U.S. DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20590

STATEMENT OF SECRETARY JOHN A. VOLPE BEFORE THE SUBCOMMITTEE ON TRANSPORTATION AND AERONAUTICS OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE REGARDING H.R. 11824 AND H.R. 11826, PROPOSALS DESIGNED TO BENEFIT THE SURFACE TRANSPORTATION INDUSTRY, MONDAY, MARCH 27, 1972.

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to appear before you to discuss legislative proposals designed to address the urgent problems which are besetting many segments of our surface transportation industry. Everyone concerned with this vital industry concedes the need for change. It is clear that improvement is necessary. What is less certain are the means to accomplish it. I am pleased that your Committee, Mr. Chairman, has provided for an extended hearing schedule so that all viewpoints--government, carriers, shippers, and others--may be heard and considered. The timeliness of these hearings is indeed appreciated by all involved.

In my testimony, I will discuss in detail the Administration's legislative recommendations, which are part of its program to insure the existence of a safe, efficient and economic surface transportation industry. They are H.R. 11826, the Transportation Regulatory Modernization Act, and H.R. 11824, the Transportation Assistance Act. I shall also make some comments upon certain provisions of H.R. 12209, the Surface Transportation Act.

While the problems of the railroads are clearly the most critical, they must be considered in the larger context of the entire domestic surface transportation industry, which apart from the railroads includes the urban and intercity trucking industry, bus companies, domestic inland, Great Lakes, and coastwise water carriers, oil pipeline companies, and freight forwarders.

As you know, Mr. Chairman, only the railroads are totally regulated by the Interstate Commerce Commission. Substantial portions of the activities of other modes are either partially or fully exempt from regulation. For example, approximately 40 percent of the intercity motor carrier ton miles and over 90 percent of the water carrier ton-miles are handled by carriers not subject to regulation.

The importance of the surface transportation industry to the nation is reflected vividly by its average annual contribution to the gross national product of approximately ten percent. To achieve this, the industry carried 1.9 trillion tons of freight, which generated over $75 billion in revenues.

The major responsibility for the operation of our surface transportation system historically has rested in the private sector--the privately owned and operated contract and common carriers by rail, motor, water, and pipeline. While in large measure, our surface transportation network has served us well, the performance of the industry has been increasinly unsatisfactory. Price increases have accelerated while service has deteriorated often to the detriment of the shipping and consuming public. Some carriers, notably railroads, are in severe financial straits. Each mode can be characterized by its greater difficulty in obtaining financing necessary to make long-term capital improvements. We can expect that over the current decade and into the next, the demands on the industry will become even greater. As an illustration, by 1980 our transportation system must be equipped to handle over three trillion ton miles of freight--almost a forty percent increase over current levels. The capital necessary to meet that need will not be forthcoming from the private sector unless the carriers' financial posture improves. Thus, we have reached the point where a failure to apply effective remedies to the ills of the industry not only will aggravate further the deficiencies of the system, but may seriously undermine the ability of the private sector to maintain its dominant role in the operation of the system.

In response to this need, the proposals presently before your Committee, Mr. Chairman, are addressed to two basic concerns. First, there are measures designed to reform or modernize regulation. Second, there are proposals directed in various respects to the need of carriers for additional income and financial assistance needed for service and capital improvements.

Although these proposals are concerned with the same pressing problems, let there be no mistake about their fundamental difference in approach to them. Basic to the Administration's view is recognition of the disappearance of the monopoly conditions in transportation which were responsible for our present regulatory system. In light of this change, modernization of the regulatory structure seems in order. Therefore, we seek to place greater reliance on real-world competitive factors. We believe that provisions in the Interstate Commerce Act governing rate regulation, entry provisions, and abandonment procedures must share responsibility for the current unhappy state of this industry and that revision of these provisions is essential to the revitalization of the privately-owned surface transportation industry. In this connection, it is noteworthy that the two segments of this industry which are the healthiest are the least regulated--the barge and pipeline companies.

On the other hand, proposals to provide massive Federal financial assistance to the industry, unaccompanied by modernized regulation, seem to us to do little to cure the basic illness. I would hope that more permanent and meaningful relief would be prescribed.

The need for revising and modernizing the regulatory laws affecting surface transportation has been recognized for many years. Numerous proposals to that end have been advanced and considered by Congress. Few specific changes have been made, however, due to the complexities of the regulatory laws themselves and the numerous investments and commitments that have been made under the present system. The change remains difficult, but the challenge continues to grow in urgency.

The Department, as the Committee is aware, has a deep interest in these regulatory laws and has made a searching inquiry before proposing our changes. The result of our effort is the Transportation Regulatory Modernization Act. The proposals contained in this bill represent not only the considered views of this Department but also those of all interested executive branch agen cies and departments who shared in our deliberations.

At this point, let me turn to the major features of the Administration's Transportation Regulatory Modernization Act and present some of the rationale behind our recommendations. The first major feature of our regulatory proposal provides for a measure of pricing freedom within what has been characterized as a "zone of reasonableness". This provision would be applicable to rates charged by all regulated carriers subject to the Interstate Commerce Act. Given transportation alternatives available to most shippers in today's transportation market, we believe that the establishment of surface transportation rates should increasingly be premised on the costs of providing the service in question. In our view, a movement toward a more cost-based rate structure can be achieved by substituting competitive forces for the present scheme of detailed rate regulation. We have provided for such a substitution with appropriate safeguards. Under our proposal, individual carriers would be permitted to change rates, up or down, without regulatory approval, subject to several limitations.

First, existing law states that rates must not be unduly preferential or prejudicial or unjustly discriminatory. This principle is valid, and we have not changed it.

Second, where a shipper faces essentially monopolistic service, that is, there is no alternative competitive service of another mode, the Commission would be empowered to establish a ceiling on rates so that they do not exceed a 50 percent mark-up over the full costs of handling such noncompetitive traffic. For example, if a shipper had available only railroad service by one or more railroads, such a ceiling would apply; on the other hand, if that shipper could also avail himself of effective competitive alternative service, such as by truck or barge, as is commonly the case, the ICC would have no authority to set such a rate ceiling. We believe that, in this latter situation, the intermodal competition would provide an effective ceiling control. We estimate that the elimination of rates currently set above this ceiling level would result in annual savings to shippers of approximately $2 billion.

Third, there must be a floor for rates at compensatory levels. We have defined a compensatory rate as one which equals or exceeds the variable costs of moving the traffic. We feel that by establishing this floor at compensatory levels, we shall reduce subsidization of certain shipments by higher than required rates on other shipments--a practice not in the best overall interest of either the shippers or carriers. We also feel that such a floor under rates would prevent predatory rate competition through use of below cost rates, designed or having the effect of eliminating competing carriers from the marketplace with the ultimate deterioration of total service.

Using the best available data, we estimate that the annual loss to the railroads of transporting traffic below the compensatory level is $480 million. Supportive of this estimate is Penn Central's experience. Penn Central lost $80 million during 1970 from moving commodities at rates below variable cost. Extrapolating Penn Central's loss experience to the entire rail system would give an annual estimated loss of about $650 million. Of course, Penn Central's particular situation is more aggravated than that of the rail industry as a whole, so that the $480 million estimate is a more reasonable one for the rail industry as a whole. In any event, we are most confident that the imposition of a floor on rates, on the basis we have proposed, would have a pronounced beneficial effect on railroad revenues and income.

Let me add another point at this time. I have talked with a number of major shippers during and subsequent to the development of our proposals, and they indicated their concern over the need for fundamental changes in our surface transportation industry. Many of them expressed a willingness to bear increased rates and charges where they would be accompanied by improvements in transportation service. Current marginal rates often lead to marginal service, which serves to increase shippers' total costs. We believe that our proposal will cut shipper costs and improve quality of service to the consuming public.

Fourth, in connection with the establishment of this zone of reasonableness, our proposal provides for a measure of phasing. In other words, rate freedom is introduced gradually. Notwithstanding the floor and the ceiling provisions, no rate, upon a protest, may be increased or reduced by more than 20 percent in the first year after the bill's enactment or by more than an additional 20 percent up or down in the second year. While we would not expect swings of this magnitude to take place in many instances, it seems desirable to provide an orderly transition from the existing procedures to the new approach we are recommending. In this way carriers, users, and the market they serve will have sufficient time to adjust to the revised rate structures.

While we are aware of those who contend that the Commission under existing procedures has already prescribed a "zone", we question whether it can be described as a reasonable or effective one if it permits non-compensatory or excessive rates to be established or if its administration permits delays which prevent carriers from promptly adjusting rates in response to changing market conditions.

Another primary objective of our regulatory proposal is to simplify and streamline the functions of rate bureaus. As you know, the majority of carrier rate practices, arrangements for the interchange and pooling of equipment, and similar matters are very often established in concert pursuant to agreements between carriers of the same or different modes under section 5a of the Interstate Commerce Act. While they are formally titled under various names, the organizations created pursuant to these agreements approved by the ICC are collectively known as rate bureaus. Of particular importance to our considerations in this regard is that section 5a of the Interstate Commerce Act grants immunity from prosecution under the antitrust laws for agreements approved by the Commission and joint actions taken by the carriers under such agreements.

Indeed, these rate bureaus perform a number of important functions. They establish rates and regulations for the interchange and facilitation of traffic moving over the lines or routes of two or more carriers. They also establish standards that are applied throughout the territories over which they have jurisdiction. It appears, however, that the rate bureaus and associations have a retarding effect on carrier competition by discouraging flexibility and innovation in carrier pricing and services. Consequently, to retain section 5a and the carrier agreements established under it, in their present form, would be inconsistent with our objective of placing increased reliance on competitive forces and enhancing the ability of the carriers to respond to these forces individually based on the dictates of their own particular markets.

Therefore, our proposal has made the following revisions in rate bureau operations: (1) antitrust immunity would no longer extend to agreements which permit any action with respect to any rate or any other matter applicable to only the traffic or routes of a single carrier; (2) rate bureaus would be prohibited from protesting a rate proposed by one of their member carriers; and (3) a representative of the ICC would be notified of all rate bureau meetings and could attend them at his option.

The thrust of these and other proposed changes in this area is to indicate those activities which are no longer to be approved by the Commission and thereby immunized from the operation of the antitrust laws. The ICC would retain its authority to approve all rate bureau agreements and to impose such additional limitations and conditions as it believes reasonable and necessary.

A third key feature of our regulatory bill establishes new procedures and standards for the adjudication of railroad abandonment cases.

Despite the growth of the vast highway and pipeline networks, rail system mileage is only slightly smaller today than it was in 1939. Much of the mileage is in light density branch lines whose maintenance and operating costs constitute a major financial drain on the railroads. Abandonment of much branch line trackage appears essential to restoration of their financial health and concentration of their resources where they are most efficient.

Existing regulatory procedures have tended to discourage rail abandonments. Under current procedures, the Commission may require continued operation of an uneconomic line if it is determined to be required by the present or future public convenience and necessity. Since there are no explicit economic standards for defining this term, many abandonments are protested. As a result, abandonment cases often entail protracted hearings, and the prospect of going through the expense, delay and uncertainty of this regulatory process discourages the filing of abandonment applications.

Our proposal seeks to speed up the regulatory process in abandonment cases and to provide concrete standards for adjudicating them. At the same time, the right of the users to adequate notice, and, in some cases, to the continued operation of the line, on a compensatory basis for the carrier, is maintained.

In brief, our proposed abandonment provisions work as follows: A railroad is required to give three weeks' public notice prior to the filing of any abandonment application to the Commission. The railroad can abandon the line thirty days after the filing, if there is no complaint. If, upon complaint to the ICC by a user, it is determined that the abandonment would substantially injure the user, the abandonment may be suspended for six months. During this period, the Commission must determine whether the line lost money in the past twelve months. In determining losses, the bill adopts a standard based on the variable costs of the line or operation in question.

For light density lines or operations, defined in the bill as those failing to generate at least one million gross ton miles of traffic per mile over the twelve-month period prior to the application, where losses can be presumed, the bill does not require that the railroad initially demonstrate losses. Where the Commission finds that a particular line or operation is covering its variable costs, the application must be denied, except that no application shall be denied if the continuation of such line or operation would require the making of capital improvements, the economic cost of which will not be covered by an excess of revenues over the variable costs of such line or operation over the life of such improvements. If the railroad did lose money, and shippers have effective substitute service available, the applications must be granted. If no effective alternative transportation service is available for a money-losing line, the Commission may delay the abandonment for an additional six months. At the end of this period, the Commission must grant abandonment unless revenues are then found sufficient to meet variable costs, through, for example, improved operating efficiencies, rate adjustments, or direct financial compensation from private or governmental entities.

Based upon a recent Departmental survey of low density rail lines, we have estimated that there would be abandonment of about 21,000 miles of line handling less than 100,000 carloads of freight annually. These 21,000 miles of track comprise more than ten percent of the nation's total trackage, but the resulting reduction of 100,000 carloads constitutes less than one-half of one percent of the nation's annual freight carloads.

We also estimate that these 21,000 miles of track cost the railroads in 1971 a net loss of approximately $60 million, and over half of these lines is operated by marginal or bankrupt railroads that can least afford ineffective resource allocations. Clearly, in these areas served by low density lines shippers would benefit from more trucking service to meet their needs. Our proposals address this issue, which I will now discuss.

At the present time, the entrance of a common carrier into a new market requires that the carrier obtain operating authority in the form of a certificate of public convenience and necessity, either through grant from the Commission or by purchase from a carrier already in the market. The Commisson has frequently taken the position that operating authority should not be granted to a carrier when that carrier's entry would have an adverse effect on the traffic of existing carriers. This view has been taken even when the applying carrier has satisfactorily demonstrated its fitness and ability to perform in the market. The effect of these restrictions is that those carriers, who attempt to achieve greater system efficiency by rationalizing their route structure, are often forced to either purchase operating authority from another carrier or, if an acquisition is not available, to do without. In either case, the restrictions on routes and/or commodities carried, with which the carriers have to live, contribute to overall system inefficiency, and in the long run lead to higher costs.

In addition to these considerations, modernization of the regulatory requirements over entry seems desirable in light of our bill's provisions for rationalizing rail abandonments. Rail abandonment should cause some increases in the demand for trucking in areas where rail service is reduced. However, it would appear that unless entry considerations are refocused shippers in these areas may not receive adequate substitute service in a timely fashion. Revised entry considerations in trucking and water carriage is also desirable because of rate flexibility granted the carriers. Also, any tendency for existing carriers to use ratemaking freedom to exploit a strong market position could be checked by a potential for new entry. Further, as below-cost rail rates rise, there may be an increased demand for substitute truck and barge service for these commodities.

The issue of revising motor carrier entry regulation has been much discussed in the press and elsewhere since our proposals were submitted to Congress. There are some who urge complete elimination of regulation in this area--the policy of free entry. Others recommend no change at all. I want to make it clear that we do not endorse any proposals for total deregullation in this area. We are <u>not</u> proposing free entry. Rather, we believe that meaningful change can be accomplished by changing the focus and emphasis of the present regulatory system to that of meeting shipper needs. Our proposals have been developed in this light.

Our proposal seeks to revise entry restrictions within the present certification process. The law now requires an ICC certificate or permit to enter new markets. We retain this and the present statutory requirement that an applicant be "fit, willing and able" to perform common or contract carriage. In addition, the requirement that an applicant meet the basic standard of "public convenience and necessity" is retained. Thus, an applicant for a certificate will still be required to show that there is an ascertainable need for the proposed service.

Although the present law makes clear that the public convenience and necessity must be served, it unfortunately does not make clear how to determine it. Our proposal explicitly identifies what we believe is the true measure of public convenience and necessity for 1971 and the years ahead. Our revisions have the effect of modifying the present criteria in the following manner: We would preclude the denial of entry based on the adverse effect on the traffic of a competing carrier, subject to one important qualification. The Commission may deny an application for entry on grounds of injury to an existing carrier if a protestant carrier can demonstrate that, as a result of certification, total quality and quantity of service in the market to be served would be reduced.

Similarly, our proposal would preclude the Commission from imposing certain restrictions (such as on commodities carried, points served, and equipment or routes used) in grants of new entry on the grounds that such restriction is necessary to prevent adverse effect on a competing carrier unless such adverse effect would impair the overall quantity or quality of service in the market to be served. In determining whether such an impairment occurred, the bill requires the ICC to consider specifically the effect of a change upon originating and terminating markets and upon the adequacy of short-haul service to, from, or between points intermediate to an originating or terminating market.

These are the major features of our approach to regulatory revision, Mr. Chairman. Our proposal contains some additional provisions which for reasons of time I will not discuss at this time. I have gone through the major points in some detail so that the Committee would have some insight into the specific application of the basic policy principles, which I set forth at the outset of my statement.

I would now like to turn to the regulatory provisions contained in H.R. 12209. A number of its provisions have much in common with those proposed in the Administration's proposals H.R. 11824 and H.R. 11826. Others, however, do not. For example, the provisions of H.R. 12209 concerning railroad abandonments, are conceptually very similar to our own. Overall, however, we feel our proposal is more complete in this regard, and consequently we favor our abandonment procedures.

On the other hand, the provision which extends regulation over the motor carrier transportation of a number of agricultural commodities both as to rates and entry is directly at odds with our policy objective to lessen regulation. Aside from this consideration, the rationale for selecting and singling out these particular areas in the agricultural sector for further regulation is not wholly clear. While we are fully cognizant and appreciative of the difficulties which Congress has had in years past, most recently in the Transportation Act of 1958, in defining the scope and character of the exemption in this area, nevertheless the choice seems somewhat arbitrary. The motor carrier transportation of these commodities has generally been free of economic regulation for over 35 years. We know of no evidence to date that shows that any economic interest, whether it be carrier or shipper, would be better served by more regulation in this area. In this connection, it should be pointed out that studies that have been done by the Department of Agriculture have shown that the aggregate rate level tends to increase following the imposition of full economic regulation in the transportation of previously exempt agricultural commodities. We therefore believe that before additional regulation is seriously considered in this area, Congress should be fully apprised of the views of the shippers of these commodities.

Another change proposed in H.R. 12209 would require the publication of rates on the water carrier transportation of commodities in bulk. This Committee and the Congress have recently dealt with this issue in the context of the so-called mixing rule legislation enacted in the last Congress. Therefore, I will not discuss this point in any length. As you know, that legislation directed the Secretary of Transportation to do an extensive study of all relevant issues involved in the transportation of bulk commodities by all modes of surface transportation and to report back to Congress in December 1972 with recommendations for further action, including additional necessary legislation. We believe that any decision on this item should be postponed for further consideration upon the completion of this report.

The third regulatory feature of H.R. 12209 is somewhat unclear. It would seem to provide the Commission with both the direction and the authority to develop standards, criteria, etc., to insure the carriers' rate structure was generating adequate revenue. We gather that this provision is designed to set forth explicitly in statutory form a set of procedures for the Commission to adopt and apply in the processing of across-the-board general increases in rates. Assuming there is, in fact, a legal necessity for this provision, its basic effect would be to legislate a policy favoring across-the-board general rate increases as the most appropriate method for improving the surface transportation industry's revenue and income position. We have previously stated to the ICC, most recently in Ex Parte 267, that we do not regard general rate increases as either a sound or useful device for meeting carrier revenue needs. Significantly, the industry has recently come forward with a request to increase rates on selective commodities.

There is one non-regulatory feature of H.R. 12209 that I will briefly comment upon. Title 1 of that bill provides for up to a $5 billion authorization for direct loan or loan guarantees, or a mixture of both, to individual carriers unable to raise sufficient funds at reasonable rates in the private money market. Although differing considerably in detail, the program authorized by Title 1 very much resembles the old Reconstruction Finance Corporation which provided assistance of this sort to transportation companies and other businesses during the depression years. It is granted that many segments of the surface transportation industry will require additional capital to meet both present and future demands and that many carriers are presently experiencing considerable difficulty in raising needed funds at reasonable rates. However, our analysis has tended to indicate the problem is not a shortage of available funds in the private capital market, but rather that the surface transportation industry simply does not offer an attractive enough inducement in the form of a high rate of return to attract this capital. Given some assurance that the surface transportation industry has long-term viable economic prospects and can be operated in a modern businesslike manner, we feel that the sufficient capital will be forthcoming. We believe that our proposals provide the basis to bring this about.

Further, we believe that the Federal Government has taken and has proposed many meaningful measures which will provide significant financial assistance to the surface transportation industry, especially to the railroads, the most depressed segment of that industry. In addition to our proposals contained in the Transportation Regulatory Modernization Act and the Transportation Assistance Act, assistance has been provided through the Emergency Rail Services Act of 1970, the Rail Passenger Service Act of 1970, the Department's R&D program for safety and high speed ground transportation, as well as through investment tax credit provisions and guidelines for accelerated depreciation, which I referred to earlier. Those programs already implemented coupled with our current proposals will subsequently assist in creating the kind of financial environment necessary for a healthy, privately-owned surface transportation industry.

I would now like to touch briefly upon several features of our Transportation Assistance Act. This proposal would prohibit the continuing practice of many State and local governments in assessing and taxing common carrier property in a discriminatory manner. I note that H.R. 12209 contains a similar provision. I hope that Congress will promptly act on this measure.

In addition, our Transportation Assistance Act creates a Federal Railroad Equipment Obligation Insurance Fund which would be used by the Secretary as a revolving fund for the purpose of insuring obligations issued by railroads to finance the acquisition of rolling stock. The aggregate amount of unpaid equipment obligations outstanding at any one time under our proposal could be no higher than $3 billion.

Lastly, our proposal calls upon the Secretary to conduct research and development into the design of a national rolling stock system within two years from enactment of the bill. At the end of the two-year period, the Secretary would be required to report to Congress his recommendations respecting the organization, development, funding, and implementation of any national system which he may design as a result of this research and development effort. The Secretary may also determine the costs and benefits, and make recommendations toward the installation of rolling stock scheduling and control systems on individual railroads which are compatible with any national system that may be designed. During this two-year period, he would also be required to begin demonstrations to test the feasibility of, and benefits from, the installation of rolling stock scheduling and control systems in railroad yards and terminals. We have requested an authorization of $35 million to carry out these provisions.

These three proposals of our Transportation Assistance Act are designed to address three critical problems facing the railroad industry:

(1) the inability to secure on reasonable terms an adequate supply of freight cars and other rolling stock; (2) the lack of modern national system for controlling the distribution and utilization of freight cars; and (3) the continued existence of discriminating and unfair taxes on the property of railroads and other surface common carriers by state and local governments.

Adoption of these proposals should make a substantial contribution to moving the railroad industry toward profitable operation and yet would keep to a minimum the involvement of Federal funds and the exercise of Federal control in the direction and operation of our railroad system.

In conclusion, let me make two final points. Our proposals represent a very careful analysis of the problems of the surface transportation industry and a weighing of the issues. We earnestly believe our proposals will help build a better, stronger surface transportation industry. We also believe that our legislation will benefit <u>all</u> surface modes. Let me illustrate this. In 1970 each intercity surface transportation freight dollar was divided as follows: motor carriers, 60.3 percent; railroads, 34.5 percent; and water carriers, 5.2 percent. We estimate that in 1980 with our regulatory changes the dollar will be divided as follows: motor carriers, 62.1 percent; railroads, 32.9 percent; and water carrier, 5 percent. Without regulatory change we estimate that in 1980 the railroad piece of that freight dollar will fall to 29.5 percent, and the railroads will have a consolidated deficit of $309 million--hardly the basis for continuation of viable privately-owned rail system. We feel that preserving that system in private management is in the national interest.

Finally, Mr. Chairman, I wish to repeat our appreciation for the timeliness and extended nature of these hearings. The Administration is particularly pleased to learn that so many individual shippers and shipper organizations plan to testify in favor of many of our proposals. We feel this group--the users of the system--the people who pay the bills--are uniquely qualified to evaluate how the system is working today and to recommend what is needed to improve it for the future.

We also recognize you will hear from industry and others who will support only parts of our proposals. We are confident, however, that the proposals presently before this Committee provide a broad and sound base upon which meaningful assistance to this vital but troubled industry can be formulated.

Mr. Chairman, that completes my prepared statement. I and members of my staff will be happy to answer any questions the Committee may have.