To achieve the third objective they are designed to put a floor under rates in order to keep a higher cost carrier in business or, in other words, arbitrarily to allocate traffic among carriers by the use of "umbrella" rate making.

Costs and Predatory Practices. Practices that utilize pricing in order to drive out competitors may be subject to two tests: (1) rates that are below relevant costs which thereby result in an absolute loss on the traffic in question leading to a diminution of the total net revenue of the carrier that offers them; (2) rates which even though they are above relevant costs, are below those which would maximize the revenue on that traffic. Rates based on either of these considerations should be prevented in the interests of protecting competition. If the rates maximize the net revenue on the traffic to which they apply, they are economically competitive and are in the public interest. Rate making by this test should not be subject to the limitation of merely meeting competition. It should be permitted to make competition.

Undue or Unreasonable Preference or Advantage. In the language of transport this constitutes unreasonable discrimination. If the spread between rates is unreasonable and the lower rates meet the tests already outlined, the remedy is to lower the higher rates, not vice versa. In other words, it is the maximum rates that should be reduced, not the minimum ones raised. The primary test for this procedure is not average or fully-distributed costs, but the overall net revenue requirements of the carrier. This is because the non-traceable costs economically have to be recovered from the traffic that will bear them.

III. Competition in Transport.

Types of Competition. Competition among the suppliers of transport services takes place among modes, within modes, between regulated and non-regulated carriers for hire, and between for-hire and not-for-hire carriers. Minimum rate regulation applies primarily to common carriage. It is not applicable to agricultural commodities by motor, to bulk commodities by water, nor to private carriers. The primary opposition to the elimination of minimum rate regulation is from common carriers by motor who also want to eliminate back haul competition and so-called illegal carriage for hire, and from the water carriers. The desire for protection against competition is emphasized by the endeavors of common carriers by motor to impose all possible restrictions on private carriage, on contract carriage, and on nonregulated carriage for hire, as well as on competition by rail. The water carriers want to preserve the position they enjoy and to restrict competition by railroads. In other words, the basis of the objections to the removal of minimum rate control is the restriction of competition.

Growth of Minimum Rate Regulation. Minimum rate regulation was

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adopted as part of federal policy in 1920 to limit rate competition in transport, but prior to 1935 it was used principally to protect water carriers. In 1935 it was extended to motor carriers partly to protect the railroads, and partly, along with restriction of entry, to protect motor carriers against competition within their own industry. Competition within the industry was also the prime reason for extending regulation to certain types of water carriers in 1940. This extension of minimum rate regulation was based in part upon the erroneous theory that it was necessary to protect competition. This is contradicted by the situation in industry in general even where firms are big and fixed costs are relatively large.

The extension of minimum rate regulation and the controversy over its application has grown with the increasing intensity of competition resulting from the impact of modern technology. The prospects are that competition from this source will increase. Public policy to date has extended the basis for competition in transport at the same time that it has endeavored to restrict the economic advantages to the public stemming from that policy. The chief victim, among the carriers, of this contradiction is the railroads who are restrained by minimum rate regulation at the same time that they are required to support through taxes some of their rivals in order that the latter may remain "forever free." The real victim, however, of public policy of this sort is the general public which is saddled with excess transport facilities and denied rates that will result in the most economical use of them.

Minimum Rate Regulations and Stability. The regulation of minimum rates in order to promote the stability of rates is an illusory goal. Regulation which puts a floor under rates which is higher than economical competition would yield results in higher rates than the public should be expected to pay. It applies to regulated carriers only thereby serving to divert traffic to the non-regulated segments. This is not likely to give a notable advantage to the small shipper and it will not serve to stabilize transport costs to the community as a whole. Shippers are not obligated to accept the services of common carriers and the latter must stand by with their hands tied in competition for the business. To the extent that safeguards against whimsical rate making are desirable these can be afforded by requiring due notice for changes. While opposing the abolition of minimum rate controls many of the carriers want minimum rates pegged at fully distributed costs of the rival carrier, and if these are not high enough to give the desired protection, they seek a differential above the full costs of the protestant. This is "umbrella" rate making and traffic allocation at its worst.

IV. Protection of the Common Carrier.

Relative Decline of the Common Carrier. The relative decline of the role of the common carrier in the transport system of this country has been attracting much attention in policy circles, among the railroads, and among motor common carriers. The decline in the relative position of the common carrier in these two modes is, first of all, the result of technological developments. A large part of land transport no longer fits the assumptions underlying the common carrier concept. Furthermore, the developments have made the motor transport industry highly competitive within itself as well as with the railroads. Despite this, the rigid controls developed for railroads down to and including the Act of 1920 have been extended to common carriers of

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the various modes. This has imposed severe handicaps on the railroads in particular and on common carriers in general. Proposals to resolve the difficulties by extending controls to the nonregulated areas of transport constitute an approach to public policy that flies in the face of technological developments and contradicts the competitive assumptions on which a private enterprise system must rest.

Remedy for Relative Decline. The remedy for the situation lies not in the retention of handicaps that restrict the competitive ability of the common carrier, but in the removal of them so that it can demonstrate by its competitive capacity the economical role that belongs to it in the transport system. Unfortunately, the principal opposition to change in this direction comes from those water carriers that are unhampered by existing restrictions, and from common carriers by motor that want protection against railroad competition as well as protection from nonregulated competition within their own industry. In short, whatever may be the problem of protecting the common carrier *per se* it is not related to the question of minimum rate control.

V. Conclusion.

From the standpoint of economics an efficient transport system in the public interest in the United States today does not call for the regulation of minimum rates. It is questionable that it ever was needed. It was not employed until 1920 and rate wars among railroads had not been a problem for over a quarter of a century. Even before that they would not have presented any serious difficulty had it not been for a public policy which compelled competition and resisted consolidation. Nor was minimum rate regulation an appropriate means of implementing the rule of rate making in the Act of 1920. The extension of the device in order to limit competition among common carriers was illogical and uneconomical but in keeping with the restrictive policies of the 1930's. As a means of dealing with predatory practices, intent to eliminate competitors, and unreasonable discrimination it is analogous to the employment of a blunderbuss when sharpshooting may be called for on occasion. Revision of transport policy in keeping with changed and developing transport technology and in the interests of an economical and efficient transport system calls for the elimination of minimum rate regulation.

*John L. Weller**

I am glad that this question has been put in the context of the *public* interest, rather than the special interests of contending parties. Were I the President of a rich and powerful railroad, or the traffic manager of an industrial giant with plenty of traffic muscle to flex, I might be tempted to vote in the negative. However, there can be little question that minimum rate regulation is in the interest of the general public; it is also in the interest of all common carriers, by highway, air, water, and rail.

Recent years have seen an enormous pressure of propaganda to the effect that minimum rate regulation, adopted in the Esch-Cummins Act of 1920, was formulated solely to protect railroad competitors against an existing

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railroad monopoly; that it has been harshly administered by a bureaucratic Interstate Commerce Commission, bent on retarding transportation progress; and that, in an event, any law adopted in 1920 should be repealed automatically. After all, we regulated the minimum area of bathing suits in 1920, and why shouldn't rate regulation get the bikini treatment?

It reminds me a little of the propaganda prevalent in Germany during the 1920's and 30's, to the effect that Germany had been deprived of victory in 1918 by a "stab in the back," and all her problems could be resolved by eliminating democratic elements. The sad thing was that the Nazis came to be deceived by the "Big Lie" which they themselves had promulgated.

While it is true that planes, automobiles, or trucks had not yet assumed important roles in transportation in 1920, the textbooks reveal that Congress' reasons for enacting minimum rate regulation in that year were: (1) maximum rate regulation alone had proven to be ineffective in preventing rate discriminations; (2) the tendency of the railroads to engage in "out-of-pocket" rate warfare between themselves and with other forms of transportation had been demonstrated.

Economists called this "ruinous competition." It occurred largely because of excess and wasteful railroad mileage which had been constructed without economic justification, and which endeavored to attract traffic at almost any price. This tendency had been particularly apparent in the railroad financial collapse which led to the necessity of a Government takeover in order to carry on the War.

Professor Merrill Roberts, in his textbook on transportation, stressed that the weaknesses of the negative approach to regulation "based upon a mistaken belief in the effectiveness of competition, had encouraged discrimination, reduction of rates to unremunerative levels, wasteful hauls, excessive construction, and unduly elaborate services."

Congress had become aware that, in the public interest, regulation must seek a healthy transport system, not just the day-to-day control over maximum rates and discriminations. In the long run, the public would pay for all the costs of transportation, including the excesses or follies of wasteful and foolish managements, either through increased rates, poor service, bankruptcies, trusts, or bail-outs at taxpayer expense.

Consequently, in the 1920 Act and the amendments thereafter, the Commission was assigned the objective of regulating rates with a view to financial health in the transportation industry, as well as preserving reasonable maximum levels and eliminating discriminations. It could not achieve this without some control over minimum rates as well as maximum rates.

It was hoped with reason in 1920 that the growth of the country eventually would fill up the capacity of some of the wasteful and duplicative railroad mileage which had been constructed in the pre-1920 era. This might have happened except for the technological revolution in the ensuing 43 years which has seen the emergence of the airplane, the private automobile, the motor bus, the modern highway truck, together with a revamping of the railroad industry through Diesel locomotives, centralized traffic control, and other technological factors. The fact is that today we have an excess of railroad mileage, probably as great as at any time in our history. The Doyle

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Report of a few years ago estimated this excess at 60,000 miles. It is an indelicate fact which no one wants to recognize, but a material one.

Today, there exists in exaggerated form all of the factors which led the authors of the Esch-Cummins Act of 1920 to minimum rate regulation. In 1947, the railroads were successful in obtaining adoption of the Bulwinkle Amendment which relieved them, to a large degree at least, from penalties of the anti-trust laws which apply to other citizens. Following upon this, there has evolved a campaign of ruinous rate cutting and rate manipulation copying the techniques and tactics of the latter 19th Century. Far from having proven to be a strict overseer, the Interstate Commerce Commission has been a placid bystander exercising its powers feebly and infrequently, if at all.

Powerful and affluent railroads gang up in even bigger combinations; the weaker and less powerful are left out of the club and are reeling under the onslaughts of "out-of-pocket" rate cutting. The bankruptcies of several important Eastern systems appear possible, and Congress is regularly beseeched to bail these systems out at the public expense. Discriminations, personal and local, are a frequent concomitant of the rate structure, not the exception.

Rebates granted on the basis of corporate size, similar to those for which the old Standard Oil combine was odious, have once again made their appearance. Water carriers and the ports they serve are discriminated against, and our domestic merchant marine, so important to the national defense, is in danger of extinction.

Yet it is argued by propagandists for the elimination of minimum rate regulation that this power of the Commission has been over-exercised. It was also argued, with equal truth, and unfortunately with equal acceptance, that Heinrich Bruening and the ministers of the Weimar Republic were harsh and brutal in suppressing the Beer Hall Putsch of 1922. In fact, history says that the Weimar Republic died because it was afraid to carry out the duties and powers entrusted to it; similarly, history of the future may say that the Interstate Commerce Commission became a dead letter because it was afraid, in the face of a barrage of false propaganda, to administer with courage the duties entrusted to it.

One of my good friends who is a leader in the fight to emasculate the Interstate Commerce Act maintains that unless meaningful regulation is expunged, the railroads must go into public ownership. On the contrary, I believe that unless transportation is willing to accept reasonable regulation in the public interest, public ownership is inevitable. Reasonable regulation, in my view, encompasses regulation of minimum as well as maximum rates (one cannot exist without the other); the elimination of discriminations and manipulation of rates; and an attempt at a financially prosperous transportation system. This last cannot be accomplished through ruinous rate wars now, anymore than it could before 1920.

Those who are old enough will remember that the Esch-Cummins Act of 1920 was the result of a controversy between those who wanted Government ownership of the railroads, and those who wanted private ownership, with Government regulation. Said Professor Elliot Jones in 1924:

> "Whether the experiment with government regulation of railways on which we are now embarked will prove successful will depend

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> primarily upon the character of the Interstate Commerce Commission. In the future, however, it will no longer be possible for the advocates of regulation to explain its failures upon the score of the inadequacy of the Commission's powers. This was formerly a more or less valid argument, but by the passage of the Esch-Cummins Act it has lost its validity. Whatever else may be said about the Esch-Cummins Act—and it has its bitter critics—it has the prime merit of putting the experiment of railway regulation squarely to the test. Should this experiment prove to be a failure the logical next step would appear to be the ownership and operation of the railways by the government."

I do not wish to say that every detail of regulation adopted in the past is necessarily sacred. I do believe that minimum rate regulation in the public interest is even more essential today than it was in 1920. True, the Commission has not adequately and forcefully discharged the duties delegated to it by Congress, but those in transportation who clamor for the repeal of regulation are like the frogs in Aesop's Fable who, continually dissatisfied with their king, were finally sent a stork who ate them all. As Professor Jones so forcefully pointed out in 1924, the alternative to regulation in the public interest is public ownership. It may be that the propaganda barrage of recent years will soon bring about this result.

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