

Collective Ratemaking Reconsidered: A Rebuttal*

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I. INTRODUCTION

In a recent issue of this *Journal*, Jesse J. Friedman set forth a number

* This article was submitted by the author as a partial response to the analysis contained in Friedman, *Collective Ratemaking by Motor Common Carriers: Economic and Public Policy Considerations*, 10 *TRANSP. L.J.* 33 (1978). This rebuttal is based upon testimony the author presented on behalf of the Federal Trade Commission before the Interstate Commerce Commission in *Ex Parte* No. 297 (Sub-No. 4), 43 *Fed. Reg.* 1666 (1978). It represents the author's own views and does not necessarily reflect the views of the American Enterprise for Public Policy Research, with which he is associated.

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of considerations in defense of collective ratemaking by motor common carriers. Whether the limited antitrust immunity afforded under section 5a of the Interstate Commerce Act will continue, and if so in what form, is of course an issue of current debate, both within the Interstate Commerce Commission (ICC or Commission) and in the halls of Congress. In a belief that an airing of both sides of a policy issue is desirable, the following rebuttal is presented to Friedman's position in favor of collective ratemaking. While this material is based on the author's rebuttal to Friedman's statement¹ in a case pending before the Commission, it also responds to many of the points raised in Friedman's original article.

II. JUSTIFICATIONS FOR COLLECTIVE ACTION

In his recent article, Friedman argues that collective action is needed to maintain equitable, nondiscriminatory rates, to assure rate stability, to preserve the "national trucking network," and to make regulation and enforcement manageable.² These issues are addressed below.

A. MAINTAIN EQUITABLE, NONDISCRIMINATORY RATES

The first justification of collective action is that it aids the Commission in maintaining equitable, nondiscriminatory rates.³ Economists usually define the term discrimination to mean rate relationships that are at variance with relevant measures of cost. Realizing, of course, that the definition of discrimination often used in regulatory proceedings, especially at the Commission, is not quite the same, two points should be kept in mind: (a) a competitive market would not be characterized by discrimination as economists define it, and (b) the achievement of nondiscriminatory rate relationships at variance with the economist's definition of discrimination is costly in terms of resource allocation.

If markets are competitive, discrimination (as economists define it) simply cannot obtain. If one carrier is providing service at a higher rate than another, the shipper discriminated against will simply choose another carrier. Thus, in a competitive market, carriers would have to meet the "market test," and discrimination would be eliminated.

If rate relationships are artificially maintained at variance with appropriate measures of cost, then resources are misallocated. Those favored by rates below cost value this service at the margin less than the value of the

1. National Classification Committee, Opening Statements of Facts and Argument (Sept. 18, 1978), Vol. I, Section J, in *Ex Parte* No. 297 (Sub-No. 4), Reopening of Section 5a Application Proceedings to Take Additional Evidence; Section 5a Application No. 61, National Motor Freight Classification-Agreement.

2. Friedman, *Collective Ratemaking by Motor Common Carriers: Economic and Public Policy Considerations*, 10 *TRANSP. L.J.* 33 (1978) [hereinafter cited as Friedman].

3. *Id.* at 42.

resources used in producing the service. Those who pay rates in excess of costs value the service at the margin more than the opportunity costs of the resources. The result is that transportation costs, overall, are higher than need be. Of course, how equitable rates are depends on one's point of view. Obviously, those receiving below-cost rates tend to think they are equitable, whereas those paying more than necessary tend to think they are not.

In his article Friedman identifies a number of ways in which collective action allegedly brings about rate equity. He notes, for example, that because of collective action, all shipments of the same size transported the same distance are charged the same rate.⁴ But it is likely that costs will vary for a given distance because of differences in carrier efficiency or because of certain characteristics of the service, such as congestion, factor prices, and loading. In such a case, one shipper may be truly favored over another, even though for the given distance the rate is the same. Thus, to the extent that collective ratemaking encourages uniform rates, it may well foster price discrimination.

Friedman reserves his strongest remarks for the allegation that without collective ratemaking, economically powerful shippers would be in a position to gain more favorable rates than less powerful shippers.⁵ In theory, there is no reason to expect "more powerful" shippers will receive favored treatment. No carrier would be willing to transport any shipper's freight below cost, and could not do so in the long run and stay in business. The argument that collective ratemaking now assures that small shippers (arguably "less powerful") get equal treatment with large shippers (arguably "more powerful") does not seem persuasive. For example, it is my understanding that at present what shipper "participation" now occurs in rate bureau proceedings tends to be from large shipper interests, not small shippers. Thus, if shippers have any effect on rate bureaus, it must be the large shippers who get the favored treatment.

B. ASSURE RATE STABILITY

Friedman states that:

[S]hippers must be able to rely on a fair amount of stability in the transportation charges they pay. . . . [T]here is no doubt that in many commercial activities, including transportation, the purchaser regards the need for a reasonable degree of price stability as inseparable from the need for a reasonable price itself.

. . . A system of individually-established rates would be at the opposite pole in this respect in important ways such as lack of ready ascertainability of prevailing charges and tariff conditions under the welter of alternative rates and

4. *Id.* at 43.

5. *Id.* at 42.

routes available.⁶

It appears certain that rate regulation (though not necessarily collective ratemaking) causes rates to be more stable than they would be in an unregulated environment. All else being equal, shippers value this rate stability. However, shippers also value lower overall rate levels. Economic efficiency requires that rates be adjusted to changes in demand, and it is important to note that rates vary over seasonal cycles and often by direction of movement. This increases utilization and lowers average costs. If any institutional arrangement restrains such variations (or "rate instability"), then the result is higher costs of transportation.

Shipping firms realize, of course, that rate stability is of value to consumers and make a trade-off between stability and straightforward cost minimization. Thus, we find that in unregulated markets such as commuter airlines, restaurants, and professional services, rates have a certain stability even though there are wide, sometimes unexpected, variations in demand and even cost. The important point is, that from the standpoint of the consumer of the service, there is an optimum combination of lower rates and rate stability. On the basis of economic theory, it is quite clear that a competitive market will approximate that optimal combination. There is, however, no reason to assume carriers will choose this optimal combination through collective action.

C. PRESERVE "NATIONAL TRUCKING NETWORK"

Friedman argues that collective action is necessary to preserve our national trucking network. He states that "total interlacing of trucking service across the nation is inconceivable without the machinery of collective rate action by all the carriers concerned and the antitrust immunity which makes it possible."⁷ This argument is not persuasive for two reasons.

First, would carriers have an incentive to interline where this would be in the interest of shippers? The answer, of course, is yes. Without doubt, some traffic is interlined today because of regulatory restraints on service.⁸ In an unregulated environment we must expect slightly less interlining because carriers would provide direct service in many cases. But in other cases, it would be more economical for a carrier simply to interline a shipment tendered to it. The incentive to provide such service would exist since rates would be charged to cover costs. Why does interlined through service now exist? The Commission has no authority to force interlining of traffic, so the willingness of carriers to interline is a function of other

6. *Id.* at 45.

7. *Id.* at 44.

8. Such poor service is one of the costs of regulation.

incentives.⁹ It is difficult to see how collective ratemaking provides further incentive, except to raise prices above costs in certain instances.

The second issue is whether truckers need antitrust immunity to interline traffic. The Justice Department has often given its judgment that such arrangements pose no problem under the antitrust laws. The important point, it seems, is that individual carriers contract with individual carriers, rather than contracting on a collective basis. To the degree that scarcity of information creates the need for a "clearinghouse" type of institution, a form of a brokerage market would evolve such as exists (for a different function) in the exempt agricultural trucking market.

In the same vein, there appears to be no difficulty in having a system of motor carrier freight interlining in the absence of collective action on classifications. The reason is, that parallel to the incentive for rate stability, there is an incentive for standardization in any industry. As in many other industries, informal classification standards would develop as carriers adopted reasonable standards proposed by other carriers. That is, the market itself would determine what constituted the most efficient standards for producers to follow. Information on rates and classification would be communicated among carriers which interlined freight either directly or through brokers lacking antitrust immunity. In either case, the type and amounts of interlining would be more efficient than under today's regime of collective action.

D. MAKE REGULATIONS AND ENFORCEMENT "MANAGEABLE"

Friedman argues that "[i]n the absence of collective ratemaking, effective regulation would literally be impossible." He also argues that without collective ratemaking there would be "gigantic problems of enforcement."¹⁰ Basically, the argument is that if carriers set rates and classifications individually, the temptations for rate inequities would be more than the Commission could control. Several considerations are involved.

First, as discussed above, there is reason to believe that even without collective action there would be a good deal of standardization on rates and classifications. One does not, for example, observe a great deal of variation in prices for homogeneous products and services in unregulated markets. Carriers could set rates through rate publishing agents rather than through rate bureaus, and one would anticipate a great deal of uniformity with respect to rates and classifications in the absence of collective action.

9. We observe vertical production processes in many areas of the economy. The farmer produces wheat and sells it to the grain elevator operator, who sells it to the bread manufacturer, who sells it to the wholesaler or retailer, who then sells it to the consumer. The reason this system continues to function is the set of incentives. We would expect no less under a deregulated trucking environment.

10. Friedman, *supra* note 2, at 41.

Second, as is well known, monopolistic firms have a much greater ability to price-discriminate than competitive firms. Competitive ratemaking would thus, on this account, be expected to result in fewer classes and rates. Third, the existence of independent action results in limited variations from the bureau-proposed rates and classifications.

Finally, and perhaps most importantly, the rate control and enforcement burdens on the Commission depend very much on the Commission's policies. If the Commission deems it appropriate to scrutinize rate reductions in great detail and to entertain protests from competing carriers, then the burden may actually increase and enforcement problems proliferate. But if it chooses, the Commission can reduce its burden quite substantially by changing its policy. As economists have noted for many years, the Commission's policy of maintaining minimum rate control has had substantial anticompetitive effects. The fact that elimination of collective ratemaking might increase the regulatory burden on the Commission is just another reason for a change in its policy toward minimum rates. There would be less need for Commission supervision if rates were competitively determined because competition would assure that rates were reasonable and nondiscriminatory.

III. SAFEGUARDS TO RATE BUREAU ABUSES

Friedman argues that while collective ratemaking restrains competition, the system contains sufficient safeguards to limit abuse. These include ultimate Commission supervision, the right of independent action, and the opportunity of shippers and other interested parties to have their views heard. Each of these purported safeguards is addressed below.

A. COMMISSION HAS FINAL WORD

Friedman notes that "the ultimate protection of the public interest lies in the all-embracing array of powers with which Congress has equipped the Interstate Commerce Commission for the purpose of regulating rates."¹¹ The problem with this line of reasoning is that it assumes that the Commission has the resources necessary to regulate each rate proposal and to assure that rates established under collective action are not excessive or discriminatory. Because of the size of the job in relation to the resources of the ICC, rate bureaus do in essence set trucking rates. Because of the hundreds of thousands of rates that are proposed each year, the Commission can do little more than apply its rubber stamp of approval. According to the latest ICC annual report, during fiscal year 1977, of the 221,874 trucking rates proposed, only 5,246 were suspended (2.4%) and only

11. *Id.* at 47.

1,827 were rejected (0.8%).¹²

Moreover, there is considerable evidence that rates of return in the trucking industry exceed competitive levels. Perhaps the most notable piece of evidence is that operating certificates command high prices. While a portion of this value stems from regulation-induced inefficiencies in routes, commodities, and services, a great deal of the value reflects monopoly profits that are being earned in certain markets.¹³ In short, it is simply not feasible for the Commission to adequately police the abuses of collective ratemaking.

B. INDEPENDENT ACTION

Friedman emphasizes the role of independent action in policing any potential abuses of collective action.¹⁴ The existence of independent action may somewhat constrain the ability of rate bureaus to set prices above competitive levels. The question is, how effective is this safeguard, given the coercive nature of the bureaus.

Some indication of the role of independent action in restraining rate bureau abuses can be gleaned from the Commission's responses to the eighty-six questions put to it by the Senate Subcommittee on Antitrust and Monopoly.¹⁵ First, it should be noted that after the Commission's initial decision in *Ex Parte No. 297*,¹⁶ which forbid rate bureaus from protesting independent actions by their members, the percent of protests by motor carrier rate bureaus fell precipitously from 27.6% to 13.3%.¹⁷ Protests by individual motor carriers, on the other hand, rose from 13.3% to 38.2%.¹⁸ During the subsequent year, the proportion of protests accounted for by individual motor carriers fell precipitously and the share of motor carrier rate bureau protests more than doubled.¹⁹ This suggests that rate bureau members objecting to an independent action may have been able to get another rate bureau to protest the action.²⁰

12. ICC NINETY-FIRST ANN. REP. 113 (1977).

13. See *The Value of Motor Carrier Operating Authorities*, COUNCIL ON WAGE AND PRICE STABILITY (CWPS-247) 27 (June 9, 1977). Of course, excessive returns are a function of the Commission's entry and rate policies as well as of its policy of granting antitrust immunity for collective action.

14. Friedman, *supra* note 2, at 37.

15. The subcommittee, during the course of its hearings, put eighty-six questions to the Interstate Commerce Commission. Neither these questions nor the ICC's answers [hereinafter cited as *Hearing Questions and Answers*] are yet generally available to the public. OVERSIGHT OF FREIGHT RATE COMPETITION IN THE TRUCKING INDUSTRY (1978).

16. *Ex Parte No. 297*, Rate Bureau Investigation, 349 I.C.C. 811 (1975).

17. See *Hearing Questions and Answers*, *supra* note 15, ICC's answer to Question No. 32.

18. *Id.*

19. *Id.*

20. Curiously, the number of total independent actions fell after the prohibition against rate bureau protest of member initiatives. *Id.* Crosscurrents were at work here. On the one hand, with

Between one-third and one-half of motor carrier independent actions are suspended following protest,²¹ and nearly three-quarters of the motor carrier rate proposals suspended were established by independent action.²² Only a minor proportion of motor carrier rate proposals that were suspended were ultimately approved.²³ Finally, the vast majority of independent actions were for rate decreases rather than rate increases.²⁴ Where the vast majority of independent actions are for rate decreases rather than rate increases, where these actions are much more likely to be protested than rate proposals issued by bureaus, and where if protested, they are extremely likely to be suspended and not allowed to go into effect, it is farfetched to believe that independent action constitutes a truly significant restraint on the abuses of collective action.

C. INTEREST GROUP "PARTICIPATION"

Friedman and others have argued that another check on rate bureau abuses, in fact, a specific advantage of rate bureaus, is that they offer a forum where various interested parties may reason together. It should be noted, however, that competition provides an incentive for carriers to develop new services and lower prices, and for shippers to propose new services and to insist on lower prices. The distinguishing characteristic of rate bureaus²⁵ is that while the various interest groups may present their cases, the decisions are made by the carriers in secret vote. An analogy is relevant here: suppose that instead of our having the opportunity to shop for clothes at any of the local department stores or from mail order houses, we were forced to make application for a new suit at a proposed price before a "Board of Tailors" representing all retail outlets. Who would argue that we would have more consumer sovereignty and more voice in our selection of clothes and the prices we pay under such an arrangement?

While the access of shippers to rate bureau proceedings may in some sense reduce the abuses of collective action, the effect cannot be very significant. Moreover, it cannot be seriously argued that a direct discussion between a shipper and a carrier is somehow inferior to having a rate bureau pass on a specific proposal.

a prohibition on rate bureau protests of member initiatives, the chances of an independent action being successful would seem to be raised (which would lead to more independent actions); on the other hand, since a rate bureau knew it would be unable to protest an independent action, perhaps it was more lenient on member initiatives to propose new rates. That is, the bureau had little to gain in opposing the action, so what would ordinarily have been an independent action simply went forward as a bureau proposal.

21. See *Hearing Questions and Answers*, *supra* note 15, ICC's answer to Question No. 33.

22. *Id.*

23. *Id.*

24. *Id.*, ICC's answer to Question No. 30.

25. See, e.g., Friedman, *supra* note 2, at 46.

IV. CONCLUSION

The discussion above, the extensive writings of economists, the findings of the Senate Antitrust and Monopoly Subcommittee,²⁶ and the hearings of the National Commission for the Review of Antitrust Laws and Procedures,²⁷ show collective ratemaking in trucking to be contrary to the public interest. Rate bureaus set rates at higher-than-competitive levels and they provide a mechanism to police deviations. Clearly, the alleged benefits of rate bureaus are either vacuous or can be achieved by substantially less anticompetitive means.

Of course, advocates of the existing regime will continue to say that without collective action dire consequences will result—that the national trucking system will break down, and so on. As one who has spent a great deal of time and research in another area of transportation—the domestic airlines—this writer is struck by the similarities in the arguments. At present the nation is experiencing a transition in airline regulation from an environment in which prices have been very inflexible, entry has been very difficult, and competition has been channeled into service dimensions, to an environment in which there will be price as well as service competition and entry will be reasonably free. When this experiment in regulatory reform was first proposed, the opponents made many of the same arguments now being leveled at the proposals to reform trucking regulations. Yet, policy makers rejected these arguments as insufficient to outweigh the benefits of reform. The results so far have confirmed this view, and it is reasonable to expect the same will hold true in the motor common carrier industry.

26. Findings of the subcommittee are not yet available to the public.

27. NATIONAL COMM'N FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL 197 (1979).

