History of Trucking Regulation: *1935 to 1980*

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At the beginning of the century, the railroad began feeling stiff competition from small truckers. Farmers preferred trucking their produce to the market rather than transporting it with slower, more expensive railroads. As the government carpeted the country with highways, the motor carrier industry's rates undercut the monopolistic rates of the railroads. In response to the trucking competition, the rent-seeking railroads clamored in Washington for regulation. Congress responded by passing the Motor Carrier Act in 1930, which limited entry and stiffened regulation of the trucking industry with the Interstate Commerce Commission, all of which led to higher trucking rates and far less efficient operations. The heavy regulation of the trucking industry continued until Congress passed the Motor Carrier Act of 1980. At that point, the trucking industry has changed dramatically with this revised statute.

This paper will examine the history of regulation in the motor carrier industry during the 1935 to 1980 period and determine the reasons that lead to the 1980 Act. In this historical case-study, the forms that regulation may take will be presented. After examining the forms of regulation and the antecedents to the Motor Carrier Act of 1980, the paper will concentrate on the passage of this historical deregulatory Act ushered in along with the "Reagan Revolution." Not only will the paper evaluate the effects and motives of the Act, but will explore the negative externalities of the trucking market that may call for renewed regulation according to social cost-benefit analysis in the future.

In order to understand the historical context of legislation, it is often important to review the economic situation confronting business at that time. Two major pieces of legislation, the Motor Carrier Act (MCA) of 1935 and the Act by the same name of 1980, mark a period of pervasive federal regulation. Each of these acts are products of their periods; the MCA of 1935 of the Great Depression and MCA of 1980 anti-regulation sentiment. Regulation of the motor carrier industry, however, did not originate with the MCA of 1935. States began regulating trucking as early as 1914 but the laws dealt more with the safety. This paper will concentrate on the federal economic regulation as opposed to safety regulation. In presenting the arguments for and against these pieces of legislation and other laws or court decisions that molded federal regulation, this paper will also refute or support many of the justifications given for trucking regulation.

The beginning of the century saw a shift from rail to trucking, particularly in the food and agriculture sectors. Farmers saw the benefit of quicker transportation via trucks and preferred this method due to several factors. Trucking had some inherent advantages over railroads: flexibility and convenience of service, completeness of service (i.e. door-to-door), and considerably cheaper rates.[1] Although railroads had the advantage of transporting larger volumes, the trucking business slowly but surely encroached on the railroads' market.

As reliable highway infrastructure increased throughout the country, the motor carrier industry's rates were significantly lower than the comparatively high rates of the railroads. Not only did the network of roads facilitate the trucking industry's expansion but invention of the pneumatic tire, hard-surfaced roads, and assembly-line production in the 1920's also helped the growth of the industry. In 1920, motor carriers carried less than 1.0% of the intercity freight loads. By 1939, this had increased to 19.2%. By contrast, railroad intercity transportation of freight loads decreased from 84% in 1920 to 61.3% in 1940. During World War II, however, there was a brief period of railroad market share "recovery" because truckers found difficulty in finding gasoline, tires and vehicles.[2]

In response to the trucking competition, the railroads clamored in Washington for regulation of the motor carrier industry. The lobbying organization for the railroads sponsored a bill calling for economic regulation of the trucking industry. The railroads argued that it would be only fair to regulate interstate motor carrier entry, rates and service because the railroads were subject to that pervasive regulation.

Although the railroads' attempt to reduce the growing market share of trucking is an important factor in the eventual passage of regulation, it is a mistake to attribute any specific legislation to simply the political power of railroads. The Great Depression is perhaps the most influential

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factor in the resulting legislation in 1935. This period is one characterized by hundreds of bankruptcies, intensive competition, and monopsony in the trucking industry. According to the economists of the day, the economic structure of the trucking industry resulted in "excessive competition" or otherwise termed, "destructive competition."[3] It is important to remember that during the Great Depression, competition was severely criticized as a method of organizing economic activity.

The economic structure of the motor carrier industry is inherently competitive. Each economic unit is so small that it cannot influence the market price. There are no significant obstacles to the movement of resources in or out of the industry or even any markets. The economies of scale are reached quickly, so that a trucker currently servicing a shipper can be easily replaced. And, the entry barriers are very low.[4]

If one assumes the "excessive competition" of this economic structure means more than just a façade to hide the intentions of rent-seeking railroads and large trucking companies, then the term means that producing prices are consistently below costs. In microeconomic theory, when production prices are below costs, the following occur: consumers are not guided by relative costs; there is a distortion of the allocation of resources, and a concomitant low return on investment.[5]

Although "destructive competition" was much evident during the period, it is important to remember that this structural problem cannot be removed from the larger economic context of the Great Depression. In other words, the economic problems of the trucking industry are intimately related to the general state of the American economy. For example, it was argued that the problem of the trucking industry was that entry was too easy. Entry simply required a driver and a down payment on a truck. During the Great Depression, the high level of unemployment suddenly made entry into the trucking industry attractive. The industry's overcapacity in turn drove trucking rates to a level where it was difficult to maintain equipment and consequently, safety took a low priority. The "destructive competition" and the remedial 1935 legislation, therefore, was more a product of the period than of the anti-competition sentiments of the railroads.

Before discussing the provisions of the MCA of 1935, it may be useful to review its legal antecedents. As was the case with railroads earlier, larger truckers began to cross state lines. The trucking industry experienced the *size effect,* which led to difficulty in state regulatory control because of interstate commerce. Two states attempted to regulate carriers that crossed state lines and subsequently suffered defeat in court. The Supreme Court in 1925 determined in *Buck v. Kuyendall* and *Bush v. Maloy* that state regulation of interstate motor carriers was unconstitutional because the states could not interfere with or otherwise regulate interstate commerce.[6]

As the court decisions that precluded state regulation of interstate motor carriers and the conditions of "destructive competition" discussed previously, there were increasing calls for federal regulation. President Franklin Roosevelt appointed ICC Commissioner Joseph Eastman as Federal Coordinator of Transportation to review and improve the nation's transportation system. The MCA of 1935 would be a result of his recommendations. It is interesting to note that the National Grange, the group that had called for regulation of the railroads in the 1870s, was against economic regulation of motor carriers. This group and other farmer organizations interpreted regulation as a device by which large truck companies would eliminate the small trucker, which would lead to higher rates and less competitive service. And, to an extent they were prophetic.

The MCA of 1935 gave the Interstate Commerce Commission, which had originally been created to regulate the otherwise anti-competitive tendencies of railroads and pipelines, the authority to regulate the interstate trucking industry. This jurisdiction included the authority to regulate trucking rates and to determine the number of carriers, the areas and routes served, the commodities that could be carried and who could be a carrier. Private carriers (e.g., a farmer who took his produce to the market) that were otherwise exempted from regulation were prohibited from taking loads for hire. But, the control over entry was perhaps the most important feature of the legislation. The ICC issued operating rights based on the following criteria; whether or not the operator/service would be useful to the public, whether this service was actually needed vis-a-vis the existing carrier, and whether the applicant was qualified. The principles were embodied in the concept of "public convenience and necessity." And, not surprisingly, those carriers that already had certificates permitting them to operate would continually protest applications of would be new entrants, which both reduced new competitors and led to centralization within the industry.

It is difficult to argue against the principles that underpinned the 1935 Act. Entrepreneurs, it was hoped, could meet the criteria specified. Yet, government control of the trucking industry coupled with actions by existing licensed motor carriers to prevent the entry of new competitors demonstrated the detrimental effects of regulating entry. The entry restriction provisions of the Act led to the issuance of thousands of artificially limited certificates. A single carrier would have dozens of certificates covering parts of its route system. The control of entry also resulted in a "particularization" of certificate terms. The certificate specified operating authority on: specific areas covered, the specific commodity for which authority was sought, the kind of equipment used, geographical routes, points and areas served, size of shipments, and direction of movement.[7] Not surprisingly, these specifications led to a less productive industry.

The effects of regulation are not always evident immediately upon passage of the legislation. For example, in 1954, there were only two men assigned to enforce both the economic and safety regulation for 26,022 carriers in New England. In 1957, however, the ICC significantly increased its staff both in the field and in Washington, D.C. to handle the agency's greater responsibilities.[8] It takes time for regulation to "kick-in".

In addition to the fact that it takes time for the implementation of laws to take effect, the activities of the regulatory agency resulted in growing compliance and enforcement cost and larger budgets for both the carriers and the ICC that had little

relevance to the services being provided. The government had to hire workers to conduct investigations, handle complaints, and handle the casework pertaining to adjudicating applications, operating practices, rate reasonableness, discrimination and safety regulation. And, the truckers had to hire staff both to ensure that they were operating within the limits of their authority and to attempt to foreclose would be competitors from intruding into their service areas.

The 1935 Act held the principle that a new carrier would have to prove that the new service proposed was needed by the public and that there was no existing carrier providing the service. As microeconomic theory would suggest, this principle seriously impeded entry and produced a concentration in the industry. With the growing power of enforcement in the ICC, the share of the thirty-seven largest firms grew from 17% to 29% between 1955–1959.[9]

Not only did the restrictions impede entry, but the specifications and limitations on these certificates resulted in excess capacity, or the production of a good above its lowest average cost. In the trucking industry, excess capacity in part took the form of the empty back-haul. The ICC restrictions resulted in excess mileage. The *Geraci* case in 1973, exemplifies that inefficiency caused by these restrictions. The ICC determined that Geraci, a Florida farmer that transported fruits and vegetable to Cincinnati, Ohio could not transport alcohol from a company in Covington, Ohio back to Florida because private carriers (carrier transporting their own products) could not take loads for hire and a carrier of produce cannot carry alcohol.[10] The inefficiency caused by these restrictions that prevent a back-haul load is obvious. Not only was there a distinction between private and for-hire carriers, but the ICC also controlled the transportation of commodities that may have resulted in a back-haul. Notwithstanding the sensible restrictions pertaining to specialized carries (e.g., oil carriers), the ICC control discussed here simply had the effect of preventing entry and caused a huge amount of available capacity to become non-productive. It was economic regulation—not safety regulation—run amuck.

Economic regulation of the trucking industry was not limited to restrictions on entry and transportation of commodities. The MCA (1935) gave the ICC the power to ensure that tariffs were "reasonable." As Congress left the determination of reasonableness unclear, the ICC established rate bureaus that could establish rates for all truckers in a region, which rates were ordinarily deemed by the ICC to be reasonable. That reasonableness effectively meant, however, that trucking rates should be at a parity with those of the railroads. In order to evaluate whether rates were reasonable, the ICC was concerned about rate reductions, which could indicate to the agency that carriers were realizing artificially depressed earnings, so that the proposed reductions were deemed excessive. In coming to these conclusions, both the ICC and the rate bureaus heavily used the operating ratio, operating expense divided by the operating revenue as the basis for determining whether trucking rates were reasonable.[11]

These rate bureaus were immunized from the Sherman Act for the purpose of collectively fixing prices. The ICC's authority to grant this immunity to fix prices derived from the *Reed-Bulwinkle Act 1948*. In this statute, Congress authorized the ICC to immunize carriers from the Sherman Act of 1890. Although President Truman vetoed the legislation, the Eightieth Congress overrode his veto and effectively gave the rate bureau anti-trust immunity. And, importantly, members of the rate bureaus could deter rate reductions by protesting a carrier's proposed price decrease. Consequently, the number of such rate reductions protests increased from 227 in 1946 to 4,712 in 1962.[12]

While it is evident that this process was "fixed" in an attempt to place truck rates onto a parity with railroad rates, one could argue that the passage of two pieces of legislation, the Transportation Act of 1946 and 1958, demonstrated an effort—in principle at least—to avoid forcing a nonmarket determined parity of prices. Both Acts called for impartiality by the ICC on regulating rates pertaining to intermodal competition. This effort remained purely one of wishful thinking because the ICC did not adhere to it.

Calls for regulatory reform grew as early as the end of the 1950s. President Kennedy sent a message on transportation reform to Congress. President Johnson also called for reform and the establishment of a cabinet position governing transportation, which resulted in the formation of the Department of Transportation in 1966. However, the ICC still had the sole control of the economic regulation of truckers, as DOT only inherited the responsibility for safety regulation. But with the calls for more efficiency following the OPEC crisis of 1974, the sentiment for regulatory reform grew. Congress established the National Transportation Policy Study Commission in 1976 to examine this issue. This Commission recommended easier entry, a "zone of reasonableness" for rates within which proposed changes could not be challenged, and to subject rate bureaus to antitrust legislation.[13] A belief that regulation in general was expensive and ineffective became widespread.

In 1977, President Carter's appointments to the ICC began to implement some of the Study Commission's recommendations. The ICC changed its policy on the qualification issue for new motor carrier entrants. Under the new policy, a carrier that protested a new carrier's entry now had the burden of proving the lack of need for the new carrier. Other administrative policy changes that loosened barriers to intermodal trucking competition included granting nationwide operating authority rather than limited geographic licenses; authorizing carriers to transport all commodities (in what were called "general commodity certificates) rather than for just an individual commodity; and permitting truckers to service all shippers rather than a specific shipper. This administrative change in regulation of entry was so great that the most important provision of the Motor Carrier Act of 1980, namely, easier entry, simply codified the ongoing changes that the ICC made administratively. Consequently, the MCA of 1980 galvanized entry despite an unfavorable economy. Applications for operating authority jumped from 6,746 requests in 1976 (70% approved) to 28,414 in 1981 (97% approved).[14] The average value of a license decreased from $400,000 in 1974 to $15,000 in 1982. The number of firms increased from 18,000 in 1980 to 37,000 in 1987.[15]

In addition to the provision on entry, the MCA of 1980 also called for a "zone of reasonableness" as the Study Commission had recommended. Since passage of the Act, the ICC could not investigate, suspend, or revoke any rate increase or reduction unless the proposed rate changed by more than 10%. This "no-suspend" provision weakened the rate bureau's price fixing power. The Act also called for periodic Congressional oversight of the effects of the new law.

The effects of the reform lived up to economic theory. After entry and rate control became more liberal, carriers emphasized operating efficiency and cutting costs.[16] For example, the fall in union wages after deregulation reflects the need to cut costs under more competition. Under regulation, union wages were high because the entry barriers and regulation on commodity transportation and rates created a concentrated market structure whereby unions called for wage increases because the firms operated with profits well above their marginal costs. Regulation by operating ratios actually encouraged carriers to increase wages because it made a wage increase less unprofitable than it would have been without regulation.[17] Consequently, union wages after the passage of MCA of 1980 did decrease. The average wage for a carrier employee between 1973–1978 was $12.45. In the deregulated period, 1979–1985, the average wage felt to $11.15.[18]

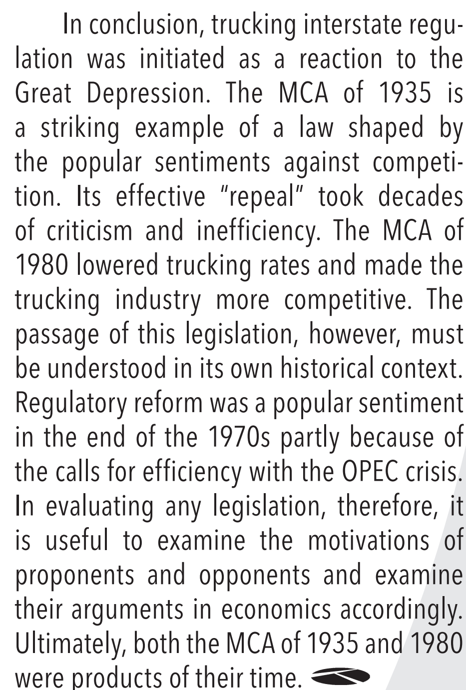
One of the arguments against passage of the MCA of 1980 was that deregulation would hurt service to non-urban areas. This argument basically states that if the market is the sole determinant of who gets served, these areas will receive poor service and high rates because of the low demand. For example, in 1968 there were 8,700 complaints to the ICC of the carrier service (i.e. rates, poor service) to small communities.[19] The ICC investigated these complaints, entered remedial orders and complaints subsequently decreased. There is empirical evidence that deregulation did not have a detrimental effect on trucking service to small communities as proponents of regulation had argued. At worst, deregulation had a neutral effect on service and a decrease in the rates.[20]

Although service to small communities has not suffered as a result of deregulation, the cost-benefit of collective ratemaking by a rate bureau is not conclusive. A Harvard economist, William B. Tye, makes an interesting case for collective ratemaking. He points out that the MCA of 1980 eliminated the most important instruments to the formation of a cartel. In addition to the eliminating entry barriers, establishing a "zone of reasonableness," the MCA of 1980 also encouraged "independent action," whereby a carrier does not have to abide by a collectively determined rate. Given these impediments to the formation of a cartel, a rate bureau can be useful in decreasing the transactions cost, or the cost of negotiating with the shipper. A rate bureau, he argued, should therefore be immune from antitrust laws.[21] (The MCA of 1980 did not remove antitrust immunity from rate bureaus but established an ad hoc committee to study the issue.) Through the rate bureau, a shipper has a published price that will most likely be competitive because of the competition in the trucking industry was now possible.

Despite this convincing argument on the benefits of having published collectively determined rates, the gains from the cut in transactions costs does not seem to merit antitrust immunity. Some sectors of the trucking industry are highly concentrated (e.g., LTL, less-than-truckload=less than 10,000 lb.), so that antitrust immunity allowed these sectors to translate a collectively determined rate into a monopoly profit.[22] Also, the benefit of the decrease in transactions costs still needs more empirical study.[23]

Although, this paper has focused on economic regulation, economic regulation may have implications for safety just as safety regulation may have implications for the economy. Empirical analysis of accidents after deregulation has shown that deregulation may pose a risk in terms of accidents on the highway. As the proportion of miles travelled by trucks increases so does the number of fatalities on the road. The U.S. Department of Transportation, however, found a decrease in the number of fatalities between 1980 and 1986. This unexpected outcome has been explained as a result of trucking companies better maintaining their trucks in order to keep customers. There were also improvements in the enforcement of safety because the safety risks of deregulation attracted attention.[24] Nonetheless, the positive relationship between the number of fatalities and the proportion of miles travelled by trucks remains troubling. Consumer benefits of lower rates would certainly be offset by an increase in fatalities. However, that there are ways of dampening the effect of proportional mileage increase by strictly enforcing or even decreasing speed limit.

In conclusion, trucking interstate regulation was initiated as a reaction to the Great Depression. The MCA of 1935 is a striking example of a law shaped by the popular sentiments against competition. Its effective "repeal" took decades of criticism and inefficiency. The MCA of 1980 lowered trucking rates and made the trucking industry more competitive. The passage of this legislation, however, must be understood in its own historical context. Regulatory reform was a popular sentiment in the end of the 1970s partly because of the calls for efficiency with the OPEC crisis. In evaluating any legislation, therefore, it is useful to examine the motivations of proponents and opponents and examine their arguments in economics accordingly. Ultimately, both the MCA of 1935 and 1980 were products of their time.



Endnotes

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