THE UNIVERSITY OF CHICAGO LAW REVIEW

VOLUME 27

WINTER 1960

NUMBER 2

OCEAN FREIGHT RATE CONFERENCES AND THE AMERICAN MERCHANT MARINE

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I

THE RATIONALE AND METHODOLOGY OF THE STUDY

A NY STUDY of the costs and benefits of the American merchant marine should include an inquiry into ocean freight rate conferences. One obvious reason is that an American-flag fleet could conceivably earn its keep even if it did nothing but mitigate monopoly power that otherwise would remain unchecked. The strength of this argument obviously depends both upon whether monopoly power exists or would exist without a United States fleet, and upon whether the United States fleet is actually used to reduce monopoly exploitation in a cheaper fashion than would otherwise be feasible. The nature of shipping markets in which the United States merchant marine has been committed, as well as how those resources are used, must be determined if that potential benefit is to be evaluated.

Necessarily implicit in that issue, of course, is the question whether, and to what extent, conferences *should* be influenced or altered through the use of a United States fleet or otherwise. To answer it calls for an appraisal of uninhibited conference operations and an inquiry into the effects of modifying various aspects of those operations. Some hint of the complexities involved and the direction that this inquiry will take can now be given briefly.

For better or worse, the degree and character of competition in ocean trans-

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portation is said to influence, among other things, (1) the regularity and frequency of service, and (2) the level, structure and stability of rates. The conference system undoubtedly influences competition. In turn, the operation of the conference system is affected by the existence and participation of American flag operators and by our national policy with respect to conferences themselves.

The situation is probably even more complicated than that. Not only is it possible that a United States fleet could influence the conference system and, therefore, competition; but it is also possible that the existence of the conference system could influence the health and quality of the United States merchant marine. Prime objectives of the maritime policy of the United States are to affect the size and quality of the active American merchant marine and to promote the full development of our foreign commerce. For the most part, the chosen instruments of this policy have been American flag liner companies, the great bulk of which belong to ocean freight rate conferences. Both the Maritime Administration and the subsidized carriers have repeatedly asserted that effective conferences are essential to the conduct of trade, and that the continued participation of American operators in conferences is likewise indispensable.¹ This, they argue, is true for at least two reasons, the consistency of which is perhaps not immediately apparent: (1) the conferences would collapse without American participation, and world trade requires that peculiar rate and service stability which only conferences can provide; and (2) whether the conferences collapse or not, American operators cannot survive outside of them.

The chosen instruments of our maritime policy, as well as the ultimate objects of it, are thus said to stand in a relationship to conferences which is both uncommonly intimate and delicately dependent. That is plausible. In peacetime, at least, shipping services are sold for money in a market that is in substantial part commercial. Market forces, whether they arise spontaneously from the natural conditions of a trade or are the legacy of a more conscious plan, have an immense capacity to shape the enterprises and dreams that are exposed to them. But durable business institutions like conferences are not always purely passive. To one degree or another they can make and mark those channels through which market forces flow. The markets for liner services, in which conferences are important, behave differently from the markets for tramp services, in which they have no role. The dry cargo berth markets are those in which conferences have long been pre-eminent, and it is those markets to which our American flag merchant marine has largely been committed. Since conferences are crucially important in those markets in which our merchant marine is most

¹ For example, "It is the judgment of the Maritime Commission that the conference system is necessary to the successful conduct of water-borne foreign trade which is of international character but that conferences cannot continue to exist in foreign trade without some means of protection such as the conference contract system." REPORT OF DELEGATES OF THE UNITED STATES, INTER-AMERICAN MARITIME CONFERENCE, NOV. 25, 1940 to DEC. 2, 1941, at 7-8 (1941) [hereinafter cited as] INTER-AMERICAN CONFERENCE.]

important, it seems reasonable that the conference systems could influence, or be influenced by, the role our merchant marine plays.

This relationship has long been recognized. Acting under a 1906 commission from King Edward VII, the Royal Commission on Shipping Rings in 1907 commenced a thoroughgoing inquiry into the conference system. Their object, in the words of the King's Commission, was "to inquire into the operation of Shipping 'Rings' or Conferences generally, and more especially into the system of deferred rebates, and to report whether such operations have caused, or are likely to cause injury to British or Colonial trade, and, if so, what remedial action, if any, should be taken by legislation or otherwise."² The principal result of the Commission's labors was the accumulation of testimony which, on account of quality and scope, remains the most valuable single source of information about the origin and mechanics of ocean freight rate conferences. Its strength seems to me to stem from several sources. First, some of the ship-owners who testified had first-hand familiarity with the origins of the system, and all had continuing experience with its development during a period of rapid adoption. Yet, in spite of near-antiquity, the testimony is remarkably immediate and fresh. Second, the testimony is remarkably frank. It is not only unembarrassed, it bears the stamp of deep conviction. The legal and social climate of that day and place did not blunt pride in profits and profit-seeking, whether by monopoly or otherwise. Faith in private property and its free exercise was apparently still dominant; at least, men of property were unashamed of success and largely unafraid. There were no apologies; there was nothing to fear. The majority of the Commissioners and the Parliament apparently shared much the same faith: the free use of property might create monopolies, as it had in shipping. But monopolies, if oppressive, would surely overreach themselves and be corrected by those who, freely exercising their rights in property, arose either to share in the spoils or to oppose the power that produced them. However bad, monopoly would not endure. This attitude was reflected no less in the English common law than in the classical economics with which many concerned were undoubtedly familiar.

The great *Mogul Steamship Case*,³ a cornerstone in the late English common law with respect to monopolies, held that a shipping conference that employed deferred rebates to exclude outsiders could not be reached by existing law; nor could those excluded recover damages. Courts would not *enforce* the conference contract or agreement; neither would they overthrow it nor compel restitution to those whom the agreement injured. The law was, in a sense, neutral on the issue. To alter that state of affairs would have required legislation from a gov-

² 39-I REPORT OF THE ROYAL COMMISSION ON SHIPPING RINGS i (1909) [hereinafter cited as R.C.R.].

³ *Mogul Steamship Co. v. McGregor, Gow & Co.*, App. Cas. 25 (1892), cited in *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271, 286 (1898). See also Letwin, *The English Common Law Concerning Monopolies*, 21 U. CHI. L. REV. 355, 382-84 (1954).

ernment and society that feared the proliferation of law. The ship owners' aplomb is thus explicable, and their frankness exposed the rationale and workings of the system in a most uncommon way. Third, an extraordinarily high level of literary competence on the part of both commissioners and witnesses produced a record that is forceful and very clear. Fourth, every important argument for or against conference organization is set forth in the testimony. The very recent Bonner Committee Hearings and other inquiries add relatively little so far as substantive issues are concerned.⁴

The same forces that gave the Royal Commission its rare quality may be responsible for the limited practical effects of its inquiry. The majority of the Royal Commission found more positive benefits than evils in the conference system. It concluded, in effect, that the benefits and evils were not severable, at all events not without legislation, which they opposed.⁵ On balance, then, the majority found the conference system, and the services it produced, desirable. Though shipowners were represented on the Commission, there is no reason to believe that its conclusions were thereby unduly influenced. In any case the Majority Report largely approved the conference system and did not call for legislation to remedy its faults. Its principal recommendation was that shippers be encouraged to unite in opposing conferences whenever abuses occurred.⁶ Eleven commissioners signed the Majority Report, two with reservations. Five commissioners signed the Minority Report; one, Sir David Barbour, with reservations. The Minority found much more bad than good in the system.⁷ Even so, it is significant, in the light of what has been said about the fear of too much law, that even the Minority were quite unprepared to recommend effective legislation. In their words:

In the view of one of our number (Sir David Barbour) no check could be applied to the system of Shipping Rings which would be sufficient to protect the public interests without at the same time involving such an amount of interference with the business

⁴ This is true even of the argument that, in the production of regular service, subsidies and cartels are partly substitutable.

⁵ Mr. Maddison signed the Majority Report, subject to this reservation: "In signing the Majority Report, I desire it to be clearly understood that I do not, in the least degree, subscribe to the view that Shipping Rings or Conferences are either necessary to, or in the interest of, the trade of the United Kingdom and the Colonies. The contrary I believe to be the fact. But, in my opinion, the evils arising out of the monopolies created by the Conferences are not so far, of a character to warrant their prohibition by statute, and for the same reason I do not favour placing them under direct Government control. It is because the Majority Report does not recommend either of these courses that my signature has been attached to it. My position may be expressed in a few words. The system under review I regard as, on the whole, undesirable, but the results, as revealed by the evidence tendered to the Commission, are not of a character to warrant State interference in the business methods of a great industry. There are, however, elements of danger which may develop, and these need to be carefully watched by the Board of Trade." 39-I R.C.R., *op. cit. supra* note 2, at 91.

⁶ *Id.* at 85-88.

⁷ It lists 13 "chief conclusions," only part of one of which—equality and stability of rates—it apparently thought favorable to the system. *Id.* at 114.

of shipowners as to make the continuance of the Rings impossible. With his exception, we who sign this report think that, before the adoption of legislation declaring illegal the deferred rebate system, or involving great interference by a Government department with the details of the working of a highly complex industry, and leading probably to much litigation, a real attempt should be made to give effect to a system of conciliation and limited supervision by the Board of Trade. We are not satisfied that any such legislation as has been proposed by witnesses, short of legislation on the lines of the Sherman Act, would be effectual; and we are not prepared at present to recommend so great a change. We would prefer to rely, in the first instance, upon the effect of giving facilities which do not now exist for bringing promptly to the attention of Parliament any serious abuses, and upon organisation being met by counter organisation; "Conferences" of shippers dealing, if possible, on something like equal terms with "Conferences" of shipowners. We think that before novel and drastic legislation is resorted to an opportunity should be given to the Conference lines and their customers to establish a real system of consultation and conciliation, and that the results of that experiment should first be ascertained and be proved to have failed.⁸

In the United States, things were different. The Alexander Committee Hearings of 1913-14 differed, not so much in terms of content, for, though the emphasis was upon United States experience rather than upon British, the anecdotes were parallel and the conference arguments, pro and con, essentially identical. The differences, as reflected in both the hearings and report, may be explained in terms of national objectives and a somewhat different philosophy of government and law. The United States was not a maritime power and sought to become one; antitrust law was hostile to cartels and trusts, though it probably emphasized "abuses" rather more than monopoly power itself;⁹ the Interstate Commerce Commission Act had shown the way for government regulation of domestic transportation; and there was apparently even then the same confidence in the ability of regulatory agencies to improve the workings of a private property system that was shortly to be reflected in the Clayton and Federal Trade Commission Acts. The *Alexander Committee Report* thus bears the stamp of the times.¹⁰ In essence, it finds untrammelled competition in ocean transportation unachievable or ruinous, in which case it cannot endure. The conference system is found to be an admixture of bad and good; the good so good as to be worth keeping; the bad either not so bad as to be beyond cure

⁸ *Ibid.*

⁹ This was, of course, only shortly after the landmark cases of *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911), and *United States v. American Tobacco Co.*, 221 U.S. 106 (1911).

¹⁰ *Hearings Under H.R. 587 Before the House Committee on the Merchant Marine and Fisheries*, 62d Cong., 2d Sess. (1913) [hereinafter cited as *Alexander Comm. Rep.*] Mr. John J. O'Connor, attorney for the Isbrandtsen Company, has pointed out that what is now universally cited as the *Alexander Committee Report* is more accurately the *Huebner Report* after the Committee's staff economist who prepared it. See *Hearings Before the Special Subcommittee on Steamship Conferences of the House Committee on the Merchant Marine and Fisheries*, 86th Cong., 1st Sess., pt. 2, at 603-11 (1959) [hereinafter cited as *Bonner Comm. Hearings*], See esp. 605-07. Nevertheless, it will herein be cited as the *Alexander Committee Report*.

or capable of being removed. The solution seemed to the Committee to be regulation, by which the good would be protected, the bad cured or banished.

The *Alexander Committee Report* had positive consequences: the United States received the Shipping Act of 1916, and embarked upon a program of maritime achievement through subsidy. Though the law has since been somewhat changed, and the program expanded, it is fair to say that the national policy with respect to ocean conferences is still close to that recommended by the *Report*. That policy is now under review by Congress.

Thus it is that two early inquiries contribute much to an understanding of present policies and of the evaluation of the conference system itself. In addition, this study relies upon recent hearings and studies and interviews of steamship operators.

I am indebted to the American flag operators, not alone for their knowledge of shipping and conferences, but for their candor and patience as well.

It remains true, however, that relatively little of a fundamental nature has changed since the inquiries of 1909 and 1914. The policy debate still centers around the same arguments and much the same business practices. The Royal Commission and Alexander Committee would have to learn relatively little to be conversationally at home in discussing conferences today. This is not really surprising, since there is little evidence that human nature and economic principles change very rapidly or very much.

II

CARTELS: ORGANIZATION AND FUNCTIONS

Comparing cartels with ocean freight rate conferences is not merely a pleasant academic pastime.¹¹ The questions of what conferences really are and what they do should be answered if we are to settle the issues posed in the introduction as well as the now very timely question of what is an appropriate public policy with respect to the conferences themselves. Arguing that conferences are in various ways unique, some supporters have concluded that an anti-cartel policy cannot appropriately be applied to them. The questions of whether and how conferences are unique have therefore come to be relevant to the policy issues.

There are two basic ways of getting at these problems. One simple technique is to discover whether the apparent objectives and organization of the conferences are closely similar to those of cartels. This is a "look-alike" type of taxonomy that is often illuminating. Another technique is to compare actual conference *behavior* with some general principles that have been developed over the years to explain and predict the behavior of cartels and single firm monop-

¹¹ Daniel Marx, Jr., in *INTERNATIONAL SHIPPING CARTELS: A STUDY OF INDUSTRIAL SELF-REGULATION BY SHIPPING CONFERENCES* (1952), proclaims that conferences are cartels. In recent testimony before the Bonner Committee, conference supporters have vehemently denied that the conferences are cartels.

lies. Such a comparison not only has the formal merit of providing an organizational scheme for the orderly display of fact, but in addition has the practical virtue of analyzing *workings* rather than form. Furthermore, any unexpected or unexplained facts discovered by such an inquiry may ultimately aid in improving our power to generalize, which is a central objective of science. Both of these approaches will be used.

A. CONDITIONS FAVORING CARTELIZATION

A cartel is an association of firms cooperating to fix price or other terms of trade. To the extent that a cartel is successful, it suppresses competition in those terms about which there is agreement. From the standpoint of any industry, it is desirable to suppress competition entirely, or at least to mitigate it. Such a task is not equally easy or attractive everywhere. Both to predict where cartels are most likely to appear and to understand them better wherever they are found, it would be useful to draw up a brief list of conditions that favor cartelization.¹² First, the costs of organizing and maintaining the cartel should be small; ideally, zero. The number of independent firms to be coordinated will probably influence such costs. On this account alone, a plan to cartelize all of, say, retail trade is more likely to be a vainglorious dream than a scheme to be relied upon. If, however, some smaller portion of the market can be carved out and insulated, there is hope.

Second, it is highly desirable that there not be burdensome size or other diseconomies to plague the cartel once it is organized.¹³

Third, the price elasticity of demand for the product should ideally be very low at the competitive price.¹⁴ The lower it is, the further the cartel can advance prices without suffering a disastrous loss of custom. Put simply, any cartel can make greater profits if, under competition, buyers were not very sensitive to a price increase. This may be roughly equivalent to saying that there is no very good substitute for the service or product, a condition that often appears to be met in the real world.

Fourth, it would be of slight comfort to construct a cartel that scarcely survives its creation. A durable one is what is wanted. Durability will be lessened by centrifugal forces within the combination itself and by the easy creation or expansion of outside supplies. In cartels the first problem is that of defection; the second, of entry and the growth of existing outsiders. Though both are influenced by technological and other natural conditions, both may, nevertheless, be subject to a considerable degree of control, as we shall see.

¹² I am indebted to Aaron Director for these predisposing characteristics.

¹³ This is much to be hoped for, not only for the obvious reason that any producer, competitor or cartelist will fare better if he can produce any output at lower cost, but also because if entrants of a more efficient size arise, the cartel would face a somber long run.

¹⁴ The limiting, and most favorable, case would be when costs are zero under competition and elasticity of demand zero as well.

As the number of participants in a loose confederation rises, the problem of coordination grows, even if all concerned honestly and earnestly seek to preserve that solidarity which is the central object of the coalition. Furthermore, with greater numbers, it becomes somewhat easier for an individual member to defect without appearing to have done so. The difficulties of policing the agreement multiply; the attractiveness of a unilateral policy grows. In sum, large numbers encourage a separation of group and individual interests. In addition is the problem of heterogeneity within the group, which is sometimes a function of the numbers of participants. Cartels are much concerned with these problems, which are multiplied by the uncertainty and wavering confidence that are inherent in human affairs. Some of the ways in which such problems actually arise and are solved are analyzed below in connection with coalition mechanics and objectives.

Important though these internal problems are, there are also dangers from outside. Entry is the nemesis of cartels. Cartels could rest much more securely if there were natural barriers to entry. These might include scarce resources or a very long gestation period for those resources that must be committed for successful entry. Still another might be economies of size, of various kinds, that compel entry on a scale so large relative to the market that no entry will occur. Every cartel would welcome some check on entry, and some of them have devised policies and institutions to accomplish that objective.

B. CARTEL ORGANIZATION AND BEHAVIOR

A great deal is known about cartels. There is a large and growing case study literature that describes and analyzes specific cartels. Then, too, monopoly theory has, with some modifications, been adapted to explain and predict their behavior. Indeed, the very size and breadth of this literature is a barrier to the non-specialist. For that reason, it is desirable to discuss in a general way the rational objectives and functions of cartels.

Cartels are not purely fraternal organizations. They are primarily business institutions that serve the purposes of businessmen, though the state for various reasons may see fit to support them. By and large, businessmen perfect them and run them. The chief function of a businessman is to make profits. The rationale of cartels is simple: the avoidance of competition is profitable. This does not mean, of course, that all cartels make super-normal profits, but only that business can be more profitable without competition than with it. Some students of the cartel problem have claimed or implied that most cartels are formed during periods of bad trade to avoid ruin, are not very profitable, and are, therefore, not very prejudicial to the public interest. Whatever the cyclical pattern of cartelization actually is, monopoly is an attractive goal for businessmen in either good or bad times. Furthermore, the principal objection to cartels is not that they make their creators rich, but that they distort resource allocation generally, thereby making society poorer. In other words, by raising prices

or inhibiting entry, cartels tend to permit fewer resources to be used in their trade than free consumer and producer choice would dictate. Another implication is, then, that relatively too many resources tend to be devoted to non-cartelized fields. We should not, therefore, decry those monopolists who are rich, and embrace those who are poor.

Finally, though data showing return on investment are useful, they must be used very carefully if they are to tell us anything about the existence or profitability of monopoly, for the rate of return depends crucially upon how capital investment is defined and upon whether there is too much of it. Assume that a previously competitive industry is cartelized. Prices and profits rise, in response to which capital values also rise. In other words, the cartelized industry, and any single firm in it, would now sell for prices that equal expected profits, discounted appropriately. Any buyer of such a firm, or industry, would thus have to pay such a high price that he would enjoy only the competitive rate of returns upon his "investment." The "rate of return" to the purchaser will thus be moderate, even though the industry is cartelized. The recipients of cartel gains will thus have been those who created the cartel in the first place and sold out at a premium that reflects the suppression of competition.

Furthermore, however low they are, cartel earnings *can* be higher than competition would permit. That earnings may not, in fact, be great is sometimes attributed to the managerial laxity that is said to be a feature of monopolistic organization. If this contention is correct, capital investment on which profitability is calculated could be too large or earnings too low. In either event, rates of return would be misleading.¹⁵

There are other reasons why putative profitability can be an unreliable indicator of monopoly. First, there is always the possibility, which, in a changing economy, often becomes a sad reality, that the monopoly may fall on bad times. A powerful cartel may be ruined by a change in public tastes. A monopoly of fasteners for shoe-buttons, valuable in its time, would not amount to much today. Second, unless it is sternly disciplined by pools or rationalization, a cartel may ultimately fritter away its golden promise. For example, though each member may gain by expanding his capacity without departing from the cartel

¹⁵ Some economists have claimed that monopolists may be content with less profits than they could, or should, make with greater exertions. Some have attributed this to the lethargy that stems from an unchallenged lead; others to the possibility that society sets an upper bound on monopoly profitability; and monopolists will, perforce, take some of their rewards as non-pecuniary income. In either case, monopolies could add private inefficiency to the sin of general resource misallocation.

Professor John R. Hicks has pointed out that one of the greatest monopoly profits may be a quiet life. Hicks, *The Theory of Monopoly*, 3 *ECONOMETRICA* 1 (1935). Professors Armen Alchian and Reuben Kessel, in an unpublished paper, urge that monopolists may take some of their rewards as non-pecuniary income.

Government agencies that are responsible for operating, promoting, or regulating specific industries are probably aware that some of the difficulties of their task can be reduced by promoting or acquiescing in cartels.

price, all may suffer from what each finds it profitable to do. In the end, capacity and costs could become so largely inflated as to leave the cartel little or no more profitable than if competition prevailed. Yet shippers, and society, would pay the bill, which is higher than it need be under competition because of the heavy burden of unused capacity. Such a process is, of course, less than ideal even to the cartel, and there is a presumption that its members will try jointly to stay its corrosive influence. There is, however, some opinion that this misfortune has at times actually occurred. For example, the *Minority Report of the Royal Commission on Shipping Rings* chided the conference system for its "positive temptation to waste."¹⁶

Assuming that the favorable predisposing characteristics obtain, cartelization nevertheless remains both attractive and feasible. If a competitive industry is in long run equilibrium, firms earn only normal returns, and there is no incentive either to enter or leave the industry. Under those circumstances, effective cartelization will make the industry's earnings positive. If the members of the industry are sensible, they will prefer cartels to competition. First, aggregate earnings will be increased. Second, so long as every firm earns somewhat more than competition would permit, it is better off under any division scheme which starts by giving it higher profits than competition would establish.

So long as output is reduced below the competitive level, and price raised, cartelization serves the interest of the industry and injures that of the public. It is nonsense, therefore, to embrace those cartels that do not make their members rich and to abhor only those that do.

Quite apart from troubles with the law, a going cartel faces continuing problems, even when favorable predisposing characteristics are present. When the number of firms to be cartelized is large, the mechanics of coalition become complicated for several important reasons: first, it is difficult to watch everybody. Second, price cutting is singularly attractive to any participant: if he assumes that his fellows will adhere to the program, he can gain all of the business he wants by shading prices slightly; in addition, the effects of his cutting will be dispersed among his many collaborators, and the impact on any one of them will probably not cause great alarm. In short, the group and individual interests tend to become separated. Third, the communication problem is enhanced, so that diverse interpretations and lags in response actually become a substantial problem even when all members want to serve the group. Perfect knowledge would, of course, remove this problem, and detailed agreements, supported by penalties, will go a long way toward solving it. To agree upon price, it is necessary to define precisely what it is that is being sold. Even with relatively homogeneous products, there is usually more than a simple product-price dimension in any real transaction. As a consequence, various industrial cartels have found it desirable to define and regulate the sale of "seconds," eliminate or limit especially troublesome service competition, attempt to regu-

¹⁶ 39 I R.C.R., *op. cit. supra* note 2, at 107.

late trade-in allowances, check weights and measurements, standardize qualities, and so on. The more such dimensions there are, the more difficult it is to achieve stable agreements, even when all participants honestly *want* them. Similarly, the more such variables there are, the easier it is for any selfish participant to defect without seeming to do so.

Then, too, the costs of cartelizing may be higher than the fruits. It always costs something to organize; and these costs may grow with the complications mentioned above. There is almost always at least one imperfect substitute which it is not feasible to control. If it is not for most buyers a very good substitute, there will be some "room" to raise prices and therefore some gain to be gotten. If it is not too bad a substitute, the gains may be small. Under unfavorable conditions, the costs of achieving them may be so high that cartelizing is not worthwhile.¹⁷

Important though they are, solving the problems so far discussed is not enough, for cartels tend to increase industry earnings above the equilibrium point. Success sires an urge to emulate, and successful cartels create an incentive for outsiders to enter. If entry is too massive and too quick, the cartel is doomed.

When the number of firms in any trade is large, there can be no presumption of important economies of size. If there are no artificial barriers to entry, and large size is no advantage, the only hope is that lags will be long enough to make cartelization worthwhile. Under some circumstances, the lag need not be very long. All that is required is that any increase in earnings during the effective cartel period outweighs any abnormal losses that may accompany its collapse.¹⁸

What can produce the lags that are so helpful for cartel profits? First, there may be a long gestation period for the capital goods necessary in the trade. Second, there may be a dearth of know-how outside the industry, and a fairly long time necessary to get it. Third, there may be a fixed (or temporarily limited) supply of some strategic factor that must be employed by anyone who would enter. Fourth, it is possible that outsiders will require some time to learn how profitable entry would be.

In many cases these lags will be long enough to make a cartel worthwhile. But what happens when there *is* entry? Suppose it is gradual. There is a tendency for prices to fall, but a contrary tendency for the cartel to contract its sales.

¹⁷ These organizational costs are, in a sense, fixed: they constitute costs of forming a cartel and may be uninfluenced by its level of activity once it is formed and running. In an unpublished paper, V. Stephens Hastings has pointed out that there may be analogous "control costs," which are those variable costs that must be incurred to keep the cartel running. Such costs may grow as the cartel seeks to raise prices. If control costs are important, they constitute a brake on the ability (or willingness) of a cartel to advance prices; for the cost of raising prices—and preserving them at a high level—may prohibit obtaining as high a price as a single firm monopoly would establish.

¹⁸ More precisely, the present worth of assets must be higher with the cartel than without it. This is possible even if, when the cartel collapses, subnormal earnings result in the future. See Stigler, *Monopoly and Oligopoly by Merger*, 40 AM. ECON. REV. 23 (1950).

On the basis of a wealth of historic experience, a sensible expectation is that both will fall.

If the market does not grow, ultimately the number and total importance of newcomers would become so great that the cartel has only the power to set competitive prices, and the end is at hand. In fact, if things go this far, the cartel members will then be worse off than they were even under competition. For, if the industry was originally of the proper size under competition, and grows larger because of entry, it will be too large when competition is re-established. The cure for that is severe. The industry would suffer losses and shrinkage of capacity.

It may be worthwhile to point out that, in important respects, entry is little different from the growth of firms which are already in the industry but which were never in the cartel; or the defection of those which were once in it. In the short run, the power of the cartel exists, even though some firms never belonged, simply because the outsiders do not find it profitable to expand output indefinitely. When there is time for facilities to be revamped and new ones built, their willingness to expand will very likely be more elastic and more troublesome.

Thus it is that uninhibited entry tends to make any simple cartel a short-run phenomenon. Even so, the "short-run" may embrace a lot of calendar time, and when cartels secure government blessing or support, or erect effective entry barriers, they can be very durable. Similarly, if demand grows faster than entry, there is no reason to suppose that the cartel will ever collapse.

If, as sometimes happens to government-regulated cartels, law or regulations of some sort should fix rates at the cartel level, but do not control entry, anomalies arise. They are similar to the overcapacity that can result in an ordinary cartel when service competition is effective in getting business, yet is not regulated. The cartel would be better off to lower prices as entry occurs, if it is going to occur anyway. If it cannot lower prices, distortions of resource allocation would remain, even after the industry is in quasi "equilibrium." Prices would be too high and there would be too many firms operating with too much idle capacity to be efficient. Prices would then be higher than the competitive level. Even so, if the firms retain free choice, rationalization of facilities would ultimately take place to raise profits by reducing costs. There would then be fewer firms, or smaller ones, and less capacity. But successful rationalization, and the profits it produces, would then encourage further entry and the same problems that it was designed to overcome. The process could then begin anew.

The problems of price-setting and sales division remain. A producer with higher costs would prefer that output be lower and prices higher than would those who have lower marginal costs. This is a potential cause of misunderstandings and conflict. But the problem is not insoluble if the cartel members are sensible; for the group objective need not be inconsistent with the individual

ones. The prime group objective should be to make as much money as possible. The low cost producer would set prices too low and output too high for group maximization. The high cost producer would set prices too high and output too low. To any sensible person, all one should have to say is that the group as a whole will make more money than under the partial or prejudiced scheme he prefers, and all can therefore pay him, and it will pay all of them, to go along with group maximization.

Any firm, monopolist or competitor, should obviously prefer that its costs be zero. Everyone in the cartel will prefer that there be no inefficient firms in the group, since aggregate profits will be lower; but solidarity has its rewards, and it will usually pay to count in the less efficient, too, if they are viable at the price level that the cartel will establish. In cartel management a promiscuous admission policy need not be a vice.

If the desired cartel output can be produced most cheaply by laying up high cost capacity, it would pay to compensate the owners for doing so. There is, however, a possibility of reluctance, since starting-up costs might be great if the conference goes up in the air. Yet, in general, it will pay the group to calculate, roughly or precisely, the lowest costs at which different outputs can be produced, and to apportion output so as to equalize costs at the margin for all active participants. Some inefficient units may have to be laid up. Some more efficient ones may still be underutilized. Generally, the allegiance or loyalty of all will be sought,¹⁹ so that aggregate costs will perhaps be temporarily higher than under competition—the limping brothers will also tend to make out.

One fairly sophisticated technique for allocating cartel production is to take internal bids: the low cost producer will bid highest; can obtain a fee for producing that order; and the cartel will set the price, distributing profits among all members. The firm to which the order is worth most gets it.²⁰ A thorough-going pool has much the same effect.

While all of these decisions are logical and simple in concept, they may be difficult in fact. They involve haggling and, probably, compromise. As a consequence, a cartel will be in for greater trouble if market forces change frequently. For cost and demand conditions may change and affect different firms differently. If, in addition, the law is hostile to the cartel, it may be impossible to make it work. Perhaps as a consequence of this kind of problem, some cartels have adopted the policy of quite rigid prices, even when there are substantial changes in cost or demand. Such stability, or rigidity, of prices is sometimes said to be a good symptom of collusive action. Where numbers are large and costs or demand change substantially, price rigidity is strong evidence of non-competitive behavior.

¹⁹ More properly, a cartel will be promiscuous so long as it possesses no effective technique for preventing entry. If it has such a technique, it would pay to exclude from its membership those who cannot survive outside the cartel, but to embrace those who can.

²⁰ Compare *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898).

Quotas, though not sophisticated, are quite consistent with the more complicated schemes outlined above: when costs differ among the producers, quotas should reflect cost advantages. If costs are identical, quotas can be "democratic"—the demand can be cut into equal parts, each of which has the same price elasticity at the same output.

The kind of cartels so far discussed are highly centralized. Indeed, the behavior predicted is very close to what is expected of a *single* firm with monopoly power. The more subject cartels are to problems of the sort just discussed, the more likely it is that they will require meticulous centralized administration to achieve the desired coordination. Because of the very nature of cartels, we should expect that they will seldom function quite so precisely or reliably as would a single firm operating under like circumstances.

Yet it is possible that these differences are not very great. Apparent differences could arise from economists' oversimplifying the behavior of a single firm with multiple plants, for there are those who, claiming to be political realists, dwell upon the troubles that beset the management of any divisionalized, or even departmentalized, firm.

It is probably correct that single firm monopolies are, on the whole, less fragile than cartels. This may not only be true because of the obvious perils from defection, but because the organizational form of the monopoly may be symptomatic of underlying economic factors of the greatest importance to entry. If law is neutral, we should expect that the form monopoly takes would be determined by the existence and character of economies of firm size. If size economies are great, we should expect to see tight-knit monopolies, not cartels. If there are significant diseconomies of size, we should expect to see cartels, not huge firms. Hence, cartelized fields may easily be those in which scale economies pose no barrier to entry. There is an additional possibility that should be mentioned. Where cartels operate in a hostile legal climate, which has generally been the case in the United States since the Sherman Law of 1890, it is to be expected that their organizations will be less formal and tight. As a consequence it would not be surprising to find that departures from the "ideal" behavior expected of cartels in theory will be greater than when the law is neutral or promotive. This hypothesis is broadly confirmed by American experience. Before the law intruded, cartels in the United States were often tightly organized, with pools, penalties and other devices to assure precision and solidarity. After the Sherman Law was passed and was found to have some force, it was only natural that a successful cartel would have to function as well as could be, taking into account the need to minimize discovery and punishment. The phenomenon is illustrated again by the history of the short-lived NRA codes, some of which, under protection of law, became highly detailed guides to cooperative action.

III

THE RATIONALE, ORGANIZATION, AND INTERNAL OPERATION
OF OCEAN FREIGHT RATE CONFERENCES

A. ON PREDISPOSING CHARACTERISTICS

With rare and somewhat transient exceptions, ocean freight rate conferences have been confined to one relatively small portion of ocean transportation. The conferences were developed and remain pre-eminent in the dry cargo liner services. These services are broadly characterized by the scheduled carriage of heterogeneous cargoes that typically are originated by many shippers at several ports and destined for many consignees at several ports. Liner services are sometimes defined by contrasting them with tramp operations. In the classic case, tramp ship service is characterized by the unscheduled carriage of homogeneous cargoes in shipload quantity from one originating port to one terminal port. Various other distinctions are often made, including the slower average speed, smaller average size, and, typically, less specialized capacity of the tramp. More important, perhaps, is the fact that in a given trade some cargoes are typically carried by liners while others are typically carried by tramps. Even very broad cargo statistics indicate this, and steamship men in any particular trade normally have little difficulty specifying which are liner-type and which are tramp-type commodities. Indeed, government cargo statistics are regularly classified into liner-type and non-liner-type commodities.

This undeniable differentiation is enormously important. We will not at this time systematically explore *why* tramp services are not perfectly substitutable for liner services or why specific commodities are typically carried by one or the other type of carrier. We will simply take it as an established datum. Its relevance is to indicate that the liner and tramp markets are to a substantial degree separate. Tramp shipping is a large industry. The tramps carry enormous tonnages of cargo, very much larger volumes than are carried by liners. There are many tramp ship firms. The tramp's long suits are flexibility and mobility; indeed, the tramp is sometimes called the vagabond of the oceans. Such a market, very loosely defined geographically, and with many relatively small firms, is exceedingly difficult to cartelize. This point is well made by an exception. There is one outstanding example of a private conference in tramping. The Baltic and White Sea Conference, comprising some two and a half million tons of shipping (primarily tramp ships) was formed in February, 1905. Membership included roughly 75 per cent of the tonnage engaged in the trade. Concentrating upon coal, timber, and phosphates, the Conference endeavored to obtain better rates than unbridled competition would permit. In this object it apparently succeeded for a time. As Mr. Noble put it, "For a period we were

able to get from 10 per cent. up to 20 per cent. advance. . . . Unhappily, by June, 1908, rates had gone very much back to the level of 1905."²¹

Cartelization is likely to be not only more difficult in such a field, but much less durable as well. There are thus two powerful evidences of that fact: (1) private cartels have apparently only rarely been attempted in the field; and (2) even governmental schemes to cartelize tramp ships have been extremely difficult to effect and impossible to maintain.²²

If tramp ship services, an intractable subject for private cartelization, were a perfect substitute for liner services, it would be virtually impossible to cartelize the liner field. In addition to technical and natural demand differences that can explain why the two types of services are not perfect substitutes, we will see in a subsequent section that the conferences have attempted to separate them still further.

Theory and history suggest that the number of firms engaged in a trade is relevant to the success with which it can be cartelized. Numbers may also imply something about whether a cartel or tight-knit combination will be the organizational form chosen if monopoly is the goal.

Fortunately, there are data showing the number and identity of firms participating in those conferences which operate in United States-foreign trade. This furnishes at least some indication of the relevant factors.

Table 1 shows the number of members of the ocean freight rate conferences registered with the United States Maritime Administration as of specific dates in 1934, 1939, 1943, 1947, 1950, 1954, and 1958. This is the way the count has been made.

Many conferences have both regular (*i.e.*, full) members and associated lines.²³ Even though they do not vote, the associated lines cooperate with the conference; if they did not, the conference might not work as well or might even fail. It could therefore be argued that a count of conference members should include both full members and associated lines. The full members are probably the relevant ones, simply because they are most important. Only full members vote; insofar as coalition mechanics influence rates, voting membership is the relevant count.

It is also common for a conference to have one or more joint-service members.

²¹ 40-IV R.C.R., *op. cit. supra* note 2, at 308, 309. One problem in such a scheme was that the conference was unable to impose loyalty ties upon the shippers. At first glance, it appears that passenger conferences would suffer from the same disability, since they have been unable to enter into total requirements contracts with passengers. Passenger conferences overcome this problem by exclusive arrangements with ticket agents and travel agencies, each of which agrees to book passengers only on conference ships. If one defects, he is dropped from the "approved list" of agents and is thereby prevented from serving passengers who seek passage on any conference vessel.

²² See, *e.g.*, W. ARTHUR LEWIS, *OVERHEAD COSTS; SOME ESSAYS IN ECONOMIC ANALYSIS* 106 (1949).

²³ See text following note 45 *infra*.

A joint service, *i.e.*, a schedule of sailings, is often provided by two or more shipping companies. We have counted each such joint service as one member line, irrespective of the number of firms that have conjoined to provide it. This corresponds with conference practice; each full member joint service has one vote. In the case of joint agreements *between* conferences, there were two different counting techniques that could legitimately have been used. First, we could count any two conferences that have joint agreements as two separate conferences and not count the joint agreement as a conference at all. In short, we could ignore the existence of joint agreements insofar as they affect the number or size of conferences. Or, we could count any two conferences that have a joint agreement as *one* conference and count the members of the two conferences, so far as they are different lines, as members of one larger conference. In some respects, the second counting method conforms more closely to the economist's notions. For when two conferences have a joint agreement, this reflects the competition or complementarity that could arise between them for at least some commodities and ports. Otherwise, there would be no need for an agreement. Thus, on at least some issues, and perhaps all, the two conferences are acting as one. For those issues, at least, it would be useful to count them as one. On the other hand, since it is practically impossible to know the extent of such overlap, and mechanically somewhat difficult to eliminate double counting, there are problems inherent in such a procedure.

In any case, whichever counting technique is used does not much alter the general pattern of conference membership, and we have elected the first option. Some few conferences, for example, the Manila Conference, have several "sections." In this case we have counted all the sections as one conference, eliminating double counting among sections. Simply *because* the conference *is* organized into sections, however, I suspect each section should really be treated separately.

In each case we have omitted five types of "conferences": (1) passenger conferences, (2) purely administrative conferences, (3) joint agreements, (4) local conferences, and (5) those agreements known to have been transferred to Interstate Commerce Commission regulation.

Table 1 shows the size distribution of conferences at seven different dates for the period 1934-58.

Some significant inferences can be tentatively drawn from these data and some important hypotheses can be tested with them. First the size of coalitions is typically not very great, which is presumably a help in establishing and running them. Indeed, in 1958 there were more conferences with eight full members than of any other single size. Most conferences are thus relatively small coalitions. Some, on the other hand, are very large. In 1958 there was one conference with 52 full members, four with 25, and 39 with 12 or more members. As we will see, the favorable legal status of conferences has obviated any fear of detection, and has undoubtedly permitted that more explicit and detailed regulation

of conduct which is important as numbers grow larger. Without closely circumscribing independent conduct, those conferences with large numbers would have a difficult time preserving solidarity.

Second, up to some fairly small size there are evidently *private* economies of scale in liner shipping, at least when it is subjected to conference organization. This inference is drawn from the frequency of joint services provided by two or more firms. If there were no such economies, no single firm, so long as it owned one ship, would need to join forces with others to provide a liner service. Such indications of private economies may nevertheless overstate the social economies actually involved. For, as we will see, artificial barriers may raise the

TABLE 1*
SIZE AND NUMBER OF APPROVED STEAMSHIP CONFERENCES, 1934-58

NUMBER OF MEMBERS	Number of Conferences						
	1934	1939	1943	1947	1950	1954	1958
2-6.....	60	57	69	58	46	43	48
7-11.....	22	20	27	23	24	29	35
13-16.....	15	20	9	18	15	23	24
17-21.....	6	5	1	6	12	10	10
22-26.....	1	1	.....	.....	2	2	4
27-31.....	1	1	.....	.....	1	1	.....
32-37.....	.....	.....	1	.....	.....	.....	.....
37-41.....	1	.....	.....	1	.....	.....	.....
42-46.....	.....	.....	.....	.....	1	.....	.....
47-51.....	.....	1	.....	.....	.....	.....	.....
52-56.....	.....	.....	.....	.....	.....	1	.....
57-62.....	.....	.....	.....	.....	.....	.....	1

* Source: Statistics compiled by William Jordan, Northwestern University Transportation Center. Data on file.

minimum scale on which entry can occur. Third, although there are evidently diseconomies of very small size, there appear to be diseconomies of very large firm size as well. If, at any point in time, the small trades have small conferences and the large trades have large conferences, it may also be that any conference that serves a growing trade will probably have a growing membership. If this is true, it suggests that there are significant diseconomies of firm size beyond a level reached by conference members at the beginning of the process. For if existing conference members suffer no size diseconomies, they will simply grow to meet the greater needs of the trade, and newcomers will not significantly swell the membership list. If the number of members grew roughly in proportion to the size of trade, the hypothesis of diseconomies would be confirmed. Several problems of measurement arise in connection with empirical tests of the hypothesis. One is that the most readily available data are collected according to the "Essential Trade Routes" concept. Although the outside geographic limits of the conferences often conform closely to the trade route definition, sev-

eral conferences typically serve a single trade route. Overall growth of the trade route as a whole may not correspond with growth of the trade covered by each of the conferences concerned. Another problem is that of measuring the size of a trade. Clearly, the most relevant measure would be one for liner cargoes, and they may have different growth patterns than apply to the trade as a whole.

Lacking appropriate data, we have not been able to show the precise quantitative relationship between conference size and trade size over time. This is a job that should be done. Nevertheless, it is very clear that there is no presumption of natural monopoly; the conferences have two or more members, and some have very many. If there were a natural tendency to monopoly, we would expect to see trades served by one firm. Second, although we have not had the detailed data that would be necessary to establish a precise relationship, the data appear to be roughly consistent with the proposition that small trades tend to be served by conferences with small memberships. Third, potential competition between as few as two or three firms must be substantial, since there are conferences with two members and with three. This must be so since if oligopoly—small numbers—were inconsistent with competition, it would not be necessary or desirable to form a conference in the first place. That is, organizing and preserving conferences costs money. If they accomplish nothing more than unadorned oligopoly secures, it would not be worthwhile to spend it.

Theory suggests that the elasticity of demand is a factor in making cartelization more or less attractive. Unhappily, in the case of ocean shipping as well as in other practical problems, it is difficult to say anything very precise about the price elasticity of demand. It may serve to rely upon the opinions of shipping people who claim that the level of rates ordinarily does not much affect the quantity of goods carried. It is also possible to go through the logic of derived demand, applying it commodity by commodity to arrive at some rough notion of the relevant demand elasticities. We have not elected to do that.

Of the characteristics that in theory would be favorable to cartelization, liner transportation seems clearly to have at least two. We do not know enough about the others to say definitely one way or the other. For whatever reasons, ocean freight rate conferences have turned out to be remarkably durable. Most have had their ups and downs; some have dissolved formally and have been reconstituted with the return of more favorable circumstances; many, even though formally intact, have practically disintegrated in depression and under other shocks.²⁴ Yet, it is clear that the typical conference has lasted long enough

²⁴ One example is found in the testimony of Alex Cocke of Lykes Bros. Steamship Co.:

"MR. COWEN: Yes, sir. But the conferences themselves, without any dual-rate system, grew and prospered?

"MR. COCKE: They grew and prospered up to a certain time.

"MR. COWEN: What time?

"MR. COCKE: Well, I would say in the beginning about 1929 and 1930 and the competition became rampant, the competition became very keen. Not only were there non-conference lines

to have accomplished something. Their relative durability may be attributed to a number of factors, among which are the development of institutions that help to discourage (1) internal chiseling, and (2) entry. These institutions will be discussed in subsequent sections.

Circumstances have thus been rather favorable for the formation of conferences. The law has not been hostile, and the government policies of maritime nations have on the whole been neutral or actively promotive.

B. OBJECTIVES AND RATIONALE OF CONFERENCES

Though it is often fascinating to inquire into *why* people do things, it is generally difficult to do. One reason is that people are sometimes reluctant to admit or emphasize motives of which others may disapprove. In the case of conferences, we are in luck. Some interesting testimony on objectives was presented before the Royal Commission of 1907-09. As a consequence, we have the direct testimony of English ship owners who participated in, or formed, the earliest steamship conferences. For example, Sir Thomas Sutherland, Chairman and Managing Director of the P. & O. Company, testified in 1908 that, "in the late seventies . . . the remaining Lines, then engaged in a hand-to-hand competition, began to draw together so as to stave off disaster by coming to arrangements between themselves and with their customers."²⁵ Whether to avoid ruin or to achieve positive benefits, the objective was to increase revenue. For, as Sutherland put it:

Without that sort of agreement, which we refer to as a Conference agreement, I suppose our freight revenue would have been 30 per cent. or 40 per cent. less than it is, in fact, our service would not have existed as it has done—it would have been impossible. You should understand that a mail contract, or even passenger traffic, does not keep a business like ours going. The goods traffic is at least six times as great as the amount of the mail subsidy, and the passenger traffic, as you are aware, is to a very much larger extent an out-going, that is to say, the expenses are very much larger, proportionately, than they are on freight. Therefore, the crux of the profit really depends mainly upon freight, and that, if there had been no agreement, could never have attained the figure that it has attained, and there would have been such a condition of affairs that I doubt very much whether the P. & O. would have been in existence at the present time—it would not have been in existence in its present shape, at all events; it might have existed in some other shape.²⁶

but there were a great number of tramp ships, tramp ships that found a fertile field in the gulf like Reardon-Smith, British, German outside lines that came in and took full cargoes of cotton from one shipper to one port whereas a medium-sized shipper found it very, very difficult to compete. That is when we tried out the conference contract in 1930 and 1931.

"MR. COWEN: Would you say, sir, that the general economic conditions of the thirties had anything to do with the shipping situation?

"MR. COCKE: I think it had something to do with it. I think many of your commodities, the quantities had been so curtailed, that there was not too much business." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 297-98.

²⁵ 40-IV R.C.R. *op. cit. supra* note 2, at 268.

²⁶ *Id.* at 270.

The freights in Singapore at that time were 5s. per ton, and we, who were engaged in the trade, had to endeavour, if we possibly could, to get the state of things amended. It was found that we could only do it by purchasing, as it were, the chartering business of those firms. We paid them, or made an arrangement by which they were to be paid, for ceasing to charter; and the result, of course, was that instead of the Singapore rates being at 5s., they were gradually worked up to about 25s., which is not by any means an outrageous rate.²⁷

In commenting upon the increased speed and quality of vessels, Sutherland gave his view of competitive rates and pressures on costs. As he saw it:

You can build a cargo ship, I suppose, for about £5 per ton upon its weight-carrying capacity or something of that kind; and the intermediate class of ship, which is employed in the Calcutta trade now, would cost £10 per ton, at least. *If you have an open state of the trade, in which freights would be lower and would always be liable to oscillation*, it is quite certain that the man who works with the cheapest ship, not only in the original cost but also in working expenditure in the way of fuel, and so on, would have a better chance of living than the man who builds the expensive and the ambitious ship.²⁸

The 1908 testimony of Mr. Frederick Alcock, General Manager of the Pacific Steam Navigation Company, is equally pointed and clear. Whereas there had been a secular decline in rates, so that the conference rates were in 1908 lower than competitive rates of years before, the conference raised rates above the level prevailing just before its formation.²⁹ As Alcock's testimony shows, the conference was a great help:

You have handed in a table of freights, and from that I find that the rate from 1894 to 1898 for first-class goods was 36s. 9d.?—Yes.

And now it is 55s.?—Yes. That is one of the benefits of the conference. . . . But there are other reasons for putting up rates *besides the natural result of combination*. . . . But take these rates as they stand here—36s. 9d., 38s. 6d., 44s., 48s., 44s., then there is a rise to 50s.; and then to 55s.—all the movements, with one exception, are upward?—Yes. I should like to see it go up to 80s.³⁰ . . .

Was it the rebate system which enabled you to raise the rates?—Yes; the element of competition being got rid of.³¹

Mr. Charles Booth, Jr., of the Booth Line, in explaining his view that rate levels are improved by a strong conference, said:

The only advance that came was after the keen fight with the German companies. When we made peace with them, we did in certain cases put the rates up, *I mean up on what they had been prior to the fight*. . . . In our trade since the introduction of the de-

²⁷ *Id.* at 271.

²⁸ *Id.* at 276. (Italics supplied.)

²⁹ "[W]e were fighting some of the companies that have come into the Conference." *Id.* at 282.

³⁰ *Ibid.* (Italics supplied.)

³¹ *Id.* at 283.

ferred rebate system, yes; our rates, I think, are, if anything, rather higher than they were before. As I say, we compared them, after we made terms with the German companies, with the rates charged in other parts of South American trade, and found that in certain cases we appeared to be unnecessarily low.³²

The success, as well as the usual objectives, of cartels can sometimes be seen in surprising circumstances. One unusual case is the tramp ship conference previously discussed.

The substance of these candid admissions is not surprising. Economics predicts that businessmen find cooperation useful in raising prices, and that is their principal reason for cooperating. Though he also developed a broad rationale to prove the social necessity and essentiality of such schemes, MacKay quite openly admitted that, "The original idea of the combination—and no doubt that is the backbone of it at the present moment—was to benefit ourselves. . . ."³³ A more modern version was given by Alex Cocke, Vice President of Lykes Bros. Steamship Company:

Mr. Johnson. Would you not say that the first interest is to protect the members of the conference?

Mr. Cocke. As members of the conference, yes, but I think it behooves us to also do everything we can to protect the shipper because he is our customer.³⁴

In closing his testimony, Mr. Cocke appealed to Congress to choose wisely between two sharply different alternatives. As he put it:

It has not been my purpose here to tell your committee that conferences are free of faults. Admittedly they are not perfect, but the problem is not how to devise more regulation and control of conferences but for Congress to decide whether this Nation wants *rate cutting* in foreign commerce as advocated by Isbrandtsen and others, or *rate uniformity* as advocated by our committee. It is not possible, in our opinion, to have both.

With the tremendous financial commitments that most of us have undertaken, you cannot expect us permanently to *hold up a fixed, uniform rate structure* among ourselves and our foreign-flag colleagues if the effect is simply going to be that we sacrifice our customers to self-styled "independents," using our conference rates as an *umbrella over their rate-cutting methods* of competition.

Naturally, we would all like to "quote profitably lower rates" as Isbrandtsen claims it has a right to do. But if we all should insist on that right, the inevitable result will be open-rate competition, which no line, including Isbrandtsen, can stand for very long. In the final analysis, it is up to Congress to decide whether uniform rates are desirable or not. The conferences provide uniform rates, not Isbrandtsen and others who practice rate cutting. We think that uniform rates are desirable and, in fact essential, to promote prosperous foreign trade. If the Congress does not agree, then the answer must

³² *Id.* at 3-7. (Italics supplied.)

³³ *Id.* at 264.

³⁴ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 336.

be to do away with the conferences. *If you do agree then the answer is to give the conferences the means of keeping their customers from patronizing cut-rate operators.* This is what our committee seeks in these hearings.³⁵

I believe that history fully demonstrates that the objective and effect of shipping conferences has been to raise rates; and that an effective dissolution of conferences would lower rates. This brings up the issue of whether conference rates are "unreasonable." Clarence Morse, Chairman of the Federal Maritime Board, has recently denied that conferences "unduly" raise rates. As he saw it:

Conference limitations on competition have not had the harmful result of unduly increasing rates. Conference agreements are in effect price-fixing agreements, and the immediately look-for [sic.] result of such agreements would ordinarily be the imposition of unfairly high rates upon the consuming public. The fact is that the level of conference rates is limited by (1) the competition of tramp ships, and (2) the competition of other sources of supply on selling markets for shippers and buyers in the particular trade. A comparison of conference rates with prices of other goods and services shows the interesting fact that in recent years conference rates have increased more slowly than have prices in other fields where competition is theoretically less restricted.³⁶

Apart from the question of how much competition the conferences face—a question of fact that is discussed elsewhere—it is clear that one man's judgment of what is an "unduly" or "unfairly" elevated rate may easily differ from another's. Indeed, that is one very good reason for relying upon competition to regulate prices whenever possible rather than upon the forbearance of price fixing combinations or the wisdom of government regulatory bureaus. As Lloyd Tibbott, Chief of the Board's Regulation Office, testified, "We have complaints from people that claim that a conference is using its ability to make uniform rates to charge rates which are higher than they should be. Yes, we have complaints of that nature, sir."³⁷

Furthermore, there are few monopolies—including even most of those that have patent or other state privilege—whose powers are unqualified by some outside competition. This is amply demonstrated by the common defense, used in antitrust cases by industrial cartels, that there is much outside competition and that prices fixed by the combination are not "unreasonable."³⁸ Such defenses have, appropriately, largely lost their force in antitrust cases. They are not more appropriate in the context of conference rate-fixing.

³⁵ *Id.* at 337. (Italics supplied.)

³⁶ *Id.* at 12.

³⁷ *Id.* at 74.

³⁸ See, for example, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *Appalachian Coals Inc. v. United States*, 288 U.S. 344 (1933); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927); *United States v. Addyston Pipe & Steel Co.*, *supra* note 20.

C. CONFERENCE ORGANIZATION

An ocean freight rate conference is an association of shipping firms cooperating to fix rates and agree on other matters of joint concern.³⁹ The firms otherwise maintain their legal and managerial independence, since the union is neither perpetual nor complete. Firms can resign or be expelled, and, under certain circumstances, new members can be admitted. Conferences can be dissolved, and new ones can be formed. Two or more conferences can, and sometimes do, make joint agreements when their interests overlap substantially.

The conferences are legal, even in the United States;⁴⁰ those whose agreements are approved by the United States Maritime Board and do not otherwise violate the basic statutes are exempted from antitrust prosecution.⁴¹ Their existence is not secret, even if it is not popularly appreciated outside of shipping circles; but their inner mechanical workings have normally been well-guarded business secrets. They are not only legal, they are respectable. The United States Maritime Administration has consistently applauded their efforts as an example of the public good that can arise from government-inspected self-government in industry.⁴²

³⁹ There is apparently some question of whether a conference is a legal entity. As Mr. Mahoney, a conference attorney, said: "The only case that I know of where the conference has a legal entity and existence independent of its member lines and where it is recognized as such seems to be before the Federal Maritime Board. Those conferences are generic. When you get into the State courts the judges and nobody else know what they are. They were recognized by the Shipping Act of 1916. Therefore, the Maritime Board deals with them as legal entities, but whenever we are sued or on those occasions where we bring an action anywhere other than before the Maritime Board we are very careful to, and I believe most other conferences are careful to, bring an action in the name of the member lines themselves to obviate this problem." *Comm. Hearings, op. cit. supra* note 10, pt. 2, at 883.

Much of the literature suggests that the first conference—the Calcutta Conference—was formed in 1875, and that the rise of conference organization was coincident with the rise of steam. Yet it is clear that conferences existed before that, and that even sailing ship operators in some trades had found the system beneficial. See, for example, 39-II R.C.R., *op. cit. supra* note 2, at 87.

⁴⁰ See p. 252 *infra*.

⁴¹ The difference between Board approval and legality is illustrated by *FMB v. Isbrandtsen Co.*, 356 U.S. 481 (1957), in which the Supreme Court found that the dual rate system proposed by the Japan Gulf Atlantic Conference was unlawful. See p. 252 *infra*.

⁴² Yet there is apparently some question about how rigorous the "inspection" process has been, as the following testimony of Chairman Morse reveals:

"MR. GARMATZ: Mr. Morse, you spoke about not hearing necessarily all the complaints providing they are settled satisfactorily to both parties. Also, on page 4, you say—"There are 125 steamship conferences covering the various foreign trades of the United States. The minutes and records of their meetings, and their rates and practices, are filed with the Board and are examined so far as staff limitations permit." . . . Is it possible in these conferences that they could make agreements among themselves that may be breaking the rules and regulations somehow or other without it even coming to your attention through lack of staff?

"MR. MORSE: Yes, Mr. Garmatz; that is possible.

"MR. GARMATZ: Do you have much of that? I do not want to blame anyone but is it possible that they could make certain agreements among themselves which are not up to the Board

Like all such confederations, the conferences have as their basic objective, now as with their original adoption, the abandonment of selfish competition for the good of the group. They meet regularly, and sometimes frequently, to fix new rates, change old ones, and formulate policies to regulate their own and influence outsiders' conduct.

There is at least one very loose and limited agreement, which results in something that might be called a "quasi-conference." As Mr. Cocke of Lykes Bros. Steamship Company explained it,

The Robin Line, the Farrell Line, and the SAF Marine and ours have an agreement filed with the Board where we confer about rates. We do not necessarily have to agree. If we do not agree with them, we can quote what rate we decide but we will notify them. That is an agreement which is filed and not nearly as good as a conference agreement.⁴³

Much can be learned about conference organization from a study of conference agreements on file with the United States Maritime Board.⁴⁴

In a real sense, the agreements are constitutions, having much the same breadth and generality which have been found appropriate to the establishment

thinking but which might not be called to your attention? They may be in practice for a year and not reach your attention.

"MR. MORSE: We have 21 people employed in our Regulation Office. The CAB on the other hand, which does not have substantially greater volume of work, has practically 150 people.

"MR. GARMATZ: Is it not important, then, to have enough staff to go into those things?

"MR. MORSE: It surely is.

"MR. GARMATZ: How important is it?

"MR. MORSE: It is very important. I feel that we have been derelict in our duty to a degree in failing to get enough additional appropriation to have enough people in that office." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 26. Similarly, Lloyd Tibbott, Chief, Regulation Office, Maritime Administration, testified that, "Obviously, with these tariffs coming in at the rate of about 2,000 a month, three men cannot perform these other duties and give a very close scrutiny to these tariffs." *Id.* at 70. "There are roughly, I guess, about 250 minutes a month that come in from these conferences. They specify the conference activities and practices and are gone over as best they can by the two examiners that are detailed to this work. They catch a number of provisions but they do not catch all of them. These men also handle informal complaints and protests. . . ." *Id.* at 71.

⁴³ *Id.* at 320.

⁴⁴ The Regulations Section of Maritime provided copies of the agreements, including those covering pooling arrangements. According to Clarence G. Morse, Chairman of the Federal Maritime Board, "In addition to the 125 conference agreements, there are approximately 400 supporting or related agreements covering trans-shipments of cargo, joint services and sailing schedules and the pooling of revenues, all of which receive similar scrutiny and attention." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 4.

The agreements are often strikingly similar in format. This is explicable, in part at least, by the Board's efforts at standardization. As Mr. Tibbott, of the Board's Regulation Office, recently explained, "In many respects they have a consistent pattern. Some of them vary in accordance with the trade. There are different problems in different trades. There are many provisions that are uniform, and many years ago in an effort to achieve uniformity, we drew up what you might call a standard form of agreement for guidance of persons entering into these conference agreements. We have distributed copies to persons to use as a guide." *Id.* at 81.

of other kinds of government. They specify the locus of authority and its limits; define the mechanisms for change, provide a system for settling disputes and for discovering and punishing transgressions, establish and limit the franchise, sometimes explicitly provide for establishing friendly relations with other conferences and are flexible enough in fact to provide for such relations, provide for financial support of the organization, spell out crucial ground rules and establish procedures for elaborating and applying them, and meet the need for dealing with hostile outsiders. Superficially, at least, it is strange that obviously unequal members of a coalition should be given equal votes. Whether it is only a manifestation of democratic egalitarianism or reflects some deeper economic motivation, many industrial cartels have given each firm only one vote, irrespective of output or capacity. The same phenomenon appears in the case of ocean freight rate conferences.

Each full-member firm has one vote, irrespective of its size. Associated lines, and affiliates, cooperate but do not vote.⁴⁵ Voting practice varies widely among conferences. Within a given conference the required voting majority typically is greater for the graver issues, generally being highest—often requiring complete unanimity—to admit newcomers and to modify the basic agreement. For most issues—as for tariff changes, for example—the usual preponderance required by the various conferences is either three-fourths, two-thirds, or a simple majority. Some conferences require majorities that decrease as the number of members increases; the upper limit being, of course, unanimity for two members.⁴⁶

Many, but not all, conferences charge admission or membership fees. Ap-

⁴⁵ The Maritime Administration definitions are: "Associate Member—a line, not a regular conference member, operating a service parallel to that of conference members, agreeing to observe conference rates, rules, regulations, and conditions on traffic which it handles in the trade covered by the conference agreement." "Associated Line—a line, not a conference member, operating a service between a port or ports from or to which the conference agreement applies and an intermediate port, agreeing to observe conference rates, rules, regulations and conditions on through traffic in the movement of [sic] which it participates." "Affiliated Line—A line owned, controlled or affiliated with a conference member and by the terms of the conference agreement bound to the observance of conference rates, rules, regulations and conditions on traffic which it handles in the trade covered by the conference agreement." FMB, *Approved Steamship Conference and Related Agreements Between Common Carriers by Water on File with the FMB* (pursuant to § 15 of the Shipping Act, 1916. Revised to January 4, 1954, p. ii).

⁴⁶ As an example, agreement number 6060 (the Pacific Indonesian Conference), provides that when the membership is greater than three, issues shall be decided by unanimous vote less one. Some conferences that began with two members and a unanimity rule have not changed the rule as membership has swelled. One example is the Pacific Coast-Australasian Tariff Bureau (agreement number 50-1). Examples of the unanimity rule are agreements 3578 (USA/South Africa Conference), 4294 (Pacific Coast/Caribbean Sea Ports Conference), 4490 (North Atlantic Continental Freight Conference), and 5300 (Norway/North Atlantic Conference).

John J. O'Connor has prepared a recent list of conferences and their voting requirements. *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 611-13.

parently the highest membership fee is about \$2,500; and several conference agreements specify that amount. Interestingly enough, several conference agreements provide higher membership fees for "charter" members than for late-comers. One of the more interesting admission policies is that of the Pacific Coast European Conference (agreement number 5200), which provides that newcomers must pay a membership fee of \$1,000; while re-admission to the conference costs \$12,500.

Taken alone, membership fees may not be large enough to discourage entry of full blown liner companies. In addition to such fees, conferences commonly require that members post performance bonds, generally in the form of cash or negotiable securities. The most obvious rationale is to encourage compliance with conference rules and tariffs: liquidated damages for breach of the agreement—*i.e.*, fines—are to be paid out of such bonds, the amount of which is dutifully to be kept at the requisite level. The largest performance bond is apparently \$50,000;⁴⁷ there are several of \$25,000 and many at about the \$5,000 level. (Even these amounts are unlikely to discourage a liner operator who wants to enter a trade on a regular basis.) Conference agreements generally spell out how "liquidated damages" for breach are to be calculated. "Damages" are sometimes specified dollar amounts for each of various kinds of breaches or violations.⁴⁸ Probably the most common technique is to assess damages as a multiple of freight earned in violation of the agreement, or as a multiple of freight that would have been earned by the violator if the tariff had been adhered to. In such cases, some agreements provide for the payment of only the full freight; more common is a penalty of four times the freight earned.

Conference chairmen and staffs often serve two or more different conferences. Some five chairmen or secretaries represent 47 conferences.⁴⁹ Although this presumably has the merit of economy; it may also lead to the more harmonious

⁴⁷ East Coast Columbia Conference, agreement number 7590.

⁴⁸ For some kinds of violations, the American Great Lakes-Mediterranean East Bound Freight Conference (agreement number 8250) levies damages of \$1000 for the first violation, \$5000 for the second and \$10,000 for the third. This same conference provides damages for tariff violations on the basis of 10 times the freight so earned or that would have been earned, one of the highest of the freight-multiple standards for damages. In addition to fines, there are also policing mechanisms to discourage secret competition. As Charles R. Andrews, Chairman of the Transatlantic Associated Freight Conferences, testified, "As a further step toward eliminating possible future deviations from conference rules and regulations, and to eliminate disputes between carrier and shipper about cargo measurements, the Atlantic Cargo Inspection Bureau, division of the New York Shipping Association, a nonprofit association, has been employed since March 1958, to verify measurements, weights, and descriptions of contents of shipments to protect both shippers and carriers against erroneous freight charges. A notice of this service was mailed to all shippers on Feb. 27, 1958." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 730, 765. For additional examples of conferences using sworn weighers and measurers, see conference agreements numbers 14-1, 14-14, 85, 150-10, 194, 3103-9, 5600, 8190-2.

⁴⁹ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 639.

settlement of issues arising between conferences that do not have joint agreements.⁵⁰

Costs of conference operations, including compilation of tariffs and the like, are borne by the members, sometimes on the basis of capacity or carryings;⁵¹ sometimes equally.

Since conferences carefully delimit the market with which they are concerned, two conferences do not overlap geographically. There are, however, several obvious cases in which two or more conferences are interdependent with respect to rates: when a rate reduction by one conference reduces the carryings of another, they are actually competing conferences so far as the affected commodities. In at least some such cases, as would be expected, there are agreements between conferences.⁵² One of them was explained by James Dennean, Chairman of the Far East Conference. In his words:

I would now like to explain the operation of the joint agreement between the Far East Conference and the Pacific Westbound Conference.

As we saw during the historical narrative, the prewar joint agreement was terminated in 1930. Thereafter, there were occasional efforts to reestablish a cooperative relationship between the two conferences, but it was not until 1952 that a new joint agreement was entered into and approved by the Federal Maritime Board.

⁵⁰ Marx shows graphically this interlocking-secretary aspect of ocean conferences, *op. cit. supra* note 11, 175-183. Inter-conference matters apparently are sometimes settled by the lines themselves or the two different conference chairmen involved. See the testimony of Alex Cocke, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 330.

⁵¹ Interestingly enough, the only shipping company whose representatives told me that conferences lower costs was a very small one. The claim was that their share of the cost of conference tariff preparation was less than that of unilateral preparation.

⁵² There are ten so-called joint agreements filed by conferences in United States foreign trade. I do not know, but doubt, that these formal agreements in fact cover all cases in which conferences "compete." That this suspicion is correct is indicated by this testimony of Alex Cocke of Lykes Bros. Steamship Co.:

"MR. DOWNING: All right. Now, what about coordination between the various conferences? Do you coordinate with any other conference?

"MR. COCKE: I would not say that we coordinate. I think we cooperate to the extent that our chairman and the chairman of the North Atlantic Conference discuss matters from time to time. If I have a problem and it is involved in the North Atlantic or the South Atlantic, I have no hesitancy in calling Mr. Wierda of the U.S. Lines or Mr. Maas of the Holland American Lines. We work out things very well, I think. We do not have any specific agreement between conferences but we do discuss matters.

"MR. DOWNING: You do not have an association of conferences?

"MR. COCKE: No sir. We have what we call in the gulf the Gulf Associated Freight Conferences, but that is only for the handling of personnel and conference expense setups but they have no relationship. . . . We have done that on numerous occasions, Mr. Downing; talked to prominent members of those conferences in an endeavor to have them adjust certain things. There are a number of members of those conferences who are members of our conferences. From time to time we talk it over with them, but I do not think as a general proposition that we could effect a definite setup.

"MR. DOWNING: It would certainly be nice if you could.

"MR. COCKE: Yes, it certainly would be." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 330.

This agreement is very general in its terms. It states as its purpose the establishment and maintenance of stability of ocean rates and frequency, regularity, and dependability of service to the economic interests of all coasts of the United States in the export trade to the Far East. Under its terms the parties agree to establish rates to be charged for transportation except with respect to 12 enumerated commodities when shipped in bulk.

The agreement provides for an initial meeting to make rules for the changes of rates, rules and regulations. However, it provides that, notwithstanding any provision of the agreement or of any rules and regulations adopted pursuant to it, if either constituent conference should determine that conditions affecting its operations require an immediate change in its tariffs, it may, on 48 hours' telegraphic notice or 72 hours' airmail notice to the other conference, make the changes thus required without breach or violation of agreement. The agreement requires each conference not to admit a new member who does not simultaneously become a party to the joint agreement. The agreement continues in effect until the 90th day after any party shall have given notice of termination. . . .

Pursuant to these rules, certain items have been classified as "local initiative items," that is, one conference or the other may adopt rates and changes in rates on those items without reference to the other conference, such other conference being free to follow the action of the conference having the initiative. A commodity may not be assigned to this category unless 70 percent or more of the Far East exports of that commodity originates on the coast within the scope of either the Pacific Westbound Conference or the Far East Conference agreement. When a commodity so qualifies, the conference whose members carry the 70 percent or more may request the "local initiative" with respect to that item. The concurrence of the "opposite" conference is required to add the item to the local initiative list.

As to the items of cargo which have not been placed on the initiative list, either conference must obtain the concurrence of the other in a proposed rate change. If, for example, the Far East Conference votes to reduce the rate on an item on which there is no local initiative, the conference teletypes advice of this action to the Pacific Westbound Conference and requests concurrence. The rate change cannot be put into effect until that concurrence is received. The converse procedure applies when rate action is voted by the Pacific Westbound Conference in the first instance. In the Far East Conference all requests for concurrence are referred to the rate committee and, in the vast majority of cases, a recommendation is made and voted on at the next regular meeting of the conference. To guard against the pigeonholing of requests for concurrence, the joint regulations provide that if the conference requesting concurrence receives no reply to its request within 10 days, it may take its proposed rate action.⁵³

It is clear that the operation and results of a loose association of this type may differ from those of a single firm operating at the same capacity. Differences in national business cultures intrude and may abrade; personalities may clash; what pleases one line may wound another; even pride in tribe and flag, and variations in national governmental policies may impede cooperation in any such international body; and so on. What is not so clear is the extent, and kind, of such divergence. Some have characterized conference members as an

⁵³ *Id.* at 388-89.

unbroken phalanx. Others claim that they are, at best, in uneasy truce, and that the inherent centrifugal forces built up in such coalitions may at any time wreck the structure entirely. Unfortunately, it has not been possible for an outsider to penetrate the conference meetings; only the insiders know, but they rarely will volunteer what they know.⁵⁴ Then, too, since it is essentially divergences from ideal that are at issue, and such divergences arise from differing objectives of the members, it is unlikely that parties to the important conflicts can be disinterested in their recital of them. Nevertheless, some examination of the logic of such conflicts, coupled with anecdotes about some of them, is essential to this inquiry.⁵⁵

D. CONFERENCE OPERATION

Although it is helpful to understand something of conference organization and form, it is useful to inquire into their *operation* as well.

Just as in the case of cartels, conferences perform, in principle at least, three major tasks: (1) price-setting; (2) allocating output among the members; and (3) dividing revenues. The problem of entry is of such importance that it will be treated separately. As was also true of many cartels, in most cases conferences perform only the first task explicitly, leaving the other two functions to be performed implicitly as a legacy of the price that all have agreed upon. When price is set, in theory there will be an equilibrium division of output and revenues for the group. In other cases the second and third functions may be combined explicitly; in still others they may be explicit but separate.

Conference Rate Setting.—If the rates made by loosely-organized independent firms are to be the same⁵⁶ and kept at the desired level, they must first be agreed upon. In principle this is not difficult to achieve: The character of demand could be estimated, roughly or precisely, and an aggregate cost function derived from the individual costs of members. Rates would then be set, in accordance with classic monopoly principles, so that the present worth of the cooperating firms would be maximized.⁵⁷ When the service provided is heterogeneous, it is not surprising that demand elasticities may differ among those who use the different varieties of services. Elasticities of demand for shipping services are derived demands, resting ultimately upon the demand for the finished, or delivered and

⁵⁴ Some conference agreements explicitly command secrecy and fine those who break the commandment. For example, see agreements number 7650 (Santiago de Cuba Conference), 8140 (Great Lakes-United Kingdom Westbound Conference), 8120 (U.S. Atlantic and Gulf-Haiti Conference), 8300 (Atlantic and Gulf West Coast of Central American and Mexico Conference).

⁵⁵ See pp. 298-306 *infra*.

⁵⁶ Or, in certain cases, most importantly in passenger services, just enough different in view of differences in the quality of service to make offerings of all equally acceptable to users.

⁵⁷ This is equivalent to long-run profit maximization under single-valued expectations. It also ignores the possibility, which has been discussed above as a qualitative restriction, that cartels are somewhat different from single firm monopolies.

served, commodities into which they ultimately will be incorporated or transformed. It must always be remembered, however, that the demand for *conference* shipping services will not always be identical, at every rate level, to the aggregate demand for shipping services. At some, and conceivably at all, rate levels, non-conference services, including tramp ships, become partly or completely substitutable. Taking that qualification always into account, the elasticity of demand for conference shipping services will generally vary among different commodity classes, in accordance with the final elasticity of demand for the delivered good. Given these differences in demand, it will generally pay the conference to exploit them, charging higher rates where the rate-elasticity of demand for shipping service is low and lower rates where it is high.⁵⁸

Some conference ship operators have objected strenuously to the suggestion that they discriminate in rates among commodities. In a personal interview, one went so far as to say that "Our rates are not discriminatory; they are based on what the traffic will bear." The *essence* of discrimination, in the economic sense, is, of course, charging what the traffic will bear to different groups that can be made to "bear" different prices.⁵⁹ The shipping people are not being sophistical; they are simply using the term "discrimination" in a different sense from that used by economists. To them, "discrimination" means only "unjust" or "unfair" discrimination, as when shippers of the *same* commodity

⁵⁸ One technical difficulty should now be mentioned: the preceding section stands without qualification only where costs of providing the various services are identical. Where they differ, as indeed they often will, matters become more complicated, but in no way theoretically intractable. Presuming that neat severability of costs that only theorists can generally manage to find, we could deduct from each separate demand schedule those costs in excess of a basic minimum. The resulting net demand schedules, together with the basic minimum cost schedules, could then be manipulated, or interpreted, as described in the text.

That this task is not as fruitless or unmanageable as it at first appears may be indicated by one confidential study recently undertaken by a large steamship company. As a result of variable cost studies, direct cost differences were calculated for various commodity classes, with the result that gross profit contribution estimates were gotten for each product class. These estimates vary markedly among commodity classes, showing that net prices and profitability vary among commodities. In addition, the study revealed a good correlation between the *level* of individual rates and their contribution to profits. This, assuming reasonable reliability of the cost constructs, is evidence of a discriminatory rate structure. If that type of structure persists, it is an excellent symptom of monopoly power itself.

⁵⁹ The following colloquy is suggestive:

"MR. COWEN: I am getting at this, sir. Is there any realism between a rate of \$27.50 for dried peas as against \$57.50 for seed peas?"

"MR. DENNEAN: I do not know. There might be if I had the facts before me. I do not know whether there is or not. Do you mean as to conference rates on both of those commodities?"

"MR. COWEN: Yes, sir.

"MR. DENNEAN: I do not know what the distinction is between the two. It might be that seed peas are entirely different commodities from dried peas. They might be more valuable. I do not know.

"MR. COWEN: Granted that they are more valuable but is that not a rather wide differential between the two?"

"MR. DENNEAN: I would think so. Yes, sir."

Bonner Comm. Hearings, op. cit. supra note 10, pt. 2, at 417.

are charged different rates.⁶⁰ The ability persistently to discriminate in this fashion is a hallmark of monopoly power: Competition would level rates everywhere to correspond with the costs of service.⁶¹

This principle applies clearly to commodities that are, often or occasionally, carried by liners but are quite capable of being managed by tramps at no discount. In such cases, liner rates will often be "open," *i.e.*, competitive, or lower than for other more insulated commodities.⁶² Somewhat higher will be rates on commodities that could be managed by tramps, but only at some cost of infrequency, irregularity, slowness, or cargo accumulation that shippers will happily pay to avoid.⁶³

⁶⁰ A similar principle is apparently applicable in the case of the Board's investigations of shipper complaints. As Mr. Tibbott, Chief of the Board's Regulations Office, recently testified:

"MR. CASEY: What is your yardstick for determining whether the rate is too high or not?"

"MR. TIBBOTT: The biggest yardstick or principal yardstick—and I might as well be frank—is whether somebody kicks or whether they do not kick." *Id.*, pt. 1, at 85.

⁶¹ The testimony of Mr. Charles Booth, Jr. of the Booth Lines, referred to the conference rate structure as a "scientific tariff," and acknowledged that it rested upon monopoly: "You realise that by the rebate system you get a species of monopoly control?—Yes, certainly. . . . This scientific tariff is dependent entirely upon the monopoly which you obtain, is it not?—It is, entirely." 40-IV R.C.R., *op. cit. supra*, note 10, at 317.

Mr. Edward Lloyd, a Director of the Bucknall Steamship Company, put it this way: "Take the case of a high rate in the African trade, if you like—the 40s. rate dealing with goods of a special character. If there was a free market, there is no doubt that the rate would not exist. But, on the other hand, the Conference have rates of 12s. 6d., and so on; in a free market those 12s. 6d. rates would not exist. It is simply the case that in a free market there would probably be one rate which would apply for all descriptions of cargoes, whereas in a regulated trade under Conference regulations there is an effort to give cheaper rates, below the parity of cost in fact, on goods of certain descriptions, and a higher rate on goods of higher value which can afford to pay higher rates and in which the freight is not an element entering into the question of shipment or export." *Id.* at 159.

Richard D. Holt, a shipowner and member of Parliament, succinctly summarized the rationale of conference rate making when he said: "generally speaking, the ruling considerations are (a) the cost of rendering the service, (b) the value of the service to the shipper." *Id.* at 165. See also 39-III *Id.* at 248. Specie was carried at 0.5% ad valorem. According to McArthur, a shipper of tin, the rate structure would have been quite different under competition: "If there were free competition and no Conference Lines with the rebate system, then, I suppose, the freight would not depend on the price of the article?—No, it would not." 40-IV *Id.* at 8. He preferred rates based on the cost of service rather than on, essentially, the elasticity of demand. *Ibid.* See also statement of James Dennean, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 400; statement of Jack Hewett, *id.* at 424.

⁶² See *id.* at 7-8, 333.

⁶³ There is little doubt that many shippers can readily calculate the costs, other than freight rates, that apply to the various shipping alternatives. J. A. Roberts, a Ceylon tea shipper, explained the general principle in these words: "If we get the convenience of steamers calling regularly, practically every day in the week, we must expect to pay more than if we were content to depend on irregular sailings and were enabled to accumulate large shipments of tea on which they might rely to fill their boats, though they could not rely on getting them necessarily." 39-III R.C.R., *op. cit. supra*, note 2, at 271. McArthur, a shipper, put the matter more precisely: "So that if the shippers came to an arrangement to ship by tramp steamers they would actually lose about 3s. a ton in interest and about 2s. a ton in insurance, and would be actually out of pocket unless they got freight at least 5s. lower than that charged by the mail steamers." 40-IV *Id.* at 8. According to Mr. R. Maclaren, a shipper of cast iron pipe and sugar

In this case conference rates will apply. They may be somewhat higher than the tramp rates charged for inferior service, but will vary roughly in conformity with them. So-called "project rates," for moving construction materials and the like appear to be an example. It is sometimes feasible, though somewhat less desirable, to load full shiploads of such materials onto tramps; and the volumes are often great enough to warrant interest by tramp operators. As a consequence, to get such cargoes, the conference cannot by much exceed tramp rates. Yet they do provide the convenience of regular delivery in smaller lots and can be paid something for the service.⁶⁴

In an interesting memorandum written to the Royal Commission, Sir Donald Currie, a leading English shipowner, spelled out the rationale of project rates in detail. In his words:

The shipowners . . . have always been compelled to offer the various Governments of South Africa the advantage of shipping their rough cargo—e.g., rails, sleepers, cement, and other railway material—at the lowest rates at which it might be possible to obtain freight by tramp steamers in the outside market. The Conference Lines have considered it essential to take this description of cargo at these low rates for two reasons:

- (a) Because they could ill afford to run their steamers with the necessary regularity without the help of the Government cargo.
- (b) Because they would rather take it at the poor rate offered than allow it to pass into the hands of other people, who might be induced to take it at the unpayable rates at which it is carried in order to employ such cargo as a means of forcing their way into the trade.⁶⁵

machinery: ". . . I would say that I am strongly in favour of the lines, and would always give them a preference of 2 or 3 per cent of freight because of their regular sailings, and the consequential savings of storage, but under the rebate system they force not a preference of 2 or 3 per cent, but nearer 50 per cent difference." 39-III *Id.* at 348. Further, "The advantage derived from regular sailings in our business is a pretty easily ascertained quantity. It is simply the cost of storage; that is, if there are fortnightly boats, it is the difference in storage between a fortnight and a month or six weeks, until we make up the cargo." *Id.* at 350. And, "I say that the lines do not need rebates, because their regularity gives them a preference in our style of goods of from 5 to 10 per cent, or about 2s., in the freight, and I think that is quite enough for them. *Id.* at 354.

⁶⁴ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 82, 292. See also the discussion in "The Role of U.S. Flag Operators in the Conference System," *infra*, pp. 298-306, especially 300-303.

A. J. Pasch, Chairman of the Associated Latin American Freight Conferences, testified that project rates are economically necessary to exclude nonconference carriers. *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 855.

⁶⁵ *Id.* app. VI, at 51. J. P. Maclay, a tramp ship owner, confirmed the Currie position when he said: ". . . I would desire to point out the positions of the Home and Colonial and Indian Governments, and the cases of Indian Railways, &c. When they call for tenders there can be no effective competition, because the lines having command of all the other cargo necessary to make up paying cargoes are in a position to preclude real competition, and there is no active competition between the Lines. The result is that when any large quantity of rough cargo comes on the market it is secured by the Rings, and is frequently sublet to outside steamers, often at substantially lower freights than the Ring's contracted rate." 39-III *Id.* at 307. According to Sir J. L. Mackay's testimony, "Is not this the object of saying they will either

The principle and practice remain essentially the same today as in 1908. Some conferences thus have rates ranging from high to low: tariff rates, which are paid by those who divide their loyalty; contract rates for those who ship exclusively by conference liners, typically 10 to 20 per cent lower than the tariff rates; industrial rates, perhaps 5 to 10 per cent lower than the contract rate, for one or more large industries; project rates, which are sometimes as little as 50 per cent of the contract rate levels; and open rates, which are equivalent to competitive rates in the open market. Furthermore, *within* the tariff or contract rate categories, rates vary widely among classes of commodities.

In a 1958 interview, the rate specialist in a conference shipping company said that conference rate making relies heavily upon rail rate classifications. He had a copy of the *Railroad Consolidated Tariff Freight Classification Number 21* on his desk, and claimed that he consulted it very frequently, often in connection with requests from shippers for rate reductions. According to this expert, almost any commodity in foreign trade can stand a rate of at least 12 per cent of value, and they try to get more when they can. The behavior of outside "cut-rate" liner services is also consistent with the hypothesis that conference tariffs are discriminatory. According to Donald Wierda, Freight Traffic Manager of United States Lines, for example, whenever a rate cutter appears, he concentrates on "the best paying type of cargo," namely, the "higher paying package cargo." This implies that there are substantial differences between the profitability of carrying different cargoes; or, in other words, that rate differences do not truly reflect cost differences.⁶⁶

Ideally, of course, a conference, or other quasi-monopoly, should prefer to discriminate among shippers even of the same commodity if there are differences in the elasticity of their demand. In their very early period, some conferences did so;⁶⁷ and indirectly, at least, some of this practice may yet persist. There seems now to be little evidence of that practice. Why should that be? There are several reasons why conferences may refrain from rate discrimination among shippers of the same good, in contradistinction to the prevalent practice of discriminating among non-competing classes of goods. First, democratic

take all or none, that as the Conference are always sending out steamers, they can take the whole of the freight in, say, 10 or 12 shipments at different times?—Yes. That is to say, when cargo is put up for tender shipment at different ports, say, London, Middlesbrough, Liverpool, Glasgow, Cardiff, Newport, and an outside steamer is loading in London, the Conference do not want the opposition steamer to get the London cargo and to be landed with the other ports' cargo only, so the tender "all or none." 40-IV *id.* at 257. In his testimony, Mr. Currie said: "To municipalities, yes, if they put their shipments up to public tender; and even to the great mining companies, I should say so, if they will agree to give us 50,000 or 80,000 tons of cargo. Why not? Is it not natural and common sense that we should be able to do so, seeing that they would put it up to tender and make a contract with people who would put on opposition? Is that our interest? Is that fair?" *Id.* at 99.

⁶⁶ *Id.* pt. 2, at 343. See also *id.* at 348.

⁶⁷ See note 69 *infra*.

societies have made much of discrimination where they have found it; there is strong and widespread conviction, which may be shared by ship operators as well as others, that discrimination is morally reprehensible and should, therefore, be avoided. Then, too, there is the matter of the law, which, in the case of United States conferences, would be hostile to "unjust discrimination." Second, even when all members of a conference try honestly to adhere to the group policy, complicated rate structures are costly to administer and cause errors that tend to arouse bad will. Other complications are subtle. By cutting rates to some but not all competitors, the business of some rises at the expense of others; their demands for shipping space are interdependent. It is difficult, especially when interdependent demands are shifting about, to keep the cartel pulling together as a team. Third, and perhaps most important, the more intimately rates are geared to *ad hoc* estimates of individual demand elasticities, which presumably change from time to time, the easier it becomes for selfish members of the conference to chisel without being caught at it. The result can easily be a gradual erosion of the rate structure, with all members ending up worse off than before. Industrial cartels have faced the problem in connection with quantity and other discounts and sometimes have had to suppress differential pricing in the interests of solidarity.⁶⁸ Fourth, in the early days of shipping conferences there is some evidence that part of the bargain by which shippers were induced to give up occasional chartering was the agreement by the conference to treat all competitors alike and to abandon the shipment and sale of shipowners' cargo in competition with merchants.⁶⁹ Whatever the reasons, apart from unilateral chiseling from conference rate levels by defecting members, in United States foreign trade there appears to be little rate discrimination between competing shippers of the same commodity from or to the same port. In short, conference policy is apparently to preserve rate identity *within* a commodity class, but to discriminate *among* commodity classes.⁷⁰ Furthermore, there are similar limitations upon proliferating commodity classes. According to Arthur Cook, a conference operator testifying in 1908:

Take, for example, agricultural implements, which might figure as a group in some classifications; how would you deal with such a group of articles?—I suppose that the Lines using a classification would pick out articles of a similar nature, both as regards

⁶⁸ See, for example, *Sugar Institute, Inc. v. United States*, 297 U.S. 553 (1936).

⁶⁹ See 39-III R.C.R., *op. cit. supra* note 2, at 244-45. In some outstanding cases, which will be analyzed elsewhere, this *quid pro quo* involved rather more, and actually eventuated in rate discrimination among competing merchants. See pp. 240-42 *infra*. See also statement of Cocke, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 293.

⁷⁰ The matter may go even further than this: to the extent that, say, large shippers' cargoes are handled more cheaply than small, while the rates they pay are identical, the large shippers are effectively discriminated against. But the issue is subtle and complicated; if damages for contract breach, for example, are enforced against some shippers but not against others, the effect is to discriminate in net rates.

bulk and as regards value, and endeavour to group them together under one heading. We found by experience that that was very unsatisfactory, and gave rise to a great many questions and to mistakes being made.⁷¹

Though much has changed, much has remained the same. In 1958, a precisely comparable problem arose when a conference line, confronted by a shipment of "payloaders," tractors with "bucket" attachments used in roadbuilding, gave the tractor part of the shipment the lower agricultural implements rate, and charged the higher roadbuilding equipment rate only on the bucket attachment. Other lines in the trade learned of the transaction, denounced it as chiseling on the theory that the whole apparatus should carry the higher rate, and threatened to break rates on other commodities. This error, or difference of opinion, nearly destroyed the solidarity of the group until the offending line, with permission of the shipper, applied the higher rate to the whole shipment.

Logic and history lead, therefore, to the following generalizations: First, the monopoly power of a conference permits rate discrimination, and the quest for profits makes it desirable to discriminate. Second, under competition, discrimination could not persist; and weak conferences are likely to discriminate less systematically than strong ones.⁷² Third, the weakness of a conference is a product not only of the amount and vitality of outside competition, but, to some extent, probably of the number of conference members as well. Fourth, even a relatively strong conference will actually discriminate in rates less than is theoretically possible, since there is real merit in compromising with the need for simplicity of rate structure. This last generalization applies also to the matter of rate stability which can appropriately be discussed at this time.

Rate Stability.—One question sometimes asked is whether liner rates are more stable than they would have been if there were no conference. Although there are some relevant theoretical propositions that can be advanced on this subject, as an empirical matter the problem is intractable in that form. On the other hand, it may be possible to comment upon, and possibly measure, how stable conference rates are relative to tramp ship rates. There are many problems inherent in such an analysis, of course. Not the least of them is that organized data on liner rates have been scarce. Indeed, it is necessary to collect and analyze such data *de novo*.⁷³ The latter possibility not only has the merit

⁷¹ 40-IV R.C.R., *op. cit. supra* note 2, at 247.

⁷² This statement should not be misunderstood. In moving toward a lower competitive equilibrium, sellers will commonly shade prices only when necessary to get, or keep, business. At any point in time, therefore, there may easily be a certain amount of discrimination. It will not be systematic or persistent, but is part of the mechanism by which rates are cut down by competitive pressures in the real world. See McGee, *Price Discrimination and Competitive Effects: The Standard Oil of Indiana Case*, 23 U. CHI. L. REV. 398 (1956).

⁷³ There is an interesting study of nearly 7,000 freight rates in inter-American trade from 1947-1953: AD HOC COMMITTEE OF SPECIALISTS OF AMERICAN REPUBLICS TO STUDY THE SYSTEM FOR ESTABLISHING FREIGHT AND INSURANCE RATES, INTER-AMERICAN ECONOMIC AND

of feasibility, but of relevance as well. Shippers and owners have typically made such comparisons, as have students who have supported, or denounced, conferences because of the stability of their rates. Similarly, it should be possible to test the logically acceptable hypothesis that rate flexibility will be greatest when the number of firms involved is greatest.⁷⁴ Though studies presently available are not equal to the task, it may also be possible to determine whether conferences using loyalty ties (e.g., dual rate systems), tend to have more stable rates than conferences not employing them. Unfortunately, the funds and resources available have not permitted a thoroughgoing empirical investigation of conference rate stability.⁷⁵ Since the cargo data which are available do not distinguish between conference and non-conference carryings, but rather between liner and tramp, it is necessary to gauge competition by the participation of tramps. From this test, it may be possible to infer some important relationships between monopoly power and rate flexibility.

The second question is *why* conference rates are as stable as they are. Third, what are the disadvantages or advantages of such stability? Although the second and third issues are closely related, the desirability of stability will be discussed separately.⁷⁶

It has become almost axiomatic that cartel, and even single firm monopoly, prices are often quite stable. To some extent this has puzzled economists, since, if the monopolist seeks to maximize the present worth of his assets, he should be quite as interested as any competitor in changing his rates with changes in demand or cost. Apart from the hypothesis that monopolists are not much devoted to profit-maximization, the acceptance of which may reduce the pre-

SOCIAL COUNCIL OF THE PAN AMERICAN UNION: May 29, 1957. Alex Cocke, Vice President of Lykes Brothers Steamship Company, has summarized the study in these words: "A 'stable' rate is defined as one which did not change within two or more consecutive years. Of the 6,869 rates studied, 56 percent of them were found 'stable' by this definition, 37 percent had been increased, 4 percent decreased, and 2 percent had been 'opened.' Of the rates found 'stable,' however, 23 percent were unchanged over a period of 2 years, 53 percent were unchanged for a period of 3 years, 10 percent were unchanged for a period of 4 years, and the other 14 percent were unchanged for a period of 5 or more years. This, we feel, is truly a remarkable example of conference freight rate stability." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 265. See also the interesting graphic comparisons of charters, *id.* at 278-83, 284-87.

Conference and dual-rate advocates also selected rate histories that they claim are consistent with the hypothesis that rates do not rise appreciably faster in dual-rate conferences during periods of rising prices.

⁷⁴ From a test of price behavior in industries not known to have been continuously cartelized, Stigler has concluded, "If the data . . . are summarized by number of firms, we find a definite tendency for price flexibility to increase with the number of firms in the industry. Stigler, *The Kinky Oligopoly Demand Curve and Rigid Prices*, reprinted in AMERICAN ECONOMIC ASSOCIATION READINGS IN PRICE THEORY 410 at 431.

It may be that a similar phenomenon occurs in cartels themselves.

⁷⁵ Other members of the Transportation Center staff have been endeavoring to make such a study. At this writing, their inquiry is not complete.

⁷⁶ See V, "Some Issues of Policy and Values," *infra*.

dictive power of economic analysis without correspondingly benefiting it, two principal explanations have been offered. The first applies to cartels, the second both to cartels and single-headed monopoly.

It is often said that cartel prices will be stable relative to those that competition produces simply because a cartel is a loose confederation of independent firms. Because the conference has more than one member, and sometimes very many, consensus for change may be difficult to achieve. Analogies are sometimes drawn from the general experience with administrative committees, whose impotence is said to grow with the number of members present.⁷⁷ On the other hand, this alleged inertia is sometimes explained with sharper emphasis upon rivalry and imperfect knowledge than upon administrative inefficiency. Any coalition, but especially one with large membership, tends to be fragile because of the constant threat that group and individual interests may diverge significantly. A conference is a formal, but incomplete, attempt to keep those interests together. From its first moment of birth, any cartel contains stresses that may at any time destroy it. According to that rationale, any change in shares of output, rates, or revenue shares may cause trouble and, ultimately, defection. In practice, knowledge is never complete. Differences in costs, or even in personalities, tend to make any cartel, at least those that are administratively simple enough to work, at best a compromise of conflicting desires and circumstances. In this imperfect world, cartel formation itself is a somewhat expensive and delicate job.⁷⁸ Fundamental changes in a "going" cartel—as the structure of membership, rates, etc.—impose much the same strains that had to be overcome to form it and add to the continuing problems, themselves substantial, that must be overcome to keep the cartel running even if costs and demand do not change.

As a consequence, it is sometimes said, cooperating firms generally find it feasible to alter prices infrequently, doing so only when the interests of all are quite coincident and the desire for change great. To put the matter simply, there is a marked tendency not to disturb, or touch, the mechanism once it is working, unless the need or desire for change is very great. Too much change is asking for trouble, in view of the tautness with which cartels are sometimes strung.

If the foregoing generalizations are correct, ocean freight rate conferences may have selfish reasons to prefer rate stability; or, put in another way, the inherent character of conferences compels a certain amount of rate stability and, indeed, could not work without it.⁷⁹

⁷⁷ "Anyone who has ever done business with committees knows that five people can reach a decision, fifteen people can be persuaded by a man who has made up his mind, and twenty-five people are a debating society." E. A. G. Robinson, *THE STRUCTURE OF COMPETITIVE INDUSTRY*, 48, 49 (1948).

⁷⁸ See pp. 196-204 *supra*.

⁷⁹ See the testimony of Mr. Cook, 40-IV R.C.R., *op. cit. supra* note 2, at 249, and Mr. Park, *id.* at 211.

The second possible explanation of price stability, under either cartel or single-firm monopoly, rests on the elasticity of demand. One of the strongly predisposing characteristics for profitable monopoly is that the elasticity of demand be low at the competitive price.⁸⁰ Under pure monopoly, at least, the price will be advanced to the elastic range of the demand curve. Even if the monopoly produces at zero cost, the elasticity will be higher under monopoly than competition; and if we take a simple case, as for example, with linear demand curves, that alone would mean that the same increase in costs will increase rates relatively and absolutely more under competition than under monopoly. Similarly, the same decrease in costs will lower rates more under competition than under monopoly. So far as elasticity of demand is concerned, the argument to this point has been that if the *number* of rate changes is the measure of flexibility, there is nothing to suggest that monopoly prices will be more stable than competitive prices; but that if the measure of stability is the amount or amplitude of price movement, there is some reason to believe that monopoly prices will be more stable.

There are two formal arguments that do directly deal with the matter of the *frequency* of price changes under monopoly. One has to do with the cost of changing prices in the light of the elasticity of demand. The other is concerned with the relevance of elasticity of demand when demand shifts.

Changing prices will generally involve some costs, and under monopoly there may be changes in costs or demand relatively so slight that they do not justify changing prices at all. Thus, in the limiting case, changes in demand or costs that produce some change in price under competition may produce none under monopoly, essentially because of differences in price elasticity under the two different business structures.⁸¹ Similarly, since monopoly price is a function of cost and demand elasticity, it is not only shifts in the *position* of a demand curve relative to the value of the cost function that determine price changes, but also what happens to the elasticity of demand as it shifts. Thus, demand shifts that change prices under competition may produce no change in even short-run optimum monopoly price, since the shift may be compensated for by stability or change in the elasticity of monopoly demand.

"The" theory, though it is mixed and imprecise, seems to argue that conference rates will be more stable than those that would prevail in its absence.

Allocating Output and Revenues.—Every cartel, conference, or, for that matter, multi-plant firm has the problem of allocating output among the various producing units. Ideally, a shipping conference should strive to minimize costs, and that would mean that low cost members should have larger shares than those who incur higher costs. When all members have identical costs, or very

⁸⁰ See p. 197 *supra*.

⁸¹ I am indebted to Professor Lawrence Fisher for this point.

nearly so, equal quotas would be perfect.⁸² A good many of the old shipping conferences allocated sailings, and some used revenue pooling, to accomplish the allocative task with considerable precision.⁸³ Though pooling arrangements in United States foreign trade are legal if approved by the Maritime Administration, there appear to be relatively few of them.⁸⁴

Apparently more rare are explicit agreements to allocate sailings. If sailings are not allocated and limited, but minimum rates are prescribed, the only technique by which one member line can improve its position relative to the rest is by better service. This might be done, though at higher cost, by offering faster passage or more favorable sailings.⁸⁵ Such "competitive" techniques tend to be self-arresting, since the more effective of them will probably increase costs appreciably.

It is not obvious that advertising and other promotional efforts will be highly successful as competitive devices where industrial shippers are concerned. The apparent rarity of agreements to suppress non-price rivalry is presumably the best evidence that conference members do not regard them as dangerously competitive.⁸⁶ Nevertheless, to the extent that such rivalry exists, it raises costs

⁸² See the pooling agreement between the Swedish Line and Scantic Line. Under its terms, the "lines agree to alternate sailings under Swedish and American flag. . . ." Agreement number 7549-1. See also, for example, agreements number 7601, 7616, 7655-3, 7707, 7765-2, and 7825.

⁸³ See, for example, the passenger conference arrangements described in the Alexander Committee Report. *Alexander Comm. Rep.*, *op. cit. supra* note 10.

⁸⁴ As of January, 1959, there were 23 registered pooling agreements. Nineteen were active. Some of these were joint service agreements between only some members of a conference. Pooling agreements on file with the United States Maritime Board as of January 13, 1959. *Bonner Comm. Hearings*, *op. cit. supra* note 10, at 313.

⁸⁵ It is clear, however, that no shipper is confined to shipments on only one conference line; indeed, there are good reasons to expect that he may normally prefer to spread his patronage among two or more. "More favorable sailings" would mean, then, only that many who now ship on, say, Friday, would prefer Monday sailings, and that it pays a line to put additional ships on for Monday departure.

⁸⁶ One conference member said that over a wide range of possible services, the only significant factor that would divert business from one line to another is a difference in rate. As a consequence, he said, capacity utilization is remarkably constant among members; indeed, the best evidence that someone is chiseling is that his ships sail more fully loaded than those of his fellow conference members. He said that the most casual binocular inspection of load marks on a loaded freighter will generally reveal such a condition. Similar logic underlies this statement of Alex C. Cocke: "Well, you remember very well, and I have told you and many of your staff about the Fabre case. Fabre was rebating. Fabre was paying extra commissions. We spent 6 months on that case. What came out of it? We proved beyond a shadow of a doubt what was happening in Europe, but we did not have the evidence in black and white. We knew what they were doing. We had seen letters and take this as an example. We made the trip on our ships to Genoa in 18 days. Here was a new line that came into the Italian trade. They took 32 days to go to Genoa. On one ship they carried 15,000 bales of cotton. We carried 5,000 bales. Is that not proof enough? But nothing came of it because the Board said that they did not think under their procedure they had the authority to fine or penalize Mr. Fabre. All they did in that case was to say, 'Mr. Fabre, submit your manifests to us with the stipulation that these rates were charged.'" *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 1, at 310. The facts of passenger cartels are different, presumably because of the greater relative importance of services, meals, and entertainment. Passenger conferences are well aware that competition in those dimensions is significant, and try to minimize it.

above the necessary minimum, judged by the interests of the group, and may, in addition, lead to rather more concentration upon speed and other non-price dimensions than would occur if there were no conference at all. This inflation of services is discussed below in connection with the resale price maintenance argument.

Though opinions in the industry differ, the consensus seems to be that rates are the most powerful competitive force, and that the other dimensions of rivalry are not very important.⁸⁷ The consensus seems also to be that no cost savings accrue from conference membership.⁸⁸

IV

THE CONFERENCE FACES THE OUTSIDE WORLD: ENTRY

A. DEFERRED REBATES AND THE CONTRACT PREFERENCE SYSTEM

In their fullest flower, ocean freight rate conferences have often resorted to one or another kind of rate preference system to assure the loyal custom of shippers. By "loyalty" is meant, quite simply, the direction to conference vessels of all, or all of specified kinds of, cargo originating from or controlled by shippers.⁸⁹

The most important of such devices are the deferred rebate and contract preference systems.⁹⁰ In their classic form, both are exclusive agreements or total requirements contracts. The United States Shipping Act of 1916 specifically proscribes the use of deferred rebate systems in the foreign trade of the United States. Deferred rebate systems retain their pride of place wherever permitted: conferences operating in United States foreign commerce may not lawfully use them; elsewhere, the practice is common. As we will see, the conferences prefer deferred rebate systems, though not for the reasons most commonly advanced.

For various reasons, it is important to inquire into the mechanics and

⁸⁷ This is interesting in view of the formal representations of shipowners—as in the Royal Commission Reports—which assert that much rivalry remains in spite of conference agreements to fix rates. It is necessary to point out that one steamship company employee recently told me that great cost reductions would arise if only the lines would rigorously limit and allocate sailings. Their objections to the scheme rest, he believes, upon their short-sighted desire to do the best they can on their own and upon a belief that the Maritime Board would frown on the policy.

⁸⁸ This might mean that non-price competition offsets some economies that might otherwise have been achieved; but this is apparently not what the ship operators believe. Their oral statements better indicate that there are no economies from cooperation in conferences as they are now constituted.

⁸⁹ The loyalty "tie" can be applied to shippers, consignees, brokers, or agents, or to any combination of them. One present difficulty is that shippers may evade loyalty ties by claiming that the cargo was sold f.o.b. or f.a.s. and, controlled by the shipper, is directed to non-conference vessels. For a modern discussion of the f.o.b. and f.a.s. loopholes, see the testimony of Messrs. Dennean and Wierda, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, especially at 391, 347, 353, 358.

⁹⁰ Contract preference systems are often also called "dual rate systems," or simply contract rate systems.

effects of these two types of tying arrangements. First, their status under United States law has, at least until recently, been quite different; we have proscribed the one and embraced the other. Second, it is difficult to analyze conferences without understanding institutions that they have used to achieve or maintain their power.

Deferred Rebate Systems.—Though their details and force have varied greatly, all such systems have one common feature: those shippers who remain wholly loyal to a conference during two succeeding periods receive at the end of both periods a rebate of some fixed proportion of the freight paid to the conference during the first period.⁹¹ Some of these systems provide that a rebate of 10 per cent of the gross freight bill paid during the first half of the year is payable at the end of each year if the shipper uses conference vessels exclusively during the whole year. This can be called a six-month/six-month 10 per cent rebate system, and clearly requires continued loyalty during the second period to validate a claim for those rebates formally accruing during the first. One superficial merit of the deferral feature is that substantial monies are "held" at all times to insure continuing loyalty.⁹² Further analysis suggests, however, that the relevant demand schedule facing the conference is defined by net rates (after return of rebates) and the quantities of shipping services that will be bought at such rates. That is, a system of fines would have the same effects.⁹³

Contract Preference Systems.—Many ocean conferences offer contracts requiring shippers to use only conference vessels in return for which the conference agrees to charge a "contract" rate, which is often 10 to 20 per cent lower than the "non-contract" rate.⁹⁴ Most contracts can be terminated on advance notice by either party, and rates are often guaranteed for periods of 30 to 90 days.⁹⁵

⁹¹ There is no reason why a single firm could not employ the same system, and there is some evidence to suggest that it was so employed in the early days of steamship liner service.

⁹² In the words of Chairman Morse, "It affects too strong a tie on the signatory. His rebate is conditioned on his continuing to utilize the services of the carrier for a period of time succeeding the time when he was to get his deferred rebate so that it is virtually signing the individual up for continuous trade." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 48.

⁹³ I am indebted to Professors Lawrence Fisher and Arnold Harberger for this point.

⁹⁴ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 620.

⁹⁵ Alex C. Cocke, Vice President of Lykes Bros. Steamship Co., but testifying as Chairman of the American Steamship Committee on Conference Studies, gave a generalized definition of such contracts: "(e) 'Contract/non-contract-rate system' (sometimes called the 'contract system' or the 'dual-rate system') is a system based on an agreement between a conference and shipper whereby, in return for his exclusive patronage, the shipper is billed at 'contract rates.' 'Contract rates' are usually 10 to 20 per cent lower than 'noncontract rates.' 'Noncontract rates' are those charged shippers who do not agree to give their exclusive patronage to the conference lines. When a contract/non-contract-rate system is used by a conference, all shippers, regardless of size or volume or shipments, are invited to sign the contract. Most such contracts permit either party freely and without obligation to cancel the contract after giving the other party specified advance notice. They also bind the conference not to increase rates unless it first gives the shipper a certain specified advance notice, often 60 to 90 days or more. If, after a contract shipper has tried unsuccessfully to find space on a conference

If the contract shipper breaks such an agreement by shipping on a non-conference vessel, he is usually subject to damages equal to or some multiple of the freight he would otherwise have paid the conference on the transaction in question. In addition, he must pay the higher non-contract rates for any shipments he makes on the conference vessels during the period of his continuing disloyalty. As of August, 1958, there were 63 conferences in United States-foreign commerce that employed a contract preference system. Of these, 58 provided liquidated damages for contract breach.⁹⁶

The contract preference system is unlike the deferred rebate system in that the benefits of loyalty accrue immediately on each transaction. The higher rates are paid only by those who do not contract to ship solely over conference lines. Loyal performance during a period is rewarded in that period, not in a succeeding one.

Because of this difference in form it has generally been contended that deferred rebate systems impose a tighter hold upon shippers. In fact, this is much less obvious than it may at first appear. A few hypothetical examples will serve to evaluate the contention.

Assume that a conference establishes a deferred rebate system at the beginning of the year. Under its terms, if a shipper remains loyal to the conference throughout the year, at the end of that year, he will receive a rebate of ten per cent of all of the freight charges he paid the conference during the first six months. Take the case of an individual shipper who ships the same volume of cargo each month and each month pays gross freight of \$100 to conference lines. If he remains loyal to the conference through December, he will receive rebates of \$60 (\$10 for each month through June), or, ignoring the impact of a discount factor on deferred receipts, will, in fact, have paid a net freight bill of \$540 for the first six months. Suppose now that, instead of remaining loyal, the shipper makes his July shipment on a non-conference vessel. If again we ignore the effect of a discount factor, he will thereby have relinquished his rebate claim of \$60 and will have paid, on one interpretation, a net freight of \$600 to the conference for the first six months. On another interpretation, he will have paid \$540 freight, and a \$60 fine. To make his disloyalty worthwhile, the shipper must either (1) have gotten a freight quotation from an outsider of \$40 or less for his July shipment alone, or (2) anticipate that outsiders will continue to be willing to offer cargo space to him at rates that will, over time, more than compensate him for the loss of rebates. The latter presupposes, of course, his confidence in the future availability of regular non-conference sailings. If he has no such con-

vessel, and has so notified the conference, and the conference is unable to accommodate him, the shipper has the right to use a nonconference ship without violating his contract. The contracts usually obligate the contract shipper to pay certain specified liquidated damages if he breaches the contract and establish both parties' rights to submit disputes arising under the contract to arbitration." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 277.

⁹⁶ Source: Regulations Office, Federal Maritime Board.

fidence, the freight quotation offered him by outsiders for July shipments must be, *at most*, \$40. What this means, among other things, is simply that the real cost to a casual non-conference carrier of attracting the July shipment is higher than that which must be incurred by the conference to retain it. Given a conference quotation of \$100, and an outside quotation of \$40 for July shipments, the shipper will be indifferent.⁹⁷ Unlike some other devices—predatory price cutting, for example—which are commonly supposed to be exclusionary in character, the real merit of deferred rebates is that they impose greater costs upon the entrant than upon those who seek to exclude him.⁹⁸

Take now the case of an identical shipper who is confronted with a contract preference system, instead of a deferred rebate system, and accepts it. Assume the same volume and regularity of shipments and a contract which provides an immediate ten per cent freight discount to those loyal shippers who sign and honor it. Each month, from January through June, he pays the conference lines

⁹⁷ This quite ignores the inevitable costs to the shipper of changing sources of supply of his services, as well as the possible retaliation that he may suffer if, at some future time, he must use conference vessels. In the early 1900's, there were some allegations that conferences denied shipping space to shippers who previously had been disloyal, or threatened to do so. There have been rate contracts that, upon breach, provide that the shipper pay the conference the non-contract rate upon *previous* as well as future shipments. See, e.g., the dissenting opinion of Mr. Justice Frankfurter in *FMB v. Isbrandtsen Co.*, 356 U.S. 481, 517 (1958), referring to *Far East Conference v. United States*, 342 U.S. 570 (1952).

⁹⁸ Compare McGee, *Predatory Price Culling: The Standard Oil (N.J.) Case*, 1 J.L. & Econ. 137 (1958).

This logic suggests that the frequent, but vague, allusions to "fighting ships" are more romantic than real. Most such references are to the Syndikat Rhederei, a Hamburg group that, about 1904, is alleged to have employed four trampships as a disciplinary or predatory force. I have not been able to verify these claims, and am inclined to doubt them. See also, 4 *Alexander Comm. Rep.*, *op. cit. supra* note 10, at 45, 225; 1 *id.* at 177, 422, 433-34, 605, 608.

Two statements made before the Alexander Committee are especially interesting in this context. Mr. Chester Kellogg, General Freight Agent of the Munson Steamship Line testified as follows:

"MR. WILSON: As a matter of fact, could not the corporations that had 10 charters available put the individual tramp ship out of business by simply lowering the rates for cargo, having 9 other vessels available with which to handle the business?"

"MR. KELLOGG: It could not.

"MR. WILSON: Would not they have 10 times the opportunity for cutting that the one tramp ship would have?"

"MR. KELLOGG: They would have 10 times the opportunity of losing the money also . . . if the 10 ships tried to fight the 1, the 10 ships would all have to take the low rate of the 1." 1 *id.* at 660.

Mr. W. G. Sickel, Vice Director in Charge of Traffic for the Hamburg-American Line, summed up his knowledge of the Syndikats-Rhederei in these words: "Well, to tell you the truth, I do not know many times that the Syndikats-Rhederei has been called upon to exercise its fighting abilities, except once to my knowledge, in the trade between the continent of Europe and Cuba and Mexico. . . . My recollection of that is the interests that were competing with the conference lines engaged in that trade finally admitted the man who wished for an entry into the trade, even though the fighting ship was on. I refer to Menzells, who made an effort to engage in that trade. The fighting ship was used, and he is in it to-day, working with the conference. That is a case where the fighting ship was not an effective tool." 2 *id.* at 829.

freight charges of \$90. His total net freight bill, if he is loyal, will have been \$540, the same as in the previous example. Suppose that, in July, he wishes to break his conference contract by shipping on an outside carrier. It may at first be supposed that he will find this alternative worthwhile so long as the freight quotation of the outside carrier is less than \$90. That supposition ignores the common provision of liquidated "damages," which are payable to the conference upon breach of contract.⁹⁹ If such damages are as great as \$60, the shipper—and the outside carrier—finds himself in precisely the same position as under the deferred rebate system discussed above. If, as is common, liquidated damages are equal to the freight he otherwise would have paid the conference lines on the outside shipment—in this case, \$90, at the lower contract rates—the shipper and outside carrier would be worse off, by \$30, under the contract system than under the deferred rebate system.¹⁰⁰

Why, then, do ship operators prefer deferred rebates to dual rates? The reason is simple and has little to do with arithmetic. Under deferred rebate sys-

⁹⁹ See, e.g., *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 458-59.

¹⁰⁰ Without rigorously establishing a more general analytic framework for comparing the net costs to shippers of defecting from deferred rebate, as compared with dual rate contracts, we can point out the variables that influence the result: (1) Time of breach relative to the period of the contract. (2) The time distribution of shipments. (3) The rate of "discount" under the contract system as compared with the rate of deferred rebate. (4) The method of calculation and, therefore, the amount of liquidated damages under the contract rate system.

Matthew S. Crinkley of Isbrandtsen claims that the higher non-contract rate is a penalty or fine. As he testified: "I do not call it a reward at all. I say that for two or three reasons. In the first place, you talk about a dual-rate system so you set up two rates. In one trade where we fought this particular system, the rate that was currently in effect as the tariff rate . . . , the rate that had been paid right along, became the contract rate and they arbitrarily took a rate up about 20 per cent higher as the noncontract rate. That is the simplest illustration I can give. There is no reward there. It was just an undertaking by the conference that they would not crack these fellows over the head with 20 per cent higher rate if they did not agree to confine themselves to conference shipping." *Id.* pt. 1, at 211. Further, in Crinkley's words, "I can tell you that now. That was in the trade between U.S. North Atlantic ports and continental Europe.

"In October 1948, they had not used the conference contract system since World War II and they made a public announcement that effective on November 1, 1948, they were going to institute the conference contract dual-rate system and that the tariff rates which theretofore had been quoted would become the contract rates and the conference was setting up a tariff on which noncontract rates were shown and they were calculated at about 20 per cent higher.

"Incidentally, we filed complaint and went into a district court to get an injunction against the institution of that contract system. One was granted predicated on our going to the Maritime Board and filing complaints and having hearings, which was done.

"The Maritime Board approved the use of the conference contract system whereupon we appealed that back to the Federal District Court which ruled in our favor, whereupon that decision was appealed to the Supreme Court and the Supreme Court ruled in our favor. I believe that was January 24, 1951." *Id.* at 214.

Mr. Donald I. Wierda of the United States Lines Company had a slightly different version of the affair. In his words, "In 1948 I believe that the Conference, when it announced this contract system which it never put into effect, announced that the noncontract rates would be 20 percent higher than the contract rates; but when the actual contract was placed into effect 8 years later, there was a reduction in the tariff of 10 per cent." *Id.* pt. 2, at 366.

tems, the burden of claims for rebates and substantiation of continued loyalty falls upon the shipper; in the case of breach of a dual rate contract, the conference is obliged to prove it and, in the limiting case, to sue for liquidating damages. Sir James L. MacKay, Director of the British India Steam Navigation Company, saw this quite clearly. As he put it, in 1908, contract systems are inferior to deferred rebates, for, "I should think it would be much more troublesome. If a man broke his contract and shipped by an outside vessel, I suppose you would have to sue him; whereas now you do not put him into Court, you simply withhold the discount that he would get otherwise."¹⁰¹ American ship operators, long used to contract systems, today recognize this difference, and would much prefer to use the deferred rebate system that is denied them by law.¹⁰²

The more difficult question is why law favors the one technique and forbids the other, when the two systems can be made analytically equivalent. Apart from the possibility that people are easily fooled, there does not seem to be a simple explanation.¹⁰³

A fundamental problem remains. Though both systems are obviously designed to secure shipper loyalty, not all loyalty ties are incompatible with competition. All contracts are to some extent restrictive. To discover whether the types of loyalty ties employed by conferences are inconsistent with competition, or aid in suppressing it, it may be helpful to see what form such ties might take under competition. Assume that there are several independent liner firms serving a given trade. Assume further that there is no conference and no agreement on rates, loyalty arrangements, or any other aspects of their business. Each of the liner firms unilaterally offers a regular service; the service of all taken together is frequent as well as regular. As is generally possible in any business, each liner firm may be able to reduce costs by reducing uncertainties.¹⁰⁴ If each line offered contracts by which shippers guarantee to purchase

¹⁰¹ 40-IV R.C.R., *op. cit. supra* note 2, at 265.

¹⁰² The statement of M. S. Crinkley, of Isbrandtsen, suggests that the problem of enforcing contracts is a real one. In his words, "I call attention to the fact that in the more than 25 years this practice has been used that only on two occasions did the steamship conferences operating on American foreign trade routes attempt to enforce their contracts through the courts. In both instances they lost. In both instances they appealed the decisions to the Supreme Court of the United States and that body refused to hear the appeals, and thus upheld the decisions of the lower courts." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 208.

¹⁰³ Even Chairman Morse is somewhat unclear on this subject. In his words, "I think without question the deferred rebate is a much more effective weapon than a dual rate. Just why it is, I am not sure I could explain clearly, but it is my distinct understanding that the dual rate system is much more effective in controlling shippers." *Id.* at 59.

¹⁰⁴ As Stigler has pointed out, "We customarily find in entrepreneurship the limitation to the size of firm, and we find the chief tasks of the entrepreneur arising out of uncertainty. Much, although of course not all, uncertainty stems from the competitive behavior of rivals, so that entrepreneurship may well be subject to increasing returns to relative size as well as to decreasing returns to absolute size, with no clear verdict for either force over a wide range

certain minimum amount of space, it might thereby reduce uncertainties. Reducing uncertainties might lower costs. To enforce the agreement, liquidated damages could be used, as in the case of any contract. Some inducement would, of course, have to be offered shippers if they are to relinquish access to the "open" market. Rates would be lowered to reflect any cost savings resulting from greater certainty. Thus those who agreed to buy a specified amount of space could obtain a lower rate; those who did not would have to pay a higher rate. In one sense, such an arrangement would be analogous to quantity discounts.¹⁰⁵

Similarly, total requirements contracts, which do not specify the amount of space to be taken but simply provide that all of a shipper's goods will be sent via the contracting carrier, to some extent would reduce uncertainties. Each line could independently make such contracts with shippers and thereby become much more certain that they would not defect to competitors during the term of the contract. Nevertheless, fluctuations in the demand for shipping space would remain.

Even so, when such contracts are not made cooperatively, when there are numbers of competitors competing freely for customers' contracts, and when the contracts are of relatively short duration, there are not very serious objections to be raised against them.¹⁰⁶

Loyalty schemes under conference organization go very much further, yet lack some of the desirable features that would be expected from "competitive" requirements contracts. In the first place, the rates and other contract terms are fixed according to cartel principles, not competitively. There is thus no guarantee that the level of structure or rates will bear that close relationship to costs as would be found under competition. Indeed, there is every reason to believe that cartels will use their power to enhance rates and profits. Competition is the only guarantee that a loyalty scheme rests upon cost savings rather than exclusionary motives, and that cost savings will inure to those who are responsible for them. Conference organization is *itself* incompatible with com-

of sizes." Stigler, *Monopoly and Oligopoly by Merger*, 40 AM. ECON. REV. 23 (1950); reprinted HEFLEBOWER & STOCKING, A.E.A. READINGS IN INDUSTRIAL ORGANIZATION AND PUBLIC POLICY 79 (1958).

¹⁰⁵ In discussing the total requirements contracts found in *United States v. American Can Co.*, 87 F.Supp 18 (N.D. Cal. 1949) (a Sherman Act case), James McKie says: "American Can had presented convincing evidence that requirements contracts are necessary to protect food canners, in view of the great uncertainty of crop yields and timing, and that canners preferred them to fixed-quantity contracts; hence the court did not prohibit them altogether." McKie, *The Decline of Monopoly in the Metal Container Industry*, reprinted in HEFLEBOWER & STOCKING, *op. cit. supra* note 104, at 102. (Emphasis added.) The court *did* limit such contracts to one year.

¹⁰⁶ Mr. Robert Bicks of the Antitrust Division of the Department of Justice has said that "I think it would be possible to draw a so-called dual rate system in the form of a standard requirements contract that would stand up under the antitrust laws." *Bonner Comm. Hearings*, *op. cit. supra* note 10, at 186.

petition, however admixed may be the motives for loyalty ties. Second, not only do those firms that are *now* in the market cooperate to suppress competition among themselves, but the "all-or-none" option presented to potential *entrants* reduces the number of alternatives open to shippers over the long pull.¹⁰⁷ Third, the theoretic cost savings attributable to the device are likely to be illusory in practice. The present conference contracts do not specify minimum quantities of shipping space that will be paid for by shippers. As a consequence, considerable uncertainties remain even if we consider the conference as a whole, since fluctuations in the shippers' business linger on to trouble all parties. For this reason, the cost-savings argument for loyalty arrangements is less powerful than if quantities were specified. The North Atlantic Continental Conference contract is unique in that it does guarantee to lift cargo and guarantees rates for six months. But even that one does not specify quantities.¹⁰⁸ Furthermore, it is the individual member firms that bear the risks and costs of output fluctuations; the conference is not a separate risk-bearing and cost-minimizing firm. And although loyalty schemes may somewhat reduce the output fluctuations of the conference group taken as a whole, they are consistent with substantial fluctuations for individual lines: the loyalty contract is honored when the shipper uses *any* of the conference lines; it does not require loyalty to any single one of them. Shippers thus retain an essentially costless option to scatter their custom among the lines and to shift from one line to another. Only in the case of thoroughgoing pooling, or single-firm monopoly, can the cost-savings argument be very convincing. Neither case is typical in conferences serving United States trade. Finally, as will be seen later, the cost-savings argument is, essentially, based upon a diminution in output fluctuation; and there are other features of conference organization, notably rate rigidity, that appear to be somewhat inconsistent with that result.^{108a}

B. CONFERENCES DEALING WITH BLOCS

It is conceivable that in some markets blocs, of sellers may face blocs of buyers, and negotiate prices which are mutually acceptable but which may nonetheless have serious broader repercussions on entry and competition. Much of the foregoing analysis suggests that the public interest is not ideally served by cartels. Yet it is also clear, from the various public inquiries made in this and other countries, that many shippers, at least, have found little to complain

¹⁰⁷ See *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 2, at 634-35.

¹⁰⁸ See *id.* at 347, 351, 366.

^{108a} See statement of Chairman Morse, who favors some form of the conference system: "My personal philosophy is that the purpose and intent of a dual rate contract is to garner all shipments of every character by the conference line . . . the purpose an intent of a dual rate system is to drive out nonconference competition." *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 2, at 634-35.

of in the conference system. Some, indeed, have supported it warmly. It is also clear that other shippers have opposed the conference system strenuously. This split in shippers' opinion has been somewhat puzzling to those who predict that the purchaser of anything should prefer that it be produced under competitive conditions, since it will generally cost him less.¹⁰⁹ The possible explanations for the support that some shippers have given can be attributed essentially to these main causes: (1) Rightly or wrongly, they believe that the services they want could not be furnished as well in the absence of a conference system. This is essentially a resale price maintenance notion which is discussed in some detail below.¹¹⁰ (2) They may in effect be partners with the conference so that for any rate cut their gains as shippers must be balanced against their loss as participants. (3) Even though not "partners," some groups of shippers may enjoy special treatment which pleases them, yet which has unfortunate implications for other classes of shippers or, more importantly, for the public interest. (4) As is probably true of some industrial cartels, shippers who achieve or increase monopoly power *because* of the rate stability or other policies of

¹⁰⁹ Mr. Morse, Chairman of the Board, testified that "The Board receives each month about 150 to 200 informal complaints and protests and requests for information, advice, and assistance from shippers, receivers, and others having to do with the rates and practices of carriers in our foreign trade, both conference and nonconference. These informal complaints and requests for aid and advice all receive attention. However, the Board's regulatory staff is limited and, as a result, questionable practices usually come to light only when attention has been directed to them by outside inquiry or complaint." *Id.* at 6.

The following excerpt from a letter written by Mr. Lloyd Tibbott, Chief of the Regulations Office of the Board, to Representative Bonner explains the nature of the "complaints" received: "On February 26, 1959, I testified before your committee in its steamship conference study. In the course of my testimony I referred to informal complains and protests received by the Regulation Office and to requests from shippers and carriers for information concerning conference agreements. At this point you asked how many complaints a year we received from shippers against conference practices. I replied that we probably get about a thousand during the year, one way or another.

"After reading the transcript, I now feel that my reply was unintentionally misleading. The staff of this Office receives and handles 1,000 or more inquiries and requests from shippers, carriers and others during the course of a year. However, the bulk of these are not complaints against conference practices. Many of these inquiries are in the nature of requests to be advised as to specific provisions which appear in rate tariffs or conference agreements and regulations, or for interpretations of these provisions, without any indication that the person making the request is dissatisfied or is complaining or protesting the rate or provision.

"Probably less than 200 of these could be properly characterized as complaints . . . against the practices of forwarders, terminals and common carriers by water in the domestic offshore trades as well as informal complaints against the rates and practices of steamship conferences in the foreign trade. Only about one-half of the total informal complaints received are in the nature of complaints against conference practices in the foreign trade. My reply should have been that we receive a little over 100 complaints during a year against conference practices in the foreign trade.

"I deeply regret any erroneous impression which may have resulted from my answer to your question, and I hope that this letter will be accepted in correction of the record." *Id.* at 72.

¹¹⁰ See p. 279 *infra*.

carriers, have a special interest in supporting them.¹¹¹ (5) Though it does not satisfactorily explain why some shippers volunteer to *applaud* the conference system, fear of retaliation may account at least for the reluctance of some shippers to denounce it.

The general merits of stable conference rates and regularity of service to all shippers have not yet been discussed.¹¹² The intimidation theory of shipper reticence is difficult to test and will therefore be ignored. The merit of stable rates to shipper cartels is, perhaps, obvious, but difficult to illustrate for ocean shipping.

The present discussion is therefore confined solely to the participation of shippers as partners in the conference system, and to the special status enjoyed by some strategic groups of shippers. Whatever the present extent and importance of these relationships may be—and, for obvious reasons, this is exceedingly difficult to determine—they apparently explain a number of early instances of common interest.

Perhaps the most famous example is that of the early Baps Ring, a group

¹¹¹ It is unfortunate that the following line of testimony could not have been developed more fully. In any case, whether this testimony describes a cartel or not, it does illustrate the problem. Speaking for the National Association of Alcoholic Beverage Importers, Harry L. Lourie praised the "stability" that negotiated conference rates bring to their trade. As he testified, "May I take another minute of the committee's time to explain that under the very rigid system of control which the U.S. Government as well as the 47 States which permit the sale of liquor—and Oklahoma is voting today and we will find out about that tonight—many States will not allow the sale of wines or spirits without posting prices. They have price controls.

"I leave it to the imagination of the members of this committee and your economic advisers to determine the situation the importers would be in if we were subject to fluctuating rates for freight or insurance or all the other things that make up a base cost and had to post prices to carry out these fluctuations in these different States. It would be an impossibility. . . .

"We think it gives us stability and I may cite one example which proves it. In August 1939, when the war was imminent and the British pound began to decline, our original rate with this conference was in pounds. It happened to be 55 shillings for a measurement ton of 40 cubic feet. The British pound fell very sharply as you know. We had a clause which called for arbitration or renegotiation in case the pound varied more than 10 percent from an arbitrary value of \$5, I think. We called a meeting of the conference here in New York and told them that we were not in a position to waste time trying to negotiate a new rate.

"We promptly offered to convert the contract from pounds to dollars at the rate which was in existence on the day the contract was signed, because *we wanted to avoid the impossible competition which would arise if one man happened to make his freight shipment on the day when the rate of the pound was favorable and another fellow might have made it on the day when it was unfavorable.*

"*Certain things should be the same. Freight rates should be the same for everybody in any part of the commerce of the United States. The freight rate is set by the ICC on that premise. It should be so on the ocean.*" *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 420. (Emphasis added.)

Both the Royal Commission on Shipping Rings and the Alexander Committee concluded that many shippers feared conference retaliation; some declined to testify, allegedly on that account. See, e.g., Mr. Justice Frankfurter's dissent in *Federal Maritime Board v. Isbrandtsen Co.*, 356 U.S. 481, 500 (1958).

¹¹² See p. 208 *infra*.

of Rangoon rice millers operating in the early 1900's. Export of rice from Rangoon was heavy and, apparently, largely controlled by Baps. The Ring controlled enough cargo readily to charter. If they chartered it would mean not only the loss of rice cargo to the conference—or at least a competitive determination of rice rates—but the certain evolution of competition for general cargo. Outside ships calling for rice would find that, with this substantial "core" cargo, general merchandise could also profitably be picked up. To prevent that, the conference had to "pay" Baps for abandoning the charter market and using only conference vessels. In exchange, the conference shipped rice only for Baps.¹¹³

A somewhat similar case arose in the Straits-Homeward Trade. In 1896 some 20 to 30 conference lines made a side agreement with three large merchant companies, the result of which was to make ship owners and merchants partners in monopoly. Indeed, the agreement was a necessary condition to establishing a solid conference in the first place.¹¹⁴ The same kinds of arrangements were alleged to exist in other trades. C. P. Smith, for example, said of the South Africa Merchants' Committee that, "I was given to understand that they were more or less a buffer for the steamship companies, and that they got a *quid pro quo*."¹¹⁵ George Lambe, a produce broker, claimed the same of the China trade, when he asserted that:

... the London Chamber of Commerce in the China section has in it those large firms whose interests are quite as much bound up with the shipping trade as agents for the shipping companies as they are in the freight which they pay. . . . I do not wish to be invidious, but there is no large firm in China, or very few of them, but what are agents for the steamship companies. . . . It is not to their interests to upset these transactions. . . . Their interest as customers is outweighed by their interest as agents. . . .¹¹⁶

Tozer asserted that Liverpool brokers were effectively partners with the shipping monopoly;¹¹⁷ Batty, Managing Director of the two West African Trading Companies, testified that commission merchants in the West African trade shared in the pecuniary benefits of the Conference monopoly, and thus had the best of all reasons for supporting the system.¹¹⁸ In the Ceylon trade, shipping agents got one-half of the rebates;¹¹⁹ and "A great many [of the merchants] are agents for steamships. . . ."¹²⁰ In the West African cotton trade, it developed that Sir Alfred Jones, a leading conference shipowner, was also

¹¹³ In 1907, Mr. Arthur S. Gladstone and a Mr. Bibby, appearing before the Royal Commission, engaged in an interesting exchange over the merits and consequences of Baps. See 40-IV R.C.R., *op. cit. supra* note 2, at 79, 293.

¹¹⁴ *Id.* at 10, 14, 15, 22, 178-78, 202, 271, 293. See also 39-III *id.* at 108, 111. Another such partnership arrangement was operative in the Australian outward trade. See 40-IV *id.* at 269, 277.

¹¹⁵ 39-III *id.* at 136.

¹¹⁸ *Id.* at 240.

¹¹⁶ *Id.* at 147.

¹¹⁹ *Id.* at 260.

¹¹⁷ *Id.* at 224.

¹²⁰ *Id.* at 272.

president of the British Cotton Growing Association,¹²¹ which fixed cotton rates in conjunction with the conference.¹²²

In view of the number of such agreements that appear in the early history of steamship conferences, and the obvious private benefits to be gotten from them today, it is not surprising that they may still be with us.^{122a} The recent testimony of Mr. Dice, of the Department of Agriculture, and Mr. Cocke, of Lykes Bros. Steamship Company, among others, shows that now, just as early in the game, groups of shippers find it advantageous to bargain collectively with shipping conferences.¹²³ As a consequence, it would be prudent to inquire closely into the status of all shippers or manufacturers expressing opinions of the conference system. All of this is not to prejudge the sincerity, or validity, of shippers' appraisal of conferences, but only to aid in evaluating it.

Finally, and most important, there is no reason to suppose that combinations of shippers or brokers facing conferences will have socially beneficial results. It is well established, in both theory and history, that bilateral monopoly produces far from an ideal outcome. As the very able Royal Commissioner Gonner said in 1907:

Supposing there was a combination or rather a negotiation between the ship owners and the merchants, you get these two parties interested, namely the merchant who wants to ship the goods and the ship owner who is to carry the goods; and they combine to determine the rates. Have you thought of what the effect might be on the party who is not represented, namely, the consumer—because, after all, I suppose the consumer is the person who benefits or suffers most by alterations in price? . . . I am bound to say that I think there is a good deal to be said for the view that the consumer is not always able to take care of himself . . . and that he does suffer very much, by alterations in the price . . . the interest of the consumer is really an important interest, and that it might be neglected, even if you get agreements between shippers and ship owners, because the consumer might not be represented, and you might so arrange matters as to take him out of one form of monopoly into another form of monopoly, and you would have two parties in the ring instead of one party in the ring?¹²⁴

This is an opinion well worth consideration today. For the common good is broader, and often different, than the interests of buyers and sellers. Where monopoly exists, that which serves the latter may injure the former. This obvious truth is reason enough to make shippers' interests only the beginning of an inquiry into conferences, rather than its end.

¹²¹ 40-IV *id.* at 34. See also 39-III *id.* at 250-51.

¹²² In the United States the Cotton Shippers' Association each season negotiates with the conference to determine the cotton rate. See the enlightening testimony of Mr. Alex Cocke of Lykes Bros. Steamship Company. *Bonner Comm. Hearings, op. cit. supra*, note 10, pt. 1, at 268, 297, 307, 308, 311, 312. See also *id.*, at 317, and pt. 2, at 495, 515-16, 593, 595.

^{122a} See the testimony of Cocke, Bonner Committee Hearings, *op. cit. supra* note 10, at 268, 307-308, 311, 312, and 317.

¹²³ *Bonner Comm. Hearings, op. cit. supra* note 10, at 593, 595.

¹²⁴ 39-III R.C.R., *op. cit. supra* note 2, at 47.

C. ENTRY

Like other businessmen who have developed moral outrage against those who compete with them, conference supporters early perfected—and still adhere to—a code of ethics that leaves no place for tramps. As one able advocate put it: "The tramps are eager to share in the business that the liners have cultivated—but without enduring the dust and heat; moreover, tramp owners are not concerned for those interests of merchants and shippers that are protected under the Conference system."¹²⁵

With the rationale came the instrument: deferred rebates were principally directed to exclude the tramp or casual operator;¹²⁶ as well as to avoid the casual competition of even a large shipping firm.¹²⁷ Unless the liner firm sought uni-

¹²⁵ 39-II *Id.* at 49. The same attitude exists today. Trade unionists depreciate "scabs," retail trades in which resale price maintenance has been strong—as in liquor and drugs—decry "price-footballers;" the regulated railroads and airlines oppose "cream-skimming" and the present-day ocean conferences denounce the "opportunistic," "piratical" and "cut-rate" practices of non-conference liners and tramps. In a statement prepared for the Bonner Committee Mr. Solon B. Turman, President of Lykes Bros. Steamship Company said: "In simple terms, this mutuality of interest [fortified by a contract preference system] has in effect bound the conference lines and the shippers together against the opportunistic practices of nonconference cutrate ships." Furthermore, "these tramp ships complicated the operations of liner companies by introducing instability of volume as well as rates." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 657-58. In this field, as all others, competition "complicates" the life of those who are used to less of it. Alex C. Cocke, Vice President of Lykes Bros. Steamship Co., put the matter more colorfully when he said: "immense damage to shippers, shipping companies and our foreign commerce is caused by these nonconference lines which try to *free-ride* constantly just beneath the conference-rate umbrella in order to obtain more cargo than they would carry if they accepted the responsibilities of conference membership." *Id.* pt. 1, at 260. (Emphasis supplied.) "[T]hey take the calculated risk that their parasitic rate practices will trigger a rate war." *Id.* at 263.

Mr. Bicks of the Antitrust Division of the Department of Justice summed the matter up in these words: "Mr. Tollefson. Is it not possible that the dual-rate system conceivably could be intended to meet outside cutrate competition?"

"Mr. BICKS: Well, Mr. Tollefson, any competition which people in an industry do not like is called cutrate. We have seen this in our whole pattern of retailing distribution. When discount houses opened 10 or 12 years ago, established retailers argued that discount houses were cutrate, somehow less reputable, somehow less worthy of access to the market and to consumer favor.

"However, the essence of our free competitive enterprise system is that every form of distribution like every form of shipping is entitled to gain acceptance in the market-place on its own merits. Neither Government regulation nor restraint by private groups should bar such entry. That is the theory of our free enterprise system. *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 171.

¹²⁶ 40-IV R.C.R., *op. cit. supra* note 2, at 140. See also testimony of Holt, *id.* at 169; testimony of Nelson, *id.* at 44; and testimony of Sutherland, Chairman and Managing Director of the P. & O. Company, "To put the matter quite clearly and openly, the Conference system and the rebates exclude fairly what you might call the casual competition. Without the rebate system, you are liable to have a state of chaos; with the rebate system, that casual competition which would throw things into a state of chaos is excluded. *Id.* at 275.

¹²⁷ See testimony of Booth, 40-IV R.C.R., *op. cit. supra* note 2 at 313; testimony of Cocke, *id.* at 312.

laterally to provide in that trade a fully competitive regular service; it could be excluded.

This is the severe test of any cartel: the problem which is posed by the arrival, or growth, of outside supplies. As a consequence, many economists have remained untroubled by cartelization in fields where entry will be massive and quick on the grounds that competition will as rapidly accomplish as much as any sensible social policy aimed at the evil, and will involve fewer costs and dangers.^{127a} Cartels that partially or completely solve the problem of entry are clearly, therefore, more important and injurious. Shipping conferences, like some other cartels, have sometimes been blessed by the existence of more or less "natural" inhibitors, into whose character we will now inquire.

One barrier to competition is the smallness of a market. A small market will support fewer firms than a large one; and the attractiveness of entry will be reduced if it must occur on a scale so large relative to the market as to have markedly adverse rate effects. One example was apparently the North Brazil-United Kingdom trade, about which Mr. Booth said in 1908: "... it was the very smallness of the trade that protected us prior to 1895, I think, sufficiently without the rebates; because the outward cargo was extremely small, and the homeward even smaller. The protection that we still have is the extremely small quantity of homeward cargo from North Brazil."¹²⁸

Even today, there may be trades relatively so small that entry is unlikely, presuming that the conference does not badly overreach itself. One example seems to be the United States Gulf Coast trade with the West Coast of South America. Markets can be defined both in terms of production and demand; the usual test being relatedness in demand. Production relations can also be important, notably in the instance of a large number of relatively small ports that must be served if sea transport is to be carried forward economically. The implications can be seen best by analyzing two hypothetical examples of "natural barriers." Both examples illustrate the existence of economies of large size, where size is defined relative to the market.

Homogeneous Services.—Assume, for simplicity, that in a given trade¹²⁹ only one kind of transport service—regular and scheduled—is demanded by many shippers; no one of whom can, within his own cost and demand con-

^{127a} This contention rests more solidly upon worries about fateful changes in the posture of government toward business than upon the problem of relative costs involved in the two alternative remedies. For, if the cartel erosion is complete, there will be a period of general overcapacity, in the social as well as private sense, that might theoretically have been avoided if only the cartel could have been prevented or dissolved at the start.

Furthermore, if there is a presumption of business intelligence, cartelization will take place in the first instance only where it has some high probability of moderate to long life.

¹²⁸ 40-IV R.C.R., *op. cit. supra* note 2, at 313. A pithier summary of the same state of affairs, in another trade, is the following: "There is not room for more than one regular line of steamers [in the Falkland Islands trade]." 39-II *id.* apps. pt. II, at 173.

¹²⁹ Defined in economic terms so that, in the short-run at least, there are no close substitutes.

straints, load a whole ship at one time. Furthermore, assume that there are several ports that must be served to load a ship economically. An additional constraint could be seasonal¹³⁰ or geographic¹³¹ fluctuations in demand for shipping. Under such circumstances, the requirements of scheduling could create marked economies in the use of a "pool" of ships.¹³²

If the cartel achieves all of such economies, or more of them than would be achieved by a smaller bloc of capacity, it is entirely possible that entry would not occur. For newcomers to compete effectively might require such a large new bloc of capacity that it would depress rates too far to make entry attractive. In such a case the cartel might rationally resist admission of newcomers, since they would not be able to enter the trade without access to the central pool of ships and the economies that it makes possible. Under these circumstances, it would be fatal to be denied admission to the cartel. This would be analogous to classic "bottleneck" monopoly, which would be stable unless the total market grew large enough to support new and efficient firms.

Heterogeneous Services.—It will now be useful to supplement some of the assumptions of the previous example. The first example shows why a certain kind of economy of size may exclude outsider liner companies from a market in which there is no demand for tramp shipping. The present example shows how certain kinds of economies may exclude trampships from markets in which there is a demand for their services, as well as for those provided by liners. Assume that on the relevant route there are demands for both (liner and tramp) types of services. For some shippers, the two types of services may be perfect substitutes; for others they may not be substitutes at all, or very poor substitutes. If the quantity of tramp service irregularly demanded is small, or if it is scattered among several ports, tramps may not find it attractive to enter the trade. Put in another way, there is no room for tramps qua tramps; and liner entry may be barred by the factors previously discussed.

There is another possibility. Although the *demands* for regular and irregular service may very well be independent,¹³³ their respective cost functions may not be. If the conference liners have more than enough capacity to carry both those commodities which demand regular calls and those which do not,¹³⁴

¹³⁰ The demand for shipping would then not be uniformly spread over the year, so that at least on some parts of the route there would be peaks and troughs. A particularly important condition would be that for the route as a whole there is no significant seasonal fluctuation, but for small "pieces" of it, there is.

¹³¹ So that the percentage of total shipping demanded by any one port (or group of ports smaller than the total) varies over time.

¹³² Similar economies are said to have arisen from the centralized control of a large pool of railroad sleeping cars. See Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception*, 22 U. CHI. L. REV. 157, 173-74 (1954).

¹³³ That is, neither competitive nor complimentary.

¹³⁴ This assumes, not unreasonably I would guess, that the "irregular" demand does not require regular service, but can be satisfied by it. There may be cases in which this is not true.

they would top off regular cargoes with irregular ones; and would accept, if need be, any rate which covers the marginal costs involved. In the short run, costs of carriage would favor the combination of irregular and regular carriage in liner service. It is enough that the costs of providing the two types of service together are less than those of providing them separately. An even stronger barrier would exist if the total costs of supplying both types of service were only a little larger than supplying only one of them. Since this cost interdependence could certainly be reflected in rates, independent tramp operators would find it difficult to break in.¹³⁵ It would be especially difficult if, at the same rates, shippers found the cartel services more desirable than those supplied by the tramps.

In sum, it is conceivable that tramps cannot enter without providing what amounts to liner services as well; and entry into liner service may be estopped by the relationship between costs and size.

As interesting as these more or less "natural" monopoly possibilities are, they are merely hypotheses for which confirmation generally seems missing in the real world. Indeed, there are at least two reasons for rejecting them as general explanations. First, there are many purely liner companies—offering regular scheduled berth service but no tramp service—and many purely tramp companies that offer no liner service. Second, many shipping conferences have not relied wholly upon natural barriers to entry. Instead, various institutional arrangements, the two most important of which have already been discussed, have been perfected.

Though size economies evidently do not serve as general explanations of why entry does not destroy conferences, they may nevertheless explain why tramp ships are of little or no influence in certain general cargo trades. For the tramp ship, the port is the market; in a liner service dedicated to many small ports, the trade as a whole is the market. Put in another way, each "market" is so small as to exclude the transient tramp as a regular force; to provide a regular trade requires stringing together several small "port-markets." It is in such trades, with or without rebates or dual rates, that tramp competition will be less likely to appear; and this aggravation will be greatest when the number of ports, and length of route, is greatest.¹³⁶

In the case of the trade between the United States Gulf and the West Coast of South America, such conditions apparently now apply. There are no railroads, few roads, and ports are small and fairly numerous. The American carrier in the

¹³⁵ It might be thought that tramp ship costs of satisfying irregular demand are enough lower than those in the cartel to overcome this apparent disadvantage, and that is possible. But operating costs are only part of the story. When it is necessary to consolidate many irregular shipments, or to call at several ports, costs of consolidation and near-scheduling will be involved. Much of the costs of this kind have already been met by the cartel for its regular services, and incremental costs may be very small for its members.

¹³⁶ See statement of Sir Ralph Moore, 39-III R.C.R., *op. cit. supra* note 2, at 244, 254; statement of William E. Halm, 1 *Alexander Comm. Rep.*, *op. cit. supra* note 10, at 283.

trade employs four ships serving fifteen foreign and five domestic ports. Average voyage turnaround time is 58 days, 26 at sea and 32 in port. This operator calls at ten or twelve ports in Peru alone. Four lines operate in the trade: a Danish line, and the national lines of Columbia and Chile. There is virtually no non-conference competition, and the Chilean line pools with the American operator. The obvious problem of market size and indivisibility is complicated by problems of providing lightering service. Finally, there are local government restrictions on the eligibility to carry cargoes that they control, and this would be a further bar to outside competition. Full scale entry of an outside liner service is difficult in such a trade. It is nevertheless significant that the conference employs a contract preference rate system, which indicates that the "natural" barriers are not wholly to be relied upon.

Though they are, in reality, only special cases of market smallness, several other factors should be mentioned. Among them are the perishability of cargo, stowage characteristics that remove any real possibility of cargo-lot carriage, and the more or less constant—as opposed to seasonal—dribbles of cargo that characterize much of mercantile trade and even some agricultural movements. Of all of these, perishability is the most obvious constraint; for perishable cargo is, by definition, incapable of being stored to await transport bargains, or, often, even of being held till enough cargo is assimilated to make up a full shipload.¹³⁷ Even in the case of mahogany logs, perishability was apparently a problem: worms rapidly ruined the product in the dampness of the dock; it needed quick dispatch, often for relatively small quantities.¹³⁸ A similar problem is said to have arisen in the case of Ceylon tea and malt.¹³⁹ Although the physical problem of perishability is not now as important as it once was, there remain the costs of overcoming it, and the specialized capacity needed to do so. Such capacity may be more congenially employed in the special trades that warrant it, and may not be acceptable for general tramp usage.¹⁴⁰

There is the additional, and allegedly important, circumstance that shippers and consignees may be very numerous and the average parcel relatively small. In such cases, they may be effectively foreclosed from the tramp ship market.¹⁴¹

¹³⁷ If ports are large, in the sense of generating large volumes of cargo over a short interval, perishability will not necessarily cause such a problem. Even so, there may be, as in the case of frozen and chilled cargo, problems of availability of specialized cargo carrying capacity.

¹³⁸ 39-III R.C.R., *op. cit. supra* note 2, at 166.

¹³⁹ In Roberts' words: "Practically the whole of the Ceylon tea drop is shipped from Colombo, and on account of the dampness of the climate there it is undesirable to hold it there more than a few days." *Id.* at 270. As Tredwen testified, "I have actually had to send malt back to the maltster to be redried, because we dare not ship it, because it had got damp through waiting for vessels." 40-IV *id.* at 76. Butter and fruit are other examples.

¹⁴⁰ For a discussion of related problems in the Ceylon tea trade, see statement of Roberts, *id.* at 270, 271, 276.

¹⁴¹ Some of the difficulties, if any, may be that (1) the parcels are going to a large number of different destinations, which would discourage trampship operation; (2) such general cargo may require quick dispatch on account of forward orders (the due dates of which may differ)

Even in so large a trade as the United Kingdom to India, this was said to be a factor. According to Sir James L. MacKay, a Director of the British India Steam Navigation Company, "The export trade to India is to a large extent what may be described as a retail trade. The number of separate shipments by each steamer averages about 1,150, and the tonnage shipped under each shipment, excluding large consignments by the railway companies and by the Secretary of State for India, averages three to four tons."¹⁴²

So far, we have discussed factors that militate against tramp ship and liner entry, though it is clear that some of them will be more powerful against one or the other. In some trades, generally the smaller ones, these more or less natural inhibitors may be enough. Where they are, on purely logical grounds, we should expect that no concessions will be made or penalties imposed by the conference to secure the loyalty of shippers. In short, rebates, whether in the form of contract rate reductions or otherwise, will be given only where necessary; they are, in one narrow sense, a sign of weakness rather than of strength.¹⁴³ Whenever dual rates or rebates are found, potential competition, at least, exists. Where they are nowhere in evidence, logic suggests either that the market has been made quite competitive because of ever-present outsiders,¹⁴⁴ or has been quite monopolized. For bulk goods, such as grains, ores, and coal, there will be no rebate; such goods move in full cargo lots and are thereby subjected to continuous and overpowering pressures from tramp ships.^{144a} Nothing can be

or of the cost of storing and holding; (3) it is conceivable, but doubtful, that the type of heterogeneity of cargo may be suitable for specialized carriers but not for ordinary tramps. There is also the obvious problem that large numbers of consignors and consignees will require some mechanism for consolidating and organizing shipments, and that this is costly. But this factor is not so appealing an explanation as it may first seem. For, unless there are some reasons of economy, control, or law, it is not obvious why this function, which is regularly performed by or for the liners, could not as well be performed for the irregular carriers.

¹⁴² 40-IV R.C.R., *op. cit. supra* note 2, at 254.

¹⁴³ Conferences that now use dual rates or deferred rebates would be still weaker if they were not permitted to employ them. But the adoption and existence of loyalty ties has, at least historically, been related to the growth of potential competition. In that sense, conferences that have no need of the devices have no problem of competition. Those that do would be in greater difficulty if they were obliged to abandon them.

It may be helpful to note some difficulties involved in attempts to test these hypotheses empirically. Nowadays the law with respect to loyalty ties is no longer quite neutral. As a consequence, as recent hearings show, some conferences that want to employ loyalty ties to repel outside competition have not been able so far to put such a system into force. Hence testing the evidence of outside competition simply by whether a contract preference system is used in the trade would be misleading. Furthermore, if we assume, say, that present-day shipping markets are large enough so *potential* competition at least exists everywhere, logic predicts that those conferences employing loyalty ties would be *less* bothered by successful competition than those which, for legal or other reasons had not been able to employ ties. See also the testimony of Mr. A. J. Pasch, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2 at 857.

¹⁴⁴ In which case all rates will be "open" and the conference is, in essence, impotent.

^{144a} See testimony of Alex Cocke, *Bonner Comm. Hearings, op. cit. supra* not 10, pt. 1, at 333.

done with such goods. In the case of other sorts of goods—as refrigerated meats and silk at about the turn of the century—the tramps pose no challenge whatsoever, and a rebate is not needed to preserve loyalty. As a corollary, the amount of rebate, or tariff reduction, will be higher the less remote is competition. In explaining the absence of rebates in the Glasgow-Newcastle trade outwards, Colonel James S. Park said: "...practically the reason we have not experienced any difficulty is that the Glasgow Montreal trade is so closely filled, as it were, that there is no possible room for another Line to start. Our own Line could carry the whole of the cargo of the other Line as well as our own, and a great deal more."¹⁴⁵

The monopoly of silk carriage was of like strength, according to Sir M. Nelson, and there was no rebate: "You cannot very well ship silk in any other way than by the mail boats; it is too valuable. . . . There is no need to hold any inducement." Another illustration can be taken from the West African trade, in which no rebate was offered on rubber, gum, ivory, cocoa, and other high-value but small volume goods. Rates on these goods were high, reflecting in part their high value. Rebates did apply on mahogany, maize, ground nuts, palm oil and kernels, cotton and other goods that moved in larger volume. According to Holt, a shipowner, "... they suppose that is quite enough to get the shippers in their hands by giving them that rebate and excluding the others."¹⁴⁶ Mr. James Batty, a West African trader, confirmed this impression when he testified that, "... up to . . . 1905 the bulk of the produce . . . consisted of palm oil and palm kernels, and the quantities of rubber, cocoa, gum, ivory and other products was so small relatively, that I think the steamship company only thought it worthwhile to give a rebate on the major portion."¹⁴⁷

The amount of rebate, or the amount of current discount for loyalty, will rise as competition grows. This "prediction" is confirmed by history: faced by the competition of the Sun Line, Woermann increased rebates to 40 per cent.¹⁴⁸ In the Madras cotton trade from Manchester, threatened competition from the Clain Line brought an increase in rebates from 10 per cent to 20

¹⁴⁵ 40-IV R.C.R., *op. cit. supra* note 2, at 214. Park was in both the liner and tramp ship business. According to Lloyd, unchallenged, single-headed monopoly has no need for rebates: "The only steamship service in the nature of a monopoly known to me is one where the rebate system is not in force, the monopoly being upheld by other means." *Id.* at 140. He referred to the Canadian South African Line. *Id.* at 144.

¹⁴⁶ 39-III *id.* at 182.

¹⁴⁷ *Id.* at 235. Treasure and opium apparently stood in much the same position. According to Gladstone, speaking of the Calcutta-China trade, "The trade is a good deal in opium, and for opium a quick service and first-class steamers are essential. Opium is probably the most valuable cargo in the world except gold or silver. Of course, the shippers cannot hawk it about in the market to outsiders; it must go at regular intervals, and it must go quickly and safely. So what they call the opium steamers run from Calcutta regularly, and they take for the rest of the cargo what there is offering." 40-IV *id.* at 80-81. See also the testimony of Morse, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 39.

¹⁴⁸ 39-II R.C.R., *op. cit. supra* note 2, at 196; 39-III *id.* at 159, 161.

per cent;¹⁴⁹ in 1898 rebates given in the Newfoundland trade rose to 20 per cent with the arrival of outside opposition;¹⁵⁰ large-scale entrance into the Indian trade by the Hansa Line increased rebates to 25 or 30 per cent;¹⁵¹ when Bucknall came into the South African trade in 1892, rebates rose from five per cent to ten per cent.¹⁵² Indeed coming forward to recent examples, the Japan-Gulf-Atlantic Conference did not seek to re-institute a contract rate system till, in about 1953, the growth of Isbrandtsen, and of the new Japanese merchant marine, proved bothersome.¹⁵³

Nevertheless, as we have seen, ¹⁵⁴ inducements to undivided loyalty are numerous and important. It is not clear whether, as the market for shipping services has grown larger, they have been used more frequently. There is also considerable confusion about the objects and effects of the various loyalty systems. Even so keen an observer as Alfred Marshall was misled when he concluded that:

This association of Conferences is a matter of but little direct concern to the Tramp: for she has no fixed route and presents no good target for their artillery. So they turn their attacks not on her, but on any who make use of her for work which they are ready to undertake: they think it an unfair competition for the Tramp to come in when things are good and drop out again when things are bad. They are not able to eliminate the "fitful tramp" from the regular trades: but their weapons are turned against anyone who sets up a regular Line of cargo steamers, which may divert traffic from the Conference.¹⁵⁵

It is easy to see how Marshall was deceived, for his argument comes at one stage very close to the mark; but he ends by a conclusion that is quite wide of it. He comes close, in the beginning, when he perceives that shippers who generate full cargo lots at one port for discharge at another can readily avail themselves of the tramp market; that is a job for which tramp ships are eminently suited and a market in which they remain predominant.¹⁵⁶

So far as one-way movement of full cargoes from one port to another, the conference is powerless; and Marshall saw this clearly. At the other pole lie the full-blown liner companies which can put the requisite pool of ships into a trade

¹⁴⁹ 39-III *id.* at 28.

¹⁵⁰ 40-IV *id.* at 205.

¹⁵¹ "They reduced the rates so much that our rates had to come down, and, practically, the rebates had to go up to something like 25 or 30 per cent. It was understood, too, that they offered to make up to shippers any rebates they might forfeit through shipping by them." Statement of MacKay, *id.* at 258.

¹⁵² 40-IV R.C.R., *op. cit. supra* note 2, at 157.

¹⁵³ *Infra* pp. 153.

¹⁵⁴ *Infra* pp. 89.

¹⁵⁵ Marshall, *INDUSTRY AND TRADE* 437-38 (1923).

¹⁵⁶ See Cook's testimony. 40-IV R.C.R., *op. cit. supra* note 2, at 250. Cook was a member of the firm of Messrs. Lamport and Holt, a liner company. According to MacKay, "No Ring has tried to form a system for the homeward business to which I refer there; and I fancy it would be impossible in any case, because the great bulk of the trade referred to there is done by merchants shipping entire cargoes, and not by small sectional shipments." 39-III *id.* at 308.

to challenge the conference. If these companies can unilaterally provide the requisite frequency and regularity, they can overcome conference opposition, though it will cost them something to do so. Thus it is that the conference loyalty systems are really directed not against one-way, full cargo tramps, or primarily against full-blown liner services, but rather against the casual tramp who tops off part cargoes with general merchandise, or who sporadically seeks to pick up whatever is offered to obviate an empty back-haul; and against the small but casual "liner" who cannot independently provide regularity and frequency of service.^{156a} Loyalty schemes thus have the object and effect of pre-determining the scale of entry, but are useless against full-cargo shipments and of restricted force against regular outside liner service.^{156b} This, of course, does not mean that such schemes are totally useless; it only states the limits of their usefulness.^{156c}

D. SOME ASPECTS OF LAW AND POLICY WITH RESPECT TO ENTRY

So far an analysis has been made of the logic and history of entry into trades served by conferences. Because the practices and institutions of con-

^{156a} That the occasional tramp is a menace to the conference has been attested to. See testimony of Watts, 39-III R.C.R. *op. cit. supra* note 2 at 396. "... there are many occasions on which a tramp for his own purposes, might go in. For instance, he might want to get his vessel out in a certain direction, and then he might cut in and take a freight that would entirely upset the apple-cart of the liner for months perhaps, in other words, he would cut rates. That is one of the reasons why, I take it, these conferences are so iron-bound."

^{156b} Conference histories confirm that loyalty ties have been insufficient to prevent entry of large and dedicated liner firms. 40-IV R.C.R. 139, 145, 300, 302-04, 312-14; *Alexander Comm. Rep., op. cit. supra*, note 10, Vol. I, pp. 546, 174; (either R.C.R. or Alex. Vol. I, pp. 135, 159, 160; pp. 28, 150, 202, 205, 242-43, 258; Vol. III, pp. 85, 145, 157. For examples where the attempt to enter failed, see Vol. I, pp. 141-42, 145, 169, 180, 196.

^{156c} Perhaps the best modern statement of the monopolizing rationale and effect of such loyalty ties was given by Mr. A. J. Pasch, Chairman of the Associated Latin American Freight Conferences: "Let us take any of these trades; Cuba, or example. Let us assume that these things have never evolved. We are starting fresh now. There has never been a contract system in effect. All we have is a rate per ton and the rate is \$30 per ton. We know from experience that so long as that situation lasts with no tie upon the shipper, we can expect to be attacked by nonconference operators.

"During the course of any year instead of handling the 100,000 tons that moves in that trade at \$30 we will handle probably 60,000 tons and our rate will be \$16. Having gone through that type of experience for several years, let us assume now that we are going to look for a cure and in evaluating our own position we decide that, if we can reach out through some kind of a contract arrangement or other type of tie upon the shipper and assure ourselves of, say, 90 per cent of that movement, we do not need \$30. All we need is \$26 and we pass that \$4 saving back to the shipper in exchange for his willingness to contract with us." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 869-70.

That conferences have actually achieved monopoly power can be seen from other evidence as well. Of the 113 conferences analyzed by Mr. Bicks in late 1958, some 53 of them faced absolutely no liner competition. *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 164, 168-69. See also the case of a conference, which even when stricken by unusually intense competition, still retained 72 per cent of the sailings in the trade. *Id.*, Part 2, at 341, 365. For other information about competition in specific trades, see *id.*, at 747, 920, 931-34.

ferences have undoubtedly influenced entry, it would presumably be quite feasible to affect the ease of entry by influencing conference conduct.

It is possible to break policies with respect to entry into two parts. The first is the issue of devices that can be used by conferences to exclude entry to a trade by nonmembers. The second is the question of policies for admission to conference membership itself.

1. *Contract Rates, Entry, and the Law: The Isbrandtsen Case*

An inquiry into the recent *Isbrandtsen* case¹⁵⁷ is necessary for any study of the conference system. Ocean freight rate conferences in United States foreign trade would violate our antitrust laws except for specific exemption. The exemption applies only to those conferences whose agreements meet the tests of the United States Shipping Act of 1916 and are approved by the United States Maritime Board. The *Isbrandtsen* case undermines the exemption in the case of conferences that employ exclusive patronage or dual rate systems. The fact that 63 of the more than 100 freight rate conferences in United States foreign trade employ such systems suggests that the issue is important.¹⁵⁸ Some shipping people suggest that it is not only important, but actually vital to the continuation of effective conferences and, therefore, to the United States merchant marine. Congress evidently thought the case important, too; in response to the decision, it has passed a one-year moratorium bill which preserves the legality of all pre-existing dual rate systems till June 30, 1960, by which time it will have investigated the desirability of permanent legislation to overturn, or sharply modify, the law as revealed in the *Isbrandtsen* case.

Another interesting aspect of the case is the sets of legal bed fellows it created. *Isbrandtsen*, a rate cutter, was joined by two government agencies, the Departments of Justice and Agriculture. Against them stood the conference and the Federal Maritime Board. Government is evidently not quite monolithic. One party summed up the schism in these words:

On one side, the Departments of Justice and Agriculture are animated by the view that antitrust concepts must at all costs be applied to international shipping. On the other, the Board, with 40 years experience in the regulation of shipping under legislation committing that function exclusively to it, contends that, in international shipping, antitrust concepts without modification to fit particular circumstances mean chaos; and that the Shipping Act objectives of promoting our foreign commerce and improving our merchant marine require rate stability and uniformity, and that these objectives can justify associational activity necessary to achieve them.¹⁵⁹

¹⁵⁷ *Federal Maritime Board v. Isbrandtsen Co.*, 356 U.S. 481 (1958).

¹⁵⁸ Letter from L. E. Ranck, Acting Chief, Regulation Office, Federal Maritime Board, January 19, 1959, to John McGee.

¹⁵⁹ Petitioner's Writ for Certiorari to the United States Court of Appeals for the District of Columbia Circuit, p. 11, *FMB v. Isbrandtsen Co.*, 353 U.S. 908 (1957).

In his interesting testimony before the Bonner Committee, Chairman Morse reviewed the Board's holdings with respect to dual rate systems. In his words, "In those trades where it is in use, we have become aware of no widespread dissatisfaction on the part of the shipping

The following review of the facts is based upon the Supreme Court's decision and upon the briefs presented by parties at interest. It is not drawn from a study of the record itself, which covered some 4,500 pages of testimony and exhibits. With that caveat, most of the basic facts appear to be clear enough. The case climaxes a long struggle by Isbrandtsen to outlaw exclusive patronage contract systems in ocean transportation. Isbrandtsen is a non-subsidized American flag operator and the only important non-conference American liner operator.

public. So far as the Board and its staff are able to observe the sentiment of the shipping public, we believe that such sentiment is far more generally in favor of the dual rate system where it is in use than against it. This shipper support, frequently expressed in the sworn testimony of shippers, stems from the general realization that stability of rates is a necessary element in the conduct of international trade.

"The use of the dual rate system has been surrounded by safeguards directed to the prevention of any greater limitation upon competition than is absolutely necessary. Thus, the Board's predecessors have held that the dual rate system will not be approved when inaugurated by a single line which seeks to exclude all other carriers (*Eden Mining Co. v. Bloomfield Fruit & Steamship Co.*, 1 U.S.S.B. 41 (1922)). Shortly after 1933, when the Intercoastal Shipping Act gave the Board power to control minimum and maximum rates, the Board announced that it would no longer approve dual rate systems in the domestic trades (*Intercoastal Investigation*, 1 U.S.S.B. 400, 452, 454, 456, 467 (1935); *Gulf Intercoastal Contract Rates*, 1 U.S.S.B. 524, 529, 530 (1936)). The system will not be approved unless conference membership is open to any carrier in the trade (*Phelps Bros. & Co. v. Consulch Società*, 1 U.S.M.C. 634, 640, 641 (1937)) upon payment of a reasonable membership admission fee (*Pacific Coast European Conference*, 3 U.S.M.C. 11, 14 (1948)). It will not be approved when it is used to forbid shippers to route traffic via a port not served by the conference (*Contract Routing Restrictions*, 2 U.S.M.C. 220, 226 (1939)). The Board will not approve liquidated damage provisions which are restrictive or too severe upon the shipper (*Pacific Coast European Conference*, 3 U.S.M.C. 11, 19 (1948); *cf. Isbrandtsen Co. v. North Atlantic Freight Conference*, 3 F.M.B. 235, 246 (1950)).

"In its recent decisions, the Board has emphasized that a dual rate system will not be approved if its effect will be a monopoly in the conference lines to the virtually complete exclusion of all independent competition (*Transpacific Freight Conference of Japan*, 4 F.M.B. 744 (1955); see *North Atlantic Continental Freight Conference*, 4 F.M.B. 355 (1954)).

"I might interpolate there by saying that I filed a dissenting opinion in that docket 743 which is in the matter of the statement of Transpacific Freight Conference of Japan filed under General Order 76.

"Subject to these safeguards, the Board has approved dual rate systems when a weighing of the pros and cons led to the conclusion that advantages stemming from the use of the system outweighed the prima facie discrimination inherent in the use of the rate differential. Approval of any system has depended consequently upon a showing that it is necessary to prevent rate wars, to permit forward trading by shippers, and to assure rate stability and regularity of service (*Rawleigh v. Stoomvaart*, 1 U.S.S.B. 285 (1933); *Pacific Coast European Conference*, 3 U.S.M.C. 11, 17 (1948); *Isbrandtsen Co. v. North Atlantic Freight Conference*, 3 F.M.B. 235, 244, 245 (1950); *Secretary of Agriculture v. North Atlantic Continental Freight Conference*, 5 F.M.B. 20 (1956)). The support of shippers in the trade has been given weight (*Pacific Coast European Conference*, 3 U.S.M.C. 11, 17 (1948); *Isbrandtsen Co. v. North Atlantic Freight Conference*, 3 F.M.B. 235, 245 (1950); *Japan/Atlantic and Gulf Freight Conference*, 4 F.M.B. 706 (1955)).

"Again, consistent with the principle that the system should not be used except so far as it is absolutely necessary, the Board has disapproved so much of a proposed dual rate system as would have been applicable to commodities which are not carried by nonconference competitors (*Japan/Atlantic and Gulf Freight Conference*, 4 F.M.B. 706 (1955)). And the Board's decisions emphasize that the proposed differential between the contract and the noncontract

The case concerns the homeward trade from Japan and the Japan-Atlantic and Gulf Freight Conference that controlled it. The conference was formed in 1922; the first agreement was approved in 1926, and the present agreement was approved in 1934.¹⁶⁰ At the time of hearing, it had 17 members: five American lines, eight Japanese, and four of other flags. Before World War II the conference faced no liner, and not much tramp, competition. Isbrandtsen came into the trade after the war, offering approximately fortnightly sailings as part of its round-the-world service. The only non-conference liner service in the trade was provided by Isbrandtsen.¹⁶¹ It undercut conference rates on the average about 10 per cent, a policy that by 1952 had gained for it about 34 per cent of the cargo carried in the trade, although Isbrandtsen provided only 13 per cent of the sailings.¹⁶² Like other outsiders facing cartels or dominant firms, Isbrandtsen was getting good operating levels under a high-rate umbrella. Unlike some of them, however, Isbrandtsen cut the conference rate substantially.¹⁶³

rates must not be so great as to prevent use of the nonconference line or lines (North Atlantic Continental Freight Conference, 4 F.M.B. 355 (1954); Japan/Atlantic and Gulf Freight Conference, 4 F.M.B. 706 (1955)).

"Furthermore, the Board has disapproved conference proposals to control the routing of traffic by persons who are not signatories to the conference's exclusive patronage agreement. The Board has insisted that conferences not interfere with the freedom of shippers to accede to the routing instructions of buyers who have not signed exclusive patronage contracts and who have retained the right under their sales contract to designate the carrier and to pay the freight. Contract rates (Japan/Atlantic-Gulf Freight Conference, 4 F.M.B. 706 (1955); Secretary of Agriculture v. North Atlantic Continental Freight Conference, 5 F.M.B. 20 (1956)). *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1 at 16-17. The position of the Department of Justice is outlined clearly in the statement of Robert A. Bicks, First Assistant, Antitrust Division, *id.* at 159 *et. seq.*

¹⁶⁰ Brief for Co-Respondents, the United States and the Secretary of Agriculture, p. 4, *Federal Maritime Board v. Isbrandtsen Co.*, 356 U.S. 481 (1958).

¹⁶¹ Brief for Petitioner Federal Maritime Board, p. 5, *Federal Maritime Board v. Isbrandtsen Co.*, *supra* note 160.

According to Matthew S. Crinkley, Executive Vice President, "Isbrandtsen has never been and is not now a member of any of the steamship conferences and is the largest independent steamship line operator in the world." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 197.

¹⁶² Brief for the United States and the Secretary of Agriculture, p. 5, *op. cit. supra* note 160.

¹⁶³ It is not obvious why Isbrandtsen had to cut conference rates at all, and more troublesome that it did so substantially and continuously. In the absence of penalties, if its services were equivalent, shippers would tend to be indifferent between the conference and Isbrandtsen at the same rates. Slight rate differences should have done the trick, on this theory. This point is neither noted nor explained in the Court's decision.

Matthew S. Crinkley, Executive Vice President of Isbrandtsen, has explained the situation in the Trans-Atlantic trade in these words, "they were using the conference contract system and a large amount of people perhaps needed service to more ports than the independents were giving.

"You take a place where you have roughly 10 conference lines and they have two sailings

Beginning in 1951 Japanese lines returned to the trade. By 1952 eight had entered the conference. Total sailings in the trade almost trebled, reaching more than 300 in 1953 as compared with 109 in 1949. In one way or another, the Japanese lines rapidly built up custom. Some shipping people claim that the Japanese employed secret rate-cutting and rebates to build up their position. They also assert that foreign lines are better able to employ such techniques than are United States flag lines; United States law forbids the practices that are most effective in such a campaign and the foreign lines are less impressed by United States law than are our own. If true, this could explain the steady decline of the American carriers' share of the trade.¹⁶⁴ In any event, by 1951 the Japanese had captured about 15 per cent of the liner cargo trade; by 1952, some 49 per cent. By the first half of 1953 Japanese liners had 66 per cent of the business. It should be obvious, though few had recognized it explicitly, that the re-entry of Japanese lines to the trade was a much more "disruptive" influence than anything Isbrandtsen did, or conceivably could have done, with the capacity at its command.¹⁶⁵ In fact, the conference share of liner cargo in the trade reached a low point of 66 per cent in 1950, before the re-entry of Japanese firms, and before rates collapsed. Isbrandtsen's share of the trade declined steadily from 1950 to 1953. The conference share rose steadily.¹⁶⁶

a month between them and they say to their contract signers 'You have 20 sailings a month available to you.'

"There is one independent and he has two sailings.

"There is a tremendous advantage where the shipper would be able to select a conference carrier almost every day where he would have to hold his shipments to the lesser amount for the independents.

"Our around-the-world service calls at a maximum of three ports in the Mediterranean, at Beirut, and Alexandria, but at times at Genoa [sic]. Shippers have business in Barcelona, Istanbul, Piraeus, and many other ports that we cannot serve so that shippers having business over a range of ports there and having the contract dual rate system have no choice. They have to sign it." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 213.

If this is correct, it suggests that the independent must, because of the practically all-or-none option afforded by the conference, offer concessions in rate because his unilateral service is necessarily inferior to that of the combination.

¹⁶⁴ Omitting the carryings of Lykes and American President Line, American flag carryings were 53% of the total berth cargo in 1950, 46% in 1951, 34% in 1952, and 21% in the first six months of 1953. Brief for Petitioner Federal Maritime Board, *op. cit. supra* note 160 at 6.

Isbrandtsen made much of these facts: "Instead of applauding the independent efforts of Isbrandtsen to maintain United States flag participation in the trade, the Board seems quite insistent in snuffing out this one last vestige of American flag independence." Brief for Respondent Isbrandtsen Co. Inc., p. 33, Federal Maritime Board v. Isbrandtsen Co., 356 U.S. 481 (1958).

¹⁶⁵ Most conference members denounce Isbrandtsen as the basic and proximate cause of the trouble that ensued. One official of a United States flag line, however, frankly conceded that "Isbrandtsen is the whipping boy." Japanese entry was much more important. See also *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 622-631.

¹⁶⁶ Brief for Co-Respondents, the United States and the Secretary of Agriculture, p. 5, *op. cit. supra* note 160.

Interviews with shipping people and the staff of the Federal Maritime Board indicate that intra-conference "chiseling" was the proximate cause of the collapse. Ultimately, when the conference was in danger of dissolution, the members agreed to hire and send an outside observer to Japan to police the agreement. According to my information, both the Japanese and United States governments became interested in restoring "order," and applauded the lines' efforts to do so. The key was apparently to increase the effectiveness of policing at the Japanese end.

In late 1952 Isbrandtsen announced that it planned to increase sailings from two to as many as four per month. The conference then reduced rates 10 per cent. Thereupon, Isbrandtsen undercut the new conference rates by 10 per cent. On December 24, 1952, the conference filed proposed dual rates with the Federal Maritime Board. According to General Order 76 of the Federal Maritime Board,¹⁶⁷ such rates would have become effective after 30 days unless opposed by the Board or protested by other persons. Isbrandtsen, the United States Department of Justice, and the Secretary of Agriculture all protested formally. In January, 1953, the Board ordered a hearing. Isbrandtsen petitioned the United States Court of Appeals for the District of Columbia to stay the authorization of a dual-rate system. In February the court announced it would enter a stay, and on March 23 it did so. In March, the conference "opened" rates on ten major commodities. It later opened rates on most major commodities.

Rates fell, ultimately to about 30 to 40 per cent of the previous conference level. In July Isbrandtsen pegged its rates at about 50 per cent of the old conference level; in other words, somewhat above what the conference members were then charging. As a consequence, "Isbrandtsen . . . carried little cargo in the trade."¹⁶⁸ On December 14, 1955, the Board issued its report; and on December 21 and January 11, 1956, approved the proposed dual-rate system after removing refrigerated cargoes from the list of contract commodities. The Court of Appeals set aside the Board's orders.¹⁶⁹ The United States Supreme

¹⁶⁷ 46 C.F.R. § 236.3 (1958).

¹⁶⁸ 356 U.S. at 487.

¹⁶⁹ According to the United States Supreme Court, "The Court of Appeals set aside the Board's orders on the ground that this system of dual rates was illegal *per se* under § 12 of the Shipping Act, 1916, 39 Stat. 733, as amended, 46 U.S.C. § 812 Third." *Federal Maritime Board v. Isbrandtsen*, *supra* note 203 at 483. Section 12 provides: "No common carrier by water shall directly or indirectly in respect to the transportation by water of passengers or property between a port of a State, Territory, District, or possession of the United States and any other such port or a port of a foreign country—First. Pay or allow, or enter into any combination, agreement or understanding, express or implied, to pay or allow a deferred rebate to any shipper. The term 'deferred rebate' in this chapter means a return of any portion of the freight money by a carrier to any shipper as a consideration for the giving of all or any portion of his shipments to the same or any other carrier, or for any other purpose, the payment of which is deferred beyond the completion of the service for which it is paid, and is made only if during both the period for which computed and the period of deferment, the shipper has complied with the terms of the rebate agreement or arrangement.

Second. Use a fighting ship either separately or in conjunction with any other carrier

Court was asked to decide whether the Board's orders should have been set aside.

After reviewing the legislative history of the Shipping Act of 1916, the Court concluded that Congress, learning much from both the Alexander Committee Hearings and Report and the British Royal Commission Report, had sought to preserve the "good" of conferences and remove the "bad." Section 15 of the Act provides for filing and Board approval of lawful conference agreements, and bestows antitrust immunity upon them.¹⁷⁰

Nevertheless, Congress never intended that conferences should be given *carte blanche*. For, as the Court saw it:

[T]he freedom allowed conference members to agree upon terms of competition subject to Board approval is limited to the freedom to agree upon terms regulating competition among themselves.

The Congress in [section] 14 has flatly prohibited practices of conferences which have the purpose and effect of stifling the competition of independent carriers. . . . Similarly, [section] 14 Third prohibits another practice . . . to "retaliate against any shipper by

through agreement or otherwise. The term 'fighting ship' in this chapter means a vessel used in a particular trade by a carrier or group of carriers for the purpose of excluding, preventing, or reducing competition by driving another carrier out of said trade.

Third. Retaliate against any shipper by refusing, or threatening to refuse, space or accommodations when such are available, or resort to other discriminating or unfair methods, because such shipper has patronized any other carrier or has filed a complaint charging unfair treatment, or for any other reason.

Fourth. Make any unfair or unjustly discriminatory contract with any shipper based on the volume of freight offered, or unfairly treat or unjustly discriminate against any shipper in the matter of (a) cargo space accommodations or other facilities, due regard being had for the proper loading of the vessel and the available tonnage; (b) the loading and landing of freight in proper condition; or (c) the adjustment and settlement of claims.

Any carrier who violates any provision of this section shall be guilty of a misdemeanor punishable by a fine of not more than \$25,000 for each offense."

¹⁷⁰ In the words of section 15: "Every common carrier by water, or other person subject to this chapter, shall file immediately with the Federal Maritime Board a true copy, or, if oral, a true and complete memorandum, of every agreement, with another such carrier or person subject to this chapter, or modification or cancellation thereof, to which it may be a party or conform in whole or in part, fixing or regulating transportation rates or fares; giving or receiving; special rates, accommodations, or other special privileges or advantages; controlling, regulating, preventing, or destroying competition; pooling or apportioning earnings, losses, or traffic; allotting ports or restricting or otherwise regulating the number and character of sailings between ports; limiting or regulating in any way the volume or character of freight or passenger traffic to be carried; or in any manner providing for an exclusive, preferential or cooperative working arrangement. The term agreement in this section includes understandings, conferences, and other arrangements.

The Board may by order disapprove, cancel, or modify any agreement, or any modification or cancellation thereof, whether or not previously approved by it, that it finds to be unjustly discriminatory or unfair as between carriers, shippers, exporters, importers, or ports, or between exporters from the United States and their foreign competitors or to operate to the detriment of the commerce of the United States, or to be in violation of this chapter, and shall approve all other agreements, modifications, or cancellations. . . . Every agreement, modification, or cancellation lawful under this section shall be excepted from the provisions of the [Antitrust Acts]. . . ." 39 Stat. 733 (1916), 46 U.S.C. § 814 (1952).

refusing . . . space accommodations when such are available . . ."; that prohibition, moreover, is enlarged to condemn retaliation not only when taken "because such shipper has patronized any other carrier" but also when taken because the shipper "has filed a complaint charging unfair treatment, or for any other reason."¹⁷¹

According to the Court, Congress had correctly predicted that contract systems would arise to replace the deferred rebate systems that the Shipping Act outlawed. But, in the Court's words:

Congress was unwilling to tolerate methods involving ties between conferences and shippers designed to stifle independent carrier competition. . . . Whether a particular tie is designed to have the effect of stifling outside competition is a question for the Board in the first instance to determine.¹⁷²

Turning the cannons of expertise upon their masters, the Court then said: Since the Board found that the dual-rate contract of the Conference was "a necessary competitive measure to offset the effect of non-conference competition" required "to meet the competition of Isbrandtsen in order to obtain for its members a greater participation in the cargo moving in this trade," it follows that the contract was a "resort to other discriminating or unfair methods" to stifle outside competition in violation of [section] 14 Third.¹⁷³

Indeed, the Court went even further when it recognized that:

[U]nder this agreement not only is there no guarantee of services and rates for a reasonably long period, but the liquidated-damages provision bears a strong resemblance to the feature which Congress particularly objected to in the outlawed deferred rebate system. Certainly the coercive force of having to pay so large a sum of liquidated damages ties the shipper to the Conference almost as firmly as the prospect of losing the rebate. It would be anomalous for Congress to strike down . . . dual-rate contracts having the same objectionable purpose and effect. Events have proved the accuracy of the prediction that the outlawing of the deferred-rebate system would lead conferences to adopt a contract system, as here, specially designed to accomplish the same result.¹⁷⁴

This is not, formally at least, a *per se* doctrine of illegality. For, "... as we hold, [section] 14 Third strikes down dual-rate systems only where they are employed as predatory devices. . . ."¹⁷⁵

Nevertheless, since *all* collusive dual-rate systems have the effect of inhibiting outside competition, this principle seems to place all of them in jeopardy. That, I think, is a good place for them to be placed, although there may be questions about some of the Court's analysis of history, and the logic by which it challenges the system.

¹⁷¹ 356 U.S. 491 (1958). (Emphasis added.)

¹⁷² *Id.* at 492-93.

¹⁷³ *Id.* at 493. The Board had "found" that the dual rate system would probably leave Isbrandtsen with "10 per cent or more of the cargo in the trade as against the 26 per cent carried by it in 1952" 4 F.M.B. at 737.

¹⁷⁴ 356 U.S. 495 (1958).

¹⁷⁵ *Id.* at 499.

Most economists would be astounded by the Board's conception of monopoly power, as it is revealed in this case. Although the Board maintains that it would not approve dual rate systems that result in "virtual monopoly,"¹⁷⁶ it acknowledged that the proposed dual rate contract would leave Isbrandtsen with as little as 10 per cent of the carryings—which "would be at least an equitable share of the trade."¹⁷⁷ The contention that 90 per cent of a market relevantly defined is different from "virtual monopoly" would not only astound economists. It is also much more charitable than even the tolerant standard established in the Sherman Act with respect to single-firm monopolies¹⁷⁸ which have historically been permitted higher market shares than would be tolerated in any cartel style of organization.

It is interesting to compare that line of reasoning with another statement from the Board:

The contract system should be frankly recognized as a device tending towards the monopolization of ocean commerce in particular trades by the members, collectively, of conferences which serve those trades. We use the word "monopolization" with no ideological overtones, but merely in its dictionary sense, which is the obtaining or assumption of "exclusive possession or control." Whether the contract system in a particular case actually has the effect of producing a complete monopoly (i.e., control of a trade) depends upon how well it works; admittedly, it is monopolistic in purpose. The extent to which it is monopolistic in effect depends upon how successfully that purpose is achieved . . . if a contract system is wholly effective, it will result in a complete monopoly in the sense that all cargo moving in a trade where the system is used, will move in ships of conference carriers. Necessarily, in these circumstances, there would be no service by independent operators.¹⁷⁹

There will be some skeptics, too, who doubt that any administrative agency

¹⁷⁶ Brief for Petitioner, *FMB v. Isbrandtsen Co.*, 356 U.S. 481 (1958).

¹⁷⁷ Chairman Morse of the Board recently testified that "We had the conference from Japan to the Pacific coast in which it was not permitted by the Board, and the other case was Japan to the Atlantic coast in which it was permitted.

"In the latter case, as I recall, it was estimated that somewhere in the neighborhood of 10 per cent of the cargo would be outside of the dual-rate contract system, and all of the Board felt that there was sufficient volume of cargo available to the non-conference lines so that they would not be frozen out of the trade.

"As I recall, in the Trans-Pacific Freight Conference case, to the Pacific coast, the contracts with shippers by the conference would have controlled 95 or 97 percent of the cargo moving and the majority felt that under those circumstances it would be detrimental to the commerce of the United States in that nonconference would be frozen out." *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 1, at 43-44.

¹⁷⁸ See *United States v. Aluminum Co. of America*, 148 F.2d 416, 424 (1945).

¹⁷⁹ Brief of the Federal Maritime Board, *Isbrandtsen Co. v. United States*, 96 F. Supp. 883, quoted in the court's opinion at n.13, p. 888. Cited in the Brief for the United States and the Secretary of Agriculture as *Amici Curiae*, *FMB v. Isbrandtsen Co.*, 356 U.S. 481 (1958). See also *Japan/Atlantic and Gulf Freight Conference v. United States*, 345 U.S. 975 (1952). For a contrary position on this case, see the interesting, but somewhat uncritical, unsigned note, *The American Shipping Industry and the Conference System*, 2 *STAN. L. REV.* 136 (1958).

or planning board will be able to determine precisely the "right" amount of competition. For, as Trotsky once put:

If there existed the universal mind that projected itself into the scientific fancy of Laplace; a mind that would register simultaneously all the processes of nature and of society, that could measure the dynamics of their motion, that could forecast the results of their inter-reactions, such a mind, of course, could *a priori* draw up a faultless and an exhaustive economic plan. . . . In truth, the bureaucracy often conceives that just such a mind is at its disposal; that is why it so easily frees itself from the control of the market. . . .¹⁸⁰

2. *United States Policy with Respect to Admission to Conferences*

The consensus is that the United States Maritime authorities have compelled conferences to follow a more "open" admission policy.¹⁸¹ This implies, of course, that the conferences have power to exclude, if left alone, and that United States policy has weakened or eliminated that power. As Chairman Morse recently put it:

One of the safeguards against conference abuses that has been consistently asserted by the Board in its administration of section 15 has been the preservation of complete freedom of admission to conference membership. This requirement insures that any carrier seeking to enter a trade must, upon payment of a reasonable membership fee, be admitted to conference membership if he is a bona fide common carrier. Conferences are prohibited under a long line of Board precedents from becoming "closed corporations" or asserting any exclusionary power against an applicant for membership.¹⁸²

The formal policy with respect to entry can be seen in greater detail in the administrative decisions made by the Maritime Board and its predecessors. I have found 18 such decisions involving entry into conferences, and there may be more.¹⁸³ In six of them the United States Shipping Board Bureau (USSBB), or its successor organizations, approved the conference's decision to deny membership.

*Wessel, Duval & Co. v. Colombian S.S. Co.*¹⁸⁴—Wessel Duval ("Wessel"),

¹⁸⁰ TROTSKY, *SOVIET ECONOMY IN DANGER* 29-30 (1931), cited in LERNER, *THE ECONOMICS OF CONTROL, PRINCIPLES OF WELFARE ECONOMICS* 62 (1949).

¹⁸¹ Each conference agreement provides that no common carrier shall be denied admission to membership "except for just and reasonable cause." My 1958 interviews with officials of U.S. firms that belong to conferences revealed both a conviction that the Maritime Board has created "open" conferences, and a marked disapproval of the result of that policy. This is perhaps the best evidence that U.S. policy has actually forced admission of some carriers that otherwise would have been less effectual competitors of the conferences.

¹⁸² *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 1, at 12.

¹⁸³ In a letter of January 19, 1959, L. E. Ranck, Acting Chief, Regulations Office, Federal Maritime Board, said, "we are enclosing . . . copies of reports of the Board and its predecessors involving admissions to Conference membership (Docket Nos. 175, 434, 515, 517, 526, 503, 527, 519, 565, 595, 547-48, 642-43, 653, 729). We know of no court cases involving admissions to Conference membership." I have turned up additional decisions; there may be still others.

¹⁸⁴ 1 U.S.S.B. 390 (1935).

which for years operated ships in the New York-West Coast of South America trade, had formerly belonged to the conference covering that trade. After making only four sailings in 1930, it made none in 1931. In 1932 it operated one ship in the trade, none in 1933. The conference asked "Wessel" to resign, which it refused to do. Thereupon, the other members resigned and formed a new conference. In 1934, "Wessel" notified the new conference that it was going to re-establish its South American service and requested admission to the new conference. "Wessel" asked the conference to grant its slower freight steamers a differential of 10 per cent below rates charged by combination passenger-cargo vessels, as had been the practice in the old conference. In May, 1934 the conference declined, claiming that its agreement did not provide for discriminatory differentials amongst member lines. In late 1934 the conference admitted the Panama Railroad Steamship Line, permitting it, under its modified agreement, a 10 per cent rate differential on cargo trans-shipped at the Panama Canal. Some other conferences provided rate differentials under similar circumstances.

"Wessel" did not own the vessels with which it resumed service in 1934, but rather relied upon foreign-flag vessels that it chartered or operated under agency agreement.

The USSBB placed the burden of proof squarely on the shoulders of "Wessel" when it said: "Complainant has not shown that it is equipped to furnish any service in this trade beyond the four sailings which it expected to provide with the four vessels under time form of charter for one voyage each as noted above."¹⁸⁵

As to the request for a rate differential, the Department of Commerce was unimpressed, and again placed a burden of proof on the complainant when it said:

Granting that such handicaps might reasonably influence or compel the operator of cargo vessels to maintain rates lower than those of other lines operating faster passenger vessels in order to successfully compete with such other lines, complainant has not demonstrated that ten (10) per cent would be a proper differential in any case, and no legal basis has been established to support a finding by this Department that any vessels operated or to be operated by complainant are entitled to a ten (10) per cent differential or, in fact, any differential.¹⁸⁶

The Department concluded that it would not be justified in compelling admission, and dismissed the complaint.

The application of Red Star Line G.m.b.H. for admission to the North Atlantic Continental Freight Conference posed more subtle issues.¹⁸⁷ In May, 1931, the Board approved conference agreement 1456, and in January, 1933, approved an amended agreement which provided, among other things, that the Arnold Bernstein Line—a German firm—would confine its carryings solely

¹⁸⁵ *Id.* at 393.

¹⁸⁶ *Id.* at 393-94.

¹⁸⁷ Red Star Line, 1 U.S.S.B. 504 (1935).

to unboxed autos, chassis, trucks, tractors, and aeroplanes. In addition, Bernstein was to limit sailings, and to carry no more than 55.05 per cent of such cargo moved in the trade. In June, 1933 the parties modified their agreement to allow Bernstein 62.5 per cent of the "unboxed rolling material" transported to Antwerp and Rotterdam. This modification was not submitted to the Board for approval. In November, 1934 Bernstein demanded 70 per cent as its share. The other participants refused. In December, 1934, Bernstein organized the Red Star Linie G.m.b.H. and with the intention of carrying general cargo, applied for membership in the North Atlantic Continental Freight Conference from which it had previously been excluded. Its application was denied.

The Board concluded that the Arnold Bernstein Line, Red Star Line G.m.b.H. and Arnold Bernstein, were "one for the purpose of this case." On that theory, admitting Red Star—i.e., Bernstein—to carry general cargo at the same time that Bernstein qua Bernstein was denied general cargo under agreement 1456, "would be sanctioning two agreements under section 15 in conflict with each other, contrary to public policy."¹⁸⁸ Thus, if agreement 1456 were valid, the denial of admission to Red Star "was justified." But agreement 1456 was not valid, since it "does not reflect the present understanding of the parties."¹⁸⁹ Approval of it was therefore withdrawn. On August 24, 1935, the Board approved a new agreement made by the parties to the old agreement—except for Societe Anonyme de Navigation Belge Americaine, which owned the trade name "Red Star Line." Since the decision does not state how the new agreement differed from the old, what really happened is not clear. That something fundamental had changed can be inferred from the Board's concluding words:

It is not apparent from the record whether Red Star Linie G.m.b.H. is willing to join the conference as now existing under the agreement approved on August 24, 1935. If so, there will exist after the order in this proceeding, and upon the record now before the department no lawful reason for refusing its admission to membership.¹⁹⁰

I am not sure what this decision means. It appears to say that an agreements that limits sailings, preserves some types of cargoes for some members and denies them to others, and specifies the proportion and amount of carryings that may be gotten by a line that is restricted to some cargo classes, is legal; and that a conference can lawfully prevent a restricted carrier from improving his position by multiple membership through two lines that are owned or controlled in common. The formalism through which the conference limitation and division of services was preserved was, in this case, the Board's entry policy. It is far from obvious that the public interest was thereby best served.¹⁹¹

¹⁸⁸ *Id.* at 508.

¹⁸⁹ The Board referred to the unapproved modification of June 6, 1933, discussed above.

¹⁹⁰ *Id.* at 509.

¹⁹¹ But see the *Waterman S.S. Co. Case*, 2 U.S.M.C. 238 (1939), from which I infer that Bernstein ultimately joined the conference.

On August 1, 1936 the United States Shipping Board Bureau decided *Seas Shipping Co. v. American South African Line, Inc.*¹⁹² Seas was a non-conference American carrier in the New York-Baltimore/South and East Africa trade. American South African was also an American-flag carrier serving essentially the same trade and was a leading member of the conference under agreements 3578 and 3578A. American-flag participation in the trade had begun in 1919 when the United States Shipping Board started a service under the style "American South African Line."

In addition to rate-fixing, the conference agreement provided for rotation of sailings and reserved for American South African a minimum of 12 sailings per year, if total sailings did not exceed 48. Total sailings had not, in fact, exceeded that figure. After deducting the 12 reserved sailings, the foreign lines in the trade split the remainder into seven equal shares, with one line having two such shares and the others having one each. There was also a pooling agreement.

In 1935 Seas put four ships, which it owned, into the trade; by the time the hearing was held, it had made six successive monthly sailings. Seas applied for admission to the conference and was turned down. The conference said it would be inconsistent to do otherwise, since it had declined to admit the Kerr Steamship Company on a previous occasion. Seas wanted to be admitted with one sailing per month, the same share as had been reserved for the American-flag conference member. It realized that its admission would force a modification of the sailing rotation scheme then in effect.

During ten months in 1935 there were 20 non-conference sailings from New York, as compared with 12 in each of the preceding four years. In addition, sailings from Canadian and Gulf ports were increasing; the upshot was that total sailings in this and related trades increased steadily after 1931. Rates were declining and "unstable." Freight brokerage was increasing as a result, or symptom, of increased competition. In 1935 unused space on conference vessels in the trade rose to about 35 per cent, which was slightly greater than in 1931, much greater than the 19.7 per cent of 1934, but much less than in 1932 and 1933. Although automobile exports in 1935 were at an all-time high, the conference carried fewer cars through October, 1935, than in the same period of 1934. In late 1935 auto movements were exceptionally heavy, and both conference and non-conference lines shared in them; some cargo had to be shut out and the conference placed additional ships on berth. According to the Board, "Despite allegations to the contrary, there is no evidence of any disarrangement of sailing frequency because of complainant's entrance into the trade."¹⁹³

The Board discovered that the conference had four main reasons for refusing to admit Seas: (1) Seas lacked the financial strength to continue permanently in the trade; (2) sailings rotation would be disrupted; (3) the trade was over-

¹⁹² 1 U.S.S.B. 568 (1936).

¹⁹³ *Id.* at 578.

tonnaged; (4) the business was not profitable. According to the decision, the first reason was invalid; the second, doubtful. But "... it has not been established on this record that the other two reasons are not valid grounds for the action of the defendants."¹⁹⁴

The decision hit sharply at the low, and "unremunerative," rates prevailing in the trade¹⁹⁵ when it said: "Had the power been given this Department to compel complainant, defendants and all other carriers in the trade to raise their rates, the situation is such that that power would now be exercised."¹⁹⁶

Furthermore, the Board said that the defendants were justified in combating low rates. As the decision puts it:

Defendants have been in the trade for many years, three of them since 1896. The steps taken by them indicate a natural, though perhaps ruinous, attempt to meet and overcome everincreasing competition and retain business developed by them over a period of years through good times and bad. However disastrous to all concerned a rate war in our foreign commerce may prove, the Congress has not given this Department the power to terminate it.¹⁹⁷

All things considered, the authorities concluded that defendants had appropriately denied admission to Seas.

American Caribbean Line, Inc., v. Compagnie Generale Transatlantique,¹⁹⁸ involves admission to the Association of West India Trans-Atlantic Steam Ship Lines, which covered the trade from Europe to the West Indies from St. Thomas eastward, and the Guianas. The Association employed deferred rebates, which were, and are, lawful outside of United States-foreign commerce.

American Caribbean ("American") maintained a fortnightly service to the West Indies and Guianas from New York. In October, 1934 "American" sought admission to the conference, undertaking to maintain rates on European cargo transhipped in New York. The Association sought to exclude the traffic to and from Great Britain from any agreement to which the complainant might become a party. "American" rejected that proposal, and one negative vote—by an English line—sufficed to deny admission to the complainant.

The foreign opposition claimed three grounds for its inhospitality. First, unlike the other members, "American" did not serve the trade directly across the Atlantic, but rather engaged in transshipment at New York, a substantially longer transit. Second, the trade from Great Britain to the Guianas was British domestic trade in which the United States had no legitimate interest. Third, a newcomer would only aggravate the present situation of excess tonnage.

The opinion denied that the domestic trade argument was a sound reason

¹⁹⁴ *Id.* at 582.

¹⁹⁵ It also struck at the unwarranted (*i.e.*, too small) rate differential between boxed and unboxed autos.

¹⁹⁶ *Id.* at 583.

¹⁹⁷ *Id.* at 584.

¹⁹⁸ 1 U.S.S.B. 549 (1936).

for obstructing entry; there was no law reserving the trade to British vessels. And, "the plea of redundancy of tonnage is not tenable under the provisions of law applicable to this case."¹⁹⁹ What did matter, according to the opinion, was that "American" was not a regular line in the direct transatlantic trade and that during its whole existence, the conference had admitted only direct transatlantic carriers. Furthermore, the conference agreement divided European port ranges among its members and complainant declined to exclude traffic to or from Great Britain from any agreement. According to the opinion, therefore: "Such application . . . is not for admission on equal terms with the members of the Association in accordance with the letter and spirit of the agreement. . . ."²⁰⁰ The complaint was, accordingly, dismissed.

In both the *Thorden*²⁰¹ and *Brodin*²⁰² cases, the authorities upheld conference refusals to admit new members. Thorden was a Finnish Line which applied for membership in the North Baltic Freight Conference. Although the conference agreement did not allocate ports, the conference agreed to admit Thorden only if it confined its service to Finland. Thorden complained that it wanted to enter on equal terms, which the conference offer would prevent. The Thorden service included two ships and there were plans to add a third. Thorden was already in the trade, offering sailings every three or four weeks. It claimed that conference membership was essential because conference contracts tied up a considerable part of the trade.

The Commission agreed formally with Thorden that the conference plan to limit Thorden's sphere was discriminatory. As they put it, "... there is no provision in the conference agreement restricting any member's service, and to impose such a restriction on Thorden Lines alone, if they were admitted to membership, would be unwarranted."²⁰³ It appears that a formal correspondence between the agreement and terms offered Thorden would have satisfied the Commission. In any case, though formalism favored Thorden, there were apparently contrary matters of substance. For Thorden had entered into forward contracts with shippers and agents at lower rates than quoted by the conference. These contracts were inconsistent with its obligations as a conference member. Though this was apparently the chief reason that the Commission upheld the conference against Thorden, the opinion offers other criticisms of the complainant. Some rates had been opened as a result of Thorden competition; three conference members who previously had submitted resignations withdrew them when the open rates were made, and when they were assured that Thorden would not be admitted. Not only was Thorden an unsettling influence which, in this context, is presumably bad enough, but it had also

¹⁹⁹ *Id.* at 551.

²⁰⁰ *Id.* at 553.

²⁰¹ *G. B. Thorden*, 2 U.S.M.C. 77 (1939).

²⁰² *Hind, Rolph & Co. v. French Line*, 2 U.S.M.C. 138 (1939).

²⁰³ *G. B. Thorden*, 2 U.S.M.C. 77, 79 (1939).

misled the Commission, an "inexcusable" offense.²⁰⁴ The Commission's course was clear: "We find, in view of the contract situation in which Thorden Lines are involved, that they are not shown to be eligible for equal membership in the conference and that the Record does not justify disapproval of the conference agreement. An order discontinuing the proceeding will be entered."²⁰⁵

The *Brodin* case is perhaps the least ambiguous of all those in which the Commission has refused to compel admission. In the words of the Commission, the "Brodin Line is an old, established firm of Stockholm, Sweden."²⁰⁶ Brodin sought admission to three conferences, including the "Coffee Conference" and the Pacific/West Coast of South America Conference. Brodin claimed that the refusal to admit them to membership was unjustly discriminatory since exclusive patronage contracts covered the trades to its prejudice as an outsider. In 1938, all three conferences refused to admit Brodin on the grounds that the "trades were overtonnaged": "Witnesses for complainants testify that there is need for additional carrier service in the trades involved, and letters to this effect are of record. Defendant's evidence is that no such need exists. They *show* that the respective trades are now amply supplied by vessels and that there is no need for additional service. Shipper witnesses testify to the same effect."²⁰⁷ In addition, the American Merchant Marine Institute, Inc.,—an association of American flag operators, filed a brief as *amicus curiae*, asking the Commission, . . . to consider the effect of a decision requiring the admission of these complainants to the conferences as establishing a principle that all other conferences from or to American ports must be thrown open to membership by any fly-by-night foreign operator who has never operated in the trade, with the necessary result of decreasing the revenues of the American lines in such trades and operating to the detriment of the American merchant marine.²⁰⁸

The Commission dismissed the complaint.

In 12 other entry decisions that I have been able to find, four of the complaints were dismissed since the issues had become moot.²⁰⁹ The remaining

²⁰⁴ In the Commission's words, "The withholding of the true facts and the presentation of inaccurate statements [about the contracts to the conference and to the Commission was inexcusable." G. B. Thorden, *supra* note 203, at 82.

²⁰⁵ *Ibid.*

²⁰⁷ *Id.* at 141. (Emphasis supplied.)

²⁰⁶ Hind, Rolph & Co., *supra* note 202, at 141.

²⁰⁸ *Ibid.*

²⁰⁹ *Kerr S.S. Co. v. Isthmian S.S. Co.*, 2 U.S.M.C. 93 (July 25, 1939). The conference was disbanded officially on June 30, 1939, rendering the issues moot.

Kerr S.S. Co. v. Hansa Line, 2 U.S.M.C. 206 (1939). The European War and the practical dissolution of the conference that attended it, made the issues moot.

Hind, Rolph & Co. v. Compagnie Generale Transatlantique (French Line), 2 U.S.M.C. 280 (1940). This is, in effect, *Brodin Case No. 2*. The two vessels employed in the trade by Brodin were withdrawn and proceeding to Sweden under recall orders from the owners, presumably as a result of the War. Issues moot.

Rederiet "Ocean" A/S v. Yamashita Kisen Kabushiki Kaisha, 2 U.S.M.C. 335 (1940). Denmark was invaded by Germany, whereupon complainant suspended the operations affected.

decisions compelled the conferences involved to admit complainants.²¹⁰

The breadth, or vagueness, of the administrative law on entry to conferences, which has, so far as I know, not yet been reviewed by the courts, is not conducive to pellucid summary. These decisions are *ad hoc*, the principles imprecise. Though it may be fortuitous, or a result of differing composition of Board membership over time, it is interesting that the cases eventuating in no admission are largely those of the Great Depression period; in the postwar period,

²¹⁰ *Phelps Bros. & Co. v. Cosulich-Societa Triestina di Navigazione*, 1 U.S.M.C. 634 (1937). Complainant argued that the 20 per cent contract-non-contract rate spread (minimum spread: \$2/ton) was unjustly discriminatory to its efforts to secure cargo. Defendants carried 80 to 85 per cent of the freight, in spite of complainant's rate cuts of ten per cent below the conference level. Moreover, "where a carrier is already in the trade the vessel tonnage is not increased by reason of its admission to the conference." *Id.* at 639. Finally, Isthmian Line had just recently been admitted to the Conference, and Fabre retained its conference membership in spite of not having operated in the trade since June, 1934. "Such discrimination is manifestly unjust." *Id.* at 641.

Sprague S.S. Agency v. A/S Ivarans Rederi, 2 U.S.M.C. 72 (1939). Several possible reasons for the decision appear: (1) "Contracts have been entered into with shippers covering such a percentage of cargo that it is impossible for any steamship line not a member of the conference to engage in the trade without reducing rates to such a point as ultimately might lead to demoralization of the rate structure. . . . Thus far complainant has been unwilling to disturb the rate level, although feeling assured of patronage when southbound operations begin." *Id.* at 74. (2) Defendants urged that the complainant operates chartered ships, but the same was true of three conference members. (3) There was no proof of demoralization arising from overtonnage; (4) There was no proof that complainant was unable to maintain "stability of service." *Id.* at 75. (5) As in *Phelps Bros.*, above, some conference members, though inactive, continued to vote in opposition to complainant's bid for entry. "This is patently unjustly discriminatory and unfair as between carriers, particularly when we consider the long period one member has been inactive." *Id.* at 76.

Waterman S.S. Corp. v. Arnold Bernstein Line, 2 U.S.M.C. 238 (1939). Complainant argued that exclusive patronage contracts made membership crucial. The conference claimed that there was already adequate, or surplus tonnage in the trade. *Id.* at 241. The relevancy of overtonnage and unnecessary competition is clear; "However, the record is not convincing that this would result if complainant's prayer is granted." *Id.* at 244. Further, "it is apparent that Waterman is prepared to engage regularly in the trade in conformity with the terms of the conference agreements; that the proposed direct service will be an improvement over the present indirect service; that denial of conference membership to Waterman, together with the effect of the exclusive patronage contracts, acts as an effective bar to that carriers' participation in the trade; and that it is not shown conclusively that the trade is overtonnaged." *Id.* at 243. The burden of proof had apparently shifted, for the adequacy of service, and complaint of overtonnage, is no longer "controlling." *Id.* at 243.

Cosmopolitan Line v. Black Diamond Lines, 2 U.S.M.C. 321 (1940). Seventy-five per cent of the cargo in the trade, excluding grain, moved under patronage contracts. *Id.* at 327 "[N]o rule or regulation has been promulgated which requires an applicant for eastbound conference admission to become a member of conferences operating westbound." *Id.* at 329. Although the commission, quoting its decision in the *Waterman* case, said that overtonnage "cannot be controlling," yet it took care to point out what first it had led us to believe was largely irrelevant, namely: "Viewed in the light of conditions as disclosed at the hearing, the contention as to overtonnage is without merit." *Id.* at 330. The commission concluded that the complainant should be admitted, since to do otherwise would be unjustly discriminatory, *in view of the exclusive patronage contracts.*

Sigfried Olsen v. Blue Star Line, 2 U.S.M.C. 529 (1941). One interesting feature of this case is that the conference, in the guise of a patronage contract system, charged the noncontract rate on *past* as well as future shipments in cases of breach: "Under the contracts, shippers of

one characterized generally by more prosperous conditions, the admission policy is more "open." Taking the period 1936-53 as a whole, it seems fair to characterize United States entry policy as "mixed." There are doubtless some cases where the authorities forced admission, without which the complainants would have been disadvantaged. The later decisions seem to shift the burden of proof more largely to the conference than to the outsider who wants to get in. If this is correct, it constitutes an important shift from the earlier philosophy. Yet, taking the period as a whole, it would be difficult to claim that United States policy has been spectacular, or even very impressive, in this field. For the policy is not intended to permit or encourage admission of tramps or "casual" liners. Only common carriers can make a case for admission; and the larger ones of these perhaps do not much need the Board's help in breaking into a trade in any case.

E. SUMMARY

Unless it is shielded by strong legal barriers to entry, it is most unlikely that any cartel will be able to exclude entry entirely. Many cartels that have been reasonably successful have not even tried to control entry. The conferences, in this respect, have probably done much better than average. There are various possible explanations. Some present-day ship operators claim that it is now

green coffee from Pacific-Coast ports of Central America to ports in California, Oregon, and Washington are required to offer their shipments to members of the conference. For failure to do so, there is charged on past and future shipments, a non-contract rate which is \$3.00 per net ton higher than the contract rate. The result is that defendants, admittedly, have a practical monopoly of the carriage of coffee, and complainant's efforts to secure such shipments are futile." *Id.* at 531. The trade was not overtonnaged, though the commission reiterates that this factor is not controlling in any case. "Membership in the conference continues to be held by the inactive lines while it is denied complainant." *Id.* at 532.

Black Diamond S.S. Corp. v. Compagnie Maritime Belge (Lloyd Royal), 2 U.S.M.C. 755 (1946). "In the past fifteen months we have not approved any agreement which restricted admission to carriers operating regularly in the trade. Such a provision would require an applicant who is willing and able to operate as a common carrier to do so for an appreciable period of time, probably at a loss, before qualifying for admission." *Id.* at 759.

The East Asiatic Co. v. Aktiebolaget Svenska Amerika Linien (Swedish American Line), 3 U.S.M.C. 1 (1947). Although there were, at hearing time, no patronage contracts in the trade, until September, 1939, there had been such contracts. Complainant said membership would increase its business. Though "adequacy of existing service is not sufficient reason to justify refusal of admission to a conference. . . . As complainant's operations between New York and Copenhagen are already established, admission to the conference will not increase the vessel tonnage in the trade." *Id.* at 5-6.

American-Hawaiian S.S. Co. v. Intercontinental Marine Lines, 4 F.M.B. 160 (1953). In this case, the burden of proof appears to have shifted to the conference, for the Board said: "If the members of a conference decline to admit an additional common carrier to membership they must present very clear justification within the rule set forth above, or within such reasonable requirements as their conference agreement may include. No such justification appears in this record." *Id.* at 163. "The rule is to the effect that ability and intention in good faith to institute and maintain a regular service is sufficient." *Ibid.* I am informed that the conference was a better judge of viability than was the Board. The complainant failed financially after being admitted.

very difficult to start a full-blown liner company *de novo*, allegedly because quality entrepreneurs with the specialized know-how are somewhat scarce. Although it is a troublesome contention, it is possibly true. To the extent that it is true, it would be favorable to the conferences, as would various other "natural" barriers to entry. Even if there *are* natural barriers, the conferences have evidently not been content to rely upon them. The conferences have, instead, relied upon institutions and practices. Deferred rebates and contract preference systems were designed to impede entry, and have undoubtedly had that tendency. They have probably been more effective against casual competition—which might otherwise become very substantial—than against dedicated opposition by larger liner companies. As strange as it may at first appear, the project and other special rate procedures of the conferences may also have impeded entry.^{210a} In the early days this seems to have been the case, as the BAPS Ring and other *quid pro quo* examples show.^{210b} Modern experience with cotton and other bloc-negotiated core commodities may also fit. To constitute a clog on entry, such rate practices would presumably have to operate in conjunction with what economists call "indivisibilities." Tramp and other casual competition flourishes on large movements of more or less homogenous cargoes. If such cargoes are important in any trade, there is a marked tendency for casual competition to nibble into general cargo as well. The carriage of non-tramp cargoes may be potentially profitable enough to justify special arrangements for those cargoes congenial to tramp or outside carriage. By negotiating with blocs of shippers who somehow can control the large volume cargoes, it may be possible to give them service and rates that are attractive enough to keep their custom intact, yet still come out ahead on the carriage of the general cargo, control of which has now been made possible. In sum, if such strategic core cargoes can be so

^{210a} See the 1959 testimony of A. J. Pasch, Chairman of the Associated Latin American Freight Conferences, which emphasized that project rates have an exclusionary rationale. "A construction company has been awarded a contract to build an oil refinery at one of our destination points. . . . The volume of tonnage is sufficiently great to attract operators of tramp vessels as well as some liner operators in other trades. Cut rates are, of course, their stock in trade. If we want these movements, and we do, we are obliged to negotiate for them at rates approximately the same as those established by the nonconference carriers. . . . Our transportation contracts covering the so-called project movements specifically require that all materials be of a proprietary and not of a commercially competitive character. . . . Thus we successfully guard against undue discrimination, undue preference or prejudice to similar materials which move to the same destination for competitive resale and which are subject to regular contract rates.

"The alternative is that these movements escape our best efforts and are in the hands of nonconference people. . . . Once the outside operator secures a foothold when he obtains a substantial amount of cargo for a job site, such as an oil refinery or a major construction site, the conference lines must necessarily expect immediately thereafter an attack on all of the higher rated items they carry. Therefore the project rate is an economic necessity if the conference lines are to maintain their position in the trade and to protect their regular shippers." *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 2, at 855.

^{210b} See the statement of James Dennean, *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 2, at 380-81, 382.

controlled, a shelter will have been constructed for general cargo. If outsiders cannot readily achieve the critical mass provided by core commodities, they may effectively be excluded from the rest. This possibility constitutes a very good reason for inquiring closely into the effect of special rates negotiated by blocs of shippers and blocs of shipping companies.

In any event, it appears that entry has been given a good deal of attention by the conferences, probably more than is commonly given by modern industrial cartels.

Public policy could, to some extent at least, erode the power of the conferences by weakening potential entry barriers. The *Isbrandtsen* case and United States policy with respect to conference admission procedures indicate that the Maritime authorities have not done very much to weaken entry barriers, and what they have done is not really dependent upon our having a subsidized fleet. It is now probably somewhat easier for a full-blown liner company to get into a conference than it was at one time; but the nature of conferences suggests that entry of that kind would be difficult to prevent in any case. The *Isbrandtsen* case suggests that the Maritime Board has taken an anti-entry position. If dual rates are made lawful by new legislation, one important impediment to entry will have been preserved. Thus, entry is restricted even though the Maritime Board claims credit for an open admission policy for conferences operating in United States-foreign trade. Even Maritime does not pretend to secure wholly free entry, but only for those who are essentially regular, scheduled common carriers. This excludes tramps, which would be excluded from the general cargo market by loyalty ties anyway. It would include full-blown liner companies, but if they are willing to spend something to do it they can probably enter and survive anyway, even without the hospitality of the Maritime Administration and the conference. It is, therefore, not clear that the so-called free entry policy of the Maritime Administration has significantly altered entry at all.

That the conferences have not been wholly closed may be attributed either to economic limits upon firm size or to the limitations of entry barriers. The data on conferences in United States-foreign trade broadly confirm that the conferences have grown. In 1934 the United States Maritime Board prepared the first official list of conferences and memberships in United States-foreign trade. Such lists have been prepared more or less regularly thereafter. In 1934 there were a total of 106 conferences. Eighteen of them, more than any other size of conferences, had three regular conference members. By 1958, though the total number of conferences had increased modestly, 122 as compared with 106, the absolute number of conferences with three members declined to nine. The data indicate that the average size of conferences has grown over time. Even so, at the end of the period, as at the beginning, a large proportion of the total number of conferences is accounted for by small number coalitions. Indeed, the general stability of the "profile" which describes that size distribution is a remarkable fact.

V

SOME ISSUES OF VALUES AND POLICY

The foregoing exposition and analysis have been directed largely at the rationale and mechanics of ocean conferences. Virtually no one denies that conference organization is a major departure from free competition. Many have rightly characterized the conferences as cartels. The United States, perhaps more so than any other major industrial nation, has long officially subscribed to the virtues of competition and long recognized the need to protect it. As a consequence, our policy has been, on the whole, hostile to cartels and monopoly, save for certain areas of the business economy that are claimed to be unique.

The testimony of Mr. Robert Bicks of the Department of Justice indicates the problem:

Mr. Zelenko. Now, let me ask you this, Mr. Bicks. You have lived somewhat with this problem and you are the legal man here and we want your assistance and the assistance of the Department: Do you concede that this situation in the shipping industry involving foreign competition, foreign flags, is somewhat unique? It is a little different than the usual domestic situation.

Mr. Bicks. It certainly is. It is absolutely the only area in our economy where Congress has delegated to a private group the power to set rates without any Government regulation.

Mr. Zelenko. I am not talking about a private group. I am talking about the general situation in the industry. That is somewhat unique, is it not, directly competing with foreign shipping?

Mr. Bicks. The facts of every industry are unique, Mr. Zelenko.²¹¹

Rightly or wrongly, competition has thus been a major goal of our economic policy, and each exception to that policy has had to be rationalized on the grounds that competition is impossible or manifestly undesirable in the particular areas concerned. In all of the important areas in which exceptions have been made, some kind of regulation has been established, in form at least. Our transportation policy is an excellent example of this purpose and the processes by which it is sought to be achieved. The bundle of industries that is called "transportation" has come increasingly to be regulated, and some parts of it have been exempted from our antitrust laws. Our generally similar policies with respect to the transportation industries have led some uncritically to assumed that *all* transportation is alike, that competition cannot prevail anywhere in it, and that all of it must be regulated.²¹² Yet, as has often been pointed out, all transportation industries are not alike, and policies appropriate

²¹¹ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 184.

²¹² Perhaps some of the growth in transportation policies is a result as well as a cause of this unreasoning attitude.

to one sort may be totally inappropriate to another.²¹³ It is therefore not proof, indeed not even persuasive evidence, that ocean transport cannot be competitive or must be regulated, simply *because* it is "transportation." Analysis of the conference system inevitably demands an inquiry into the regulatory rationale, for conference organization itself has become the central device by which our international ocean transportation is regulated. It is not surprising, therefore, that the most powerful arguments in support of the conference system rest upon the impossibility or evils of competition; the need for some kind of regulation and aptitude of conferences to perform it; or the happy interplay of regulation and the promotion of our own merchant marine. Each of these arguments must be carefully analyzed.

A. NATURAL MONOPOLY AND "RUINOUS COMPETITION"

Some outside experts, and most members of the industry, assert that ocean transportation cannot stand unregulated competition. The assertion is not surprising: many businessmen claim the same thing for other industries of which they are a part.²¹⁴ Common assertions are sometimes invalid. It is essential to inquire whether the argument is applicable to ocean transportation

Although the terms "ruinous" and "cut-throat" competition are popular, they are not often defined. Some mean by them only that competition erodes or restrains capital values. The logic of this usage is simple. Assume, for example, that a competitive industry is in full equilibrium: there is no disposition either to leave or enter the industry. The industry is of the proper size, given demand and cost conditions, and asset values are steady at the competitive level. Suppose now that the demand for the product declines. If the decline is permanent, the industry is now too big; firms at the margin are suffering losses, and capital values have fallen below the general competitive level. In the long run, some firms will drop out until earnings in the industry and, hence, capital values, have returned to the equilibrium competitive level. Those entrepreneurs that are forced out are, in a private sense, "ruined" by market forces and presumably are unhappy about it. But there is no reason to believe that competition has in this case proved ruinous to the general welfare. Competition will always be "ruinous" to capital values when demand declines considerably, or costs

²¹³ See, for example, the statement of Dudley F. Pegrum before the Senate Small Business Committee, *Hearings on the I.C.C. Administration of the Motor Carrier Act Before the Select Senate Committee on Small Business*, 84th Cong., 1st Sess. at 465-70 (1956). See also the Northwestern University Transportation Center's taxicab study, *THE OPERATION AND REGULATION OF TAXICABS IN THE CITY OF CHICAGO*, NORTHWESTERN UNIV. TRANSPORTATION CENTER (1958).

²¹⁴ For example, Mr. John Treanor, influential president of a large cement company, said in 1934: "The truth is of course—and there can be no serious, respectable discussion of our case unless this is acknowledged—that ours is an industry above all others that cannot stand free competition, that must systematically restrain competition or be ruined." *In re Cement Institute*, 37 F.T.C. 87, 248 (1943). Cited in STOCKING & WATKINS, *MONOPOLY AND FREE ENTERPRISE* 212 (1951).

rise. Indeed, that is its principal merit. By reducing returns relative to alternatives, resources are shifted out of one firm or industry into others; through increased earnings relative to alternatives, one industry attracts resources from others. To be ruinous in any important sense, competition must be shown to injure the public interest as compared with feasible alternatives.

Laying aside the question of natural monopoly, which I will analyze later, there are two possibly important reservations to the foregoing argument. First is the matter of the *frequency* of demand and cost changes and the costliness of adjustments that must be made to meet them; the second is the problem of the *size* of such fluctuations. They are closely related. The usual cost functions with which economists are concerned show minimum costs that must be incurred to operate continuously (or indefinitely) at various rates of output. They are not typically defined to include the costs of changing from one continuous rate of output to another. They do not ordinarily include the costs of producing different absolute quantities of output at the lowest cost achievable for each, or the lowest achievable costs of producing a given absolute quantity of output at different rates. In short, the usual cost curves drawn by economists apply to producing different outputs not only *continuously*, but indefinitely.

Take the hypothetical, but not totally implausible, example of a competitive industry which suffers very large costs whenever it must change its output rate. This might be true of industries that employ continuous chemical processes, those whose routine operations call for demanding and precise scheduling, and those whose major costs stem from providing *capacity* rather than different actual outputs. If demand changes often, competitive firms will weigh the high costs of output changes against those of storage, if storage is an option. If demand changes are perfectly predictable, that will be that. If not, one of the necessary costs to the industry will be forecasting or uncertainty costs.²¹⁵ In any case, it is clear that both the industry and society are worse off because of demand instability, since it will necessarily impose costs. There is no necessary reason to assume that such adjustment costs will make competition impossible. What they do is to raise the whole cost structure of the industry, thereby reducing its maximum viable size. But this may easily be compatible with large enough numbers to assure competitive performance. On the whole those firms that minimize the costs necessarily arising from such fluctuations will endure; those who meet the challenge indifferently or fitfully will perish.

It may at first be thought that monopoly permits such costs to be reduced. This notion appears to rest on the "stabilizing" effects of monopoly. As many observers have pointed out, cartels for one reason or another may *stabilize* prices in addition to raising them. Though somewhat higher than the competitive level, monopoly price can be very much more stable. But rigid prices in the face of fluctuating demand require that the brunt of demand changes

²¹⁵ Either in the sense of the costs of improving forecasts or the costs of not trying to forecast, but taking the whole brunt through costs of erroneous anticipation.

is borne *altogether* by output changes. In general, therefore, we should expect that *output* fluctuations will be greater under monopoly than under competition.²¹⁶ So far as costs incurred by the monopolist are raised by *output* fluctuations, a monopoly that rigidifies prices tends thereby to increase its own output adjustment costs. And if it is principally output changes that cause the adjustment costs, adjustment costs necessarily incurred by firms that buy the monopoly output would also be greater.²¹⁷

Now for the *absolute* fluctuations of demand and output, as contrasted with the frequency of such fluctuations. The *size* of fluctuations might, at a given frequency, directly influence the absolute amount of adjustment costs.²¹⁸ If this is correct, large absolute fluctuations may largely inflate costs. If this inflation runs far, the size of the industry (and perhaps firm size as well) will shrink. This could conceivably leave so few viable firms as to make competition impossible. In effect, the flexibility optimum size may somehow become large relative to the market. That is, "natural monopoly" could conceivably arise because of the high costs of adjustment.

This problem is unlikely to make competition either unachievable or undesirable. The test would be whether few firms survive. It is not enough to support the contention by showing that cartels or mergers occur, since there are always quite independent reasons to expect them.

Another issue, of a rather similar sort, remains, although it may be quite unrelated to uncertainties and fluctuations of the sort just discussed. Competition is limited by the extent of the market; the market may be so small relative to the optimum size of firm that only one efficient firm can be supported. This could arise, for example, if the optimum size of firm is absolutely very large, or if the market is absolutely very small. Rightly or wrongly, the notion appears to have been applied largely to railroads and public utilities. The same could be true of one physician, or theater, or ice-house, in a remote hamlet.

What does the theory predict? Even if the number of firms is, for any reason, at first large, one will emerge to dominate the field. For, by expanding, it can reduce costs continuously; *i.e.*, its long-run average and marginal costs are declining. This is a decreasing cost industry, in which competition is not feasible. If, because of errors or ukase, competition is attempted or imposed, it will be abortive. Indeed, competition will be "ruinous" for however long it lasts—no firm will be in equilibrium, for it could always increase profits by expanding. Furthermore, the public interest will have been frustrated, for

²¹⁶ But see pp. 205-6 *infra*.

²¹⁷ There may be certain savings in price-adjustment costs, though at the moment I do not see that they would be important.

²¹⁸ It just as well might not. If no greater resources are needed to make an adjustment, whether it is great or small—as a minimum staff of plant schedulers—the frequency of change may be the only operative cost factor. On a priori grounds it is not implausible that larger changes in output rates would impose somewhat greater costs than small ones.

(1) there will be so many firms that none can be efficient; (2) too many resources, some of which may be specific and, hence, lost forever, will be devoted to the industry. In this kind of case, competition would be ruinous in both the private and social sense.

Yet, in such industries there would be no need for artificial barriers to entry: the monopoly was established and survives because of genuine economies of size. Barring extreme folly, no one would enter. It sometimes is said that folly is widespread, and that it is desirable, in such cases, to use the power of the state to prevent entry. This, it is argued, both protects the fool from himself and assures that he will not waste society's resources by putting them where they should not be. There are deficiencies in such a policy: the only proof that natural monopoly exists is, ultimately, whether competition is viable. And if competition is never permitted a trial, it is impossible to know whether natural monopoly exists. If policy permits internal growth without limit, but prohibits mergers and cartels, any genuine natural monopoly elements will assert themselves in a pure form. Such a policy would let the relevant forces work, but would not confuse the outcome by permitting the unwarranted monopolization that would be attractive to the industry whether there are economies of scale or not. Conditions change, and the natural monopoly of today may become competitive tomorrow, if competition is given a chance.²¹⁹

The case of general cargo ocean transportation is not quite so clear. There are artificial impediments to entry. Under such circumstances the durability of monopoly is not proof of its inevitability or good.

One might have greater confidence that natural monopoly exists if each market continues to be served by one firm. This is obviously *not* the case in general cargo transportation unless it is legitimate to call a shipping conference a "firm." Under certain circumstances it might be, for the cartel might conceivably be the "firm" that closely administers and controls the requisite "pool of ships."²²⁰ But in such a case deferred rebates and similar institutions would be

²¹⁹ This logic seems relevant to domestic transport policy. Whether domestic transport media were ever natural monopolies is an issue that can be debated; but in some cases there have arisen competing branches of transport which have no natural monopoly elements. In some instances policy has then called for new regulation of the modes to "protect" the old ones' allegedly "natural" monopoly position.

²²⁰ Something like this was claimed in the early 1900's by Mr. W. E. Halm of the R. P. Huston Co., when he testified: "Well, the experience of many years of practice of the English and Continental lines, where ownership of probably 90 per cent of the tonnage of the world is located, shows that there is apparently only one way of securing adequate service to conduct the business of the world. That is, a pooling and rebate system. . . . I probably could just give you a concrete example of the way in which that works in the business from New York to South Africa. As I stated this morning, the operation of this route by five or six owners produces regular sailings. It may be that it is the Huston Line's turn to dispatch a steamer and the steamer ahead of us is going to complete her cargo and sail about the tenth of the month. It is therefore the Huston Line's turn to furnish a steamer to load on or before that date. The steamers of our fleet come up her from South America, many of them via the West Indies, where the delays are frequent. We will find a shortage of dispatching facilities or may be a

unnecessary: entry would "naturally" be unattractive to outsiders. Furthermore, it seems likely that natural monopoly requires central management, not the usual loose cartel administration. Truly centralized administration is today usually lacking in ocean transportation, though there may be unrelated reasons why the looser organizational form should be expected in ocean transport.²²¹ For the most part now conference secretariats do not schedule, plan, or control. It is difficult to see what it is that they do that could be construed as centralized management out of which great economies can arise. By and large, they rather seem to be record-keepers.²²² Risks and costs are borne by the individual lines, and to them fall the fruits as well.²²³

A related and subtle argument is that the "product" in ocean transportation is complex, and that this requires monopoly. For example, the value of a given quantity of cargo space on a given day may be related to the availability of similar (or different) cargo space on both earlier and later days. There are, according to this view, the necessity of scheduling continuous and regular service and a contention that the process cannot work in the chaos of competition. The barrier to it would apparently consist of one of two factors. The first concerns purely internal cartel mechanics. Whereas a cartel, or single firm monopoly, will schedule its offerings so as to minimize costs and satisfy consumers' needs, it is sometimes argued that this can be accomplished only through central management. Suppose that there are a number of independent liner companies serving a given market and that they form a conference. The con-

case of plague or other disease, and we find that our steamer can not get here in time to make the sailing on the 10th. That condition of affairs is reported to our principals in London. They cast around amongst themselves to ascertain what other steamer is in position. . . . We will exchange terms and the trade is not discommoded. There is no piling up of cargo. It goes forward on schedule time without any friction or without any loss to the steamship owners. . . ."

1. *Alexander Comm. Rep.*, *op. cit. supra* note 10, at 283.

²²¹ One obvious reason is that nations with subsidy programs might find special treatment of their "own" capacity difficult if it were only part of the integrated assets of an internationally-owned corporation whose majority shareholders are foreigners. Nevertheless, if there were natural monopoly elements, one would expect that the largest firms would grow fastest, under cartel or any other form of organization.

²²² In describing the Far East Conference, James Dennean, its chairman, stated that, "Apart from the chairman, the conference office has a staff of eight. There is a secretary who keeps the minutes of conference meetings and who cooperates with a tariff clerk in the preparation of tariff changes and rate supplements. There are also two statisticians, three stenographers, and one office clerk, whose services are required in the maintenance of the records of the conference and the conduct of its correspondence." *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 2, at 384.

²²³ Lloyd Tibbott, Chief of the Regulations Office of the Board, has indicated that even the conference representatives of the lines themselves may not be major entrepreneurs. In his words, "My personal opinion is that one of the weaknesses of conferences and one of their difficulties is that they frequently do not have representatives of the various lines of the highest caliber attending those meetings.

"Formerly the top traffic executive of the line attended the meetings. Many times that is not so today. I think that is not good from a conference standpoint. I doubt if that is any matter that is subject to our control." *Id.* pt. 1, at 82.

ference will, of course, strive to furnish the requisite regularity and frequency of service, and to do it at minimum cost. One reason for centralized control is obvious: suppressing competition will increase net revenues of the participants. Other gains are sometimes claimed: there may be significant size economies in certain aspects of liner management because of indivisibilities in skills or other resources. Or it may be difficult sensibly to schedule one ship for one day without knowing the scheduled position of each ship for that and other days. This is a straightforward, and common, statement that centralized planning in complicated economic affairs is superior to the resultant of many independent decisions. Yet the ability of unregulated markets to allocate resources and solve complex problems is well known.

Laying aside the possibility that size economies of scheduling may obtain,²²⁴ It will be worthwhile to examine the central planning complex-product argument. Suppose that several liner companies *compete* in a trade without benefit of a conference, and that there is no demand for tramp ship service. One fear apparently is that under competition, all ships would sail on one day, so that the value of the service to both shippers and shipowners is greatly reduced. Unsatisfied demand on the other days would make it possible to get much higher rates if only the sailings were reorganized, for rates on the days of "bunch sailings" would be very low. The fear is unwarranted. Just as in the case of currency arbitrage or commodity markets, it would pay to shift some sailings from the glutted to the unsatiated days. This is precisely the sort of mechanism that is at work in other competitive markets, and the mobility of ships should make the adjustment especially feasible and quick. Indeed, this is just what happens in unregulated trampshipping, which has to cope with bulk cargoes whose demands fluctuate very much more wildly than does the demand for general cargo. Shifts take place till rates are more or less leveled every place, which means that no firm has any incentive to shift ships from one day's sailing, or one route, to another. Each will then be in equilibrium. If super-normal profits exist, outsiders will place ships on the berth in those blank spots in the schedule, or those high rate days that produce the abnormally high profits. If the market for freight services is small relative to the smallest "indivisible" unit of transport—the ship—this adjustment will necessarily be imperfect. Some abnormal profits may then persist, but a free market can do no better. This indivisibility problem would also plague a cartel by preventing the perfectly neat accommodation of demand that profit maximization would require.²²⁵

²²⁴ There are good empirical reasons for doing so: first, such economies would encourage the ascendancy of a single liner firm on each route, and that is contrary to observation. Second, at the least, all or the typical conferences could then be expected to rationalize sailings and otherwise tightly regulate and coordinate their operating practices. In fact, however, such meticulous centralization of operating decisions is unusual.

²²⁵ In spite of some technological and economic constraints, it is clear that the size of ships can be varied. This is true not only when judged by deadweight or bale cubic capacity, but by lifting capacity per unit of time—a function of overall speed as well.

Unless there is some reason to believe that competitors are both ignorant and cannot learn, in which case we might find that everyone shifts all ships at the same time to the same place,²²⁶ there is no obvious reason why competition will not produce the appropriate time pattern of sailings. In any event, the problem of ignorance is no more specific to competition than to monopoly. Indeed, given that it is a problem in both, competition has the great merit of increasing the chances that the correct solution will be found. If monopolies make mistakes, they are less liable to correction. Though it has been briefly referred to above, the second reason for abandoning competition has to do to with outsiders, especially tramp ships. Unless there are stern and natural economic forces that exclude tramp ships, in which case there would not be any trouble from them, they may exert at least potential competitive pressures upon general cargo transport. The conferences, quite naturally, regard these pressures as pernicious. Insofar as they affect profits, this is doubtless true, though the effect in particular cases may be relatively slight. The present question is whether there is a broader social reason for avoiding them.

The first issue, again, is natural monopoly, already discussed above.²²⁷ The second, perhaps related, issue is the cost of adjustment imposed by "casual interlopers." The nature of the problem can be seen in a simple example. Assume that there is a temporary equilibrium for each liner firm in the trade, and a casual²²⁸ tramp ship appears in the market. On the day (or days) that it loads, the tramp ship will lower achievable rates: the elasticity of demand for *liner* service will be greater on those days. Profitability to the liners whose service the tramp ship has challenged will fall, perhaps to a negative level.²²⁹ Yet there is no reason to assume that rates will not cover out-of-pocket costs. In the social sense, sunk capital has zero costs and should be utilized as fully as demand permits. If ships were relatively small, some shifts would doubtless occur during the loading period of the tramp. In general, it appears that the interlopers would tend somewhat to reduce liner carryings in the same areas (or at the same time) that they increase their own, so that a loss of service frequency or regularity is not to be expected. If outside tramp ships call erratically and infrequently, so that their arrival can hardly be predicted, dam-

²²⁶ This phenomenon apparently has not arisen in the case of tramp shipping, in spite of both the very large number of firms that are involved in that line of trade, and the notorious demand instability that characterizes raw materials and bulk cargoes.

²²⁷ Tramp shipping and liner services may conceivably stand in the same relationship as trucking and railroad services. Certainly this notion is implicit in the similarity of epithets used in both fields: "piracy," "raids," "skimming the cream," "opportunistic competition," etc.

²²⁸ The economic sense of this may be that the tramp ship has carried bulk cargo inward and now seeks whatever cargo it can collect for the outward voyage.

²²⁹ If the size of ships is large relative to the market and to the elasticity of demand, it is possible that no positive rate would produce enough cargo to fill both ships. There will, however, be at least some transference of shipments from later to present loadings.

age to the conference should be small; if their appearance is regular and great, the liners will anticipate it and reallocate sailings to take account of that expectation. In neither event does it appear that the public interest has been subverted; to compete, the tramp ship must offer equivalent or better services, rates considered. If it cannot offer equivalent services, it does not menace; if it does, it is not apparent that society suffers because it chooses the tramp.²³⁰

B. SOME RESALE PRICE MAINTENANCE ARGUMENTS

One of the more sophisticated and plausible arguments for maintaining the conference system is that shippers, or the Federal Maritime Board, prefer a specific "mix" of services that unbridled competition could not conceivably produce. This argument is similar, in a subtle way, to some often used to support resale price maintenance in retail trade.

In one form the argument requires that the preferred product is a mixture of two or more ingredients and consumers are best satisfied only when *both* are offered by at least some suppliers. Thus, demand has several dimensions. With respect to certain kinds of retail trade, some have said that consumers want most, and will pay for, a certain combination of goods and services related to them, and that manufacturers have every interest in seeing that consumers get what they want. In the case of ocean transport, it is argued that a large number of shippers want and are happy to pay a premium for general cargo service that is dependably regular and rather frequent.

It may be instructive, first, to inquire in general into the retail price maintenance argument, noting where possible its strengths and deficiencies. The alleged similarities between general cargo ocean transportation and those fields in which price maintenance is applauded may then be more clearly revealed.

Some analyses²³¹ suggest that consumers of certain kinds of complex goods want instructional, preservative, or restorative services provided in addition to the goods themselves. In general, such interests of consumers tend to be met under competition by manufacturers and independent middlemen, whose interests in serving them are roughly identical. In those cases where the consumer is willing to, and can, purchase these services separately, and where it is possible to charge for them what they cost, there is no problem.

In those cases where there are economies of joint supply,²³² the manufacturer

²³⁰ This leaves out of account the possibility that the lines may not have free choice about scheduling. If, for example, governments oblige their flag lines unrealistically to adhere to old schedules in spite of new competitive offerings, the lines, and allocation of resources, may be both offended and grievously wounded. The clearest solution to that would seem to be non-intervention by governments, so far as schedules are concerned.

²³¹ See Bowman, *Resale Price Maintenance: A Monopoly Problem*, 25 J. BUS. 141 (1952); and *Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825 (1955).

²³² The goods and the related services can then be supplied at retail more cheaply together than separately.

will seek to pay the dealers—either explicitly or through discounts—to provide precisely those services that consumers want. Difficulties may arise, even if *all* consumers want both the goods and the related services, if some dealers abandon the provision of the services in favor of price cutting. These difficulties arise essentially because of a divergence between the interest of any individual dealer, on the one hand, and that of the manufacturer and dealer-group, on the other. How could that occur? In some goods, we are told, the sales and service efforts of dealers as a group are, past some point, more effective to increase consumption than is price cutting.²³³ Nevertheless, any *single* dealer presumably could greatly increase his custom at the expense of others, if he provides the desired bundle of goods and services at lower cost to the consumer. If the goods and services are in fact separable yet there is no mechanism for paying for them separately—so that the consumer can get valuable information or instruction from one dealer without paying for it—*i.e.*, without buying the product—he will generally find it desirable to take the “free service” from one dealer and buy the goods from another dealer who has stopped—or never started—providing the services, and who sells at a lower price. Given substantial overlaps between the markets of these two types of dealers, it is clear that there is a risk—from the manufacturer’s point of view—that ultimately no one will provide the services that he wants. This argument does not depend importantly upon the existence of two types of consumers, those who want services and those who do not. For even if all consumers prefer the same services, they will find it advantageous to pay as little as possible for them, and, according to the argument, may end by getting none at all. The existence of different kinds of consumer preferences imposes additional, but not offsetting, complications.

Abstracting from legal constraints, the manufacturer has several alternatives. First, he can abandon his service objectives altogether, a solution that is presumably far from ideal. Second, he can provide the requisite services himself, though this may involve massive diseconomies as compared with their provision through independent dealers. Third, he can sell only to those dealers who contract to provide the optimum mix of product and services. This will be impossible if there is both competition at the manufacturer’s level and a sizable number of dealers with a comparative advantage in price-cutting who refuse to accept his contract terms. Fourth, if there is some way in which the dealers can charge explicitly for the services they provide, he can proceed without worry. Fifth, if there were not the sticky problem of compelling dealer performance, he could pay the dealer directly for providing the services he wants. Sixth, he can devise a system that will both compensate the dealers for providing the requisite service and protect them against opportunistic dealers who take a “free

²³³ The elasticity of demand with respect to price is lower than that with respect to services. There is little ambiguity about measuring price; not so clear is an appropriate measurement of service.

ride" on the services that they undertake to provide. This may imply the same choice as is involved in the third alternative. One way to accomplish the objective is to require that retail prices be maintained at a level that provides the requisite services. Non-service price-cutters are then excluded, if price maintenance can be made to work.

Convincing examples of the foregoing process are somewhat difficult to find. Many of the obvious cases in which such dilemmas might be thought to arise have evidently not caused real trouble: sewing machines and sewing lessons²³⁴ (where the manufacturer has integrated into distribution); automobiles; and filling stations (where resale price maintenance has been tried and abandoned, without any perceptible deterioration in quality of service or any other public detriment). There are numerous other examples from the merchandising field.

Leaving aside industries in which there are said to be compulsions to "Natural Monopoly," economists have agreed that the most reliable gauge of what people want is what they are willing to pay for if they are given free choice; those offerings that cannot on their individual merits produce enough loyalty to guarantee their continued existence pass away, and their passage should not bring tears. Generally there is a belief that competition better provides the range of choice that consumers want than do cartels. It is probably valid to assert that consumers know best what they want, and that a choice made *for* them, by the state or by a private cartel, is liable, over time, to produce greater evils than those into which their own cupidity is likely to lead them.

However meritorious resale price maintenance may be—and there are widespread doubts about that²³⁵—there are substantial differences between that example and the actual circumstances surrounding ocean transportation. To apply the argument to ocean transport, it is useful to look upon the United States Federal Maritime Board as playing a role similar to that of the manufacturer in the previous examples. The Board can thus be assumed to want the "best" mix of service and price for the shippers and the nation as a whole. It would also be necessary to assume that shippers agree with these objectives.

In the case of dry cargo ocean shipping, it is clear that there are at least two types of shippers. There are those who need or want frequency and regularity of service and who are willing to pay more for them if they must, and those who do not require or want regularity and frequency and will pay more for them only if they have no feasible alternative.²³⁶

The conferences argue that outsiders—like Isbrandtsen—in fact get a "free ride" on the services that they provide. But the outside berth operators *also* provide a modicum of regularity and frequency. When the conference

²³⁴ I believe that it was Aaron Director who pointed out this example.

²³⁵ REP. OF THE ATTN. GEN.'S COMM. TO STUDY THE ANTI-TRUST LAWS 135-55 (1955).

²³⁶ This may oversimplify: It assumes that the "irregular" demand does not *require* regular service, but can be satisfied by it.

does not employ institutions that compel shippers to make an all-or-none choice, to the extent that any outsider gets business, he must be offering what the shippers want. That outsiders do *not* get the business is consistent not only with the possibility that shippers do not want what they offer but also with the compulsion of an all-or-nothing choice. In the case of "tramp" or other irregular competition, it is clear that on each *specific* transaction the tramp must offer just what the shipper wants relative to his alternatives, otherwise the shipper would not be willing to use him. The tramp, by the same token, has received no obvious services from the conference in connection with this transaction, unless you adopt the conference argument that the trade would never have developed in the first place if its development had depended upon irregular carriers.²³⁷

In the case of outside competition from berth operators, is there any free ride? The conference indictment of them is that they "skim the cream." In other words, they concentrate their efforts upon those commodities that yield the highest net rates. But that is the usual result of permitting competition to develop anywhere a discriminatory price structure exists. The only remotely obvious sense in which the outsiders are getting a free ride is that they cannot, or choose not to carry all cargo moving in the trade. Thus, they are presumably charging the shippers what they are able to get for the services they provide; the conference is only providing a "service" by offering idle capacity, which evidently not everyone is willing to pay for at the existing level of conference and outside rates. The capacity and service they provide *is* paid for by those who use it; it is free only to those who do not choose to use it. In the same sense, one price-cutting filling station operator might actually *lose* gallonage if, fortuitously, all other filling stations everywhere suddenly shut down: the aggregate volume of auto travel would shrink drastically; perhaps no cars would move past his driveways at all. In *that* sense each filling station gets a "free ride" from the existence of all of the others, but that would be equally true (however true that is!) of many other lines of trade. Both long and short-run supply would dry up entirely if present prices are slightly reduced. Such supply conditions do not, evidently, have much applicability to the real world.²³⁸

²³⁷ This may be like the following argument: The aluminum industry would never have developed in the U.S. without Alcoa; entry into aluminum injures Alcoa; entry should therefore be prevented.

The Royal Commission Report on Shipping Rings (1909), *op. cit. supra* note 2, quotes both conference and non-conference ship operators to the effect that shipping follows and does not lead commerce. Recent interviews with shipping companies show that this conviction is widely held today even among conference members, as does the following statement: "As is commonly known, 'ships follow cargo,' and Lykes is competing with vessels of the principal maritime nations of the world." Statement of Solon Turman, President of Lykes Bros. Steamship Company, *Bonner Comm. Hearings*, *op. cit. supra* note 10, pt. 2, at 649.

²³⁸ The point seems less than obvious during a period of growing surplus capacity. As Mr. Crinkley of the Isbrandtsen Company put it, "I tried to establish that point, Mr. Bonner, and it was this: If there were not quite enough ships to go around and you interfered with the

There is another possible reason for questioning the resale price maintenance argument with respect to ocean transport. In one form, at least, it requires a higher responsiveness of demand to service than to price: all active conferences suppress rate competition amongst their members; many, having done that, do not attempt to regulate service competition at all, and are not seriously disturbed by this omission. On the other hand some do attempt such regulation,²³⁹ which, though it weakens the point presently at issue, somewhat strengthens the one to follow.

There is yet another, and simpler, resale price maintenance argument.^{239a} If a manufacturer of consumer goods or a shipping cartel sets *and maintains* prices at higher levels than free competition would establish, there is a tendency to increase services as a substitute for price competition.^{239b} The argument implies that the volume of services provided will increase as rates (or prices) are advanced and will likewise decline as rates fall. For example, some manu-

operation of them, you might find that the exporters and importers would not have enough available service. Some fly-by-night, for instance, might have come in and gone out but, where you have got a situation that the world fleet is being used to 56 percent of its capacity, which means 44 percent of the world shipping fleet is surplus. I contend that there is not any appreciable danger of American exporters and importers not having enough service.

"The point about it is that the conference contract system does not provide any solution of the overtonnaging problem.

"In the world outside of the United States a conference contract system is used generally by the lines, a deferred rebate system which is something similar.

"Here the exclusive patronage contract system has been used for about 25 years, not by all of the conferences but by many of them. During that time that overtonnaging problem has become more serious every year." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 242.

²³⁹ Such arrangements include the limitation of number and kind of agencies—it is not rare for a conference to require that each member have no more than one agent or branch at each port or place. For example, see Federal Maritime Board Agreements Nos. 90-8, 150-10, 3103-9, 3302, 5600, 6010, 6150, 6190-14, 6670-5, 7190-2, 7270-6, 7540, 7590, 7890, 7900, 8061, 8061A, 8100, 8190-2, 8210, 8230-1, 8250-3, and 8390.

Others limit the quotation of through rates to interior points, circumscribe the extension of service to new port ranges, or limit the extension of credit.

^{239a} I am indebted to Professor Lester G. Telser for the best statement of this argument for resale price maintenance in retail trade. Telser, *Retail Price Maintenance* (unpublished report on file with the U. of Chi. Bus. School).

^{239b} In the words of James A. Dennean, Chairman of the Far East Conference, "I would like you to picture solicitation staffs for each of the 25 members of my conference pounding the pavements to drum up cargo, each for his own line. Each has his job of salesmanship, and what he has to sell is service; that is to say, the extent to which he can point to his line as offering superior service in any one or more of these categories that I have enumerated.

"The result of this competition in service has been a continuing improvement in vessels, both as to speed and special adaptation to the requirements of the particular trade. I would not want to be understood as claiming that conferences have been the only factor contributing to the development of better and faster shipping services. It cannot seriously be disputed that the conference system is entitled to a very large share of the credit for such improvements because it channels competition away from destructive rate competition in the direction of service competition, and because it provides the stability of rates which is prerequisite to the investment of the substantial sums required to replace obsolescent fleets with new, improved tonnage." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 374.

facturers of consumer goods who have supported resale price maintenance claim that only by holding retail prices high can they get the optimum proliferation of outlets needed to sell "convenience" goods. Conference advocates commonly advance the same argument in connection with ocean transportation. Frequency and regularity of service will, they argue, increase as a direct result of the higher level of conference rates. For the conferences typically suppress rate competition without suppressing other forms of competition. Each line, *if* it is small enough relative to the market, would then find it expedient to increase the frequency or regularity of its service to increase its carryings and profits. What each would find it profitable to do would be done selfishly by all. The level of services would then be higher than under competition, as would the level of rates. The level of services would also be higher than under either single-firm monopoly or a cartel that systematically pooled or otherwise regulated *all* competitive conduct. The virtue of conferences in producing super-good services thus rests on the supposition that conferences are seriously imperfect as devices to maximize the profits of their members. Or, put in another way, superior services are an inadvertent by-product of imperfect monopoly. This imperfection, and the alleged public virtues that stem from it, will be least important—or wholly absent—when the conferences have small memberships or place limitations upon service competition. It appears, then, that small trades, for which the provision of good service is the hardest problem, will benefit least from the imperfection; and whereas the large ones may gain most from it, they are also the ones in which frequency and regularity would be established at highest levels under unrestricted competition.

There are additional criticisms to be offered against the superior service argument for conference organization. The alleged virtues arise only from suppressing rate competition; they are thus a feature of monopoly. If monopoly means anything, it is the narrowing of alternatives, ideally to zero. And, as in fact turns out to be the case, some shippers may not want the superior services at the rates, they are obliged to pay for them. An ancient complaint against the conferences, and one still heard, is that some shippers want less service and lower rates, yet are denied the choice. Such a system, even undertaken with benign motives, would inevitably injure some to benefit others. Much more doubtful is the permanent benignity of results that stem only from the failure of private monopoly to extract maximum profits from those it serves.

A safer course thus appears to be to permit those who want the service to pay for it; and to allow those who do not the possibility of buying lesser services at a lower price. Competition would provide the option;¹ conferences do not. Finally, one of the objectives of maritime subsidies *has* been to provide regular services. To that extent, at least, the American flag lines *have* been paid explicitly to provide services.

This leaves, among other possibilities, the issue of natural monopoly and

ruinous competition, which depends, not on the difficulty of developing a system by which producers may be paid for something that consumers want and actually use, but, rather, upon the necessary incompatibility of supply conditions with continued competition. That problem was discussed in the preceding section.

We may tentatively conclude that, if rate fixing in ocean transportation is necessary and desirable, any such compulsions must arise from sources other than the nature of demand and the inability to collect for necessary services that have actually been rendered.²⁴⁰

C. THE DESIRABILITY OF STABLE RATES

However stable rates are, there remains the question of the desirability of stability as produced by a conference system. Opinions vary among those who pay conference rates, and it is difficult to state unambiguously what the preponderant view really is. Perhaps it is safe to say that shippers apparently desire rate stability, if it need not be bought at the cost of too high a rate level.

Although it is very general, probably the strongest recent claim that stable rates are desirable is that made by Chairman Morse:

Unrestricted competition is harmful because it makes for instability and unpredictability of rates and service. Rate instability imposes a serious handicap upon the conduct of foreign trade. It confronts exporters and importers with the hazardous condition of everchanging ocean rates. We have found that shippers have frequently and with considerable uniformity testified in our proceedings that even more than low rate levels, they desire stable rate levels.

This was no less true in 1915 than it is today. It was pointed out to the Alexander committee, for example, that stability of rates removes the inconvenience which would exist if merchants and shippers were obliged to quote different prices on nearly every consignment. Rate stability eliminates an otherwise undesirable speculative risk under the open competitive system; reduces complaints from buyers abroad; enables shippers and merchants to calculate laid-down costs and sell goods for delivery in the future; and permits forward trading and the building of inventories (4 Alexander Report, pp. 297-298).²⁴¹

One of the important issues that the Royal Commission on Shipping Rings faced in 1907-1909 was the desirability of stable rates to shippers and the public at large. It may be useful, first, to indicate the limits of shipper opinion as found by that Commission. As one merchant put it:

²⁴⁰ One standard conference argument is that the contract rate system is identical to reduced fares for round-trip or commutation travel on overland carriers. This contention is somewhat deficient: buyers of round-trip tickets do not contract not to use any other carriers. A more nearly comparable conference rate system would provide a lower net freight bill for the use (or non-recourse reservation) of larger cargo space than for smaller. In fact, however, quantity discounts are said to be an anathema to the conference system. See the discussion, p. 65 *supra*.

²⁴¹ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 11.

In the absence of any rebate system, with the resulting violent fluctuations of freights, my own firm would require one partner's attention almost entirely devoted to freights, or would have to employ a very experienced and highly-paid freight clerk, while all the time there would be this added cost of working the business, and any extra profit we might make in times of high rates and lessened competition, we should lose during the period of low freights and outside competition.²⁴²

At somewhat lower level of enthusiasm for stability, we find opinions that can no better be summed up than in the testimony of Sir W. Egerton: "Do you consider that [stability] a benefit?—Not if the stability is of very high freights instead of the freights that were always a good deal lower."²⁴³

Others claimed that, in addition to or in place of the cost savings of adjustments gotten from stability, the real merit was ease of making forward contracts. According to Mr. Shelford, before conferences became effective "... there was a great difficulty about getting a stable rate. A man could not make a contract ahead, we will say, for tapioca, on a basis of freight, it may be, of 15s. and count on that with absolute certainty."²⁴⁴

Mr. Zimmern, who was in the China textile trade, said much the same. In his judgment, "It is a distinct advantage in our trade to know exactly what the rates are and to have steadiness of rates, because a great deal of business is done forward, and if the rates are suddenly raised against us when contracts are pending, of course, it is extremely detrimental."²⁴⁵

Some claimed that the argument was moot in any case, either because in a free market freight rates would not fluctuate too much, or because forward rates could always be secured by those who wanted them. Mr. Langdon's testimony reflects the first view; Mr. Maclay's, the second. In Langdon's words:

²⁴² 39-III R.C.R., *op. cit. supra* note 2, at 102. A letter from the Sydney Chamber of Commerce summed up its opinion in these words: "Stability of freight is of great consideration to smaller traders and men without expert knowledge of making freight arrangements. Large shippers would almost invariably prefer open competition." 39-II *id.* at 146.

²⁴³ *Id.* at 407.

²⁴⁴ 40-IV *id.* at 16. Of course, certainty always costs something; and it is not obvious that it will cost less under conference organization than non-cooperative arrangements.

²⁴⁵ *Id.* at 48. In recent interviews, ship operators have said that much of the Orient trade today is done CIF, very far forward; thus the advantage that Mr. Zimmern stressed would, presumably, still apply. However, it is curious that the emphasis today seems to be on freight *declines* that leaves early shipments unsaleable or prey to heroic markdowns.

It is also anomalous that rate stability is claimed to be indispensable in cases where freight is a relatively slight element—as silk and some other fine goods—but for coal and other rough goods, for which freight is a high proportion of value, competitive tramp rate fluctuations have obviously not killed the trade. Under questioning, Mr. Zimmern recognized, but did not explain, that paradox: "You cannot get many trades where the freight is of less importance than the trade that you are speaking of, can you?—That is so, unless you take silks, homewards. . . . Therefore the amount paid in freight becomes a very small percentage of the value of the article?—Yes."

"And therefore it is not of nearly the same importance to you as it is in the heavier trades?—That is so." *Id.* at 50.

. . . do you think, as a practical man, that in a free freight market rates of freight would fluctuate more violently and more seriously than the prices of ordinary commodities?—I do not think they would. . . . I do not think they would fluctuate as much as the price of such articles as are dealt with on what I call future exchanges.²⁴⁶

According to Maclay:

I do not see any reason why the shipping trade should be different from other trades. I do not see that the commodity of freight is different from almost any article, and there is no article almost which does not rise or fall in value from time to time. I would put it that way, that if the merchant wants to be covered, I believe he would have a greater opportunity of being covered without the deferred rebate system than with it. If I understand the operation of Rings correctly, they usually make the freights definite for a period of perhaps six or twelve months; and I have no hesitation in saying that if a shipper went into the market and wanted his goods covered for a couple of years, he could get it done outside the Rings altogether, for any quantity of freight.²⁴⁷

On the other hand, Mr. Schlee, a shipper of China tea, testified as follows:

I do not see that uniformity of rate is desirable at all. If there is a scarcity of tonnage in the one place, why should they not charge more; and if there is a plethora of it, why should they not have it cheap?²⁴⁸

Rosling, a shipper of Ceylon tea, had this to say of the conference system of rate-making:

It undoubtedly conduces to a more level range of freights, but from the producer's point of view I do not see how he is affected by that. The producer does not mind if his neighbour gets his tea home at half-a-crown cheaper than he does himself. He is not competing with his neighbour. The tea that he has shipped is sold by auction, and it is not your aim to get it in at a price under your neighbour. We only want to feel assured that we are getting it home on the whole as cheaply as we can reasonably expect.²⁴⁹

²⁴⁶ 39-III *id.* at 52.

²⁴⁷ *Id.* at 318. Note also the following Maclay statement: "I put it to you whether there is not a peculiarity in the nature of freights which would lead to more considerable fluctuations in their rates than in the prices of ordinary commodities?—I should think it would be the other way about." *Id.* at 323.

²⁴⁸ *Id.* at 99. Heaton gave his opinion succinctly when he said, "I presume there is a certain advantage in uniformity of rates, but as a businessman I prefer to do the best we can in each case." *Id.* at 125. Heaton likes low rates better than stable ones.

²⁴⁹ *Id.* at 261. What Rosling said may be important. In anonymous markets—those that approach perfect competition—like the commodity exchanges, there is no personalized rivalry, but rather an urge to minimize costs and grab the best price going.

Other merchants professed chagrin in learning that their fellows had gotten concessions or had temporarily fared better on a fluctuating rate market. Perhaps the difference is in part a function of the type of market in which they operated. Take the limiting case of an industrial cartel which uses a basing-point system to set uniform prices. There is an advantage to the cartel to use railroad rates for setting delivered price: rail rates are regulated by the ICC and are both uniform and very stable. The cartel is able to achieve its monopoly purpose much more readily than if rail rates were competitive and fluctuating. Such an industry may be very happy to pay rigid rail rates since their rigidity is an important ingredient in a cartel

Some merchants found in rate fluctuations a source of profound general disturbance to their trade. Mr. Edelsten's testimony developed this point of view forcefully, though not very consistently:

Will you tell us why you do not like a freight fight?—Because there is an immense amount of merchandise thrown on the market—much more than at any other time—and everybody is unsettled.

Why is the merchandise thrown on the market?—Because everybody is trying to get level with everybody else, and they all want as much cargo in as possible at the low rate of freight.

I suppose it would be rather unkind of me if I reminded you of what you told Professor Gonner—namely, that the freight did not matter?—I am quite right in what I say about that; I do not think it matters so much.

But it does matter to this extent, that when there is a cheap freight going everybody wants to ship. Is that not so?—Everybody wants to get their goods in with the cheap vessel.²⁵⁰

Interestingly enough, at the other extreme limit of opinion stood those who found flexible rates a positive benefit. Maclay stressed the dynamics of trade development; Lovell stressed the dependence of profits upon uncertainties. As Maclay put it:

I believe there is no time when the development of our trade is so great as a time of cheap rates. Everytime you have a spasm of cheap rates, trade seems to extend wider than it ever did before. It gets into different classes of articles, and brings them into consumption in more distant places—away up into China, away into Africa, and away elsewhere; and once the peoples of those countries get into touch with our goods and begin to utilize and use exports from this and other countries they never go back on it, and when an improvement in trade comes, you find there has been a great development. I believe every turn of bad trade in the long run acts very much to the interests of the country; and I am speaking, not only of a reduction of freights, because freights are only an item in it, but of a reduction in the price of particular articles.²⁵¹

According to Lovell:

I do not know that it is an advantage to have steady freights, and I do not think that it is. Freights are subject to fluctuations, and there is a legitimate ground for profit in that.

Steady freights are, I suppose, an advantage to those who make forward contracts?—I do not think so.

It takes away from them one item of risk and speculative danger, does it not?—That

scheme that will, if it works well, produce greater revenues than the excess that non-competitive, but regulated, rail rates might cost.

During the Royal Commission inquiry, Mr. J. A. Spens said something that is relevant when he observed: "But to tell me that you are to pay a higher rate of freight than is reasonable in order to have a stable rate is simply this, that you agree to pay the maximum in order to avoid having the trouble of adjusting a less rate from time to time; and that cannot be in the interest of trade." *Id.* at 294.

²⁵⁰ *Id.* at 431.

²⁵¹ *Id.* at 328.

is one of the items on which you calculate to make a profit. If you are far-seeing in the matter of freights, you are more likely to do well in your business now-a-days with all the speculative elements there are in it, than if you are not.²⁵²

You think that a sporting risk in connection with freights is a thing rather to be appreciated than to be eliminated?—Yes, that is my feeling about it. I do not know whether you would call it sporting, but I think that fluctuations in freight like everything else are perfectly legitimate according to the state of the trade.

It lends an added interest to the business?—It gives you more chance of making a profit if you are far-seeing.²⁵³

It is clear, then, that opinions about rate stability are divergent. When opinions differ, logic may help. We may now inquire into the logic of benefits arising from rate stability, or the costs arising from change.

The problem consists of two interrelated parts, both of which have to do with either the indirect or direct costs of stability. The first is the issue of the destabilizing effects of rigid prices. A single-firm monopoly or cartel that makes rates rigid in the face of fluctuating demand *tends* to have a more widely fluctuating output.²⁵⁴ This, presumably, would not only affect the internal costs that must be met by the conference to make necessary output adjustments, but would have destabilizing effects in the factor markets from which the conference buys its variable inputs, and in the operations of the very firms to which it sells. The argument is not yet complete, for there may be offsets. The rigidity of rates *itself* may conceivably reduce costs amongst those who buy the service, and thus tend to *increase*, or regularize, the quantity of service that is demanded over time.²⁵⁵

Thus, some cost savings may accrue to shippers as a result of stable rates: they will not have to devote themselves to pondering the future of rates. This saving may be offset, or swamped, by either the costs of their varying outputs in the face of rigid rates or by the *level* of rates themselves. Furthermore, to show a counter-cyclical or stabilizing effect on the quantities of goods shipped (the output of the conference), it would be helpful to show that the cost savings

²⁵² 40-IV *id.* at 23.

²⁵³ *Id.* at 26.

²⁵⁴ This part of the argument is put succinctly by E. A. G. Robinson in these terms: "if in this industry demand fluctuates, so that at one moment the whole demand curve is raised, at another moment lowered, a monopoly which attempts to keep *price* fixed will have a larger output in good times and a smaller output in bad times than would be produced by competing firms with a rising supply curve. This is obviously true in all cases in which the amount that the demand curves fluctuate is quite independent of the price that may be charged at any time." ROBINSON, MONOPOLY 144 (1949).

²⁵⁵ Robinson's version of this offset is beclouded, for he includes not only the possible effect of reducing costs of uncertainties to shippers, but of the possible benefits to quality of service that may attend a cartel system, one of whose effects is to stabilize rates. In Robinson's words, "There are a number of circumstances in which a known service, regularly available at a fixed price, may succeed in evoking a greater demand than a service irregularly available at a varying price." *Id.* at 156.

to shippers from stable rates are contra-cyclical in character. If the cost savings are cyclically neutral, or conforming, instability in output may actually be increased.²⁵⁶ I see no reason for believing that the cost savings will reduce output instability; indeed, I suspect the opposite will be the case. In any event, fluctuations in the demand for shipping may arise from random, seasonal, or cyclical causes. These causes remain essentially unchanged by conference rate policy. If adjustment costs arise because of dispersion of demand, dispersion will remain.

Look now at difficulties that may arise from rate increases. If goods are sold forward, inclusive of freight, an order taken when rates are low will be less profitable to the seller if rates rise by shipment time. The purchaser will, in a sense, have received a windfall gain; the seller will have suffered a loss. One problem, it is sometimes urged, is that when rates fluctuate often and considerably, some buyers will, over a short interval of time, pay different amounts for their goods than their competitors pay; those who pay the higher amount suffer, and those who pay the lesser amount gain at their expense. If the fluctuations are important, this may be true; yet there is no reason to believe that such fluctuations will be systematic. If they are not, odds will be as good for one competitor as another. If the fluctuations *are* systematic, viable competitors will include among their business characteristics a flair for understanding (or at least conforming to) the system of fluctuations. Assume, on the other hand, that goods are sold in a large central exchange which is served by many sellers located at widely differing distances from the market. If rates of freight advance generally, prices on the central exchange will rise; but not, unless the advance persists for a long period, by as much as the advance in freights. Buyers will have suffered, as will sellers; and quantities marketed will decline.²⁵⁷ If the advance is permanent, sellers at the margin, *i.e.*, those who are located very far away and who were, at the old rate, just able to manage a precarious survival, will drop out entirely. The geographic structure of supply will have changed, and the commodity will not now move so far as before. Such permanent changes are not at issue here, since presumably neither the conference nor competitive organization would, or should, long resist permanent changes.

What about rate declines? Goods ordered for forward delivery while high rates obtain, but actually shipped when rates are low, give the seller a windfall gain and impose a "loss" upon the buyer. In the case of buyers who compete in reselling the commodity, the same observations made above will apply.

In the case of standardized goods that are traded anonymously on central exchanges by both remote and close sellers, the effects of rate declines will

²⁵⁶ I am indebted to Professor Stanislaw Wellisz for this point.

²⁵⁷ This leaves out of account the effect of rate changes that are not general but only partial. One example—indeed the limit—of the partial case is to be found when some part of the market is served by sellers, located at the market, who never incur any transport costs. They will be well-served by an advance in freights: prices will rise, but their costs remain unchanged.

be opposite to, but roughly symmetrical with, the effects of rate increases. Prices on the exchange will fall, but initially not as much as the decrease in rates; and in the short term profits will be made by the competitive supplying industry. Over a longer period, more remote supplies will come into play; and on the average the commodity will travel further to market.

It seems clear enough that the fears and actual adjustments caused by changing costs and prices impose certain costs upon buyers and sellers and upon society as well. If one could choose between a natural development such that prices will be quite stable at the competitive level, and another, equally natural, that produces prices that fluctuate in altogether an unknown way save that over a long period they will have a weighted average identical with the first; there might be reason to prefer the first. If the future fluctuations of the second series are perfectly known, there is no obvious reason to prefer one over the other, since the appropriate averaging adjustments will be made by all concerned. The important difficulties arising from fluctuations apparently are that their amplitude, frequency, and timing are unknown.

But stability of the sort produced by conferences is not natural; it is produced, incidentally or as a prime objective, by purposeful men. To produce it without disaster to themselves, the conference, even if it charged what turns out to be only the weighted average of rates that would otherwise fluctuate, must incur and recover the costs of averaging best expectations. This is essentially the same process as would have to be engaged in by shippers or buyers if there were no conference, but if there were a desire to estimate "normal" rates. Society should prefer that the conference perform this function only if it can thereby be performed more cheaply by the conference than by someone else. It may be that the conference, or any individual shipping company, can perform this function more cheaply than shippers or consignees: there may be scale economies arising from the actuarial process; or the function may be complementary to other functions regularly performed by shipping companies. The only definitive test of this, of course, is an open market for the service; but this the conference denies us. Lacking the real test, logic may serve. If actuarial size economies are involved, this could as well or better be performed by agencies—like tramp ship brokers—independent of ship operation, just as the normal insurance and future-hedging functions are facilitated by agencies quite separate from the industrial processes that they serve. If forecasting normal rates is complementary to the consolidation of many small parcels for a trade route, functions performed by each conference member, there is no obvious reason why they could not jointly be performed by combination broker-forwarders. Finally, since conferences are combinations of several otherwise independent firms that perform these functions, there is no reason to assume that the same shipping companies could not perform analogous functions even if there were no conference.

The power by which the conference fixes steady rates, that might only be

equal to the average of unsteady competitive rates, enables them to do a good deal more. If a cartel has the power to fix rates that are, essentially, long-run normal competitive rates plus the cost of "steading" them, why should it be content with that? With no additional power it can fix steady monopoly rates and would be quite foolish if it did not do so. Human nature being what it is, the safest prediction appears to be that, however steady are the rates it fixes, the conference will fix them at a higher average level than competition would permit.²⁵⁸

Furthermore, there is some evidence that small shippers may be able to get forward rate quotations from non-conference lines even when the conference rates are "open."²⁵⁹ Finally, several conference agreements explicitly *limit* the duration of forward contracts.²⁶⁰

D. CONFERENCES AND THE SUBSIDY

An increasingly common argument is that conferences should be preserved, or strengthened, because conferences increase earnings and reduce the amount of subsidy that must be paid. It is often said that United States liner companies could not survive, with present subsidies, without the level and stability of rates that conferences provide. The testimony of Mr. Clarence Morse, Chairman of the Federal Maritime Board, states the argument clearly:

Mr. Zelenko. So that, the unsubsidized company would possibly be forced out earlier than the subsidized company. The subsidized company would be in the position of requiring more subsidy or, if they would not require more subsidy, there would be no recapture, so that that would cost the Government and taxpayer money in any event.

Mr. Morse. Yes, sir.

Mr. Zelenko. So that you feel then, do you, from a general aspect, without going into detail, that conferences are necessary in this industry in order to have an American merchant marine survive?

Mr. Morse. Yes; I do. There must be some means of preventing rate wars and this is the best device that has been thought of to date.²⁶¹

This contention raises two important issues: one of the proper calculation of the amount and kind of subsidies that are involved, the other of the basic objectives of the subsidies.

The first issue depends importantly upon the composition of conferences. Perhaps some are "American Conferences," in the sense that most of the

²⁵⁸ Sir Ralph Moor's testimony is an example of the candor of old-time English shipping people: "The rebate system prevents, does it not, the freights from being injuriously cut down by competition—that is one effect of it?—Yes, no doubt." 39-III R.C.R., *op. cit. supra* note 2, at 244. See also p. 210 *supra*.

²⁵⁹ See the testimony of Eric M. Cohn, President of Northern Screw Corporation, *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 531-32, 541.

²⁶⁰ See, e.g., Conference Agreements Number 14-14, 85, 1692, 7590, 7650-5, 8120-2, 8300-01.

²⁶¹ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 28. See also pt. 2, at 352, 524.

capacity operates under American flag. But the typical conference is predominantly foreign, judged by the number of companies, ships, or sailings. In the words of Chairman Morse:

There are approximately 400 common carriers by water engaged in the foreign trade of the United States, of which about 34 are U.S. steamship lines, and about 31 are U.S. van lines holding themselves out as common carriers by water for the transportation of household goods and personal effects. The rest are foreign-flag carriers of various nationalities with headquarters abroad.²⁶²

The nature of the problem can best be seen through a simple hypothetical example. Assume that 75 per cent of the conference members are foreign, 25 per cent American, and that capacity, sailings, etc., are proportional to membership. Assume, further, that under competition, existing American flag operators could cover out-of-pocket costs but not replace capacity. They could, then, survive under competition in the short run, but without subsidy could not survive in the long run. Under competition freight rates would be lower for both foreign and American ship operators. American operators would suffer losses, but we assume that foreign ships would earn just enough to keep them in the market—i.e., the competitive return. Assume further that the present number of American ships and shipping companies is just the number wanted by the United States, for whatever purpose. It is clear, then, that without subsidy the American merchant marine would shrink, in the long run, below the “desired” minimum size. Three schemes could produce a viable American fleet of the desired size, though some other consequences would differ amongst them.

²⁶² *Id.* at 4. As of March 16, 1959, fourteen conferences in United States-foreign trade had no American flag member at all; 10 of them cover trades in which no American flag carrier operates in or outside of the conference. The following list gives the Maritime Board Conference Agreement number and name in each case.

LIST OF THE 14 FREIGHT CONFERENCES WHICH DO NOT HAVE AN AMERICAN FLAG LINE AS A MEMBER—NONE OF THESE CONFERENCES USE THE DUAL-RATE SYSTEM

- No. 138 North Atlantic Spanish Conference. (Virtually inactive.)
- No. 7560 North Atlantic Portuguese Freight Conference. (Virtually inactive.)
- *No. 3357 United Kingdom/United States Pacific Freight Conference.
- No. 5300 Norway/North Atlantic Conference.
- *No. 93 Outward Continental North Pacific Freight Conference.
- No. 7900 U.S. Atlantic and Gulf-Bermuda Freight Conference.
- *No. 8320 Scandinavian and Baltic/U.S.C. South Atlantic and Gulf Westbound Rate Agreement.
- *No. 7820 Great Lakes-Bordeaux-Hamburg Eastbound Conference.
- *No. 7830 Great Lakes-Bordeaux-Hamburg Westbound Conference.
- *No. 8130 Great Lakes-United Kingdom Eastbound Conference.
- *No. 8140 Great Lakes-United Kingdom Westbound Conference.
- *No. 8180 Great Lakes-Scandinavian and Baltic Eastbound Conference.
- *No. 8250 Great Lakes-Mediterranean Eastbound Freight Conference.
- *No. 8260 Mediterranean-Great Lakes Westbound Freight Conference.

*These 10 conferences cover trades in which no American-flag carrier now operates. *Id.* at 76.

First, every attempt could be made to establish competition in the industry, and a sufficient subsidy—or free ships—could be given to American ship operators to keep the desired capacity in being over the long run. Rates will be competitive in the sense that no one will earn monopoly profits.²⁶³ But the subsidy is an explicit cost that must be borne by someone, presumably not entirely by those who use shipping services.

The second alternative would be to permit or encourage cartels in shipping, but prohibit the American operators from joining them. In this case rates would be higher than under competition. American firms, with 25 per cent of the capacity, could be made profitable, or their losses reduced. Foreign firms, with 75 per cent of the capacity, would earn profits. The increase in foreign profits would be greater than the increase in American profits, both because of their greater share of the market and because of lower costs. If the American share is not so great as to dissipate all monopoly power, the foreign confederation would reduce output below the competitive level, carrying the burden of excess capacity. The “outside” Americans, if each is small relative to the total market, would take the monopoly rate as a given datum and simply adjust their level of carryings to it. Since the rate would then be higher than under competition, the Americans would somewhat increase their absolute carryings, as well as share of the market.²⁶⁴ In the special case where American firms earn no profits, but suffer no loss, explicit subsidies can be zero. Yet, someone has to pay the freight, and it will cost more under cartel than under competitive organization. It is thus somewhat premature to conclude that the subsidy has been reduced; it has been shifted. The cartels have shifted income from shippers and consumers to operators. If Americans buy all or a substantial part of the shipping services that have been cartelized,²⁶⁵ though explicit government subsidies can be reduced, the total cost to the American economy of maintaining the same number of American ships could easily be greater than before.

The third possibility is to permit or encourage cartels and permit or encourage American operators to join them. In this case the cartels would be stronger and rates would be still higher. Profits, too, would be higher, the greater part of the increase going to foreign operators for the same reasons as given before. But the carryings of the American operators will now be smaller than when they

²⁶³ Indeed, since the total industry will be larger than untrammelled competition would preserve, rates may be lower than the competitive level. If, however, the long-run supply of shipping services is perfectly elastic, rates will not be lower, but the foreign branch of the industry will be smaller and the American branch larger than a free market would establish.

²⁶⁴ The extent to which they would do so is, of course, related to how rapidly their costs rise as carryings increase.

²⁶⁵ This is unrealistic, though not so improbable as it may at first seem. If, for example, all American trade in the areas affected is financed by outright U.S. grants to the importing countries, the assumption is closely approximated in reality. Transportation charges are costs like any others. As such, they influence final prices paid by consumers and net prices received by producers. The size of exporting and importing industries will be influenced by them, as will short-run profitability, even under competition.

took the monopoly rate level as a datum and adjusted their output to it. Furthermore, if they are not subsidized and have higher marginal costs than their foreign confederates, they will tend to have a smaller share of the cartel carryings than their nominal capacity would suggest. The alacrity with which most American operators have entered into freight rate conferences²⁶⁶ suggests that profits inside the cartel will be greater than outside. Nevertheless, most of the increase in profits goes to foreign operators; much or most of it may come from American shippers and importers. Even if all of the profits are taken away from American shipping companies by means of a negative subsidy, the net costs of the program to the United States economy can quite easily be greater than the larger explicit subsidies that would be necessary under competition.

This subsidy argument has ignored at least two important problems. First, from the standpoint of the Congress and the Maritime Administration, it may be easier, and therefore "better," to extract much of the costs of maintaining a merchant fleet from shippers and the economy as a whole rather than from explicit subsidies. To the extent that national policy could reduce monopoly but does not,²⁶⁷ this is probably a poor choice. Since so much of the hidden subsidy of cartel earnings goes to foreign ship operators and comes from American trade, if the object of the game is to support American flag carriers, direct subsidies coupled with enforced competition may be greatly preferable even though explicit subsidies would have to be increased. An additional merit is that when subsidies are explicit, the true cost and value of the program can more readily be ascertained.

Second, the apparent options of (1) competition and (2) foreign cartels with Americans outside of them may not be accessible. Universal competition in liner services may not be achievable, either because of natural or technological circumstances that inhibit the growth of foreign competition or because of an unwillingness to subsidize enough American capacity to assure it. The preceding analysis of natural monopoly suggests that the first difficulty is not important, save for some very small trades.

There are, however, suggestions that American liner companies cannot survive outside of the conference system because of the exclusionary tactics that will be used against them. This is possible, but unlikely. It is generally said that wholly foreign conferences, which are not subject to the prohibitions of our Shipping Act, have denied entry and obstructed the growth of competition. In a real sense, however, this contention is favorable: the Maritime Administration claims that American law has modified the workings of conferences operating in United States foreign trade. If that is true, there is no obvious reason why it cannot continue to modify their workings or even extend the process. One obvious technique is to prohibit exclusionary practices and institu-

²⁶⁶ Isbrandtsen is a somewhat troublesome exception.

²⁶⁷ Or encourages monopoly power but need not.

tions by law. Another is by threat, or suggestion, to encourage the conferences to permit contract shippers to use outside American liners at the same time that it forbade American liner operators to join the conferences. It is clear that national power can be exerted in other ways as well.

Before 1916 it may have been realistic to fear conference exclusion of American shipping, but the influence and power of the United States has in most ways increased since that time. At least as important is the fact that American foreign trade is a worthwhile piece of business. Private firms will not cavalierly abandon it.

In addition to the foregoing problems of subsidies and profitability is the matter of objectives that are to be achieved through subsidies. The basic rationale for the subsidy program is the maintenance of a greater number of ships, seamen, and shipbuilders than we could control without it. United States shipping policy not only is directed to the principle of participation but also embodies implicit and vague notions of how much.

Cartels are not institutions that can be relied upon to increase supply relative to competitive levels. They will tend to produce a lower utilization of given capacity, or smaller capacity. Subsidies increase the amount of shipping that we control. More can be acquired, under either cartels or competition, by increasing subsidies. If conferences raise rates and profitability they do so in the short run by restricting use of capacity. In the long run they would tend to reduce the amount of shipping capacity itself.²⁶⁸ This appears to be inconsistent with our objective to increase or maintain shipping capacity, unless by some accident the American share of cartelized shipping is precisely what the nation requires or wants.²⁶⁹

There is a real danger that the objectives of the subsidy will be subverted if United States shipping policy encourages the preservation of cartels or if, in determining how many, where, and how American flag operators will operate, we are influenced by a desire to preserve conference strength. That this has happened, or could occur, is suggested by the testimony of Chairman Morse, who said:

Mr. Morse. I think the question arose more on whether the Board would require a subsidized line to join a conference or to quote rates established by a conference and, to the best of my recollection, the Board has never made any such requirement of any subsidized line.

²⁶⁸ This assumes, of course, that the size or number of firms is capable of reduction economically. I see no reason to assume that rationalization of facilities is not to be expected; indeed, history demonstrates that it has often been done.

²⁶⁹ If United States costs, net of subsidy, are equal to foreign costs, the United States share of conference output will be proportional to capacity. Subsidies that push United States marginal costs below foreign costs increase our share. Zero marginal costs, if the conference is sensible, would permit us to carry everything.

Much the same kind of observations apply to a competitive freight market.

Mr. Zelenko. In other words, if a line has an operating subsidy, you say the Board has never required as a condition that the operating line do not undercut?

Mr. Morse. No, that is a matter of managerial discretion.

Mr. Zelenko. I see. Would you please be good enough sometime in the future to check back in the records and see whether or not sometime in 1930 in the case of, I think, Robin Line, the Board did insist that they do not undercut? Does that refresh your recollection?

Mr. Morse. There is an agreement in the Robin and Farrell Line, in the subsidy agreements, something to the effect that as between those two lines they will quote substantially identical rates.

Whether that was suggested by the lines themselves or forced on them by the Commission, I cannot tell you.²⁷⁰ . . .

Mr. Morse. I do not recall the phraseology but in our subsidy contract we require something to the effect that he must operate in a prudent businesslike manner.

To the best of my knowledge, we have not but we could, under that phraseology, insist that the operator raise his level of rates or conduct his business in a different manner but with the one exception of the Farrell and Robin Line, to the best of my knowledge, the Board has never directed a subsidy operator to maintain a given level of rates or to join a conference.²⁷¹

E. THE ROLE OF UNITED STATES FLAG OPERATORS IN THE CONFERENCE SYSTEM

It is often said that the participation of U.S. flag operators in conferences produces important social benefits. These benefits are said to arise for a variety of reasons, ranging from a political analogy (it is better to be a part of a political machine than to fight it; it will remain dominant and the only feasible policy is to seek to reform it from within) to a simple belief that United States membership results in greater aggregate capacity and, therefore, a lower level of conference rates. The range of reasons includes a conviction that American participation keeps the foreign members "honest," *i.e.*, prevents exploitation of the United States as a purchaser of shipping space. In its boldest form, the argument suggests that United States participation makes of the conference a positive instrument for progress.

I have interviewed a number of informed people in United States flag liner companies to find factual support for these contentions. Before reciting the examples that they gave me, however, it will be helpful to investigate, in a general way, the logic of such effects. We will begin the analysis under somewhat rarified assumptions, then proceed gradually to relax them.

We may begin by assuming that a conference has as members both American and foreign flag liner companies. Assume further that all members are truly private concerns, with the respective governments playing no important

²⁷⁰ *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 58.

²⁷¹ *Id.* at 59.

role in their promotion or policy determination. If all members of the conference, irrespective of flag, serve exactly the same trades and countries, there is no reason to believe that their interests in rate making will diverge significantly as a result of flag. It may be argued, but I think wrongly, that American flag operators will be more interested in pressing the demands of United States shippers than will the foreigners, simply because of their common origin and love of country.²⁷² It would perhaps be more realistic to assume that, as businessmen first, both the Americans and foreigners will be primarily interested in doing as well as they can. This implies that rate concessions will be made to those shippers whose alternatives are better and whose elasticities of demand are therefore higher, regardless of flag.

Next, we assume that the members of the conference under analysis do not everywhere serve the same trades,²⁷³ even though their interests are roughly

²⁷² There are, and always have been, conflicting assertions and opinions on this point. Before World War I, for example, some English merchants feared the rise of the German merchant marine on the ground that flag ultimately captures the trade.

Similarly, even as early as 1913-14, some U.S. ship operators asserted that the Japanese merchant fleet was being fostered by Japan as an instrument of national trading ambition. What is not so clear is the extent to which these fears were based on nationals' preference for their own flag as opposed to the role of government power in furthering economic or military objectives. In short, the issues of personal preference for flag and flag preference for nation tend to become mixed with a government's preference for the shipping companies that it promotes.

Of these issues, the alleged devotion of commercial shipping companies to their compatriots' trading interests appears to be the clearer. According to Mr. Rufus Hardy, a United States congressman speaking in 1912, "Mr. Humphrey thought that the reason why the rates from Germany to South America, direct, were so much less than from here was because the foreign ship combine wanted to favor the German industry. Commerce is not patriotic. There is nothing in that, in my opinion. . . . And so far as your shipping combines are concerned, talking about them having a patriotic purpose and serving the interests of Germany against the United States, that particular combine is largely carried on by American capital, and whether this combination is controlled by foreign or American capital will and does make no difference. They are in business for themselves and not for their Nation." *Hearings on H. 72 Before the House Committee on Rules*, 61st Cong., 1st Sess., 49, 50 (1912). On this point, some at least, of both United States and foreign ship operators agreed. Mr. Herbert Barber, president of Barber & Co. (Inc.) of New York put the matter this way: "It has also been stated by some of the gentlemen here, who ought to know better, I think, that the flag of the steamer works for the benefit of the trade of the nation that the steamer belongs to. . . . I think that due credit should be given to people, to whom credit is due, but the flag has not the slightest influence with the world-wide merchant. Mr. Grace will charter any ship he can get at the lowest price, and he knows well enough that the flag has no more effect on the bulk of the trade he does than the color of the paint on the ship." 1 *Alexander Comm. Rep.*, *op. cit. supra* note 10, at 437-39. Mr. Joseph Slechta, New York agent of the Lloyd Brasileiro, agreed that "I do not find that it is a matter of flag or a matter of nationality. It is a matter of profit." *Id.* at 45. Mr. Beck, of the Hamburg-American Line, claimed that "they are interested only in making money. . . . It is purely a matter of dollars and cents." *Id.* at 539. See also the testimony of Mr. Seager, member of the Produce Exchange: "There is no patriotic motive about it. It is a question of dollars and cents. *Id.* at 150.

²⁷³ Analytically, much the same result is achieved when, even though all lines serve the same trades, some imperfection—like government cargo preferences, for example—guarantee that some national flag carriers will have a larger participation in some trades than in others.

identical so far as *this* trade is concerned. For whatever reason,²⁷⁴ *this* trade may be very important to some carriers but relatively less important to others. Suppose that a foreign line gets none or little of the lubricating oil cargo in this trade, but believes that it can do very much better on lubricating oil from its home country to the same destinations. It may then have every interest in seeking to raise lubricating oil rates in this trade—since it will lose no cargo in this trade by doing so²⁷⁵ and will increase the demand from those foreign refineries in whose shipments it will be able to participate heavily. The American carriers of lubricating oils from domestic refineries will have every interest in opposing this move, as will any foreign carriers whose interests are similarly best served. In opposing the move, the United States carrier, and any foreign lines that align themselves with it on this issue, by serving itself will also serve the United States oil refining industry. Whether the American carrier, and those foreign lines who agree with it, will be able to forestall the move depends upon their strength relative to those who support it. Conferences give one vote to each full member regardless of size. The issue, then, rests upon the votes that can be mustered by the American carrier.²⁷⁶ If it succeeds, this would be an example of the benefits to United States manufacturers of having American flag or other sympathetic members of the conference. But it is also clear that (1) the American carrier would have the same interest whether it is in or out of the conference; and if it were not in the conference it could serve its best interests whatever the vote of the conference might be.²⁷⁷ (2) Whether

²⁷⁴ One such reason may be the relative fixity of service demanded of United States subsidized carriers by the United States Maritime Administration.

²⁷⁵ It cannot lose what it does not have and cannot get.

²⁷⁶ One interesting side issue is raised by this hypothetical example: since two trades are competing at least so far as lubricating oil, why is there no inter-conference agreement to regulate that rivalry to the benefit of both groups?

²⁷⁷ Matthew Crinkley of Isbrandtsen gave an example: "In 1939 our company established independent service to the eastern Mediterranean. In looking around for cargo one of the items that looked like it might be a possibility was plumbing supplies, bathtubs, and lavatories and things of that nature. Some of the American companies and some of the European companies had factories in Europe that manufactured those things in competition with America. At that time the foreign buyers appeared to be willing to pay a premium because the American article was much, much better.

"Now, the freight rate at that time from European ports which I checked was a little under \$9 a weight ton. The rate from American ports to the eastern Mediterranean was \$20 a measurement ton, which was equivalent to about \$40 a weight ton, so that you had \$8 and \$40.

"I spoke to some people we had done business with in the plumbing business and they said there was a possibility there but the freight rate was too great a difference, so that I just said at the time, 'There is no way for us to quote the same rate as Europe, their handling charges there are much cheaper, but we can clear a profit at \$10 a measurement ton which is half of the conference rate, and, because of that much help and the fact that the buyers preferred the American article, there was a fair business developing on that.

"That, incidentally, is disappearing now because European countries and Japan and many others have their factories now equipped with the most modern equipment and I believe that they are turning out goods that are fully as good as American and, in some cases, perhaps better. I do not know." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 217.

they are foreign or American companies, the interests of United States manufacturers in this connection would be better served if the suppliers of its shipping needs were competing freely, i.e., if there were no conference at all. (3) Because American carriers often are a minority of votes in a conference, even if they can be made to stick together, they may not be able to prevail in any case: "In some 93 of today's 113 shipping conferences, Americans are outnumbered by foreign shipowners. Yet these shipping conferences set basic shipping rates, rates which—in substantial measure—determine American shippers' ability to compete in world markets."²⁷⁸

In sum, it is not obvious that American participation in the conference system performs any function that is beneficial on balance. Even the American participants assert that the benefits arise *in spite of minority voting power* of American flag operators. Benefits are possible, they say, because the conferences work on the log-rolling principle. If this is correct, logs must roll both ways: to get present concessions, American carriers must have made past, or make future concessions.

Assume, last, that foreign governments, rightly or wrongly, do intervene systematically into the operation of their national fleets, and use them as a weapon to increase national power at the expense of other nations. How would they go about doing it? Before World War I, it was widely asserted that Germany, through subventions and low rail rates on exports, subsidized its export industries and merchant fleet to the disadvantage of those who competed with her for foreign markets. Before World War II, Japan is also alleged to have subsidized her merchant fleet only on condition that low promotional rates would be charged. In both cases, however justified or rational the policy may have been, effectuating it presumably modified or conflicted with normal conference operations. Since no conference rate will persistently lie below marginal cost and will equal it only on "open" or special competitive goods; and since trampship rates will generally approximate marginal cost, the conference system will not really help the member countries to combat the promotional ambitions of those governments that pursue extensive strategic programs. Competition would better meet the challenge, and competition plus subsidies would probably be needed to meet it completely. It is interesting, nevertheless, that both Germany and Japan participated in conferences during those periods in which selfish promotion is alleged to have been practiced.

Perhaps the most important point in this connection is that conferences produce non-competitive, discriminatory rate structures that will generally tax the low-cost producers relative to the inefficient ones.²⁷⁹

²⁷⁸ Testimony of Robert A. Bicks, First Assistant, Antitrust Division, *id.* at 166.

²⁷⁹ An excellent example is to be found in the early rate responses of conferences to canal or port developments that cut the real cost of transport over one route as compared with another; or to those alterations in tariffs, port dues, etc., that have the same effects. When the conference adjustments were made, differential rates generally made the competing routes

An example of current interest is the St. Lawrence Seaway. If left to their own devices, conferences may largely nullify any savings in real cost made possible by the development. Lower cost routes will generally enjoy some net advantage in total transport costs, even under cartels; but theory predicts that the greatest advantage will accrue to shippers of bulk commodities that are subject to competition. Cost savings will be more closely paralleled by competitive than by cartel rates.

So much for generalizations. Some actual examples follow. One case involved an American member of a conference that made rates on mahogany, lumber and plywood to the United States. The conference raised the rate on logs relative to lumber and plywood. An American importer of logs complained to the Federal Maritime Board, and the United States flag member of the conference backed him; the conference rate was lowered. As Alex Cocke explained:

... I can cite you an example where I mentioned it very briefly where the Nickey Trading Co. of Memphis, Tenn. were large shippers of mahogany logs from the Philippines. The conference out there by a majority vote increased the rates on mahogany logs as against lumber, which meant that this concern was seriously affected. It cut down the production in Memphis. It cut down labor that they had. So they, frankly, wanted to know what to do. Well, they finally decided to ask the Maritime Board in a petition to hear the case and to decide whether or not they were being discriminated against.

They also requested a Federal injunction.

At the request of the conference they decided to cancel that provided the money was kept in escrow pending the settlement by the Board.

The Board called a hearing very promptly in Memphis and New York and Lykes was subpoenaed [sic] by the shipper or the buyer of the logs as a witness for him.

We testified, and one of our captains testified also, as to conditions of loading lumber versus logs, the difference in the commodities, and the case was decided in favor of Nickey. Nickey received a refund from Lykes Bros. of approximately \$70,000.²⁸⁰

It is not clear that such a result, if it truly reflects cost differences, would not have occurred without a conference; and it is obvious that the United States line could have lowered the rate on its own initiative if it had not been a member of the conference. It is also clear that the Board could have acted on the complaint whatever had been the position of the American carrier.

On the other hand, informed observers claim that, when it granted a subsidy

or ports more nearly equal than competition would make them. This may furnish an appealing ground on which high-cost producers and shippers can favor conferences, but it is a poor social reason to prefer cartels to competition.

Another appears in the 1959 testimony of Mr. Robert V. Peabody, General Traffic Manager of Smith-Douglass Company: "As a matter of fact, in one of these negotiations we have had with the carriers it was their contention that we could stand a higher rate because our costs were lower than theirs and we could produce fertilizer at a lower cost than theirs, but generally on fertilizer they have been exactly the same, not exactly but very close." *Id.* pt. 2, at 788.

²⁸⁰ *Id.* pt. 1, at 319.

to a second United States line on a route, the Maritime Administration insisted that there would be no rate cutting, for that would "dissipate" the subsidy. If accurate, this account suggests that subsidized carriers, at least when they "double track"²⁸¹ are subject to certain pressures to join conferences.

Furthermore, the official position taken by the Maritime Administration in the *Isbrandtsen* case²⁸² suggests that the regulatory and promotional authority is hostile to rate cutting by either subsidized or unsubsidized American flag carriers. An interesting corollary to this is suggested by American ship operators, who in 1958 complained bitterly that United States policy imposes on them a comparative and absolute disadvantage in rate cutting. Because the foreign lines are not effectively subject to United States prohibitions on competitive chiseling through rebates, discounts, and the like, while United States lines are, the foreigners are often able to make hay within the conference framework, whereas United States carriers cannot do so. In the United States/Orient trades, for example, the complaint is that in 1957-58 a great deal of chiseling was going on on the part of the conference members,²⁸³ particularly some foreign flags. Media for the chiseling included rebates, payment of false damage claims, large "gambling losses" to shippers by liner operators, underweighing or measuring of valuable cargo, "bribes," bogus brokerage, and a multitude of other ingenious devices. The upshot was that the conference hired an outsider as a resident observer in the Far East to check on and police compliance. The United States regulatory authorities knew about this move and apparently found it desirable. It is not obvious that world trade benefitted thereby, however, since United States importers and consumers presumably were paying less for their goods with the chiseling than without it, and United States exporters were presumably able to export more, and/or receive more, net for what they exported, with defections than without them. The accepted "cure" was to increase regulation; a better one could easily be to regulate less.

Two other anecdotes show the role of United States operators in the conference system. In the first, European and United States makers of capital goods were competing for one order. The two groups were served by two different conferences. An American operator participated in the one trade but not in the other and dominated the conference of which it was a member. To encourage the United States manufacturers, and, to increase its own revenues, the American line made a special rate. What this case demonstrates presumably is only that competition, whether between conferences or among carriers on the

²⁸¹ See pp. 296-97 *supra*. When two or more subsidized American carriers operate on the same route, there is said to be "double tracking," "triple tracking," etc.

²⁸² 4 F.M.B. 706 (1956). See also Brief for Petitioner, *FMB v. Isbrandtsen Co.*, 356 U.S. 481 (1958).

²⁸³ One additional complaint was that some foreign lines that belonged to the conference also owned or participated in outside lines who were cutting rates—*i.e.*, they were effectively chiseling from conference rates, while gaining the benefits of conference membership.

identical route, tends to beat down rates; and that it is better that there are not interconference agreements everywhere to suppress competition. Furthermore, the American carrier, in or out of the conference, would have had the same motive and presumably would have been no less effective outside than in, so far as rate reductions are concerned.

Similar observations can be made about another actual example. A United States export association was bidding on a large capital goods order in competition with foreign producers served by another conference. The conference, led by an American liner company, agreed that a special low rate would apply to the shipment if the United States bidders were successful. According to the story, rate reductions of this character apply only to specific pieces of business and, if the United States exporters fail to get the business, the rates do not go into effect at all. As one ship operator put it: "The special rate applies if the group gets the business; if they don't, the rates never go into effect." Indeed, even if the group succeeds in getting the order, "the tariff remains intact."²⁸⁴

Another American shipping man claimed that while American lines had prevented an increase on rates for American relative to European automobiles to some common markets, the rates on European autos are still "arbitrarily" lower to certain markets. The persuasiveness of American conference members has been inadequate to change that.

On the other hand, the conference freight rate specialist of one American flag carrier told me that he has a strong bias against *any* rate reduction since, once reduced, rates are very difficult to advance. For example, this company opposed any rate reduction on copper shipments to the United States and was ultimately able to confine the reduction to one dollar per ton instead of the two dollar cut that the foreigners urged. On another occasion foreign conference members were prevented from lowering rates on a chemical raw material shipped to the United States. If these reports are accurate, they indicate that if the persuasiveness and power of American flag operators have been exerted to lower rates, they have also been used to raise them.

The staff of another American liner company claimed that the presence of American members in conferences made rates neither higher nor lower than they otherwise would be. According to their view, all members of a conference have the same objectives and behave essentially alike, regardless of flag.

Others claimed much the same thing; the essence of successful conference operation is log-rolling. Each line, and to some extent each flag, has "pet" or "sensitive" commodities. Foreign lines that bring cotton to Europe from both the United States Gulf and Brazil are not keen on reducing cotton rates

²⁸⁴ This affair raises a number of fundamental issues, including the claim that conferences provide the same rates to everybody. It also raises the question of how accurate announced or tariff conference rates are as an indication of rates actually charged.

from the United States to Europe. Foreign lines that figure prominently in the chemical trades outward from Europe resist efforts to reduce chemical rates from the United States. American carriers of lubricating oils from the United States resist attempts to lower lubricating oil rates from the United Kingdom, and so on. Thus, it is said, some lines resist rate reductions on anything; others favor, for example, flour. In some cases the intrusion of governments influences rate making. A foreign government that purchases large volumes of United States flour tends to force flour rates down when grain rates fall. In one conference the American carrier claims that it has to "look the other way" when one national foreign-flag line shades rates. The cost of solidarity is high.

In view of the promotional effect that American-flag conference membership is claimed to have on United States commerce, it is interesting to note an earlier and somewhat conflicting opinion. Both the majority and minority of the Royal Commission on Shipping Rings concluded in 1909 that the weakness of outbound conferences from the United States—partly due to hostile United States law—had given American exporters an advantage in trade. The majority found that, at least occasionally, greater competition in shipping services from the United States had aided her and injured Britain and that "we consider that this is a grave defect in the system."²⁸⁵ The minority apparently thought

²⁸⁵ 39-I R.C.R., *op. cit. supra* note 2, at 79. The Royal Commission was, of course, aware of the Sherman Act and interested in its applicability, in principle and actuality, to shipping conferences. The chairman prepared a memorandum on this point and, although he acknowledged that "the question whether the rebate system is illegal under the Sherman Act cannot perhaps be considered as entirely free from doubt" quoted with approval the following legal opinion of Mr. Robert Newton Crane: "A contract embodying a system of deferred rebates if made in the United States or even if made out of the United States, and affecting the commerce or trade of the United States, would be illegal under the Sherman Act, and would subject those who made such a contract to the penalties imposed by the Act, provided an action was instituted to recover such penalties in the United States and the Federal Courts had jurisdiction of the parties." 39-II *id.* at 37, 36.

The majority Report itself shows a concern about the problem: "As regards the export trade of the United States on the other hand, it appears from the evidence before us that most probably the effect of legislation in that country is to prohibit the system altogether, and that at any rate the system, whether legal or illegal, is in fact no longer in operation in the export trade of the United States. It further appears that, even when it was in operation, as it was in many trades up to 1903, it was not, and owing to the nature of the United States trade, could not be, so effective as in this country in binding the shippers to the Conference Lines." 39-I *id.* at 62.

The Commission was apparently more correct about the law than about prevailing practice. In 1911 the U.S. Department of Justice initiated two actions against conferences under the Sherman Law. *United States v. Prince Line, Ltd.*, 220 Fed. 230 (S.D.N.Y. 1915); *United States v. Hamburg-American S.S. Line*, 216 Fed. 971 (S.D.N.Y. 1914). Both suits were dismissed as moot because of the Great War. The later Alexander Committee Hearings turned up agreements in the United States-outbound trades as well as those inbound. Nevertheless, it is clear that ship operators were aware of the Sherman Act, afraid of it, and to some extent were constrained by it. For example, Mr. Barber testified that, "We have no written agreement; we have an understanding which has been threshed out year after year until now we have got it right . . . some of these fellows are scared. I would put whatever I agreed to in writing and stand by it, but these fellows are scared. They think there is some Government bogey to scare them, and so they will not put it in writing. . . . It does not operate just the

that the "defect" was even more grave, for they reported that, "It does not appear to us that sufficient stress is laid upon the advantages which the United States in the future may possess in the absence of the deferred rebate system. . . . That such a monopoly and a system which have the above effects should be subject to no control appears to us inadmissible."²⁸⁶ The testimony shows conclusively that merchants and others were also aware and fearful of the advantage gained when their competitors buy shipping services competitively and they are obliged to buy from a cartel.²⁸⁷

The wheel has now come full circle. Table 2 shows February 27, 1959, conference rate data presented by Matthew S. Crinkley, Executive Vice President of Isbrandtsen. He claimed that these data show an effective disadvantage to American exporters under the conference system.²⁸⁸

It is also interesting that Mr. J. S. Jeans, Secretary of the British Iron Trade Association, in 1907 testified that "... it would appear to be an advan-

same. For instance, the Norton Line does not come to our meetings in the River Plata trade." 1 *Alexander Comm. Rep., op. cit. supra* note 10, at 428. See also the testimony of Mr. Seage, *Id.* at 143. Mr. Holm, of the R. P. Huston Co., testified as follows:

"MR. HARDY: Your only reason for not using the rebate system on the downward voyage is because you take it to be contrary to our antitrust law?

"MR. HOLM: Quite true." *Id.* at 284.

²⁸⁶ 39-I R.C.R. *op. cit. supra* note 2, at 113-14.

²⁸⁷ See, e.g., 39-II *id.* at 50, 75, 85. And 40-IV *id.* at 228-29, where Sanderson testifies that: "Whatever the merits of the deferred rebate system would be, your evidence shows that shippers from New York direct to Australia ship at a much lower rate than they can from the United Kingdom? . . . That is so. That is due to the excessive competition. [Q.] Your Line carries American goods by way of Liverpool, with transshipment at Liverpool, cheaper than you carry British goods from Liverpool to Australia? . . . That is so." See also 39-III *id.* at 67, 249-50, 251, 254, 255. Statement of Birmingham Chamber of Commerce, *id.* at 262; statement of J. A. Spens of Glasgow Chamber of Commerce, *id.* at 282; Jeans, *id.* at 296; Tredwen, 40-IV *id.* at 67; Zachonis *id.* at 39; *id.* at 220-22.

²⁸⁸ As Crinkley explained, "Following is a comparison of conference contract rates from U.S. North Atlantic ports to Mediterranean countries, India, Hong Kong, and the east coast of South America, on a number of items moving with fair regularity in international trade, and the rates charged by conference lines from European ports to the same destinations. It may be pointed out there is some independent competition from U.S. North Atlantic ports to Mediterranean ports and India, but as the independents do not and cannot cover the entire range of ports involved, the conferences have been able to force the conference contract dual rate system on the majority of shippers in those trades.

"I have made a list of rates incidentally applying on cotton textiles, machinery, hand tools, electric motors, radios, typewriters, and unboxed automobiles from New York and from Hamburg. The rates from Hamburg are the same as apply from the principal other north European ports." *Conference Net Rates (February 27, 1959)*

"Rates shown based on measurement as commodities involved would require such application. All rates converted to show application per unit of 40 cubic feet. Rates shown from Hamburg apply generally from Antwerp, Rotterdam, and British ports.

"In comparing the rates shown it should be kept in mind it costs about \$3.50 to \$4 per ton less to load cargo into vessels at European ports than at U.S. North Atlantic ports. Discharging costs at destinations are, of course, the same." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 200-01.

tage rather than otherwise to have foreigners in Conference with British steamship companies from a shipper's point of view."²⁸⁹

In sum, the benefits that are alleged to result from United States membership in conferences arise because of imperfections in the conference system itself; competing conferences sometimes lack effective agreements; and, like an increase in numbers, conflicting interests of different carriers sometimes benefit the shipper. Yet it is modest praise for conferences that their principal benefits arise from their weakness. In each case open competition would have produced the same or a better result. The interests of American traders would have been served at least as well if the American member had been a viable outsider.

²⁸⁹ 39-III R.C.R., *op. cit. supra* note 2, at 298.

TABLE 2*

COMPARISON OF CONFERENCE FREIGHT RATES ON VARIOUS GOODS FROM
NEW YORK AND HAMBURG TO SELECTED PORTS

FROM	To			
	Karachi, Bombay	Hong Kong	Buenos Aires	Genoa, Piraeus, Istanbul, Alexandria
Cotton textiles:				
New York.....	55.50	60.00	66.00	63.25
Hamburg.....	38.64	36.59	54.00	20.84
Machinery:				
New York.....	52.50	56.00	51.00	38.50
Hamburg.....	29.14	29.42	24.71	24.69
Hand tools:				
New York.....	52.50	77.00	66.00	63.25
Hamburg.....	26.61	29.42	26.75	22.88
Electric motors:				
New York.....	52.50	56.00	57.00	38.50
Hamburg.....	29.14	29.42	24.71	24.69
Radios:				
New York.....	55.50	56.00	66.00	63.25
Hamburg.....	31.67	29.42	24.71	24.69
Typewriters:				
New York.....	55.50	77.00	66.00	63.25
Hamburg.....	38.64	36.59	37.96	25.60
Unboxed automobiles:				
New York.....	39.00	47.25	36.00	33.00
Hamburg.....	30.09	27.99	14.78	20.84

* Source: *Bonner Comm. Hearings, op. cit. supra* note 10, at 201.

VI CONCLUSIONS

It is clear that the United States suffers a comparative and absolute disadvantage in providing ocean transportation: To provide equivalent services costs us more than it costs foreign suppliers. If ocean transportation were competitive, and if our criteria were narrowly economic,²⁹⁰ the United States could "buy" ocean transport services cheaper than it could provide them. It would generally be well-advised to do so.

But the world is not always constituted quite as we imagine it to be, and very often not just as we prefer. Competition may not prevail, in which case a posture of self-sufficiency makes more sense. If the United States had no merchant fleet, and ocean shipping were cartelized, we might be "exploited" whenever we bought ocean transportation services. Indeed, just before the first world war one of the most powerful arguments for creating a strong American merchant marine was to avoid paying tribute to the foreign cartels that dominated liner shipping.²⁹¹

The following exchange, quoted from the *Congressional Record*, shows that Mr. Humphrey, at least, directly linked the existence of foreign shipping cartels to the need for a subsidized American fleet:

Mr. Esch. If the world's commerce is pooled through conferences, and America should establish a mail line to South America under the subsidy bill which the gentleman has introduced, how could the American lines live under the possible competition of these conferences and pools? Would not the American lines have to come to Congress for an increase from time to time?

Mr. Humphrey of Washington. I doubt if the gentlemen's hypothesis is true. In the first place, if they were under a mail contract, we would have complete control over them, and if they enter into these pools or conferences, the contract should be canceled. If we had a single line of vessels running between here and South America which we could control, it would, to a great extent, destroy these combinations and conferences, for they would have to cut rates and carry the traffic at the same rate as the American ship. This reduction in rates would pay this country many times over what it would give these vessels for carrying the mails.

Mr. Morse. If the gentleman will allow me, what would prevent that line of vessels owned by the Americans from entering into the agreement with these people?

Mr. Humphrey of Washington. What would prevent it would be our law and the authority vested in our courts. We can control our own lines. I do not want the gentleman to understand that I am defending American lines if they belong to these combinations. I believe that the American lines running across the Atlantic Ocean that are receiving mail subsidies from this government are in these conferences. I have no direct evidence on that particular point. The evidence that I have is indirect, but I believe it is true.

²⁹⁰ *I.e.*, if we ignore defense considerations.

²⁹¹ See, *e.g.*, *Hearings on H. 72 Before House Committee on Rules*, 61st Cong., 1st Sess. (1912).

Mr. Morse. You would cut off the subsidy?

Mr. Humphrey of Washington. Yes; certainly.²⁹²

Although Mr. Humphrey thus defended his program in economic terms, he claimed that national pride and power would be served as well. As he put it: . . . under this system of conference, this mighty combination, . . . no power is strong enough except that of the Government to break it. But the Government can do it, and it would be a most profitable thing for it to do it. This Government cannot afford to be at the mercy of these foreign Ship Trusts in time of peace and much less in time of war. Private lines cannot compete with this giant monopoly of the sea, but the Government can, and it must. No American with a drop of red blood in his veins will contend that we stand helpless before this combination of foreign ships. [Applause.] It is our duty to find the remedy and apply it. [Applause.]²⁹³

Furthermore, Mr. Humphrey claimed that our toleration of foreign cartels was especially anomalous in view of the policy with respect to domestic combinations in restraint of trade. In his words:

All this is done so far without complaint and without protest on our part, and this while the whole country is filled with the sound and fury of the verbal battle to exterminate comparatively small trusts and combines at home.

No wonder that we are today, in our trade relations with other nations, considered as the blind and strutting fool of the world. [Applause.]²⁹⁴

Apart from the issue of national pride, which can perhaps best be treated or left aside as a matter of public taste, economics lends some support to the contention.

If the services we buy are cartelized, the comparison of our costs of production with the cartel's costs of production is irrelevant. The appropriate comparison is between what we have to *pay* for transportation if we provide some or all of our own, and what we must pay the cartels if we do not. If the costs to potential American shipping firms are lower than the cartel rates, it would pay them to enter. If not, it would not pay individual United States shipping firms to enter. This is essentially a commercial rule, applicable most obviously to a profit-making private firm, but with a related application to national policy. Since it is a meaningful commercial rule, private firms will arise to produce the desired result only when rates are greater than their costs. Even so, there might be barriers to entry, either of a technical or institutional variety, which are insurmountable to private firms but which can readily be overcome by the force of national policy. Exclusionary practices of the shipping monopoly may be the bar.

Under purely commercial standards, American firms would integrate into shipping until costs, including those necessary to overcome the barriers to entry, were equal to the level of freight rates. It would, in the commercial sense, not pay to enter the industry unless rates prevailing after entry would cover

²⁹² *Id.* at 90.

²⁹³ *Id.* at 92.

²⁹⁴ *Id.* at 93.

the costs of entry and maintenance of capacity. If United States costs are higher than those of other potential entrants, the ideal solution would be the entry of other low cost foreign operators, hopefully until the cartel could be broken. Purely as purchasers of shipping services we should therefore welcome, not resent, the universal subsidy of shipping by foreign governments.

In fact, the problem is rather different from what the previous argument suggests. Apparently an American merchant marine, as defined by law, cannot survive even at cartel rate levels unless it is subsidized. It is then clear that, without subsidy, given the legal requirements of American flag operation, American operators will not enter to erode the cartel's power. A basic question then arises: Is it worthwhile to subsidize to break or weaken the cartel? The issue is whether the *net* cost of shipping services can be lowered by developing limited amounts of non-cartel capacity.²⁹⁵ Put another way, the distortion of a subsidy may be more than offset by reducing the distortions of cartels. If the "outsiders" so created can offer any services at the cartel rate level, the demand facing the cartel is thereby reduced; at still higher rates, given normal assumptions about costs, the outsiders would find it desirable to offer still larger volumes of services. The result is that the demand for cartel services is reduced and, reflecting the alternative supplies, made more responsive to price increases by the cartel. The most probable result is that cartel rates will fall, and that total carryings will rise.²⁹⁶ If, at the lower rate level, the subsidized outsiders are able to produce any services, they will do so at a loss. Nevertheless, if their cost disadvantage is slight, or their output small, or the cartel rate reduction is large, or the proportion of total purchases of shipping space made by the Americans is large; the amount of necessary subsidy may more than be offset by the freight savings to the American economy.²⁹⁷

The fundamental problem remains: That policy which provides the "outside" capacity at lowest cost is obviously the best one, judged solely by economic standards. This might mean, for example, purchasing foreign-built ships and

²⁹⁵ There is the alternative of developing additional *cartel* capacity. This appears to be less desirable on the assumption that survival is not dependent upon cartel membership. For "insiders" will produce less than if they operate outside the cartel. Joint profit maximization in the cartel takes account of the price effect of output variations. When outsiders are relatively small, each ignores the effect his output has on price. This means that the maximizing price and profits for the cartel will be lower when there are outsiders than when all are members.

²⁹⁶ The full logical implications of such a policy have been spelled out by V. Stephens Hastings in an unpublished paper. It is possible that rates remain unchanged with the cartel reducing its offerings by precisely the same amount by which outside supplies have been increased. This would happen, for example, if the cartel has constant marginal costs, and a demand schedule that, as it declines, maintains the same rate elasticity at the same rate level.

²⁹⁷ If the subsidized outsiders produce *nothing* at the lower cartel rate level, a lump-sum standby would perhaps still be worthwhile: their very existence sets a lower ceiling upon the rates that the cartel can profitably charge.

hiring foreign labor. Similarly, the creation of new capacity which promptly is embraced in the cartel is less desirable if the object is to reduce rates.

Our past policies, as well as the present attitude of the maritime authorities with respect to conferences, indicate that the American-flag fleet has not been used effectively to ameliorate cartel power. General cargo transportation service now, as when the United States embarked upon active promotion of a modern merchant marine more than 80 years ago, is sold in cartelized markets. Entry is impeded, and rates are discriminatory.

Regularity and frequency of liner service have increased markedly during the many years that conferences have held sway. This undoubtedly would also have been the tendency under competition, as markets grew. Although it is impossible to gauge precisely whether the improvement would have been greater under the one organization than the other, cartels are an unreliable agency for increasing the supply of shipping services.

Rates are somewhat less flexible than they would be under competition, but that is generally true of both cartels and single-firm monopolies.²⁹⁸ The social benefits of the rigid rates produced by cartels can easily be over-estimated.

Rates have doubtless been higher than competition would have compelled. Tramp shipping, an "industry" in which the American flag is of little importance, has probably been denied as large a role in ocean transportation as it otherwise would have. The same is probably true of smaller liner services, for the market for liner services has been artificially insulated, as best it could be done, from the competition of the casual.

As far as I have been able to determine, there are no natural monopoly elements in ocean transportation. In the absence of artificial restraints there is no reason why competition would not work.

Both national security and lack of specialized competence make it impossible to evaluate here the military contribution, or deficiency, of the United States merchant marine. As a consequence, we must rely solely upon economic contributions. Only if—as many now assert—the military value of the merchant marine is slight or rapidly diminishing, will purely economic evaluation be determinative.

From an economic point of view, one potential benefit to be derived from a subsidized merchant fleet is the prevention or reduction of exploitation by cartels but the United States merchant marine has certainly not been encouraged to do that.²⁹⁹

²⁹⁸ See Stigler, *The Kinky Oligopoly Demand Curve and Rigid Prices*, reprinted in AEA, *READINGS IN PRICE THEORY* 427-30 (1952).

²⁹⁹ There are many examples dating from our earliest subsidized fleet up to the present day. Even before World War I, the Panama Railroad Steamship Company and the Panama Railroad—both owned by the United States government—sent a representative to the London Conference to fix coffee rates. 4 *Alexander Comm. Rep.*, *op. cit. supra* note 10, at 201. See also 2 *id.* at 872-3, 875. Mr. Scherwin, Vice President and General Manager, Pacific Mail Steamship Company and San Francisco and Portland Steamship Company, in 1913 testified that,

On the assumption, which may be precarious, that no one else would have provided the tonnage, the very existence of the United States liner fleet might somewhat reduce the rates and profitability of conference shipping. This would be true whether the United States liners were inside or out of the con-

"This line is working under an agreement for the maintenance of rates with the Government, the Government having put rates into effect. . . . They also wanted us to enter into an arrangement with the American-Hawaiian Steamship Line by which the American-Hawaiian Line would maintain the same rates by way of Tehuantepec maintained by way of Panama, and we declined to do it on the ground that it was contrary to the Sherman antitrust law; so that the American-Hawaiian Line was practically told that if they undertook to cut rates that the Government would put their own line on the Pacific and would put the Treasury of the Government behind their own line to make the American-Hawaiian Line maintain their rates." *Id.* at 878. After World War I, "the Government's ship operating agency, the Emergency Fleet Corporation (later the Merchant Fleet Corporation), held an active membership in most of the important steamship conferences in the United States foreign trade." INTER-AMERICAN CONFERENCE, *op. cit. supra* note 1, at 149. Indeed, it is said that the Government participated in some conferences that employed deferred rebates, even then explicitly prohibited by U.S. law.

According to James Dennean of the Far East Conference, "In an effort to eliminate at least the irrational competition among its own agents operating in the same trade, the U.S. Shipping Board, through the Emergency Fleet Corporation, caused them to organize the first Far East Conference in 1920. Only the Fleet Corporation agents operating in the trade were members. Experience soon proved that rate agreement among some of the lines in the trade, while the remaining lines were free to quote whatever rates they chose, was futile as a means of producing stability. Accordingly, the Fleet Corporation bent every effort to bring all of the lines, American and foreign, serving the Far East Trade, into a single conference. It was not until September 1, 1922, that this objective was accomplished by the execution of the present Far East Conference agreement, which was formally approved by the Board on November 14, 1922.

"Within 6 months, rates in the trade had been stabilized, and this stability was maintained with rates which gradually recovered from the depressed level to which they had fallen between 1920 and 1922." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 2, at 375.

Mr. Cocke of Lykes Brothers Steamship Company also remembered the early days:

"MR. COCKE: They built up strength. I will say that back in the old days of the U.S. Shipping Board when you had Admiral Benson and Mr. O'Connor, those gentlemen did not fail to use a big stick. I have sat in meetings where the vice president in charge of traffic of the U.S. Shipping Board, Mr. Wilson B. Keane, intimated very strongly that unless equality of rates was practiced that the Shipping Board would take prompt action.

"MR. COWEN: What do you mean by prompt action in that instance, sir?

"MR. COCKE: I meant that in one or two cases the Shipping Board authorities even threatened to pull out of the conferences.

"MR. COWEN: That was when the Shipping Board itself owned the ships?

"MR. COCKE: That was when the Shipping Board owned the ships. . . . The large part of the effectiveness and satisfactory contract systems were due to the fact that the U.S. Shipping Board controlled to a great extent the policies of the lines, and, I again say, could use a big stick and did." *Id.* pt. 1, at 297-98.

According to Lloyd Tibbott, Regulations Section, United States Maritime Board, "In view of the international character of shipping, the policy of the United States, as it has developed over a period of many years, has been to encourage self-regulation of the shipping industry through the medium of steamship conferences." INTER-AMERICAN CONFERENCE, *op. cit. supra* note 1, at 409, 410.

The recent official position of the United States Maritime Board can perhaps best be seen in connection with the *Isbrandtsen* case discussed in the *Bonner Comm. Hearings, op. cit. supra* note 10.

ferences; but cartel erosion would go further, with a given size of United States fleet, if the Americans stay outside. For two reasons it is ridiculous to assert that the United States flag companies could not survive outside of the conferences. First, the Maritime Administration has long prided itself, rightly or wrongly, on the effectiveness of United States policy in opening up the conferences and denying them the use of monopolizing techniques.³⁰⁰ In any event, our law could be a powerful instrument. This power would still exist in United States-foreign commerce, whether Americans join or do not join conferences. Second, representative American shipping firms are large enough to hold their own against the conferences, possibly even against those wholly foreign ones that employ deferred rebates. And no simple dual-rate system would be likely to stop them. This is perhaps best indicated by the continued survival of Isbrandtsen, an American-flat carrier that has neither been subsidized nor participated in conferences. And with the support of government influence and power—which, in effect, have been denied to Isbrandtsen—the situation would be even more favorable.

It may be that an American fleet of the present size would have to be more heavily subsidized if United States policy did not permit United States operators to join conferences, for rates would fall. In such a case, explicit subsidies would have to be substituted for the loss of cartel earnings; or, at the same level of explicit subsidies, a smaller United States merchant marine would have to be accepted. In the process, of course, foreign carriers would lose much greater earnings than the United States lines; and trade would benefit. It is anomalous that the United States professes the greatest belief in competition at home, yet declines to use what is essentially a national fleet to increase competition in its own foreign trade. This is particularly strange in view of our interest in the expansion of world trade and the progress of so-called underdeveloped countries, to which freight charges are often very important. Strictly from an economic standpoint, the United States merchant marine is probably bigger than would be needed to minimize the *net cost* of breaking cartel freight rates. Yet it seems that, if military requirements necessitate a fleet of the present size, or larger, that fleet should be used as efficiently as possible, making the military establishments directly and explicitly responsible for the costs incurred to secure military benefits. A national policy that encourages, or even acquiesces in, conference participation by United States shipping companies does not encourage the most efficient use of the fleet. As far as its conference policy is concerned, the Maritime Board acts in a manner similar to what one would expect if it owned the ships and sought to maximize

³⁰⁰ According to Mr. Morse, Chairman of the Federal Maritime Board, "[s]ection 14(a) of the Shipping Act, 1916 provides that if any such conferences refuse to admit U.S. flag carriers on equal terms and conditions with foreign flag members, then those foreign flag members may be denied entry of their vessels into U.S. ports. This has been an effective instrument to enable U.S. flag lines to gain admittance to these conferences." *Bonner Comm. Hearings, op. cit. supra* note 10, pt. 1, at 5.

its own net returns from them (or minimize the explicit costs—i.e., requests for congressional appropriations for subsidies).

Economists have long worried about the result of subsidies and monopoly upon private efficiency, in addition to the problem of the social or allocative inefficiencies that they may imply. It is plausible to argue that ship operations that are heavily subsidized and protected by cartel arrangements will not be quite as efficient as those that are exposed to the harsh tests of profit-making in a competitive market.

What I have said suggests that the best policy toward conferences is to deny United States subsidized carriers membership in them, at the same time outlawing exclusionary techniques by all conferences engaging in United States foreign trade. It may be objected that enforcement of prohibitions against exclusion would be difficult. Such an objection rests either upon the difficulty of uncovering violations, or upon that of doing something about them once they are found. The first objection is meretricious, since American carriers would have both means and incentive to find out. The second may be more powerful: The extra-territorial application of the antitrust laws may be somewhat unclear in principle and difficult in practice. The Attorney General's Committee, citing among others, the *American Banana*,³⁰¹ *Nord Deutscher Lloyd*,³⁰² *American Tobacco Company*,³⁰³ *Pacific and Arctic Railway & Navigation Company*,³⁰⁴ *National Lead*,³⁰⁵ *Timken*,³⁰⁶ *General Electric*,³⁰⁷ and *Alcoa*³⁰⁸ cases, concluded that combinations and conspiracies among American firms, American firms and foreign firms, or wholly among foreign firms are unlawful when they substantially affect United States foreign commerce.³⁰⁹

There remains the power (detailed in the 1916 Shipping Act) to exclude from United States ports those foreign lines that violate United States law, but that has seldom or never been done. Some claim that this raises such tender problems in connection with treaty obligations that it is unlikely to be a solution. Yet the richness of the American market suggests that no one would like to be excluded from it.

³⁰¹ *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909).

³⁰² *United States v. Nord Deutscher Lloyd*, 223 U.S. 512 (1912).

³⁰³ *United States v. American Tobacco Co.*, 221 U.S. 106 (1911).

³⁰⁴ *United States v. Pacific and Arctic Railway & Navigation Co.*, 228 U.S. 87 (1913).

³⁰⁵ *United States v. National Lead Co.*, 63 F. Supp. 513 (S.D.N.Y. 1945), *aff'd* 332 U.S. 319 (1947).

³⁰⁶ *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

³⁰⁷ *United States v. General Electric Co.*, 82 F. Supp. 753 (D.N.J. 1949).

³⁰⁸ *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

³⁰⁹ REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 66-76 (1955).

As a minimum, then, an appropriate United States policy would be continued acquiescence in United States membership in conferences, but an absolute prohibition against collusive deferred rebates, dual-rate contracts or other loyalty ties, and a prohibition of damages or penalties levied for breach of any cooperatively established loyalty agreement. Absolutely free entry into the conferences should be required, and there should be no artificial impediments even to those carriers that have no intention of providing regular, frequent, scheduled common carrier service. Such a policy would greatly erode the power of conferences, without necessitating a condemnation of them. Even so, that would be a considerable compromise, not only of the antitrust laws, but of a pro-competition policy of the United States which some say has been one of our national strengths. The economics of ocean shipping provides no excuse for such compromise.

To get the maximum economic benefit from a subsidized merchant marine, whatever the reason for building it in the first place, calls for a careful application of competitive pressures. This, along with military need, was a prime reason given for having a subsidized American fleet in the first place. A return to that objective would be a highly desirable direction for future maritime policy.