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Has Pando missed the heart of the Uber problem? A transportation industry expert writes...

By Mark Ames, written onDecember 1, 2015

FROM THETRAVIS SHRUGGEDDESK

Editor's note: In response to my article on Convoy, "the Uber of trucking," Pando received the following response from Hubert Horan, by one of the early advisers/architects of the transport deregulation in the 1970s and a well-known transportation industry expert.

The letter is fascinating, insightful, and critical. I don't agree with his characterizations of some of my arguments; but I do agree with his own arguments and explanations in this letter, and more than that, I appreciate the time and serious effort Horan put into this letter to educate all of us. Few people in America have his decades-long industry perspective and his unique political insights on the politics of transportation, antitrust, markets, and tech. Here's the letter in full.

-Mark Ames

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Has Pando missed the heart of the Uber problem?

As an avid Pando subscriber/supporter, I wanted to raise some serious concerns with your November 4th Convoy post.

I agree that Convoy, which appears to be closely mimicking the Uber playbook, raises major issues that fully warrant the attention you've given it, and I am grateful for the effort and critical thinking that you and Pando have brought to these unicorn issues over the last several years. Apologies in advance if the tone of what follows seems excessively critical, but I have four major concerns based on my background in transport and regulatory economics: (A) I think the Convoy piece (as well as most previous Pando reporting on Uber) misses the critical point that neither company has an underlying business model linked to any rational evidence of sustainable competitive advantage, and you've misled readers by equating the Uber/Convoy models with companies like Amazon, and EBay, which did have plans based on solid economics; (B) You correctly noted that the investors behind Convoy (and Uber) are seeking quasi-monopolistic dominance (trying to build a rent-extractive "narrow in the stream") but you failed to lay out for your readers the critical difference between driving thousands of less-efficient existing suppliers out of business because you've built an overwhelmingly better mousetrap, versus driving more efficient suppliers out of business using artificial market power; (C) You correctly note the already lean conditions in trucking, and it is quite reasonable to discuss Uber-type companies in a broader historical/political context. But I think you've improperly equated the politics and economic thinking behind Ford/Carter transportation deregulation with much more radical finance-driven changes 20-30 years later, and I think the 1970s points you raise aren't critical to your readers' understanding of Uber/Convoy; (D) I imagine that Pando doesn't get many letters attacking its failure to fully appreciate the problem of Uber and Uber-type companies, but if one fails to focus on the complete lack of competitive economics, and the huge dependence on (eventually) exploiting artificial market power, then I think you end up seriously understating the damage these companies could impose on the rest of society.

As a brief introduction: I have spent my entire career in transportation, mostly airlines, but originally railroads, and my career encompassed the deregulation of these industries, and figuring out how to use greater pricing/planning freedom to compete more effectively. (1) I developed the first modern international airline alliance (Northwest-KLM), was involved with other significant competitive innovations (revenue management, frequent flyer) and many of the initial post-deregulation mergers and bankruptcies. I later became a major critic when the innovations and restructurings that had created massive improvements in both industry efficiency and consumer welfare became efficiency-destroying wealth-transfer mechanisms. I testified in Congress against both the Delta-Northwest and United-Continental mergers, and before DOT against the alliance antitrust immunity grants that actually drove the radical consolidation of the airline industry. To be clear I have never had any financial links with Uber or any urban car service competitor or regulator, or with any trucking industry interests.

1. You've improperly equated the Uber/Convoy and Amazon/EBay business models—one is based on legitimate /competitive economics; the other isn't. Your post said that even if it's not Convoy, "it's safe to assume that sometime soon, tech will transform and restructure the $749 billion trucking sector" in a similar way to Uber and taxis, Amazon and booksellers, and EBay and newspaper classifieds. This totally misses a critical distinction-- Amazon/EBay type business models were based on powerful competitive advantages over the businesses they were seeking to supplant while the Uber (and apparently Convoy) models seek to "disrupt" an industry with economics that are actually worse than existing competitors. Despite other issues, Amazon could offer consumers much wider choices than they ever had before, eliminated all of the costs of retailing, achieved huge warehousing and distribution efficiencies and clearly had scale economies that no traditional competitor could match. On the other hand,

the Uber business model (software/brand company plus its “independent” contractors) fails each of these efficiency/competitive/technological tests. Uber isn’t transforming the consumer product—it offers the exact same service as traditional taxi/limo operators. Uber—even a future, more mature Uber-- will have much higher driver, insurance, training, ownership and maintenance costs. The massive subsidies that create the appearance that Uber offers better/cheaper service are not sustainable. Since the mature Uber won’t be able to produce urban car service at significantly lower cost, there are no welfare gains from increased service or lower prices. There is no evidence that a reasonably well run taxi/limo company has bloated costs that cry out for new market entrants, and there’s ample evidence (dirty cars, horribly paid drivers) that industry costs are already extremely lean. Even Uber’s vaunted app is irrelevant to competitive economics. The ordering/pricing aspects of the app are a tiny piece of total costs, they don’t drive any big network economies, and apps can easily be copied. The app actually illustrates a serious Uber structural disadvantage. The economic key to any transportation company is the ability to balance supply (i.e. assets) against volatile demand in the medium/longer term. Thus profits depend on managers with long experience dealing with complex markets, and with sophisticated tools for capital planning and shorter-term price/supply adjustments. Airlines, railroads and shipping companies use some of the most advanced management systems anywhere in the private sector. Yellow Cab isn’t in the same league, but has managers with serious fleet management capabilities, and dispatchers who understand all the idiosyncrasies of local demand patterns (factory night shifts, conventions, bar/restaurant patterns). Uber has an app that ignores the both vehicle management, and market demand forecasting, has no local market knowledge and simply reacts to short-term car requests. Any urban transport operator faces much tougher economics than freight or intercity passenger operators, because there’s no way to reduce costs by smoothing demand peaks. Airline revenue management can massively reduce capital costs by getting price sensitive people to not fly on Friday afternoon. The Long Island Railroad has had peak/off-peak pricing for a hundred years, but rush hour is still rush hour, and the LIRR suffers with the cost of hundreds of cars that only get used ten hours a week. Surge pricing will not get anyone to shift their Saturday night out to fill empty cabs midday Tuesday, and there’s nothing else in the Uber model that addresses any of these fundamental problems with the economics of urban transport. Given the vastly greater complexity of trucking, the idea that a company with a software app could produce new efficiencies great enough to drive most existing trucking companies out of business seems too ludicrous to take seriously. As you clearly point out, there is lots of historical evidence that the last few decades of competition have already made existing operators pretty efficient. Unlike urban car services, trucking includes lots of companies (UPS, JB Hunt) with incredibly

> advanced industrial engineering capabilities. Anyone who thinks that there are tens of billions worth of trucking efficiencies out there—efficiencies that absolutely no one anywhere in the trucking industry could see—and that these billions can be generated by a scheduling app, but will be so huge that they'll totally disrupt a$749 billion industry---is either delusional or willfully dishonest.

Uber-type companies need to be understood as a radical departure from Amazon/EBay type models. Instead of displacing competitors through actual efficiencies, or by creating entirely new markets, its model is entirely based on getting the world to believe that it will inevitably dominate the entire industry. This requires aggressively suppressing any discussion of empirical economic evidence (which would undermine its case) and emphasizing the factors driving inevitability--the brilliance of its early stage investors, the ruthlessness of management, and the raw political power of the company's wealthy supporters. PR is a component of every start-up; at Amazon/EBay it played a supporting role and relied heavily on economic evidence of competitive strengths, but at Uber PR is the heart of the plan, and replaces the need to figure out how to provide much better service at much lower cost. As with 97% of Uber's media coverage, the Fortune and Bloomberg pieces you cited totally avoided any discussion of competitive economics and tried to pass off its faithful repetition of Convoy's "industry disruption is inevitable" PR theme as "news reporting". But by equating the Amazon and Uber approaches you've fallen into the same trap. You've failed to tell your readers that there are no competitive economics behind the "inevitability" claim, and you've helped spread their "our valuation is legitimate because we'll produce huge economic value just like Amazon and EBay" PR claim.

2. All companies want to be big and powerful, but you've failed to explain why market dominance by Uber/Convoy is an especially serious threat to your readers. My concern here is that even among highly educated people with lots of business experience, there is frightfully little understanding of how extreme market dominance might or might not be a bad thing for the rest of society. In aviation I went through the entire transformation from deregulation (robust competition is the key driver of the innovations that are critical to consumer welfare and long-term industry efficiency) to radical consolidation into a global cartel. (2) Even though airlines get a thousand times more coverage in the business press than taxis or trucks, that coverage ignored the consumer/efficiency implications of consolidations as carefully as Bloomberg and Fortune ignored the competitive economics of trucking. Given the ubiquitous coverage (and glamorization) of companies that are (or aspire to become) huge and powerful, I don't think most readers understand your "narrow in the stream" (rent-extraction) concern, and the article doesn't clearly spell-out the importance of eliminating competition in Uber-type business plans. If the objective is to convince a general audience that a specific type of anti-competitive behavior is something that warrants extra attention, I would focus on whether the company's size and market power was economically legitimate or "artificial'? If there isn't obvious empirical evidence of huge efficiency/service advantages that competitors couldn't match (as with Uber) then it is "artificial" and alarm

bells ought to go off and critical scrutiny is justified. If your readers think Uber and Convoy are just like Amazon and EBay, they'll never understand or care about your competition concerns. Companies whose industry dominance will bring better service and lower prices will have PR programs emphasizing those benefits; companies who are seeking artificial dominance will have PR programs emphasizing that dominance is inevitable, and that resistance would be futile.

I assume that Pando readers would assume that all big and powerful companies do some of nasty things (tax evasion, worker exploitation, buying politicians, etc.) that no reputable business school professor would explicitly endorse. It may be useful to ask your readers to consider whether that nasty behavior is critical to the company's success, and whether that behavior would be possible without quasi-monopolistic levels of industry dominance with huge barriers to future entry. Amazon evaded the sales taxes its competitors paid and has nasty warehouse working conditions, but no one would claim that its growth depended on them, or claims that thousands of independent bookstores would have survived if only those practices had been blocked. On the other hand, if Uber had to meet the same licensing, insurance, training and maintenance requirements as Yellow Cab, wouldn't outlets like Bloomberg and Fortune have to start every story by wondering how Uber could possibly offer lower fares and cleaner cars? Uber can't get "independent" drivers to cover the full cost and risk of commercial vehicles, nor exploit the full power of "surge pricing" until it becomes the only game in town for drivers and riders (or leads an oligopoly of companies with similar models). If things like this, that are critical to costs and revenues, depend on extreme levels of artificial market power, then it means that investor gains will likely come at the expense of general economic welfare, and more alarm bells ought to go off.

3. You've incorrectly equated the thinking of 70s and 00s "deregulation" advocates. The history, politics and ideology of deregulation is something we both think is important. Although I imagine we'd agree on a broad range of historical points, your article suggests that the thinking behind transport deregulation was largely similar/compatible with modern day deregulation thinking, while I think the historical record strongly supports the opposite view (differences vastly outweighing similarities). My primary concern here is that this history isn't terribly relevant to your reader's understanding of the main issues (Convoy's intention to follow the Uber playbook, would Uber/Convoy's success benefit the rest of us), and may limit their understanding of your more important points.

Again, I have substantial first hand familiarity with the original deregulation movement. The academics behind it strongly believed there were critical "public interests" in every industry including economic efficiency and a range of social objectives (worker safety, consumer and environmental protection), that government intervention was required to protect these "public interests", that government interventions designed to enhance economic efficiency had to focus on overall consumer welfare, with transparent, even-handed administration without regard to the interests of individual companies, and that there was economic or political basis for believing that large industries had any natural ability to maximize consumer welfare in the absence of legal or regulatory constraints. Modern deregulation advocates believe none of these things. The "transport deregulation" movement of the 70s correctly recognized two major failings in ICC/CAB practices: regulatory micro-management had ossified these industries (should United be allowed to serve macadamia nuts on Hawaii flights?), and facilitated "regulatory capture" where the best organized industry interests could lock-in status quo inefficiencies (3) This administrative/political gridlock thwarted the theoretical advantages of market competition (increased innovation, ability to shift capital from less productive to more productive uses). "Deregulation" in the 70s was strictly limited to eliminating oversight of short-term marketing decisions (product features, pricing, capacity shifts). All of the regulatory rules (safety, financial reporting, consumer protection rules, antitrust, capital requirements, labor laws, bankruptcy, tax rules, etc.) that were important to maintaining a level competitive playing field and protecting other public interests were to remain intact. Fred Kahn, who drove airline deregulation under Carter, explicitly argued that giving airlines increased pricing freedom meant that Washington needed to beef up safety and antitrust oversight. Mergers and bankruptcies were explicitly allowed, since regulation had created huge "barriers to exit" that kept uncompetitive capital in place indefinitely. But any notion of oligopolistic concentration would have been totally rejected as pricing/scheduling freedoms were useless in the absence of strong competitive pressures.

If one were to write a political/intellectual history of how Americans have managed their economy over the last 50 years, the "transport deregulation" movement of the 70s would warrant a major chapter, but Pando readers trying to understand Uber/Convoy, or unicorns in general, wouldn't need to read it. Nor the chapter on how arguments from transport deregulation created the pro-consumer justification for banking liberalization (banks needed regulatory permission to give toasters away to people who opened new accounts). Nor the multiple chapters on the ideological war in finance against the "public interest" that allowed the freedom to give away toasters to quickly morph into the elimination of interest rate rules (that prevented extreme housing market volatility) to the gutting of Glass-Steagall to the "deregulation" of systemic financial risk. I think most Pando readers need to understand why the underlying economics of Uber/Convoy companies are fundamentally different from Amazon/EBay companies, and why they should be much more concerned by the actions of the investors behind Uber/Convoy than by the investors behind Amazon/EBay-type companies.

4. You've seriously understated the "Uber" political issue. I think the key here is the linkage between unicorn business models and empirical evidence of economic reality. If you totally replace the competitive product/efficiency advantages of an Amazon-type plan with a massive PR program emphasizing how the raw political power of the unicorn investor class will inevitably destroy all existing competitors, then demonstrations of political power (and ruthless marketplace behavior) becomes a key driver of capital markets. Extreme wealth accumulation and corporate power has been historically tolerated because of the perception that the Bezos and Omidyars of the world (like the Carnegies and Rockefellers of the past) created huge public welfare improvements en route to their wealth and power and the (more problematic) perception that the size and power of this class will be constrained by economic

reality at the end of the day. Uber-type unicorns are purely exploitative—they create fabulous wealth for a handful, while destroying economic value in aggregate (assets have been shifted from more efficient firms to a less efficient firm, artificial market power is used to exploit drivers, suppliers and consumers, etc.). Wealth accumulators who'd built companies on legitimate economic strengths needed political power defensively—to protect their pot of gold, and to slow down the market forces that would inevitably erode those strengths. Uber-type investors need much more political power, and they need to use it as an offensive weapon immediately on start-up. If the unicorn investing class thinks Uber has proven that tens of billions of private value can be created purely with PR and political strength, then "Unicorn manufacturing" becomes an industry unto itself. Lots of investors will attempt to replicate the formula time and time again, and each new unicorn creates the need to increase raw political power used to enrich these investors, and to destroy any possible political opposition.

As with Uber, the Convoy PR effort started with a huge emphasis on the fame and wealth of its early stage investors, and the "inevitability" that they would utterly disrupt their entire industry. As with Uber, no one then asked for evidence of the powerful competitive advantages that would be needed to achieve such an audacious objective, or asked why no existing competitor had ever come up with similar ways to transform competitiveness, or asked for evidence of the massive existing inefficiencies that were being targeted, or asked for evidence of the economics that would eventually allow them to sustain a powerfully dominant position over an industry that had been incredibly fragmented through its entire history. When you equate Uber/Convoy with Amazon/EBay, most readers will assume powerful economics must exist, and that they are not pursuing "artificial" market power. When you cite the transport deregulation claims of the 70s, readers will not link the investors with today's much more radical political/ideological forces. If reporting has not focused on underlying economics, readers cannot figure out whether claims about low fares reflect real efficiencies or unsustainable subsidies, and cannot figure out whether the open flouting of insurance and safety rules is something that will eventually help or harm consumers. Uber's harassment of Sarah Lacy should have been a much more important story, but I without economic context, it could easily be spun unfortunate bro misbehavior that was irrelevant to the future of the taxi industry. But if Uber has no legitimate competitive advantage, then the harassment serves as a clear signal that Uber depends on political power, and readers can see how it fits into a clear pattern with other demonstrations of its power and ruthlessness. Many business plans involve some degree of exploitative, rent-seeking or otherwise nasty behavior. I see Uber-type businesses as a radical advance, where willful exploitation based on the political power of the unicorn investing class becomes the entire basis for the enterprise. I see this type of investor behavior as a direct threat to the notion that "marketplace competition" can serve the greater good by allocating resources to more productive uses.

(1) I am personally familiar with many of the major players in deregulation movement—Paul MacAvoy, one of the fathers of trucking deregulation and a member of Ford's Council of Economic Advisors was my advisor in graduate school. At Northwest I worked for Mike Levine, who was Breyer's chief staff person on airline deregulation. My summer job

throughout college was with the economics and competitive planning group at US Railway Association which set up Conrail after the Penn Central bankruptcy. The story of how a bunch of very liberal, Ivy League oriented academics completely revitalized the moribund railroad industry has been told a number of places including Rush Loving, The Men Who Loved Trains, Indiana University Press 2006 and Robert Gallamore and John Meyer, American Railroads: Decline and Renaissance in the Twentieth Century, Harvard University Press, 2014

(2) It is not immediately relevant to the Uber/Convoy story, but since you follow the broader subject of how different industries have been radically transformed by powerful interests working to elimination meaningful competition, and how anti-competitive, corporatist ends were justified by forces nominated devoted to “market competition” you may be interested in an article I wrote describing the means (willful fraud, antitrust malfeasance, corrupt economic testimony, etc.) by which this occurred in aviation, Double Marginalization and the Counter-Revolution Against Liberal Airline Competition, 37 Transportation Law Journal 251-291 (2010)

(3) In railroads, it was agricultural shippers (starting with the Grangers) who had the power to suppress freight rates to the point where railroads could not replace capital, while shippers of manufactured goods (who subsidized agriculture under early ICC rules) shifted to truck as soon as they could. In international aviation, it was the major flag carriers (Pan Am, Air France) who made protection from competition a cornerstone of every country’s policy, ensuring that international fares were set high enough so that even the most inefficient flag carriers (i.e. Alitalia) could make money. The best single book on how regulators ossified postwar transport was George Hilton, The Transportation Act of 1958, Indiana University Press 1969, which chronicled the utter inability of the first attempt at “regulatory reform” to overcome the institutional forces that locked-in status quo inefficiencies.