SOME ECONOMIC ASPECTS OF THE NEW LONG AND SHORT HAUL CLAUSE [1]

SUMMARY

Early interpretation of this clause, 323. — I. Cases in which relief is granted; the general policy, 325. — Roundabout lines, 327. — Cross-lines, 328. — Market competition, 330. — The parallel of a protective tariff, 332. — II. Extent of relief granted, 333. — Recent trans-continental rate cases, 334. — The zone method criticised, 335. — Conclusion: the margin of tolerance and the Commission's ideal, 336.

WHEN a statute has been suddenly revived after a sleep of twenty years, we cannot help wondering whether it has, like Rip Van Winkle, been much changed in the interval. In the early days of struggle for existence, the Interstate Commerce Commission was waging a losing fight in the mere attempt to give to the "long and short haul clause" some meaning and force. Now it feels free to give the clause what meaning and force it will, subject only to constitutional limitations and to the guiding principles of reasonableness expressed in the statute.[2] Then as now, the Commission had power in special cases to permit any carrier to charge less for a longer haul, and to "prescribe the extent to which such designated common carrier may be relieved from the operation of the section." But whereas at present this power to relieve is the central fact of the fourth section, previous to 1910 it was from force of circumstances a dead letter.

[1] For a general survey, see Ripley, Railroads: Rates and Regulation, pp. 473 ff., 564-566, and chap. xix. The present study is more limited in scope, paying especial attention to the cases of 1912-13.

[2] R. R. Com. of Nev. v. S. P. Co., 21 I. C. C. R. 329, 340.

No sooner was the act of 1887 in operation than many carriers took the ground that competition of any sort at the more distant point was a substantially dissimilar circumstance, and entitled them, not to relief in the discretion of the Commission, but to complete exemption. If this sweeping claim could be made good, no special relief need be asked for, since all the cases in which it could be of moment, or in which there was any great probability of its being granted, would be already taken out of the hands of the Commission entirely. So the question of authority had first to be fought out. In defending its jurisdiction the Commission became more uncompromising than at the outset as to what were "substantially similar circumstances." It held, for purposes of giving vitality to the act, that nothing but competition of water carriers or of rail carriers not subject to the act could remove any rate from its operation,[1] tho in the first case heard it had conceded that the roads might be entitled to exemption "in rare and peculiar cases of competition between railroads which are subject to the statute, when a strict application of the general rule of the statute would be destructive of legitimate competition."[2]

Whether or not this change of front was a wise tactical move, it probably had little effect on the outcome. In any case it is hard to see how the power to grant partial relief could have been anything but a dead letter in the incongruous setting of the original fourth section. The power could not be exercised arbitrarily, without reason given, for then the Commission would be open to the charge of exercising legislative powers which Congress could not constitutionally delegate to it. Only as it should follow the general rules of the act

[1] R. R. Com. v. Clyde S. S. Co., 5 I. C. C. R. 324. Reviewed in 21 I. C. C. R. 414.

[2] In re L. & N. R. R. Co., 1 I. C. C. R. 31.

with regard to reasonableness and undue preference would it be acting clearly within its powers as an administrative body. But if some carriers were to be relieved wholly or in part from the operation of a section which applied to all alike, what reasonable ground could possibly be shown for doing so, other than some difference in the " circumstances and conditions " surrounding the long and short haul in those cases in which relief was granted ? If such difference were not admitted to be " substantial," it could hardly furnish reasonable ground for relief. But to admit that the difference was " substantial " would seem equivalent to admitting at once that this was a case to which the clause did not apply at all.

It seems clear that the Commission could never have succeeded in prescribing the degree of relief to be allowed, even if it had made good its claim that the clause applied to cases of competition between domestic railways. This claim, however, the Supreme Court refused to sustain.[1] A final attempt was made to prescribe the degree of relief to be granted in cases where circumstances were admittedly dissimilar, but the Commission was again overruled.[2] The first chapter was thus closed.

From this brief survey, one conclusion should stand out clearly. The original attitude of the Commission was not radical nor uncompromising. The rigid attitude commonly ascribed to it was wrought out under stress of combat, and expressed the Commission's ideas of the legal necessities of the struggle for jurisdiction, not a settled economic policy that would be followed out, once the fight for jurisdiction should be won.

[1] I. C. C. v. Alabama Midland Ry. Co., 168 U. S. 144.

[2] E. T. V. & G. Ry. Co. v. I C. C., 181 U. S. 1.

I. Cases in which Relief is Granted

In fact, the effect of the amendment of 1910 has not been by any means to establish a rigid long and short haul policy for all cases in which the discrimination is due to competition of carriers subject to the act. In the general statements with which the Commission signalized the reviving of the fourth section, it went back to the tone of its very first decisions, made nearly a quarter of a century previous, before the opening of the struggle with the courts. It proposed to grant relief in situations beyond the carriers' control — in difficulties that he has not brought upon himself by his own competitive policy. "If at the more distant point it finds a competition to which it must conform under the imperious law of competition, if it would participate in traffic to that point, it may discriminate against the intermediate point without violating the law, provided it establishes such necessity before the Commission." [1]

The passage quoted sounds very like the "rare and peculiar cases" phrase of the original Louisville & Nashville decision.[2] Indeed the "rare and peculiar" case dealt with in this early ruling is the type of the most important class of exceptions granted in consideration of railroad competition under the new act; namely that of roundabout railroad lines which are in competition with more direct routes. These it is the settled policy of the Commission to relieve from the operation of the fourth section, provided always that the short line bases its charges on distance, and that the rates to intermediate points on the roundabout line are shown to be in themselves reasonable.[3]

[1] R. R. Com. of Nev. v. S. P. Co., 21 I. C. C. R. 341.

[2] In re L. & N. R. R. Co., 1 I. C. C. R. 31, 81.

[3] Wright Wire Co. et al. v. P. & L. E. R. R. Co. et al., 21 I. C. C. R. 64; In re Rates on Salt, 24 I. C. C. R. 192, 195, and other cases.

This might seem to make a rather large breach in the barrier of prohibition that was intended to be "well-nigh universal," but no one familiar with the history of the question will be surprised. The Commissioners are only following the original policy of their predecessors; they are in accord with foreign practice, and with a sound "cost" theory of charges. The essential thing, under such a theory, is that each locality should get the benefit of its location, as measured in the actual relative costs of carriage. The circuitous route is, of course, ordinarily the more expensive, especially as the Commission has tentatively defined a circuitous route for this purpose as one at least 15 per cent longer than the direct line.[1] This is by no means a fixed rule, however; other disabilities than distance might have the same effect, even if the distance were the same.[2] The decisive thing is an economic disadvantage of some sort, that would of itself justify higher rates than those of the stronger (usually shorter) line. In view of more complex situations to come, the writer begs the reader's patience in a brief review of the economics of this simple and familiar case.[3]

An intermediate point (C in diagram) on the longer route has a right to a reasonable joint rate through the common junction and on by the direct line (CAB), if it is so near the common junction that this is the least expensive way for the carriers to haul the goods. This means a rate higher than the junction pays by an amount approaching the local charges for the haul AC.

To this rate, C is entitled on a cost basis and as a result of its location, no matter how the traffic moves;

[1] In re Rates on Salt, 24 I. C. C. R. 192, 195. Edwards & Bradford Lumber Co. v. C. B. & Q. R. R., 25 I. C. C. R. 93.

[2] In re Rates on Salt, 24 I. C. C. R. 192, 196. In re Lumber Rates, 25 I. C. C. R. 61. Grand Junct. Chamber of Com. v. D. & R. G. R. R. Co., 23 I. C. C. R. 115.

[3] For a fuller discussion, going into some aspects of the situation not treated here, see Ripley, Railroads: Rates and Regulation, pp. 219 ff.

and it is not entitled on a cost basis to any lower rate. If the route *CAB* were owned by one company and *CDB* by another, there would be no question raised of the fairness of the adjustment of charges. Why then

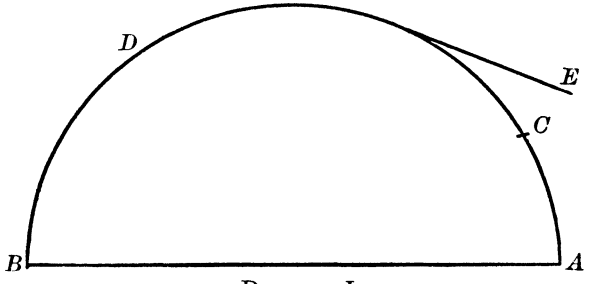

DIAGRAM I

should the principles of justice, as based on cost, turn a somersault if we suppose the stretch of track *AC* has been sold by one company to the other? In a closed circuit of this sort, the cost principle demands that to any terminus the economic mid-point should pay the highest rate, and it is only by chance that this mid-point could be identical with a junction of the lines of two separate companies.

Now if the roundabout route chooses to compete for traffic between the common termini, so long as this does not result in unduly low rates from *A* to *B* direct (the Commission requires the direct line to observe the fourth section), it is a matter purely between the two companies, injuring no one, unless it results in wasteful carriage. This latter aspect is not to be neglected;[1] but such bidding for roundabout hauls is not likely to be very prevalent unless there is some unused capacity which can be employed at slight additional expense, so that the possible waste of the roundabout haul is not necessarily as great as would appear from a glance at

[1] See Ripley, op. cit., chap. viii.

the map. If the direct line is unable to carry all the traffic between its termini, the roundabout haul becomes the cheapest way to handle the surplus and avoid congestion; a condition which occurs, to be sure, only intermittently.

But even if the short line is not congested, to compel the granting of terminal rates to intermediate points would not prevent a discrimination but create one, and one that might just as logically be extended to an outside point E. In fact, if it were not, the point E would have just cause of complaint. Thus, if a territory is divided into zones whose rates increase with distance, and one carrier happens to have a route that passes through a higher zone on the way to or from points in a zone of lower charges, it would not simplify matters to compel that carrier to observe the fourth section.[1]

Another interesting case is that of the independent cross-line forming the base of an isosceles triangle or one side of a rectangle, and able to divert in either direction through freight from its own local stations — the type of a large class of problems with which Professor Ripley has made us familiar.[2] A case of this sort has been settled, not on the ground of preventing waste in roundabout carriage, but, like the general case of the circuitous route, on the sole basis of giving each station the benefit of the shortest route available by which its traffic *might* move. Carthage Junction[3] is farther from various Ohio River crossings than are the points on either side of it, and it pays a higher rate. This is upheld, even tho "it often happens . . . that this carrier, . . . for purposes and reasons of its own, desires to haul traffic which originates west of Carthage Junction through Carthage Junction east to a connec-

[1] In re Lumber Rates, 25 I. C. C. R. 50.

[2] Op. cit., pp. 282 ff.

[3] In re Lumber Rates, 25 I. C. C. R. 50, 56.

tion with the Louisville & Nashville at Harriman or the Southern Railway at Emory Gap, and conversely, it might desire to handle traffic originating to the east of Carthage Junction through that point west to a connection with the Louisville & Nashville at Nashville or Clarksville, or the Illinois Central at Hopkinsville. In

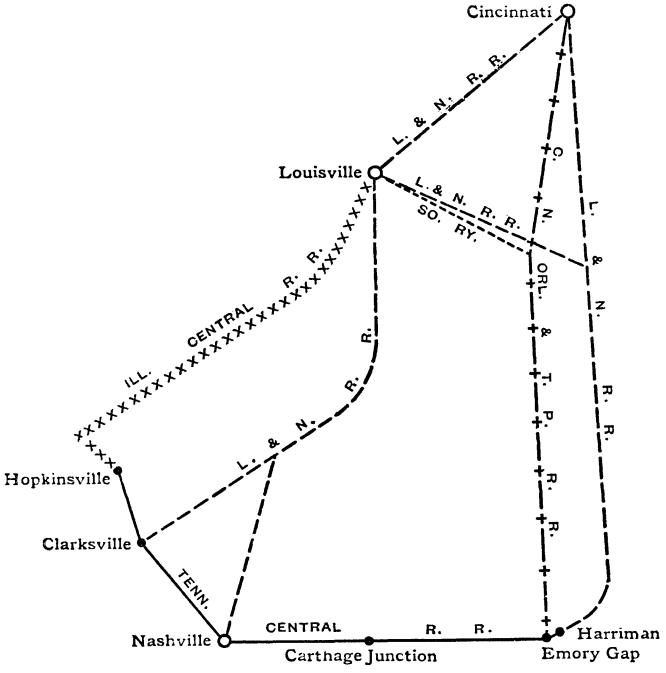

DIAGRAM II

either case the traffic would pass through a point taking a higher rate than the point of origin."

The Commission holds, in granting relief from the fourth section, that so long as the "rates are manifestly constructed upon the proper plan . . . it is entirely immaterial to the shippers upon that line whether traffic is handled by the Tennessee Central through its

eastern or its western junctions." [1] The opinion in the case gives no hint whether the " purposes and reasons of its own " which give rise to the practice complained of are matters of transportation convenience, such as the balancing of its eastward and westward tonnage so as to reduce the haulage of empty cars, or whether they are concerned with getting the most favorable division of the through rate with the connecting carriers. But it seems plain that the question at issue is not to be settled on the basis which Professor Ripley suggests, of preventing roundabout shipments at lower rates than are granted to points on the way, through which the shipments pass.

So much for the circumstances which will justify the granting of relief. The fact has already been mentioned that competition with other railroads will not of itself furnish a basis for the granting of relief to the shortest line, nor to any other of approximately equal length.[2] Market competition falls almost in the same category. By itself, it is not enough to justify departure from the general rule, tho the Commission will not say that it could never do so.[3] The writer may hazard the conjecture that when exception is made, it will be to preserve the life of established industries and the value of invested capital which have been protected so long against the superior advantages of others that they have acquired a " vested interest " in such protection.

The Commission argues, however, that if carriers make an extra low through rate to put Kansas salt into St. Louis in competition with salt from Michigan, the carriers of the Michigan salt could retaliate with equal justice,[4] and there would be no logical limit. " This

[1] Cf. Ripley, op. cit., pp. 295, 296.
[2] 24 I. C. C. R. 192, 25 I. C. C. R. 61.
[3] In re Lumber Rates, 25 I. C. C. R. 50, 59.
[4] In re Rates on Salt, 24 I. C. C. R. 192.

form of discrimination is one which feeds upon itself, . . . and it ought to be snuffed out in its infancy before property rights and commercial conditions have intervened to render the thing aimed at difficult of accomplishment." [1] It seems here to be implied that if another case of this same sort were to arise, in which the practice was not attacked until after property rights had grown up, the answer might be different.

While agreeing entirely with the general view of the Commission, the writer has had some questionings as to the logical consistency of the policy. If we accept the idea that market competition may be something more than a mere " euphemism for railroad policy," [2] we may draw some interesting comparisons. If the actual cost of making goods and carrying them to St. Louis from the east is less than from the west, but if the western carrier makes an extra low rate, low enough to meet the eastern competition, it is not at once obvious how this weak-line competition differs in principle from that of a roundabout route against a direct one joining the same termini. And if the western road makes the rate to St. Louis lower than to nearby intermediate points, have these points been robbed of anything to which their geographical situation entitled them ? By the terms of the problem, the lowest actual cost at which the goods can be made and laid down at their doors is more than the same goods need cost laid down at St. Louis.

But the assumptions (expressed and implied) on which this case rests are such as would prove in practice both elusive and unstable. To ascertain with accuracy the point at which the combined cost of making and laying down the goods is the same from the east as

[1] In re Lumber Rates, 25 I. C. C. R. 50, 60. See also Bluefield Shippers Assoc. v. N. & W. R. Co., 22 I. C. C. R. 519, 525.

[2] 21 I. C. C. R. 367.

from the west, we must know the relative costs of production at the different sources of supply, and must make allowance as well for any differences in quality which might enable one producer's goods to make way against another's even at a higher price. And if we were to base a rate policy on our findings, we ought to be sure that these relative costs and qualities would not change in the future. For if the western producers should become enough more efficient, the whole argument would fall to the ground, and the case become one of obvious discrimination in favor of St. Louis and against the intermediate points. Such justice totters on a narrow pedestal. We should also make sure that the financial situation of the railway will not change, for if it does, the road may find itself no longer anxious to carry the traffic in question at such low rates, and yet unable to alter its policy without damage to "vested interests."

The essential difference between the two kinds of competition shows itself in facts like these. In any case like the one just described, capital and labor are being supported in a relatively unproductive locality, while in the competition of routes, so long as the rates of the strongest route are not twisted out of a reasonable adjustment, no industry is affected save the railroads themselves. And if the roundabout line should decide to cease bidding for competitive traffic, or to let part of it go, that is an affair between the traffic manager and his superiors, making no essential difference to anyone outside.

Railroad systems, like nations, are prone to protect their own infant industries;[1] but the regulator who

[1] The writer has elsewhere discussed more fully the parallel between railway rate theory and the theory of international trade. Columbia Univ. Studies, vol. 37, no. 1, pp. 125-135. The discussion of Commissioner Meyer's paper at the last session of the American Economic Association (held since the above was written) shows that economists recognize the fundamental identity of principle involved.

seeks a nation's welfare is like an economist with a world-inclusive outlook viewing a protective tariff. He concedes it justifiable in certain cases, but he is likely to conclude that out of the great array of protected industries, the infants whose special nurture has repaid its cost are few and far between. Hence the fact that the Commission will not allow market competition, if unsupported by special considerations, to justify lower charges for the longer haul, may be regarded as a salutary check, making somewhat more expensive a policy which is likely in any case to be carried beyond the limits of gain for the country at large.

II. Extent of Relief Granted

It is in the exercise of its discretion to decide the degree and kind of relief to be granted that the most interesting questions arise, for the burden of proof is on the carrier to justify the rates he wishes to charge. "It must be affirmatively shown by the carrier seeking such exception that injustice will not be done to intermediate points by allowing lower rates at the more distant points."[1] This is a return to the principle of the Cullom Report of 1886, which proposed that a greater charge for a shorter distance should be "presumptive evidence of unjust discrimination."

As to the extent of the Commissioners' discretion, they have maintained that confiscation is the only limit.[2] They may fix a maximum difference between the rates of the two points in question, or a minimum rate at the farther point (a rare thing in rate regulation). They may "define the territory from which a higher intermediate charge may be made," or fix a maximum rate at the intermediate point. In fact, they may

[1] R. R. Com. of Nev. v. S. P. Co., 21 I. C. C. R. 341.

[2] R. R. Com. of Nev. v. S. P. Co., 21 I. C. C. R. 329, 340.

limit the discrimination " in any way that is definite and certain." [1] Within the limits set, it would seem that the Commissioners have a freer hand to work out their own ideas of relative reasonableness than ever before.

By far the most striking rulings have been in the cases dealing with the rates from the eastern and central section to points near the Pacific coast. The questions at issue and the general features of the decisions are now familiar. On account of water competition, the rates from the eastern coast are highest to points some distance inland, and lower to Pacific ports. When the carriers serving Chicago and other points in the eastern half of the continent began the policy of putting these cities on a par with the seaports in competition for the western markets, they took the rates as they found them, discriminations and all. Under these rates, producers west of the Alleghenies have come to do more and more of the business, until now most of the traffic paying the rates is not subject to water competition that would of itself account for the discrimination.[2] It seems to have been true, however, that the ocean carriers did reach inland and draw cargoes to the Pacific coast via the Atlantic from as far west, at times, as Chicago, often themselves " absorbing " the cost of the eastward haul. The Commission met this situation [3] by dividing the country into zones, one where water competition admittedly has full force, one where it has no force, and two intermediate zones where its effect is weak or intermittent. The amount by which the intermediate rates in question might exceed the through charges was limited to 25 per cent from the eastern zone, 15 per cent

[1] City of Spokane v. N. P. Ry. Co., 21 I. C. C. R. 400, 415.

[2] R. R. Com. of Nev. v. So. Pac. Co. et al., 19 I. C. C. R. 238, 247–251.

[3] Intermountain Rate Case, 21 I. C. C. R. 355. City of Spokane v. N. P. Ry. Co., 21 I. C. C. R. 400, 423.

from the next, 7 per cent from the next and none from the zone farthest west.

At first sight the ruling seems logical. Yet here also disturbing questionings arise which make one doubt if this will prove a permanent solution of the problem. Indeed the Commission can hardly be said to regard it as such, since it held that it would be within its rights in refusing relief to all but the seaboard zone, as it had not been affirmatively shown that the coast-to-coast rates were unreasonably low in themselves if applied to the haul from the inland zones to the intermountain region. Such being the case, and the law placing the burden of proof on the carriers to establish the reasonableness of their intermediate charges, the Commission could legally have lowered all the intermediate rates to the level of those granted to the seaports. The fact that they gave the permission to charge more, represented an attempt to be "extremely conservative in this, the first application of the new law." [1] Regarded as an attempt to set up the exact reasonable charge to the intermountain region (of which no pretense is made), the decision would surely be open to the objection raised by the Commerce Court in enjoining it,[2] namely, that the Commissioners cannot say whether the intermediate rates chargeable under their order are absolutely reasonable or not, for they do not know what those rates will be. Apparently, the Commission assumed that the coast-to-coast through rates would go no lower than they were at the time — a bold assumption in view of all the possibilities of the Panama Canal. If the decision had used percentages of the coast-to-coast rates as they stood at the time, its position might have been unassailable. Possibly the Commission had in mind its experience with the Texas Commission, in which its at-

[1] R. R. Com. of Nev. v. A. T. & S. F. Ry. Co., 21 I. C. C. R. 329, 369.

[2] A. T. & S. F. Ry. Co. v. U. S., 191 Fed. 856.

tempts to prevent a discrimination by lowering an interstate rate were frustrated by lowering the competing intra-state rate still farther. Were the Commissioners afraid that an order that should merely lower these intermediate rates would be the signal for an orgy of rate cutting by the roads who are interested in seeing the Pacific seaports do as big a jobbing business as possible?

As to the logic of the competitive situation, it would seem that the straight path to the end desired would be to determine, if possible, what rates from the various zones are needed, *bona fide*, to meet the rail-and-water competition, and to order that the only rates exempt from the long and short haul prohibition shall be rates that are not lower than the competitive rates so found. The result would be quite similar to that of the rulings of the Commission: it would level off the summit of the mountain-peak of high rates which raises its bulk so forbiddingly to the western inland rate-payer, but the method would be more direct. A rate is either determined by water competition or it is not. If not, it is not entitled to exemption; but if it is so determined, what reason is there for putting a percentage limit on the relief granted? If the method here suggested be practicable, it would seem to offer the simplest way of separating "business" reductions of rates (made necessary by direct competition of routes) from "charitable" ones (due to market competition), and enacting that charity must begin at home.

In conclusion, a few general impressions present themselves. In the first place, all cases under the fourth section cannot but be witnesses to the wide margin of tolerance for different methods of constructing tariffs that exist in our regulative machinery. Strict mileage scales, tapering scales, blanket rates of wide extent,

and combinations both forward and (with the permission of the Commission) backward from a competitive terminal point, — all are allowed within the limits of this discretionary statute. All that is accomplished by rulings under the fourth section is to substitute blanket rates for rates that disregard distance still more violently.

In many cases the Commission, acting under its general powers, has gone farther than this. It has limited the extent of single blanket rates when that seemed excessive, and has prescribed rates of its own making in the form of modified distance scales. But this work tho of the utmost interest, is beyond the bounds of the present study.

Secondly, it seems that the Commission's ideal has much to do with the efficiency to be gained by placing the country's industries in the situations most favorable for them, and less to do with preventing the losses in transportation efficiency that come directly from wasteful carriage, in ways made familiar by Professor Ripley's analysis.[1] And, thirdly, one cannot but wonder whether the shifting to the carriers of the burden of proving that rates to intermediate points are reasonable may not have been, during the months that are past, a more effective weapon in lowering these rates than it can ever be again. For the attorneys of the railroads cannot fail to learn better and better now to support this burden of proof, as the Federal Department of Justice in enforcing the Sherman Act had to learn, through the fiasco of the Knight case, how to prove to the courts that an illegal combination existed, and emerged at the end successful.

J. M. CLARK.

AMHERST COLLEGE.

[1] Railroads: Rates and Regulation, as cited.