

TESTIMONY OF THE DEPARTMENT OF TRANSPORTATION
ON THE RAILROAD DEREGULATION ACT OF 1979
BEFORE THE
SUBCOMMITTEE ON TRANSPORTATION & COMMERCE
OF THE
HOUSE COMMITTEE ON INTERSTATE & FOREIGN COMMERCE
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SECRETARY ADAMS:

Good Afternoon. I appreciate the opportunity to be here today to talk about the proposed Railroad Deregulation Act of 1979. We must enact this legislation, and we must do it soon. Every Secretary of Transportation, and every Congress in recent years, has addressed the rail crisis. That crisis continues to worsen nonetheless because those efforts have focused solely on the rail industry itself, while the crisis is not confined to the railroads. The crisis affects the entire transportation system: how shippers get their products to market, and what consumers pay for those products. The Rail Deregulation Act of 1979 addresses these concerns, and its passage is imperative for our transportation system as a whole, and for every shipper and every consumer in the country.

I and other members of the Administration have already spoken at length about the financial plight of our railroads, and of the imminent crisis they face. That was very much on our minds as we developed this bill. And it was very much on the President's mind when he transmitted it, saying: "The private freight railroads are the backbone of our industrial and agricultural production. But today the . . . industry faces a crisis which could have grave consequences for our nation's economy." Throughout the Administration

we remain very concerned that the already hard-pressed U.S. taxpayer not be asked to increase an already large and in many ways unproductive subsidy. This legislation provides a real opportunity to avoid such an unwise course of action. But as important and immediate as these concerns are, I do not want the public debate on this bill to turn solely on the railroads' financial health. Our concerns are far broader.

The shipping community has told us -- by their words and by their actions -- that the railroads can no longer serve their needs. As railroad prices have gone up, railroad service has gone down. Increasing numbers of cars and locomotives spend increasing amounts of time in repair shops. An ever-growing proportion of the rail system has declined to the point that it can be operated only at severely reduced speeds. Increasing numbers of shipments are lost or significantly delayed. Accidents become more frequent every year.

Some time ago trucks, 60 percent of which are deregulated, surpassed rails in share of the freight market. And the disparity in their shares keeps growing. In 1977, water carriers, 92 percent deregulated, carried 599 billion ton-miles of traffic, one fourth of all U.S. freight movements that year. The railroads are carrying less and less of our nation's goods -- and the nation is paying a high price for that change.

If other modes could carry all these goods more efficiently, we would not be so worried about what is happening to our railroads. The fact is, however, that a lot of the traffic carried by other modes could be carried faster, or less circuitously, or at lower cost by the railroads. But the regulatory system continues to inhibit the railroads from competing effectively for this traffic. In those instances, the loss of rail traffic doesn't just mean a loss of rail revenues. It means that we have an inefficient, costly, and less productive transportation system. And every one of us pays the bill for that inefficiency. We pay it primarily in the form of higher prices for our consumer products, and increased fuel consumption. While the transportation component of consumer prices may be small, it is a cost that is paid thousands of times each day in every community, and the total is enormous. Today's most urgent domestic problems are, thus, exacerbated by the crisis in our rail industry.

I believe that if we allow today's railroads to operate as other industries do, instead of regulating their every move, many of the industry's problems can be solved -- and solved in the private sector. But we must move quickly. This bill will allow the market to decide how products are moved, and how those movements are priced. The market will allocate traffic to the most efficient mode of transportation -- allowing shippers and consumers to reap the benefits of the so-called "inherent advantages" of each mode -- something the regulatory scheme has tried unsuccessfully to do for all these years.

Efficiency, competitiveness, productivity, innovation, and technological change have all been missing from many rail operations for too long. We must return to the natural regulation of competition, and get rid of the artificial and unproductive restraints of today's regulatory system.

Finally, let me stress that this reform proposal is not the total answer. To benefit fully from a less regulated environment, the industry must modernize its physical plant, its operations, its labor relations and every other way it conducts its business. I think this Committee is familiar with our efforts to assist the industry in these crucial areas.

I'd like to turn now to Jack Sullivan, our Federal Railroad Administrator, to set forth our expectations as to how the deregulation bill will work, and to Linda Kamm, General Counsel of the Department, to explain how those goals are realized in the legislation itself.

MR. SULLIVAN:

Thank you, Mr. Secretary. I think you have made very clear the breadth of our concerns in drafting this bill, and I'd like to try to explain the basic themes of the legislation -- the themes with which we have tried to capture the spirit and the broad goals that you set for us.

The goal of this legislation is better rail service for the American consumer. To achieve this goal we must encourage increased rail productivity, efficiency, and innovation, allowing the railroads to increase their revenues, decrease their costs and become better competitors. As better competitors, the railroads will be better able to regain some of the traffic lost to other modes, and thereby increase their profitability, their attractiveness for private investment, and their financial independence. At the same time, they will provide less costly and more fuel-efficient service, to the benefit of shippers, consumers, and taxpayers.

The new regulatory framework that we propose relies to the maximum extent possible on the same regulatory mechanism that propels the rest of the economy -- competition. Competition that is ubiquitous, low-cost, efficient, and largely unregulated. If the railroads are allowed to meet their competitive challenge fairly and head-on, they can regain profitable traffic through improved service, innovative pricing, and efficient operations. And competition will assure that the railroads' prices and services are the best possible. I'd like to be more specific as to how we expect the railroads to use this competitive freedom.

Increasing rail revenues does not mean just raising rail rates. Raising rail rates indiscriminately won't work -- in fact, it will be counterproductive. Rail rates must

be flexible and imaginative -- reflecting individual, specific costs and competitive circumstances. This will happen in several ways.

First, where rates on competitive traffic are below the carrier's costs, rates must be raised, unless costs can be reduced. Even if the railroads lose the traffic, that loss will make a contribution to rail profits.

Second, for traffic already contributing to rail revenues, further competitive progress can be made if the railroads learn to provide a variety of rate/service packages. Not all shippers want the identical service or require the same speed, or the same time of pick-up and delivery. Those who want premium service are willing to pay for it and many do so already in the form of higher truck rates. Those who want the lowest cost service are often willing to wait for it. New and profitable traffic can be attracted by the railroads if their rates and services are attractive. We have already seen this work in Canada. In a deregulated environment, the Canadian railroads have developed a marketing and pricing strategy that has increased rail revenues, and rail market shares, while improving service and decreasing costs. Given the freedom to try new things, the Canadian railroads got smart. After negotiating with the shippers, and learning their individual needs, they developed new rates and services, tailored to their shippers' needs. Competition worked there, and it can work here if we give it a chance. But our current regulatory scheme does not provide that chance.

Third, the service and rates affecting the so-called "captive shippers" must be addressed. For five years such shippers will be able to seek ICC protection. But even then the issue will be primarily one of definition. Many shippers

are captive only by habit. For those shippers, deregulation offers a major competitive opportunity. They will find many chances to improve their marketing -- new rates, new services, faster, better, often cheaper service -- whether by rail, truck or other mode, and to new markets, as well. Other so-called "captive shippers" have for many years been the beneficiaries of a regulatory policy that originally sought to promote infant or depressed industries or geographic areas, but ended up as a permanent fixture of the railroad rate structure, subsidizing mature, profitable industries at the expense of the railroads. The railroads can no longer afford this policy, nor can other shippers or the taxpayers who will have to pay an increasing share of this hidden subsidy. For such shippers, rail rate increases may be an integral part of the process of allocating traffic in a cost- and fuel-efficient way.

Finally, there are shippers who rely on the railroads as the only reasonable, economical mode of transport. This bill recognizes that need, by providing such shippers with tools to assure fair and reasonable rail rates. Discrimination is forbidden. Contract rates and peak-load pricing are encouraged, and these tools will allow railroads and shippers to reduce the uncertainty of demand, and assure competitive prices and timely service. These tools have proven their value in Canada and are among the principal reasons for the success of Canadian deregulation. Another means of helping such shippers is the five-year transition to maximum rate deregulation. Shippers will use this time to amortize existing investments and work with the railroads to make long-run plans. DOT will undertake studies during the transition period to assure that no one bears an unfair share of the costs of deregulation.

Everyone must pay a fair share, and some rate increase will occur. But the attraction of new and profitable traffic from other modes will reduce the burden that must be borne by current users of the rail system, and innovative price and service offerings will help to balance the contributions of all rail users. Again, this has already worked in Canada. In the more than ten years since the Canadian railroads were essentially deregulated, only one "captive shipper" case has been brought before the Canadian Transport Commission -- unsuccessfully. Far from paying an unfair share of the costs of deregulation, Canadian shippers are finding new competitive opportunities. Even the so-called "public interest" test in the Canadian statute has been applied only rarely -- fewer than half a dozen times in 12 years. Competition does regulate price and service -- and it does it more efficiently, more cheaply, and more promptly than the government can.

At the other end of the spectrum, reducing rail costs will also help to lower some rail rates and encourage the efficient use of the total transportation network. Our bill will encourage consolidation of track and facilities, joint trackage rights, reductions in terminal congestion, and a myriad of other operating efficiencies. Mergers will be treated more fairly and promptly, and those without significant anti-competitive effects will be consummated without imposition of heavy-handed operating conditions that rob the merger of all or most of its intended benefits.

Further, the pricing and cost-cutting opportunities available under the bill will allow some lines that today look unprofitable to pay their way. Some abandonments will occur. But let's look at them in context. Today, two thirds of all rail movements occur over only one fifth of rail track. Trucks make more rail mileage excess every day. And more

traffic can move efficiently and profitably by truck. Abandonments don't occur in the face of high density, profitable traffic; they are the formal recognition of a loss of traffic brought about by the marketplace.

Another part of achieving a better overall transportation network is encouraging intermodal service. This bill does that by allowing the railroads to change an outdated rate structure. Our proposal will require through routes, but will allow the railroads to seek the best possible partner for providing joint service. This means lower rates for the consumer and an opportunity for water/rail partnerships that could greatly enhance the water carriers' role in our transportation system. This also means increased use of so-called TOFC, or trailer-on-flatcar, movements -- in which motor carriers provide pick-up, delivery, and short-haul movements, and then place their trailers on rail flatcars for a low-cost, fuel-efficient, long-haul movement. Consumers, shippers, and the entire transportation network will gain from increased intermodalism.

Finally, let me mention one more gain to the economy --the reduction in the cost of regulation itself. Suffice it to say, by way of example, that the railroads tell us that six tons of paperwork were submitted to the ICC in support of the last general rate increase request, and that abandonments can still take up to two and a half years, and cost upwards of half a million dollars each. There are other examples -- each of them representing costs to the railroads, the shippers, the consumers, and the taxpayers.

We have many additional hopes and expectations for this rail bill. I look forward to discussing them with you as debate proceeds. But I think it is important now that Linda Kamm, the Department's General Counsel, explain some of the specifics of the bill -- how and why it works.

MS. KAMM:

Thank you, Jack. This bill accomplishes the goals you have described and, for the first time, imposes order, clarity, and coherence on a statute that through 80 years of piece-meal amendment had lost its purpose and direction.

The bill essentially has three parts: ratemaking, industry structure, and operations. As I describe the bill, however, I want to stress that it is a system of checks and balances. Its pieces dovetail, and changes in one affect, sometimes profoundly, the others. If the regulatory pieces are not designed to work together, we will not only fail to help the railroads, we will fail to help, and may harm, other carriers, shippers, and consumers.

Ratemaking

1. In today's regulatory system, the ICC can suspend a rate, based on the belief that it might eventually be found unlawful, and without letting it be tried in the marketplace. Under our bill, the ICC will no longer be able to suspend rates or initiate investigations on its own. These are procedural changes, but they are fundamental to the new system, because the new system is geared to remedying actual abuse, not trying to guess where it might occur. We believe that effective competition for the provision of transportation services is pervasive. It will constrain rail pricing behavior far better than the government can. We must let it work, and to step in only where it can be shown that it did not work. Prior restraints are not allowed elsewhere in our judicial system, and it is time to apply that fundamental economic and legal principle to the transportation industry. It is also time to start deciding cases on the basis of facts -- not hypothesis and theory.

2. Consistent with these principles, maximum rate regulation will be phased out over a five-year period and then eliminated. We think this will lead to rates more carefully tailored to the needs of individual shippers, more rate/service options, more peak-load, seasonal, and contract rates. Some rates will go up and others down, but, in general, we anticipate that shippers and railroads will talk to one another and shippers will buy what they need -- not what the ICC, or other carriers, or bureaucratic institutions are capable of devising.

During the five-year transition, there will be a 7 percent zone of reasonableness, computed yearly on top of inflation, in which carriers will be free to raise their rates as long as the rates established are not discriminatory. For rates outside the zone, the ICC will retain its ability to lower rate increases, but only if a shipper can prove -- with real evidence based on real situations -- that he has no effective transportation alternative, and only if the railroad cannot prove the rate to be reasonable. As the transition period goes on, the Department will study how it is working -- whether competition is protecting shippers, and how fast and how effectively.

The basic thing to remember here is how hard it is to have just a little regulation. The presence of regulatory power, and the 90-year dependence of railroads and shippers on that regulatory authority, create inexorable pressure to use the regulatory authority -- even in situations undreamed of by the drafters of the statute. We have just been through that with the 4R Act. And simple variations on the market dominance theme will not avoid those pitfalls.

3. Notwithstanding this rate freedom, railroads will be required to cooperate with one another to provide nation-

wide, connecting service. Through routes are the sine qua non of a national rail network. But through routes do not require that a single joint rate be imposed on the participating railroads by the ICC. We would eliminate the ICC's power in this area, and allow railroads to set their own joint rates and divide the revenues between them as they see fit. If they cannot agree on a joint rate, or a division, they can add their individual portions to get a total, thereby continuing the convenience of the single factor rate without the long and expensive divisions cases that have characterized ICC joint rate setting in the past.

To accommodate efficient and prompt joint ratemaking, we would empower the ICC to grant antitrust immunity for discussion of and agreement on joint-line rates. That is, rate bureaus are kept, but the bill provides additional constraints on anticompetitive behavior. For example, the railroads who vote on a rate in a rate bureau must be true participants in the route, lest the pricing freedom offered elsewhere in the bill become a pretext for collusive setting of rates above market prices. Similarly, discussions of single-line rates will be prohibited. There is no reason to permit one railroad to discuss with another the rate applicable solely to its own service.

In keeping with this philosophy, we will, after two years, deny antitrust immunity for discussions of and agreements on general rate increases, although any single carrier will be able to change all of its prices simultaneously. A given firm's prices should reflect its costs and its competitive circumstances, not those of its less efficient competitors. The bill also requires all bureau votes to be open and recorded, and, finally, allows rate bureaus to continue to publish rates and provide other administrative services.

4. At the same time that railroads are given this greater freedom, they must remain subject to fundamental rules of economic fair play. For this reason, the bill would continue regulation of rate decreases by forbidding predatory and other anticompetitive pricing tactics, and continues also to prohibit discrimination not based on cost or competitive differences. The discrimination provision applies even within the zone of reasonableness. The ICC will continue to enforce these restraints on rail freedom -- although new standards, based on court interpretations of existing legislation will be applied. Competition must be fair, and these safeguards are retained to assure its fairness.

Industry Structure

1. One of the least understood provisions of this bill is one providing easier entry into the rail industry. We obviously do not expect major new trunklines to be built. But entry offers many less ambitious, but equally effective routes to more effective intramodal competition. Sometimes a railroad is near, but not quite near enough, a shipper's siding. Laying just a small amount of new track may bring new competition. The bill provides for this, with minimal ICC interference, even in the situation where another railroad's line must be crossed to provide that competition. Other entry provisions allow shippers to book traffic with a railroad that is in the metropolitan area, but does not have direct access to them. These provisions help us to rely on competition to provide good service at a good price.

2. The corollary provision is, of course, abandonment. You have already heard this morning about excess capacity, track usage figures, and the need for railroads to reduce their costs. The abandonment provision of this bill is

intended to address these problems without denying shippers and communities the right to rail services where they are warranted. The ICC would have a continuing role in assuring continuation of service if shippers or others are willing to pay its true costs; and, after all, willingness to pay the real cost of a service is the true test of the need for that service. The abandonment provision gives every affected party the right to be heard, allows decisions to be made fairly and promptly, and lets the ICC be the final judge of a line's financial status and of the adequacy of a subsidy offer.

Today, the Interstate Commerce Act provides no standards for the ICC to apply in deciding whether to approve a proposed abandonment. Under the provisions of the bill, the Commission would still review proposed abandonments pursuant to a public convenience and necessity test. But, subject to subsidy or purchase offers, the Commission would be required to grant the abandonment if the railroads showed operation of the line to be non-compensatory, or if it is shown that the benefits of abandonment exceed its detriments, taking into account impact on rural and community development. Special rules are also provided when the abandonment is part of a larger restructuring proposal.

3. With respect to mergers, the bill would remove the ICC's broad discretionary power over mergers and subject the railroads to the antitrust standards applied to every other (non-transportation) industry. As a general matter, such antitrust laws are tough on parallel mergers between competitors, but make consummation of end-to-end mergers and mergers involving failing companies more expeditious. Antitrust analysis will take into consideration the nature and structure of the rail industry and the patterns of product distribution and manufacture. The bill does not diminish

the transportation concerns that would be applied to a rail merger; rather, it assures their coherent and consistent application, under a standard like that used for the rest of American industry.

Transactions of smaller scope than merger may actually hold out greater hope for the rationalization of the rail system. We will encourage cost-effective and operationally efficient proposals for trackage agreements, consolidation of tracks and facilities, market swaps, and the like. And our bill retains ICC jurisdiction of these matters but makes changes in ICC standards and procedures -- making them more like those contained in the Air Deregulation Act -- that will allow rationalization to be quicker and less expensive.

Rail Operations

The ICC can, today, order a railroad to provide a given type and number of cars to a particular shipper at a particular time, and at a particular rate. The bill will allow the railroads to have greater control over their day-to-day operations. We simply cannot any longer look to the government to decide who should get which cars, on which days, and what shippers or other railroads should pay for those cars.

Again, however, we provide a constraint based on principles of fundamental fairness: the common carrier obligation will be retained. Railroads will be required to provide service to everyone willing to pay the going rate (assuming it is lawful), and the only exception will be to allow the railroads to honor the terms of prior contracts or other obligations for cars -- the only basis on which such contracts could work.

Those are the basic outlines of the bill. We believe that it is simpler, more logical, and more coherent than what we have today. It gives the railroads the chance to help themselves, and it gives shippers, consumers, and taxpayers the opportunity for a balanced, cost- and fuel-efficient transportation system that can move our nation's goods quickly, economically, and fairly.

On behalf of the Secretary and Mr. Sullivan, I want to say again how grateful we are for this opportunity to discuss our bill. We'll be very pleased to answer your questions.