

STATEMENT OF JOHN W. BARNUM, DEPUTY SECRETARY,
U. S. DEPARTMENT OF TRANSPORTATION, BEFORE THE
SUBCOMMITTEE ON AVIATION OF THE HOUSE COMMITTEE
ON PUBLIC WORKS AND TRANSPORTATION, REGARDING
H.R. 14623, TUESDAY, AUGUST 31, 1976.

Mr. Chairman and Members of the Subcommittee:

Thank you for this opportunity to discuss H.R. 14623.

This bill would amend the Federal Aviation Act of 1958 to allow the Civil Aeronautics Board to grant an exemption from the requirements of Title IV of that Act pending consideration of an initial application for all-cargo certification. Although the bill is written in general terms, it is intended in fact to aid Federal Express in its request to operate larger planes than can now be operated pursuant to the exemption established under Section 416 for commuter air carriers.

We have carefully reviewed the bill, and we believe it touches an important area. Although much of our initial efforts to reform aviation economic regulation focused upon passenger transportation, we have always realized that the present regulatory structure creates unnecessary problems for air cargo transportation and that reform is needed in this area. Air freight in terms of volume may be a small part of the total freight picture, but air

cargo is nevertheless a very vital part of the transportation system. Particular industries, such as the garment, electronics, and aerospace industries, where speed is of the essence, rely very heavily upon air freight. Other industries may ship only a few parts via air transportation, but these parts are often key to their total operations.

We agree with the objectives of H.R. 14623. We believe that Federal Express should be allowed to fly larger planes. Airline management, all management, should be allowed to choose the type of equipment that is most suitable to its operation as long as that equipment is safe and environmentally acceptable. Once having said this, let me stress, however, that we disagree very strongly with the approach of this particular bill. What you have before you is a private relief bill. The problem, on the other hand, requires a broader based response. We must not choose short term solutions that attempt to solve one problem only to create other problems and, more important, that do not confront the larger issues. We think there is another way to address the problem of Federal Express and to avoid the problems and inequities created by H.R. 14623, but first I think some back-

ground is useful to give perspective to this issue.

Federal Express is quite a success story, especially since it is operating in an industry that in recent times has not seen much financial success. It started in operation about four years ago in competition with some fairly well-known firms. At that point it served less than two dozen communities, employed a few hundred employees, and operated less than a dozen planes. Today, Federal Express serves over 75 airports, with over 40 aircraft, and approximately 2,000 employees. Its rates are in many instances lower than those of its competitors, and its planes are flying at load factors approaching 90 percent in terms of weight. Its annual revenue is in the range of \$100 million.

Federal Express has benefitted from a fairly unique type of operation. Regardless of the origin or destination of a package, all shipments are collected and first brought to a central point, Memphis, for shipment to their final destination. This centralized shipping system allows Federal Express to maximize its efficiency and reduce its costs. For example, with a central shipping point, the number of back-up planes to be used in case of an aircraft mechanical problem is minimized.

Why was Federal Express able to achieve such success?

Considering the unique type of system developed by Federal Express, a great deal of credit must be given to the innovative spirit of the Federal Express management. But that spirit might have been for naught if Federal Express had to work in the usual regulatory environment. This company, however, was able to work within the limits of the present exemption from economic regulation provided pursuant to section 416. By using planes with payloads below the limits of the exemption, Federal Express was able to expand its route system without the usual regulatory filings and delays and to offer rates that were very often below the rates of its competitors. Such a course is not open to a certificated carrier.

Federal Express has now grown to a size where it is flying more than one plane a night to many of the cities it serves. It now has the choice to fly multiple flights into the larger cities it serves or to use a larger single plane. For most businessmen the choice would be clear. One plane saves fuel and costs. But Federal Express cannot follow this course without obtaining a broader exemption than is now allowed. Of course, there is another course,

to seek a certificate, but as Federal Express has testified before the Senate and before this Committee, certification, with all its delays, uncertainties, costs, and restrictions is not a very attractive course. Federal Express has applied to the Board for the broader exemption. The Board turned it down, claiming among other things that it lacked the power to grant such an exemption.

H.R. 14623 would remove any doubts that the Civil Aeronautics Board could grant the exemption and open the way for larger planes. But it is not a course we should take.

The rules of the game should apply to all equally. If Federal Express can operate larger planes exempt from economic regulation, then other similarly situated carriers should have those same rights. The other cargo carriers have made a significant investment in the industry, and if the rules are going to be changed, then the rules should be changed for all.

There are many problems with this private bill. If this exemption were granted, Federal Express would be free from the constraints of Title IV, at least until its certification was completed, and other carriers would not. I am sure that the other cargo carriers would like to have the freedom to choose what cities they can best serve and what rates they charge. If

such freedom is granted to one, it should be granted to all. This bill is very narrowly drafted to open the door to a broader exemption only pending an "initial certification pursuant to Section 401". This language would deny the Board the power to make the bill's benefits available to existing certificated carriers.

I might point out, however, that even if the word "initial" were removed and the bill provided that Federal Express and the other carriers would all play by the same rules, we would still be greatly troubled by this piece of legislation. The bill does not require an exemption; it only authorizes an exemption. This approach leaves open the possibility that although the present Board may find it in the public interest to grant this exemption to Federal Express, it may choose not to grant a similar exemption to other carriers at a future time. And it leaves Federal Express subject to Board control should its management decide that even a larger plane or a different type of system would produce a more efficient operation.

There are other technical problems. If the Board were to grant a temporary exemption, how would this affect the Board's ultimate decision as to certification. Just from the perspective of Federal Express, this bill may be a very unwise course. It leaves open the possibility that a temporary certificate will be granted, but a permanent certificate will be denied or perhaps only half the points desired will be granted to Federal Express.

The correct course of action is not to enact this limited type bill, but rather to go to the heart of the issue -- comprehensive reform of air cargo regulation. It is not just Federal Express that has problems. It is in fact the success story of the otherwise undernourished air cargo industry. The existing regulatory system serves the needs of the cargo carrier and shipper badly. Its emphasis is on restriction and great efforts are spent to construct an intricate labyrinth of where a carrier may and may not fly. The result is inordinate inefficiency for the carriers and confusion and inconvenience for the shipper who may have a thousand shipments and yet cannot deal with one carrier that is able to serve all those points.

It is instructive to compare the successes of the unregulated sector of the air freight industry with the status of the regulated industry. We have already discussed the success of Federal Express. But while Federal Express is the largest commuter operator, it is certainly not the only one. Indeed, more than 30 commuter carriers handle only cargo and the other commuters, in total, carry three times as much freight as does Federal Express. Still other commuters specialize in cargo, but do not limit their operations exclusively to cargo. Like Federal Express and the rest

of the commuter industry, commuters carrying freight are unregulated and provide scheduled service without subsidy. And for the past five years, the amount of freight carried by commuters has been growing at a rate of more than 30 percent annually.

Another area with limited regulation is that of air freight forwarders. The Board permits virtually free entry and relatively complete pricing flexibility. In contrast to the claims of chaos and oligopoly often predicted as a result of regulatory reform, we see a healthy and growing industry of 300 firms. Clearly the unregulated sector is doing well.

But what of the regulated sector? We now have only two all-cargo airlines operating domestically. Flying Tiger with a proud history and a leader in the industry has not been profitable domestically for years. Airlift is small, suffers from a severely restricted route system, and has had major financial problems. Clearly, the Board policy of holding up freight rates to protect all-cargo carriers has not resulted in their success. But what of the combination carriers? As for the passenger carriers, the number of all-freighter aircraft operated has shrunk. Largely because of the rates set by the Board in a futile effort to protect

freighters, belly space on passenger airliners goes largely unutilized. In the all-cargo industry, we are facing what we already face in the motor carrier industry: a movement away from common carriage to private and contract carriage because of the increasing inflexibility of the regulatory system. Indeed, this is already occurring -- as several large commercial operators, exempt from Board regulation, operate under contractual arrangements with large shippers. There is, in fact, a major contrast between the unregulated sector of the air freight industry where the forces of the free enterprise system are allowed to operate, and the regulated section where those forces are stifled.

We believe that comprehensive reform of air cargo regulation is necessary, both in terms of entry/exit and rates. Several issues are raised by such a policy, and I would like to share some of my thoughts with you on these issues. Should there be any test for entry? Should there be some limits with respect to the pricing flexibility? Should the reform be intricately phased? Since the supplementals are an obvious new entrant to scheduled air cargo service if there were such reform, should the air cargo carriers be allowed easier access to supplemental certificates as a matter of equity?

As far as a "test" for entry, it may be that something less than the existing PC and N test is required. A test limited to "fit, willing, and able" would not cause a great problem, but there would seem to be little need for any test to protect competition and service. The FAA would ensure that the planes are safe as they do now, and it might be sufficient to require registration with the CAB and authorize the Board to require proof of insurance coverage and similar practical requirements.

Is there a problem of possible discrimination or "predatory conduct?" Would smaller shippers be placed in an inferior position by reform? We believe that with a liberalized system, the threat of entry would police both discrimination and predatory conduct. The theory of predatory conduct is that you charge below-cost rates, drive the competition out, and then reap the benefits of a monopoly. This is the theory, but the theory would not hold if there were empty bellies in passenger aircraft and free entry for all cargo service. The "predator" might drive out the all-cargo competition with below-cost pricing, but if there were free entry the competition would return when he raised prices again and thus he would not be able to recoup his earlier losses.

Much of the same analysis is applicable to the question of discrimination. Discrimination implies that a carrier is charging one customer a higher price than another customer for the same service. This may go on in a monopoly situation but it cannot go on very long in a free entry situation. The high priced customer will simply take his business elsewhere.

Another course would be to attempt to define what we mean by "predatory" or "discriminatory", and then to prohibit such conduct. The problem here is the difficulty of allocating costs between passenger and freight traffic. If given this authority, the Board might simply promulgate an arbitrary allocation formula. It is possible that a standard intended to protect against unfair competition might be used to frustrate fair and desirable competition.

As for phasing, there are many approaches. The simplest way would be just to have the revised approach take effect on a certain date in the future. Any other approach might be fairly arbitrary and could make the carriers go through several adjustments unnecessarily.

What about the relationship between the supplementals and the all-cargo carriers? The supplementals have great flexibility. If there were free entry, it is possible that the supplementals would be among the first new entrants. Is it fair that the supplementals

could enter the all-cargo business but that the all-cargo carriers could not enter the supplemental business?

These are but some of the issues that need to be addressed, but I hope they will be considered very soon. Again, I appreciate this opportunity to discuss this important issue. This ends my written statement, and I would be happy to answer any of your questions.