DEPARTMENT OF TRANSPORTATION

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REMARKS BY JOHN W. SNOW, DEPUTY ASSISTANT SECRETARY OF TRANSPORTATION FOR POLICY, PLANS AND INTERNATIONAL AFFAIRS BEFORE THE ANNUAL MEETING OF THE ACCOUNTING DIVISION, ASSOCIATION OF AMERICAN RAILROADS
PHOENIX, ARIZONA OCTOBER 26, 1973

"Current Developments in Government's Efforts to Improve the Railroads"

Thank you for this opportunity to discuss some of the current activities of the Department of Transportation which relate to improving the condition of the railroad industry As one who for a number of years has had an opportunity to work closely with and observe the work of the railroad accounting profession, and in the process, developed a deep admiration for the skills, acuity and integrity of your profession, I am particularly delighted to be with you today.

The Department of Transportation has been actively involved in trying to find solutions to the serious and pressing problems besetting the railroad industry -- and, as you know, these problems are many. For the industry as a whole, profits as a percent of equity are less than one percent. Many railroads are unable to generate adequate earnings to make needed improvements in track, roadbed and facilities. As a result, a substantial part of the total railroad plant is in a state of deterioration. Moreover, the railroad industry suffers from the operation of many miles of uneconomic lines, which are a financial drain on the industry. At the same time, parts of the

railroad system are operating at, or very close to full, capacity utilization. These parts of the railroad system must be upgraded and expanded if the industry is to be capable of carrying projected traffic and providing the kind of service of which it is capable.

In addition to these broad problems affecting the industry generally, of course, we also have the pressing and immediate problem that six railroads in the northeastern section of the country are in bankruptcy. The seriousness of this situation permits neither equivocation nor double-talk -- firm action is required. The services of the six bankrupt northeast railroads are not only essential to the prosperity and well-being of the people and industry in the northeast, they are essential to the prosperity of the nation as a whole. There is no doubt that these services must be salvaged.

The northeast area served by the six bankrupt companies comprises only 10% of our total land mass, yet this region is home to 42% of our population. Located within the boundaries of this 14-State area are major centers of the automobile, steel, and machinery industries. The geographic zones served by these six bankrupt carriers account for almost half of this nation's gross national product and over 50% of the nation's total industrial production.

The clear fact is that the shutdown of these railroads does not represent a feasible alternative. But, as unacceptable as the shutdown would be -- so also would be a solution which saddled the American taxpayers with an outrageously large bill and granted to the financial community and the labor community far more than either can rightfully claim to have reason to expect. The Administration is doing all within its power to see that these results will not occur and that a viable, efficient, private sector railroad or railroads emerge out of the six bankrupt carriers in the northeast.

The deterioration of these northeast railroads did not occur overnight. It has been a long and gradual process. They were built -- most of them -- more than a hundred years ago to accommodate a society and an economy which were almost completely dependent on railroad service. Inevitably, change came. Changes in the economy of the area changed transportation demand. Heavy industry moved out, and more and more service industries moved in. Service industries generate relatively little demand for rail service. Bulk shipping decreased and packaged freight grew.

At the same time, competition from autos, truck and airlines made heavy inroads in railroad freight and passenger business, and the railroads found themselves with heavy excess capacity. The loss of the coal business to oil carried in pipelines was also a tremendous blow to these northeast railroads.

In any other industry, at least any other non-regulated industry, the order of the day would have been to trim off the excess and cut away the unprofitable lines. Had the northeast railroads been able to do this, their problems would be far less critical than they are today. Unfortunately, however, the regulatory climate hindered needed adjustments to changing demand. This regulatory system was established in the last century when the railroads held substantially more economic power than they do today. The basic aim of the legislation regulating railroads and establishing the Interstate Commerce Commission was to protect the shipper and the consuming public from the threat of the railroad power. But that's no longer the problem it once may have been.

We believe that it is imperative that the railroad system in the northeast be restructured. We also believe that it is time to revise outmoded regulatory machinery and thereby to allow all railroads -- including the new railroad or railroads in the northeast, to operate in a liberalized regulatory climate.

I.

First, let me discuss what the Department is doing about the northeast railroad problem. Confronted with the railroad bankruptcies in the northeast area, Secretary Brinegar determined that the only meaningful answer to the problem must have three essential characteristics:

(1) The restructured system should make the most efficient use of all resources;

(2) The core rail system chosen to serve the northeast should be made up of economically viable services which constituted the most efficient form of transportation; and,

(3) That service be supplied to the largest part of the dependent population with the least amount of Federal funding, and within the broad framework of the private sector.

Based upon these criteria, we have done some design testing in the northeast which leads us to believe that the restructured rail system can be viable and that it can provide well over 90% of the services now supplied.

Preliminary investigation also has convinced us that the labor question is soluable without granting displaced employees job protection that far exceeds the type of protection any other class of employees has secured. A large percentage of the present work force will be essential for the operation of the newly designed railroad or railroads. In addition, legislation for age 60 retirement has been signed by the President. The normal attrition rate is about 7%, and a large number of very young employees with little seniority are now employed on the bankrupt lines. New employment by the current railroad industry far exceeds the number of people who might be displaced in the northeast within anybody's estimate. This makes managing the people problem possible in a humane and equitable way.

In March 1973, the Department of Transportation submitted legislation to accomplish the needed restructuring in accordance with the principles which I have outlined. The Department's bill provides for an appropriation of $40 million to accomplish the restructure planning, and to establish the new corporation or corporations.

In addition, we want to ensure that the bankrupt railroads have sufficient operating cash so that there will be no cessation of service during the transition period -- that period from the time of the enactment of the enabling legislation until the acquisition of the bankrupts' assets. Therefore, we would authorize the appropriation of $85 million for payment to these railroads for cash needs during this period.

These two amounts -- $40 million to do the restructure planning and establish the new corporation, and $85 million to make up the cash needs of the bankrupt railroads during the interim period -- are the only two dollar amounts that we feel can be defined with any accuracy at this time.

Of course, we recognize that the new railroad or railroads in the restructured system will require working capital and that sufficient payment will have to be made to the bankrupt estates in order to constitutionally set up these operations. These amounts have been estimated with widely differing results by various people. It now

seems clear that nobody knows how much will be needed nor from what sources these funds may be available. Speculation on my part would do no more than add to the chorus of public bargaining we are hearing from many quarters these days.

When we have succeeded in restructuring the physical plant, modernizing the regulations and slimming down the work force, this new railroad company or companies promises to be a profitable operation that can provide low cost, efficient rail service without need for public subsidy. But while we are optimistic that a healthy private sector rail system can be extracted from the bankrupts without huge Federal financial involvement, I can assure you that the Administration is prepared to reexamine the need for government assistance after the new corporation has shown us their plans and has investigated all the possibilities for obtaining private funding. If it is found then that a restructured system is not possible without government financial aid, the Department will propose to the Congress measures to provide that aid.

Such is our plan. We believe it is the best and most equitable course of action. We believe, moreover, that it will succeed. Some others, as you know, have recommended different solutions.

Some say do nothing . . . this is unacceptable. The Penn Central is on the verge of a court-ordered liquidation. To permit such a liquidation would be to invite chaos. We have in the northeast a very deep rooted and complex problem of such magnitude that it can only be resolved by legislation. There is no other way.

Some suggest nationalization. That, too, is unacceptable. Nationalization would simply shift the losses to be borne by the general taxpayers -- and the need for surgery on the system would remain, but undoubtedly it would be more difficult and more costly to achieve. The largely state-owned rail systems of Europe and Japan, for example, now report losses in excess of $2 billion a year.

Others urge that we postpone any action and study the problem. The government has already studied the matter. The stockholders have studied it, and finally, the courts have studied it -- and the courts are prepared to act. We do not believe further lengthy study is warranted -- and it could not fail to be very costly.

The Department is also vitally interested that other major issues associated with the restructuring of the northeast rail system not be dictated by political expediency. Some of these issues involve labor adjustment assistance, and the timing and method of the transfer of rail properties from the bankrup estates to the new company or companies.

Without major adjustments in rail labor, the objective of a financially self-sustaining regional rail system is simply not obtainable. Yet many of these employees are presently working under contracts which guarantee them lifetime jobs. Consequently, any restructuring plan must recognize the need to these employees who are displaced with some form of compensation. While the burden of compensating these employees rightly belongs with the estates of the bankrupt owners who originally signed the contracts, some now advocate Federal participation in this cost. But however legitimate the claims of displaced rail employees may be, we must be leery of legislating job protection benefits for them which are both counter-productive in terms of encouraging a rational reallocation of rail labor and unfair to other workers in our society who do not enjoy such benefits but who will be asked to pay for them through their taxes. The railroad workers, like every American worker, is fully deserving of his government's concern when it comes to such important matters as conditions of owrk, collective bargaining rights and job security. Yet to legislate rigid labor protection provisions or a rigid amount as reimbursement for the costs of labor protection as part of the northeast rail solution would be to accord the railroad worker special and preferential treatment of an unprecedented nature. Not only would such a solution make it extremely difficult for future bankrupt railroads, and possibly solvent roads, to prune excessive labor forces, but it would interject the possibility that Federal "aid" would be available to other industries which experience a severe shift in their demand for labor. Had labor protection provisions comparable to some of the current proposals for dealing with the bankrupt railroad employees been available to the aerospace employees in the 1968-71 period, for example, the cost could have been $7.5 billion/year. In my opinion, therefore, we simply cannot afford either the cost or the disruption in the efficient flow of our resources which would accompany such a legislative solution to the rail labor problem.

Another major issue which raises the specter of dangerous precedents has to do with the transfer of rail properties from the bankrupt estates to the new corporation. In the interests of "getting the new corporation off and running," some feel it would be best to mandate the conveyance

of bankrupt rail properties to the new corporation. Mandatory conveyance, it is argued, would avoid the potential delay of transfer due to litigation on the part of the current creditors of the bankrupt estates concerning the transfer price of the assets. Unfortunately, while a provision for mandatory conveyances might indeed speed up the delivery of assets to the new corporation, it will also give the creditors the basis upon which to build a legal argument that compensation for their involuntary taking should be an amount which is far in excess of what they could command in the open market. They could, for instance, insist upon receiving replacement value for the assets -- a figure which would amount to $13 billion for the Penn Central alone. That is far greater than the asset base that can be justified by the earning power of those assets which the new corporation is likely to need. Who should end up paying this excess? Is the Federal Government to end up paying the excess? Thus, we are faced with the very real possibility of an unjustified "windfall" for the creditors at a huge ultimate cost to the public. And equally troubling, if not worse, would be a precedent upon which creditors of financially ailing public service companies would rely in the future to bail them out.

Fortunately, a solution to the nation's northeast transportation problem appears to be emerging from Congress in the form of the so-called Shoup-Adams bill now before the Commerce Committee in the House of Representatives. Action upon this bill is expected very soon. We at the Department of Transportation are hopeful that this proposed legilsation can be molded to meet the four major principles we consider to be essential to a sound solution to the northeast problem. These are:

(1) The legislation must protect the public interest in seeing that adequate rail service is provided where warranted;

(2) It must provide for a restructuring that involves the six bankrupt carriers as a group;

(3) In order to avoid a repeat of the present crisis, the restructured system must be economically viable in the long run; and,

(4) Federal financial assistance should be coupled with private sector involvement -- a joint effort, not a Federal bail-out with a heavy burden on the general taxpayers.

The Shoup-Adams bill comes close to meeting our criteria in a number of ways. But, at this time, we have four major objections to it. They are:

(1) We believe it essential that the transfer of assets from the bankrupt companies to the new system be arranged through negotiation. We are opposed to the provisions of the bill which would mandate any direct or indirect Federal taking. As noted earlier, we feel that a mandatory taking could lead to excessive values being placed upon the transferred assets. We believe the proper way to establish equitable value is by negotiation, not legislation.

(2) We are opposed to an excessively detailed legislated labor settlement. It is inappropriate to legislate rigid labor protection or exact settlement terms. To be sure, future job protection is necessary, and displaced employees need adequate compensation, but we prefer to agree on general guidelines and work out the specifics after the restructuring is underway and the magnitude of the labor problem is better understood.

(3) We oppose any program that in advance commits the Federal Government to an extensive financing plan. The proper approach is to first find out what kind of funding is needed, and then to arrange for the specific funds.

(4) We believe that the Federal Government should not be burdened with a commitment to provide operating subsidies for local rail service that has little hope of becoming self-supporting.

The communication is good and the cooperation is close between key members of Congress and Secretary Brinegar and Under Secretary Barnum. Each day we appear to come closer to a good solution to the problem. I look forward to seeing soon legislation that will solve the immediate northeast problem and lay the basis for a long run strengthening of the national transportation system.

II

Let me turn now to the broader question of regulatory reform and the Department's efforts on this front. In a thoughtful and important address in Seattle recently, your other panel member, Commissioner O'Neill of the Interstate Commerce Commission, suggested that the time has come for all parties to the deregulation debate, regulators, carriers and shippers, to cast aside the old shibboleths and examine critically the regulatory system to see what parts of it stand in need of repair, strengthening, or modification. The Department has been involved in such a critical exercise for a period of the last year or so, and we are about to send legislation to the Hill recommending various changes in the regulatory system. As Commissioner O'Neill observed in his Seattle address, the purpose and design of the Department's legislation is regulatory reform, not deregulation or dismantling of the Interstate Commerce Commission. However, we do believe that a major cause of the railroad industry's problems and unsatisfactory performance is an outmoded and excessively restrictive Federal regulatory policy. Existing regulatory policy has seriously hampered railroads' ability to adapt to changing economic and competitive conditions in the transportation industry. It has discouraged abandonment of uneconomic rail lines and hindered the industry in innovating new services, in responding to competitive conditions in transportation, and in attracting traffic on which the railroads have a comparative advantage.

An efficient rail system is a great national asset. Removal of outmoded regulatory restraints is an essential condition for restoring the economic health of the rail system and enabling it to provide the efficient, low-cost service of which it is capable. The DOT bill will deal with the following major issues:

(1) Abandonments - Abandonment procedures would be speeded up and more precise and appropriate standards for abandonment would be provided.

(2) Pricing - Railroads would be given greater flexibility to increase or decrease their rates. Rates below variable cost would be prohibited, and railroads would be provided an expedited procedure for establishing rates on new services requiring a large capital investment.

(3) Section 22 - Government shippers would be required to pay the same rates as other shippers.

(4) Rate bureaus - Antitrust immunity would be removed on agreements relating to single line rates, or on rates in which the carrier agreeing does not participate. The ability of rate bureaus to protest rates established through independent action would be reduced and prompt action would be required by rate bureaus in processing rates.

(5) Discriminatory taxation - Discriminatory state and local taxation of transportation assets would be prohibited.

(6) Intrastate rate adjustments - State regulatory agencies would be required to take prompt action to adjust intrastate rates in accordance with approved changes in interstate rates.

(7) Rolling stock - The bill will provide for a major study of means to improve control over railroad rolling stock.

In our deliberations about the type of regulatory reforms to propose to the Congress, we were well aware that the three regulated surface modes have collaborated on the preparation of the proposed Surface Transportation Act which received the endorsement of a House Committee in the last Congress. There are reforms in that bill which are positive, and we intend to endorse them in our proposed legislation. In fact, in a number of particulars, our legislation parallels the Surface Transportation Act. But, at the same time, it is clear that "controversial" reforms were left out of the Surface Transportation Act -- by common consent. We believe that the railroad industry needs more than that now -- particularly if financial assistance is to accompany the regulatory reforms as the industry has proposed.

As I indicated earlier, considerable parts of the rail plant in the United States are in a deteriorating state and the risk exists that the general deterioration of plant and service now prevalent in the east could expand to other portions of the country. Because of the industry's low rate of return, railroads are generally unable to generate adequate internal capital to make needed improvements. The investment community has been reluctant to provide capital because of the limited security afforded by loans on track and plant. Thus, the Department is seriously considering the provision of Federal loan guarantee

authority to finance needed improvements in rolling stock, rights-of-way, terminals, and other operational facilities and systems. However, these loan guarantees would be provided only where assurance exists that the loan guarantees will make a genuine improvement to the overall efficiency of the rail system. In other words, the loan guarantees would be provided to encourage needed long-term restructuring of the existing rail plant.

The Department's forthcoming regulatory proposals are focused primarily on the railroad industry, because the railroad industry presents the most immediate and pressing problem. However, because of the competitive relationships among the various modes, improving competitive conditions in the railroad industry should lead to improvement in the competitive climate of the transportation industry as a whole. Also, the Department has underway a major research program designed to identify the need for regulatory change in the trucking and water carrier industry. These studies address important issues, including an examination of the effect of certificate restrictions on carrier operating efficiency and the quality of service, an examination of rate bureau activities, and a number of related issues.

We hope to conduct our studies in cooperation with the ICC, the carriers, and the shippers. This process should contribute much to our understanding of the need for, and consequences of, additional regulatory reform to achieve greater efficiency and higher quality service in the transportation industry.

I trust that my remarks today leave you with the sense that the Administration and the Department in particular, are earnestly engaged in finding solutions to the railroad industry's problems, and furthermore, that we are on the right track.

Thank you.

DEPARTMENT OF TRANSPORTATION

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7-DOT-74

REMARKS BY JOHN W. SNOW, DEPUTY ASSISTANT SECRETARY FOR POLICY, PLANS AND INTERNATIONAL AFFAIRS, DELIVERED BEFORE THE TRANSPORTATION ASSOCIATION OF AMERICA INVESTORS PANEL MEETING - NEW YORK, NEW YORK
JANUARY 28, 1974

Thank you for the opportunity to be with you today and to present the Department of Transportation's views on the state of our nation's current regulatory climate. I will deal principally with the Federal regulatory climate and DOT's proposals to effectuate constructive change.

This is an important time in the history of transportation -- especially in the history of the railroad industry. Some change is already a fact. The direction of that change in the future is the critical question we face. Much of our concern recently was focused on proposals advanced for the resolution of the problems facing the bankrupt northeastern railroads. That was an immediate problem, although it was shaped gradually over the years. The carriers' plight led to a serious threat that rail service over a 17-state area

might be sharply curtailed. I'm pleased to observe that legislation to resolve the bankrupt carriers' problems proceeded through Congress with great speed. The bill was signed by the President on January 2, 1974, and we consider it a major step away from nationalization.

Now, as the job begins of implementing the legislative mandate to restore the northeast lines, we must turn our attention to assuring that we have a healthy, sound and progressive rail system -- and that we avoid future Penn Central's.

There can be no mistake about the fact that the railroad industry in the United States is deeply troubled. Net profits as a percent of equity for the industry are less than one percent. Many railroads cannot generate sufficient earnings to make needed improvements in track, roadbed and facilities. As a consequence, a substantial part of the total rail industry in the U.S. is in a state of deterioration. The railroad industry's share of total intercity freight ton-miles and the average revenue per ton-mile have been declining. The industry, furthermore, is burdened by many miles of uneconomic lines which are a financial drain and add substantially to operating costs. At the same time, parts of the railroad system are operating at or close to capacity, and these segments must be upgraded and expanded if the industry is to make its contribution to the national transportation system. I might add that funds from outside sources are not available to some of the nation's healthiest railroads for modernization purposes.

A major cause of the railroadindustry's problems is an outmoded and excessively restrictive Federal regulatory policy. Existing regulatory policy has seriously hampered railroads' ability to adapt to changing economic and competitive conditions in the transportation industry. It has discouraged abandonment of uneconomic rail lines and hindered the industry in innovating new services, in responding to competitive conditions in transportation and in attracting traffic on which railroads have a competitive advantage.

Our basic regulatory policy towards the railroad industry has changed very little since 1878 when the Interstate Commerce Act was adopted and the Interstate Commerce Commission formed. In the intervening period, the competitive position of the railroad industry has changed dramatically with the rise of alternative modes of transportation - pipelines, trucks, barges, and air. Whatever monopoly position

railroads may have enjoyed in 1887 today railroads face intense competition from other modes of transportation. This is clearly revealed by the railroads' loss of total intercity market shares to the other regulated modes. Thus while the basic competitive conditions in transportation have changed dramatically, Federal regulatory policy towards the railroad industry has not. Therefore, there is a need not only to unshackle the northeast railroads from constricting regulations which are in part responsible for their present difficulties -- but also to provide a solution to problems which have become endemic to the whole railroad industry.

An efficient rail system is a great national asset. Removal of outmoded regulatory restraints is an essential condition for restoring the economic health of the rail system and enabling it to provide the efficient low-cost service of which it is capable. For the past year or so, we have been preparing a legislative proposal to amend the Interstate Commerce Act to achieve needed reform of regulatory restraints on our railroads. On January 10, 1974, Secretary Brinegar released the Transportation Improvement Act of 1974 at a press conference in Washington. In releasing the bill, Secretary Brinegar stated that it would be transmitted to Congress shortly after Congress returns for the second session. The bill makes a number of significant amendments to the Interstate Commerce Act, including:

1. abandonment procedures would be speeded up and standards would provide that in order to require operation, the cost of that operation would have to be covered by the revenues earned;

2. railroads would be permitted to increase or decrease their rates and to improve the range of services offered without undue regulatory delay. Rates below variable cost would be eliminated and railroads will be given greater freedom to raise or lower rates without fear of suspension;

3. governments would be required to pay the same rates as other shippers;

4. antitrust immunity would be eliminated on agreements relating to single line rates, or on rates in which the carrier agreeing does not participate. Prompt action by carrier rate bureaus would be required;

5. when railroads abandon lines, motor or water carriers would be allowed to provided needed service;

6. discriminatory State and local taxation of rail assets would be eliminated; and

7. delays would be reduced in the process of State approval of intrastate rates that correspond to changes in interstate rates.

Regulatory change is particularly important in the areas of rail abandonments and pricing, and I will focus my detailed comments today on these aspects of the regulatory reform legislation we are preparing.

Excess capacity is a major problem with the railroad industry. By reducing excess capacity and eliminating uneconomic low density lines, the railroad industry could lower per unit operating cost and remove a heavy financial drain. However, the detrimental effects associated with the operation of uneconomic lines are not limited to the railroad industry. It appears clear that motor carriers are better suited to handling much of the short-haul traffic which presently moves on low density rail branch lines, while railroads have a cost advantage in long-haul markets. Thus, the abandonment of uneconomic low density rail lines would enable railroads to concentrate their efforts in providng those services in which they have a relative advantage while providing a further opportunity for trucking service to develop in markets where it would have the relative advantage.

The bill is designed to speed up the regulatory processes in considering abandonment applications by providing an explicit and appropriate economic standard for determining when an abandonment is justified.

Because our abandonment provisions are likely to result in some additional traffic for truck carriers, it is important to consider the energy consumption and air pollution effects of the bill. Typically, abandonment candidates will be low density, short branch lines. Our analysis shows that there is greater energy efficiency in carrying freight by truck, as compared to rail, for distances less than 10 miles and shipment sizes less than 130-140 tons.

Because exhaust emissions for each mode vary directly with gallons of fuel consumed per mile, the rail/truck preference from an emissions perspective would follow generally that for fuel consumption. Thus, although the envisioned branch line abandonments will result in some increase in truck traffic, transportation of the freight now carried on most of the lines to be abandoned will become more energy-efficient and cause less pollution.

Moreover, the bill is designed to encourage more competitive and efficient pricing of rail services which would assist rails in attracting traffic on which they are the low cost mode. Thus, we anticipate that the overall effect of this bill will be to improve freight transportation's energy efficiency and to reduce its exhaust emissions.

Of course, it must be recognized that under some circumstances an uneconomic rail line may be the most efficient mode of transportation available to shippers. To meet this problem, the bill provides a mechanism whereby a State or local government or other interested party could subsidize railroad operations to assure the continuation of uneconomic service for which a special need exists. We also recognize that liberalizing abandonments would result in some loss of rail service to various shippers. In order to assure that such shippers will have an effective and efficient alternative mode of transportation without any hiatus in service, the bill provides for liberalized entry by motor and water carriers seeking to provide substitute service.

Regulatory change is also urgently needed in railroad ratemaking. The current system of rate regulation severely limits an individual railroad's freedom to establish rates. As a consequence, it has created serious rigidity and distortions in the railroad rate structure. This rate structure rigidity has hindered the railroad industry in innovating new services and prevented it from responding effectively to the needs of changing transportation demand. In particular, it has prevented railroads from attracting traffic on which it has a comparative advantage. Greater flexibility in ratemaking is essential to improve the performance of the railroad industry and the entire transportation system. Serious inefficiency results where low cost carriers are impeded or prevented from reducing rates to reflect greater efficiency. The Department recognizes the need to introduce greater flexibility in the rate structure and our legislation contains various proposals designed to achieve this objective.

Another serious problem in the area of railroad pricing is the fact that nearly 10 percent of all rail revenues are derived from rates that do not cover the variable cost of the service. The railroad industry loses approximately $200 million annually handling traffic at rates below variable cost. The cross-subsidization results in a misallocation of resources both within the field of transportation and in the economy at large. The proposed bill addresses this problem directly by requiring all rates to cover variable cost.

Through our proposed legislation, we hope to create substantially more ratemaking flexibility to correct the present distortion in the rate structure and to encourage railroads to introduce new services and attract traffic on which they have a comparative advantage. The basic thrust of the proposals is to place greater reliance on comparative market forces in ratemaking. I am confident that this will result in a more economic division of traffic, a lower overall freight bill, improved service and lower cost to the ultimate consumer.

Several months ago, you may have read an article in Business Week magazine about railroad accounting -- so-called "betterment accounting." The present railroad accounting system -- which is governed by the Interstate Commerce Commission -- is outmoded and inadequate to resolve the complex problems of modern transportation firms. This is not to say that the ICC is not concerned with improving the cost accounting system of the carriers. As a matter of fact, the agency has instituted several proceedings dealing with the cost accounting issue. One proceeding, however, was begun in 1962 and reopened in 1971. Another has been pending since 1969. Neither proceeding has resulted in final decisions as of the present time.

The bill would establish a uniform cost and revenue accounting system in order to properly address the proposed abandonment, ratemaking and revenue level provisions that I have already discussed. This is accomplished by requiring the ICC, jointly with the Department of Transportation, to study and recommend uniform cost and revenue accounting methods for rail carriers.

Among our deliberations about the type of regulatory reform to propose to the Congress, we were well aware that the three regulated surface modes have collaborated on the preparation of the proposed Surface Transportation Act, which received the endorsement of a House Committee two years ago. There are reforms in that bill

which are positive, and we intend to endorse them in our proposed legislation. But it is clear that "controversial" reforms were left out of the Surface Transportation Act -- by common consent -- so that the residue of reform left in the industry bill is quite modest. We think the railroad industry needs more than that now -- particularly if financial assistance is to accompany the regulatory reforms as the industry has proposed.

As I indicated earlier, considerable parts of the rail plant in the United States are in a deteriorating state and the risk exists that the general deterioration of plant and service now prevalent in the east could expand to other portions of the country.

Thus, the bill provides for $2 billion in Federal loan guarantee authority to finance needed improvements in rolling stock, rights-of-way, terminals and other operational facilities and systems. However, these loan guarantees would be provided only where assurance exists that the capital improvements will make a genuine improvement to the overall efficiency of the rail system. In other words, the aid would help encourage needed long-term restructuring of the existing rail system.

Another basic problem in the railroad industry is the almost chronic shortage of freight cars. There are many reasons for the shortage. A key factor has been a low rate of freight car utilization. If we could improve this by 20 percent, we could reduce annual needs for new cars by approximately 10,000 to 15,000 cars. Increased utilization could save the railroads as much as $300 million in new car purchases.

Therefore, an effective system of car fleet management is required in order to achieve greater utilization. We do not have a national management system at this time -- it is sorely needed, and we have technology now to design and impelement such a system.

To expedite and assure development of a national system, the Department's bill would authorize the Secretary of Transportation to conduct research into the design of a national rolling stock scheduling and control system which would be capable of locating and expediting the movement of rolling stock on a national basis.

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REMARKS BY JOHN W. SNOW, DEPUTY ASSISTANT SECRETARY FOR POLICY, PLANS AND INTERNATIONAL AFFAIRS, DELIVERED BEFORE THE AMERICAN IMPORTERS ASSOCIATION, NEW YORK, NEW YORK, FEBRUARY 6, 1974

DOT RESPONSE TO ENERGY SHORTAGES

I appreciate the opportunity to be with you today to discuss a subject that has affected every one of us over the past several months and that will surely occupy our thinking and planning in the days ahead. I'm referring, of course, to the energy shortage. I will focus my comments on the response the Department of Transportation has been making to the shortage as it affects our national transportation system.

As the representatives of an industry which is particularly dependent upon transportation, I can appreciate your deep concern regarding the energy situation. The Department shares your concern and has a number of initiatives underway which we feel will contribute to easing the Nation's energy problems as they relate to transportation. In addition, it appears clear that the energy crisis causing us all to reexamine wasteful practices will have its "silver lining".

Liquid petroleum provides almost half of the energy that makes our nation move, our business prosper, keeps our houses bright and warm, and our living standards the highest in the world. However, with only some 6 percent of the world's population, we consume over 30 percent of the world's energy. We are, in a word, addicted to the availability of enormous amounts of low cost energy.

Unfortunately, about 3 years ago, oil from the Nation's oil fields began declining. New oil discoveries -- except for Alaska's North Slope -- have been disappointing. To offset these declines, we have had to reach abroad for new sources -- increasingly into the unstable Middle East where enormous oil reserves lay undeveloped. Of the Nation's total present oil usage of about 17.5 million barrels a day, over 6 million barrels -- nearly 40 percent -- now come from other countries. And of the 6 million, nearly half comes either directly or indirectly (for example, after processing in European refineries) by tanker from the Arab world.

Last spring we were worried about a modest oil shortfall -- on the order of 3 to 5 percent. This resulted mainly from inadequate refinery and tanker shipping capacity. A 3 to 5 percent shortage could have been managed through a few relatively minor allocations and readjustments of oil usage. Suddenly, however, the Middle East erupted into war and our worst fears became realities. Whereas we thought we were dealing with a 3 to 5 percent oil shortfall, we now must face a 15 to 20 percent oil shortage. No matter how you look at it, a 15 to 20 percent shortage is critical to us.

Oil shortages for the next few months will be most critical in diesel fuels, jet fuels, the residual oils which are used to generate electricity and power ships, and in certain areas, heating oil. The shortage already being felt in gasoline will increase if the Middle East embargo is not soon lifted. Even if soon lifted, the present interruption will mean shortages throughout the rest of the winter.

These dim prospects for obtaining adequate fuel supplies to keep our transportation system operating required thoughtful, but quick, action at DOT. Early in the developing stages of the energy shortage, Secretary Brinegar designated the improvement of transportation efficiency as a top priority of the Department. The following steps were taken immediately:

1. We developed an approach of formal appraisal of energy consequences as part of the DOT grant approval process;

2. We set out to improve efficiency of automotive transportation in using energy;

3. We improved aircraft operating procedures to reduce consumption of fuels;

4. We developed a computer simulation model to analyze alternative refinery and deep-water port locations;

5. We evaluated alternative economic, institutional options for reducing energy consumption in transportation; and

6. We assisted in the development of a more effective energy distribution network.

We have underway a number of other programs -- legislative, administrative, and research and development -- that will help reduce transportation energy consumption.

Our legislative programs include a proposal to spur revitalization of the railroad industry by removing regulatory restraints which adversely affect the economic performance of the industry, and providing funds for research efforts to improve freight car utilization. I will discuss this in more detail later.

We also were successful in winning Congressional support for our bill to repeal restrictive regulations on barge operations that previously hampered operational efficiency and adversely affected energy consumption.

We are also expediting our role in administering legislation recently signed by the President that would revitalize the Northeast rail carriers. This, in turn, will result in a more energy-efficient and service-reliable system that should be of considerable benefit to your industry.

We will seek in the months ahead greater flexibility in the way highway and transit programs are financed. We want to strengthen the ability of urban governments to make the transportation decisions and investments needed to meet the challenges of relieving highway congestion, conserving energy and meeting air pollution standards. We are also encouraging greater use of mass transit.

Generally speaking, transportation costs for all modes of transportation may increase as a result of energy shortages, but not as a constant percentage. Until recently, fuel costs for domestic air shipments were about 12 percent of operating expenses. Costs for international air operations are probably about the same. For maritime operations, the comparable percentage was between 5 and 6 percent.

A doubling of fuel prices, therefore, would increase operating expenses about 12 percent for an air carrier and about 6 percent for a marine operator hauling your products from foreign ports.

In the face of such projections, the cost of bunker fuel for ships has almost tripled in the last few months. At least one carrier now places the cost of fuel at 20 percent of total marine operating expenses. Maritime shipping, of course, is the most fuel efficient of all cargo transport. It consumes energy at the rate of only 500 BTU's per ton mile, in contrast to 63,000 BTU's per ton mile for air cargo. I'm sure that you are aware that the Mandatory Fuel Allocation Regulations announced by the Federal Energy Office on January 15 are written to maintain foreign commerce at its existing level and even to accommodate future growth.

Fuel allocated to maritime shipping is 100 percent of current requirements -- the highest possible allocation. DOT strongly supported this action in our filings with the FEO. Ships of foreign flags are to be fueled here to the limits of fuel availability, and there is to be no discrimination between flags. Unavailability of fuel at our ports is not expected to be a particular problem in the United States, because most foreign shipowners maintain contracts with international oil suppliers who make local arrangements for them in ports throughout the world. Although there are approximately 900 ships moving in and out of our ports on all coasts each day, in the first eight days since the new regulations went into effect, the FEO was called upon to assist less than 30 ships which couldn't get fuel.

However, the availability of bunkers at U.S. ports is complicated by the fact that a portion of the bunkers' fuels are bonded, and excluded from the Allocation Regulations, and that the remaining portion is "domestic" and subject to price controls. The FEO is currently contemplating the removal of the price controls on domestic bunkers so that their artificially low price would not tempt oil companies to divert their domestic stock into the international (bonded) market where the prices are higher.

It is difficult to predict the impact of future shortfalls of residual fuels on the allocation process. Some relative priorities are evident from the regulations, but the size of the bite into each class of users is unknown. While domestic and bonded prices are generally in step, there is uncertainty about the future market prices because residual fuel supply and demand statistics are incomplete, and presently providing little aid to get either time series trends or real time knowledge of the markets.

Still, there may be a complete reevaluation of the use of alternative modes in cargo shipments. This could take two forms. The first would be in terms of revised time/cost trade-offs for bulk shipments. It may still pay to send jewelry, perfume, and high value instruments via air, because of the fast processing of high cost commodities. However, for other commodities -- such as roses, or tulips from Holland -- the time savings may no longer be worth the higher costs.

Secondly, because of increasing costs, it may be expected that managers in maritime shipping will do all they can to tighten up operations. Scheduling will be closer. There will be increased search for backhaul opportunities. The option may exist to reduce speed to improve energy consumption, but this will have to be examined in terms of the new trade-off between fuel costs and crew costs. Operators will no doubt be seeking improved equipment which will be more economical on fuel consumption.

Such procedures have already been instituted in the airline industry. The immediate effects of jet fuel and aviation gasoline shortages forced early action by the government to adjust flight operation to meet the shortage problem. The airline industry voluntarily took action to meet the problem.

In addition to actions taken by the Federal Energy Office, the Department of Transportation, and especially the Federal Aviation Administration, has taken numerous steps to conserve fuel. We have recently established an Office of Transportation Energy Policy within the Office of the Secretary to handle energy-related policy and programs. In addition, in order to mitigate the rising fuel shortages, the Department of Transportation on November 20, 1973 -- through modification of FAA operating procedures -- announced a fuel conservation plan designed to save up to 20,000 barrels (840,000 gallons) of jet fuel per day. The saving would amount to 2.7 percent of the total amount of jet fuel consumed daily in the United States.

The plan consisted of the following: (1) revise gate hold procedures at airports; (2) revise air traffic flow procedures; (3) encourage increased use of optimum aircraft cruising speeds; (4) advise controllers to effect fuel savings wherever possible by holding aircraft at high altitudes, and assigning optimum altitudes and minimizing circuitous routings; (5) taxiing aircraft with fewer engines; (6) increase use of simulators for training and check flights; and (7) encourage sponsor to accelerate construction of airport runway and taxiway improvements.

Fuel conservation methods undertaken by the airlines include: reducing the cruising speed of jets; increased use of flight simulators

for training; taxiing with fewer engines; flying at optimum altitudes and reducing air traffic control delays. Flight cuts plus additional fuel conservation steps resulted in savings of more than 1 billion gallons of fuel in 1973.

Some of the carriers have felt it necessary to ground some of their larger equipment because of fuel problems and, in some instances, to replace them with smaller equipment. This should allow the carriers greater flexibility of scheduling, in addition to fuel savings. Thus far, the U.S. airlines have grounded 275 aircraft from a fleet of 2,400, of which 16 are 747 jumbo jets. The grounding of the larger equipment, in some cases, will lead to the addition of more intermediate stops on other schedules that will reduce the average segment length. Although the addition of stops and the reduced cruising speed will add to increased time for the completion of a given schedule, the increase in time is minimal, and the fuel saved seems to outweigh the added time.

From the maritime carriers' standpoint, it is in their best interests to take similar steps if feasible to control fuel consumption. They have responded by reducing vessel speed, reducing ports served and utilizing cargo space to the maximum.

These necessary steps make it increasingly imperative that we develop measures to improve the domestic segment of the surface transportation industry so as to increase efficiency of freight movements. Let me put it another way: We need to bolster operation of the surface segment to achieve flow-through efficiencies in the movement of your goods once they are off-loaded at port facilities. It appears clear that our present transportation regulatory system has inhibited more efficient use of transportation resources, and that changes in the regulatory system would improve service, reduce costs, and promote more efficient use of scarce fuels. The Administration will soon submit legislation, the Transportation Improvement Act of 1974, which is designed to remove a number of outmoded regulatory restrictions which adversely affect the performance of the surface transportation industry. The reform measures in the bill should directly benefit importers by facilitating better and more efficient movement of your goods through the domestic system to wholesalers, or to the ultimate customer. And the reforms we propose should result in significant energy savings as a bonus.

As you know, significant excess capacity exists in parts of both the main line and branch line network of the railroad industry. Reduction of excess capacity, particularly light density branch line trackage, is essential to improving the industry's financial condition. It is notable that the railroads in the greatest financial difficulty all have a substantial amount of branch line relative to main line,

while the railroads in the strongest financial position have relatively little branch line trackage.

By reducing excess capacity in main line track and eliminating light density lines, the railroad industry could lower per unit operating costs and substantially improve its financial condition.

The detrimental effects resulting from the operation of uneconomic lines are not limited to the railroad industry. Rather, their continued operation causes a basic misallocation of transportation resources. It appears clear that motor carriers are better suited to handling much of the short-haul traffic which presently moves on low density rail branch lines, while railroads have a comparative advantage in long-haul markets. Thus, the abandonment of uneconomic branch lines would enable railroads to concentrate their efforts in providing those services in which they have a relative advantage, while providing a further opportunity for trucking service to develop in markets where it has a relative advantage. The net result would be more efficient use of transportation resources.

Because the abandonment provisions are likely to result in some additional traffic for truck carriers, we considered carefully the energy consumption and air pollution effects of the bill. Typically, abandonment candidates will be low density, short branch lines. Our analysis shows that there is greater energy efficiency in carrying freight by truck, as compared to rail, for distances less than 10 miles and shipment sizes less than 130-140 tons. Because exhaust emissions for each mode vary directly with gallons of fuel consumed per mile, the rail/truck preference from an emissions perspective would follow generally that for fuel consumption. Thus, although the envisioned branch line abandonments will result in some increase in truck traffic, transportation of the freight now carried on most of the lines to be abandoned will become more energy efficient and cause less pollution. Moreover, the bill is designed to encourage more competitive and efficient pricing of rail services which would assist rails in attracting traffic on which they are the low cost mode (i.e., long-haul markets where rails are also more energy efficient and are environmentally preferable). Thus, we anticipate that the overall effect of this bill will be to improve freight transportation's energy efficiency and to reduce its exhaust emissions.

In order to protect the interests of shippers where uneconomic rail lines are abandoned, the bill provides that the Interstate Commerce Commission shall grant operating authority to any applicant as a motor carrier or water carrier between any point on the abandoned line and between such points and the nearest transfer point for movement by rail beyond, unless the issuance of the authority would cause a diminution

in the quantity and quality of service. The bill provides further that where a motor carrier certificate is issued, the Commission may require the carriers involved to establish joint rates and through routes for traffic moving to and from points on the abandoned rail line.

The substitute service provision is intended to ensure that shippers who have been using uneconomic rail service will have an effective and efficient alternative mode of transport without any hiatus in service. An important effect of the abandonment of uneconomic rail lines and the substitution of motor carrier service will be to increase the overall efficiency of the transportation system.

The bill also provides rails with much more pricing flexibility. The current system of rate regulation severely limits an individual railroad's freedom to establish rates. As a consequence, it has created serious rigidity and distortions in the railroad rate structure. This rigidity in the railroad pricing structure has hindered the introduction of new services and prevented railroads from responding effectively to the needs of the changing transportation market.

The present regulatory process has also resulted in the rates of one mode being held high to protect another mode, causing a misallocation of resources, increasing the total cost to shippers and ultimate consumers, and adversely affecting the financial condition of the more efficient mode. The bill meets this problem by prohibiting the ICC from holding the rates of a carrier of one mode up to a particular level for the purpose of protecting the traffic of a carrier of another mode. This provision should lead to more competitive and cost-related intermodal pricing and introduce greater rate flexibility into transportation ratemaking. The net result should be a more economic division of traffic.

The bill also provides $2 billion in Federal loan guarantee authority to finance needed improvements in rolling stocks, rights-of-way, terminals and other operational facilities and systems. The abandonment, ratemaking, and related regulatory improvements proposed in the bill are an essential first step in improving the performance of the railroad industry. There remains the task of rationalizing and upgrading the facilities and equipment necessary to provide efficient rail transportation service. Substantial parts of the rail plant in the United States are in a deteriorating state and the general deterioration of plant and service which is now prevalent in the east and midwest could spread to other portions of the country.

Because of the industry's low rate of return, railroads are generally unable to generate adequate internal capital to make needed capital improvements. The investment community has been reluctant to

provide external capital because of the limited security afforded by general corporate equity and because of the heavy level of existing liens on rail properties. Marginal railroads can obtain financing for rolling stock, but only at high interest rates. The bill would provide $2 billion in Federal loan guarantee authority to finance improvements in rolling stock, rights-of-way, terminals, and rail plant facilities. The conditions precedent to the guarantee would assure that the capital improvement would make a significant contribution to overall efficiency of rail operations. Thus, the loan guarantee provisions of the bill are designed to encourage needed long-term restructuring of the existing rail system.

In connection with loan guarantees for rolling stock, the Secretary is required to consider the present and future need for rolling stock and the protection to the United States afforded by the rolling stock in the event of default. In addition, with respect to any loan guarantee, the bill requires the Secretary to consider various other factors, including the return on investment of the proposed improvement, the potential for intermodal connections and substitutions, and improved utilization of freight cars. These criteria are designed to achieve, through the loan guarantee program, the needed modernization of the existing rail system.

The bill also provides for the development of a national rolling stock scheduling and control system. One of the basic problems in the railroad industry is the low rate of freight car utilization. An average freight car moves loaded a total of only 25 days during a calendar year, while an average freight car moves empty approximately 18 days out of a calendar year. Thus, for approximately 323 days in a calendar year or 88 percent of the time, the average freight car stands idle in railroad yards or at customers' locations. Improving freight car utilization would result in substantial benefits to the railroad industry and the shipping public by reducing the railroad industry's need for capital expenditures and reducing operating costs. Freight car ownership represents about 25 percent of the railroad industry's net investment. A 20 percent increase in car fleet productivity would reduce the annual need for new cars by approximately 10,000 to 15,000 cars. This would enable the railroad to save as much as $300 million in new car purchases.

Achieving a more efficient utilization of the car fleet requires a more effective system of car fleet management. Although individual railroads have made some progress in developing better control over their car movements, this Nation still lacks an effective national freight car control system. Such a system has been made possible by recent advances in communications, computer data processing, and applied mathematical analysis. The development of such a system as provided for

in the bill will result in substantial improvement in car utilization and the efficient use of scarce fuel supplies.

The Department's forthcoming regulatory proposals are focused primarily on the railroad industry because the railroad industry presents the most immediate and pressing domestic problems. Because of the competitive relationships among the various modes, improving comparative conditions in the railroad industry should lead to improvements in the competitive climate for the transportation industry as a whole. Also, the Department has underway a major research program designed to identify the need for regulatory change in the trucking and water carrier industries. These studies address important issues, including the examination of the effect of regulation on the performance of the trucking industry, an examination of rate bureau activities, studies of the effect of certificate restraints on carrier operating efficiency and quality of service. We are also studying the extent of empty backhauling by agricultural exempt carriers, the causes of such empty backhauling, the effects of empty backhauling on costs, rates and service, and appropriate remedies for the problem, including the possibility of increased trip leasing. It appears clear that regulatory change in these areas could have a significant affect on conserving fuel and improving the efficiency of the entire United States transportation system.

I believe that the measures I have described will do much to contribute to more energy-efficient transportation systems. I am concerned, of course, about difficulties you may encounter as importers. But the picture overall is not as bad as it might be. The fact that ships transporting your goods will receive 100 percent of current fuel requirements should give you reason to be optimistic about the future health of your industry.

The health of your industry is also tied to the viability of the domestic transport industry. The TIA should contribute substantially to the revitalization and improved performance of the railroad industry which is so vital to the welfare of our national commerce. In addition, the reexamination of regulatory policy generally should encourage adoption of new regulatory rules which will contribute to improved service and greater efficiency. Improving the efficiency of the transportation system also contributes to conservation of scarce fuels. The energy crisis facing this nation has thus given us an opportunity to reexamine wasteful practices and to set out in new directions to meet the problem.

DEPARTMENT OF TRANSPORTATION

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REMARKS BY JOHN W. SNOW, DEPUTY ASSISTANT SECRETARY FOR POLICY, PLANS AND INTERNATIONAL AFFAIRS, BEFORE THE SEATTLE ROTARY CLUB - SEATTLE, WASHINGTON
MARCH 6, 1974

"Surface Transportation and the Energy Crisis"

This is an important time in the history of transportation -- especially in the history of the railroad industry. Some change is already a fact. The direction of that change in the future is the critical question we now face. The energy shortage has given us a new imperative to use resources more efficiently, to re-examine wasteful practices and policies and to set out in directions to meet the problem. If we meet this challenge effectively the energy crisis will have its "silver lining".

Much of our concern recently has been focused on proposals advanced for the resolution of the problems facing the bankrupt northeastern railroads. The carriers' financial condition created a serious threat that rail service over a 17-state area might be sharply curtailed. The economic and social costs resulting from the shutdown of these railroads would have been intolerable. Equally tolerable, however, would have been a resolution of the problem which saddled the American taxpayers with an unreasonably high cost and which did nothing to ensure that a streamlined, viable private sector railroad would emerge.

Legislation to resolve the bankrupt carriers' problems and create a new system in the northeast proceeded through Congress with great speed, and the Regional Rail Reorganization Act of 1973 was signed by the President on January 2, 1974. While the Act departs in several important respects from the legislation which the Department proposed, and while the legislation which emerged does not in all respects represent the Department's preferred position, we do consider the Act an essentially sound attempt to avert a transportation and economic crisis of major proportions. The procedures provided in the Act will, in time, strengthen the private sector role of the Nation's railroads in the northeast and midwest sections of the country. It must be regarded, therefore, as a major step away from nationalization.

Now, as the job begins of implementing the legislative mandate to restore the northeast lines, we must turn our attention to assuring that we have a healthy, sound and progressive national rail system -- and that we avoid future Penn Centrals.

There can be no mistake about the fact that the railroad industry in the United States is deeply troubled. Net profits as a percent of equity for the industry are less than one percent. Many railroads cannot generate sufficient earnings to make needed improvements in track, roadbed and facilities, while funds from outside sources are not available to many railroads for these purposes. As a consequence, a substantial part of the total rail industry in the U.S. is in a state of deterioration. The railroad industry's share of total intercity freight ton miles and the average revenue per ton mile have been declining. The industry, furthermore, is burdened by many miles of uneconomic lines which are a financial drain and add substantially to operating costs. At the same time, parts of the railroad system are operating at or close to capacity, and these segments must be upgraded and expanded if the industry is to make its contribution to the national transportation system.

A major cause of the railroad industry's problems is an outmoded and excessively restrictive Federal regulatory policy. Existing regulatory policy has seriously hampered railroads' ability to adapt to changing economic and competitive conditions in the transportation industry. It has discouraged abandonment of uneconomic rail lines and hindered the industry in innovating new services, in responding to competitive conditions in transportation and in attracting traffic on which railroads have a competitive advantage.

Our basic regulatory policy towards the railroad industry has changed very little since 1887 when the Interstate Commerce Act was adopted and the Interstate Commerce Commission formed. In the intervening period, the competitive position of the railroad industry has changed dramatically with the rise of alternative modes of transportation -- pipelines, trucks, barges and air. Whatever monopoly position railroads may have enjoyed in 1887, today railroads face intense competition from other modes of transportation. This is clearly revealed by the railroads' loss of total intercity market shares to the other regulated modes. Thus, while the basic competitive conditions in transportation have changed dramatically, Federal regulatory policy towards the railroad industry has not. Therefore, there is a need not only to unshackle the northeast railroads from constricting regulations which are in part responsible for their present difficulties -- but also to provide a solution to problems which have become endemic to the whole railroad industry.

An efficient rail system is a great national asset. Removal of outmoded regulatory restraints is an essential condition for restoring the economic health of the rail system and enabling it to provide the efficient low cost service of which it is capable. For the past year or so, we have been preparing a legislative proposal to amend the Interstate Commerce Act to achieve needed reform of regulatory restraints on our railroads. On February 13, 1974, the Department of Transportation transmitted to Congress the product of these labors, the Transportation Improvement Act of 1974. The bill makes a number of significant amendments to the Interstate Commerce Act which, taken together, will substantially improve the regulatory climate under which railroads operate. Among the more important provisions of the bill are the following:

1. abandonment procedures would be speeded up and standards would provide that in order to require operation, the cost of that operation would have to be covered by the revenues earned;

2. railroads would be given greater freedom to increase or decrease their rates and to improve the range of services offered. Rates below variable cost would be eliminated;

3. governments would be required to pay the same rates as other shippers;

4. antitrust immunity would be eliminated on agreements relating to single line rates, or on rates in which the carrier agreeing does not participate. Prompt action by carrier rate bureaus would be required;

5. when railroads abandon lines, a more relaxed entry standard would apply for motor or water carriers who apply for authority to provide needed service;

6. discriminatory state and local taxation of rail assets would be eliminated; and,

7. delays would be reduced in the processing of state approval of intrastate rates that correspond to changes in interstate rates.

Regulatory change is particularly important in the areas of rail abandonments and pricing, and I will focus my detailed comments today on these aspects of the Department's regulatory reform legislation.

Excess capacity is a major problem with the railroad industry. By reducing excess capacity and eliminating uneconomic low density lines, the railroad industry could lower per unit operating cost and remove a heavy financial drain. However, the detrimental effects associated with the operation of uneconomic lines are not limited to the railroad industry. It appears clear that motor carriers are better suited to handling much of the short-haul traffic which presently moves on low density rail branch lines, while railroads have a cost advantage in long haul markets. Thus, the abandonment of uneconomic low density rail lines would enable railroads to concentrate their efforts in providing those services in which they have a relative advantage while providing a further opportunity for trucking service to develop in markets where it would have the relative advantage.

The bill is designed to speed up the regulatory processes in considering abandonment applications by providing an explicit and appropriate economic standard for determining when an abandonment is justified. Under the bill railroads would be permitted to abandon lines where the costs of operating the line exceed the revenues attributable to the line.

While the bill would expedite consideration of rail abandonments it would not result in an abrupt loss of rail service upon enactment. In fact, the case is quite the contrary. The bill requires a series of steps prior to an abandonment, and basically no abandonment may occur

under the new procedures earlier than one year from the date of enactment. In the case of protested abandonment, the various procedures under the bill could delay abandonments for up to as long as two years and six months. Thus, while the bill is designed to speed up the regulatory process in considering abandonments, it fully protects the interest of shippers and communities against the abrupt loss of rail service.

Because our abandonment provisions are likely to result in some additional traffic for truck carriers, it is important to consider the energy consumption and air pollution effects of the bill. Typically, abandonment candidates will be low density, short branch lines. Our analysis shows that there is greater energy efficiency in carrying freight by truck, as compared to rail, for distances less than 10 miles and shipment sizes less than 130-140 tons.

Becasue exhaust emissions for each mode vary directly with gallons of fuel consumed per mile, the rail/truck preference from an emissions perspective would follow generally that for fuel consumption. Thus, although the envisioned branch line abandonments will result in some increase in truck traffic, the transportation of the freight now carried on most of the lines to be abandoned will become more energy-efficient and cause less pollution.

Moreover, a major objective of the bill is to encourage more competitive and efficient pricing of rail services. This would assist rails in attracting traffic on which they are the low cost mode. Thus, we anticipate that the overall effect of this bill will be to improve freight transportation's energy efficiency and to reduce its exhaust emissions.

Of course, it must be recognized that under some circumstances an uneconomic rail line may be the most efficient mode of transportation available to shippers. To meet this problem, the bill provides a mechanism whereby a state or local government or other interested party could subsidize railroad operations to assure the continuation of uneconomic service for which a special need exists. We also recognize that liberalizing abandonments would result in some loss of rail service to various shippers. In order to assure that such shippers will have an effective and efficient alternative mode of transportation without any hiatus in service, the bill provides for liberalized entry by motor and water carriers seeking to provide substitute service.

Regulatory change in railroad ratemaking is critical to improving the economic position of the railroad industry and enabling it to operate efficiently. The current system of rate regulation severely limits an individual railroad's freedom to establish rates. As a consequence, it has created serious rigidity and distortions in the railroad rate structure. This regulatory system has hindered the railroad industry in innovating new services and prevented it from responding effectively to the needs of changing transportation demand. In particular, it has prevented railroads from attracting traffic on which it has a comparative advantage. Greater flexibility in ratemaking is essential to improve the performance of the railroad industry and the entire transportation system. Serious inefficiency results where low cost carriers are impeded or prevented from reducing rates to reflect greater efficiency. The Department recognizes the need to introduce greater flexibility in the rate structure and our legislation contains various proposals designed to achieve this objective.

The bill provides that a rate decrease may not be suspended on the ground that it is unjustly or unreasonably low. Under today's practice, rates may be suspended on the ground that they are too low, even though the rate is compensatory. By removing this ground for suspension, the bill would encourage railroads to reduce rates on traffic where they have a cost advantage.

The bill also modifies the existing law with respect to suspension of rate changes by providing that a proposed rate increase may not be suspended as being unjustly or unreasonably high if it is below the applicable class rate. With respect to rate decreases, the bill provides that a rate may not be suspended on the ground that it is unreasonably or unjustly low. However, all of the other grounds for suspension which exist in the Act today under Sections 2, 3, and 4 would remain. These changes in the suspension provisions of the Act should encourage railroads to reduce rates on traffic where they have a cost advantage while increasing rates where railroads' net income will be improved.

The bill also provides new procedures for initiation of rates involving the development of a new service involving a capital expenditure of $500,000 or more. This provision is designed to reduce the time, expense, delay and uncertainty associated with the introduction of new services, and thereby to encourage experimentation and the introduction of service innovations.

The bill also directs the Interstate Commerce Commission to raise all rates which are below variable cost to the variable cost level. The railroad industry loses approximately $450-$500 million annually handling traffic at rates below variable cost. Economic theory tells us that firms will not price at rates below variable cost, as such conduct is irrational. Conduct which is irrational and beyond the pale in an unregulated industry apparently can and does persist in a regulated industry such as the railroad industry. Undoubtedly, the regulatory system, including the present outmoded accounting methods which are prescribed by the Commission, have contributed to this result. In any event, such rates create a serious financial drain on the carriers and result in a misallocation of resources, both within transportation and in the economy at large.

The present regulatory process has also resulted in the rates of one mode being held high to protect another mode, causing a misallocation of resources, increasing the total cost to shippers and ultimately consumers, and adversely affecting the financial condition of the more efficient mode. Section 15a of the Interstate Commerce Act was amended in 1958 to allow carriers greater ratemaking freedom to meet the competition of carriers of the other modes. While the amendment was a step in the right direction, the full benefits of greater intermodal competition have not been realized because the amendment has been interpreted to allow the Commission to hold the rates of one mode above the rates of another mode to protect that mode. The bill meets this problem by prohibiting the ICC from holding the rates of a carrier of one mode up to a particular level for the purpose of protecting the traffic of a carrier of another mode. This provision should lead to more competitive and cost-related intermodal pricing and introduce greater rate flexibility into transportation ratemaking. The net result should be a more economic division of traffic.

The bill also seeks to introduce greater flexibility into the ratemaking process by modifying the present escrow provisions in the Act. At present, a carrier may be required to put funds resulting from rate changes under investigation in escrow only after the seven-month suspension period runs. The bill provides that where rate increases have not been suspened or where rate decreases have been suspended, the carriers must keep account of all amounts received because of the increase or the suspension of the decrease during a seven-month period or until a prior ICC order issues, at which time the carrier

would settle up any overages with shippers. These changes in the escrow provisions should provide additional incentives for contested rate cases to be disposed of more promptly.

Complementing these various changes in the area of ratemaking, the bill makes a number of changes with respect to rate bureau practices. Under Section 5a of the Interstate Commerce Act, carriers subject to the Commission's jurisdiction are permitted to act collectively in establishing rates and charges for transportation services, and such concerted action when taken pursuant to an agreement approved by the Commission is immune from the antitrust laws.

Rate bureaus are the vehicles through which carriers make decisions regarding the rates which the member lines shall charge, whether these rates are single line rates or rates for joint movements. Although rate bureaus provide a number of valuable services to their members and to the shipping public, they also dampen competitive forces in the ratemaking process and discourage pricing flexibility and service innovation. As a result, they have interferred with the establishment of rates based on the cost of the most efficient carrier, and have provided a mechanism through which carriers seek to set and hold rates above a competitive level.

The bill prohibits railroad rate bureaus from voting on single line movements and limits consideration of joint line rates to those railroads which actually participate in the joint movement, except with respect to scale or group rates. The bill also prohibits rail rate bureaus from taking any action to suspend rates established by independent action, while prohibiting motor carrier or freight forwarder rate bureaus from protesting a rate filed by independent action unless the protest is supported by facts showing that the rate appears to be less than the variable cost of rendering that service.

Thus, on single line rates, individual railroads will have complete freedom to propose rates based on the cost of the most direct routing, while on joint rates the influence of carriers not participating in the joint movement will be reduced. Scale rates -- rates established in terms of cents per hundred pounds for specified distances -- are excepted from this provision because these rates are designed for large inter- and intra-regional flows where traffic tends to move over all carriers.

The bill also requires all rate bureaus to dispose of proposed rate changes within 120 days from the time a rate change is proposed to the bureau. In addition, the bill requires all rate bureaus to maintain and make available for public inspection records of the votes of members. These provisions are designed to bring about speedier rate bureau treatment of proposed rate changes and to encourage greater initiative by individual carriers in making rate changes.

While the antitrust immunity with respect to joint rates is retained, the proposed legislative change with respect to single line rate agreements would exert a competitive influence upon joint rates because carrier territories overlap and single line rates are often competitive with joint line rates.

Through these various proposals dealing with rates and rate bureaus we hope to create substantially more ratemaking flexibility to correct the present distortions in the rate structure and to encourage railroads to introduce new services and attract traffic on which they have a comparative advantage. The basic thrust of the proposals is to place greater reliance on competitive market forces in ratemaking. I am confident that this will result in a more economic division of traffic, a lower overall freight bill, improved service and lower cost to the ultimate consumer.

The bill also provides for needed changes in the present cost accounting and revenue accounting system employed by the ICC which is outmoded and inadequate. The Commission's cost system relies on broad averages rather than specific experience of individual carriers. Moreover, the accounting system from which the cost data are derived is based upon outmoded classifications and specifications that no longer relate to the carrier's actual financial transactions. In addition, the accounting procedures utilized are not adequate to resolve the complex cost accounting problems which characterize modern transportation firms.

The development of improved cost and revenue accounting procedures is absolutely essential to improved regulation of transportation. The bill would require the ICC jointly with the Secretary of Transportation to study and recommend uniform cost accounting and revenue accounting methods for rail carriers, and to issue regulations prescribing new uniform cost and revenue accounting methods within two years from the date of enactment of the bill.

The Interstate Commerce Commission also has pending several proceedings dealing with the issue of developing an improved uniform cost accounting system, Docket 34012, Rules to Govern the Assembling and Presenting of Cost Evidence, and Docket 34013, (Sub-No. 1), Cost Standards in Intermodal Rate Proceedings. The proceeding in Docket 34013 was instituted by an order of the Commission dated April 16, 1962, and the Commission's decision was issued in 1970 (337 ICC 298). In February 1971, the Commission issued a new order reopening the case. The Department has participated in the main proceeding since 1968. Both the timing and outcome of the reopened proceeding are uncertain. In the sub-proceeding, which was initiated in early 1969 after the Supreme Court's 1968 decision in the Ingot Molds case, the Administrative Law Judge issued an initial decision on May 7, 1973. In sum, the bill would give direction and priority to the ICC's efforts to develop an improved uniform cost accounting system and would offer the best prospect for realizing this result.

Among our deliberations about the type of regulatory reform to propose to the Congress, we were well aware that the three regulated surface modes have collaborated on the preparation of the proposed Surface Transportation Act (H.R. 5385) which received the endorsement of a House Committee two years ago. There are reforms in that bill which are positive. In fact, there are many areas in which the TIA and the STA closely parallel each other. But it is clear that "controversial" reforms were left out of the Surface Transportation Act -- by common consent -- so that the residue of reform left in the industry bill is quite modest. We think the railroad industry needs more than that now -- particularly if financial assistance is to accompany the regulatory reforms as the industry has proposed.

As I indicated earlier, considerable parts of the rail plant in the United States are in a deteriorating state and the risk exists that the general deterioration of plant and service now prevalent in the east could expand to other portions of the country. At the same time, it is clear that potential for substantial productivity gains exists in the railroad industry if improvements are made in the basic physical plant. Thus, the bill provides for $2 billion in Federal loan guarantee authority to finance needed improvements in rights-of-way, terminals and other operational facilities and systems, and for the acquisition of rolling stock. However, these loan guarantees would be provided only where assurance exists that the capital improvements will make a genuine improvement to the overall efficiency of the rail system. In other words, the aid would help encourage needed long-term restructuring of the existing rail system.

Another basic problem in the railroad industry is the almost chronic shortage of freight cars. There are many reasons for the shortage. A key factor has been a low rate of freight car utilization. If we could improve utilization by 20 percent, annual needs for new cars would be reduced by approximately 10,000 to 15,000 cars. Increased utilization could save the railroads as much as $300 million annually in new car purchases. Therefore, an effective system of car fleet management is required in order to achieve greater utilization. We do not have a national management system at this time -- it is sorely needed, and we have technology now to design and implement such a system.

To expedite and assure development of a national system, the Department's bill would authorize the Secretary of Transportation to conduct research into the design of a national rolling stock scheduling and control system which would be capable of locating and expediting the movement of rolling stock on a national basis.

Clearly, the Department's bill will not please everyone. Some critics suggest that it represents only "modest" regulatory reform, and that it lacks a strong conceptual foundation. Let me deal briefly with these assertions.

The cornerstone of the regulatory reform measures in the bill lies in the pricing area. Virtually every academic analysis of the railroad industry problems has concluded that the existing pricing structure in the railroad industry is rigid and results in a substantial misallocation of resources both from the point of view of the transportation industry and from the point of view of the economy as a whole. In our deliberations on the bill, we were well aware of these analyses. Our own analyses confirmed the need for greater pricing flexibility -- for allowing wider play for market forces in transportation. Far from lacking appropriate theoretical foundation, the bill makes the changes in the regulatory system which both theory and empirical analysis indicate should be made.

Another criticism which we have encountered is that the bill is largely limited to the railroad industry. It is true that the primary focus of the bill is the railroad industry. This is so because the railroad industry's problems are most serious and immediate and it is in the railroad industry that the consequences of the present regulatory system are producing the greatest harm. It's important to note, however, that removing regulatory restraints from the railroad industry and thereby encouraging the railroads to price more intelligently and compete more effectively will clearly provide a stimulus for intermodal competition and thereby improve competition conditions in the trucking and water carrier industries as well.

In addition, it should be noted that in releasing the Transportation Improvement Act, Secretary Brinegar emphasized that the Department had undertaken a major regulatory research program in the trucking area designed to yield legislative proposals for the trucking area in the near future.

The Department is firmly committed to regulatory reform in other industries, but we are also firmly committed to getting effective regulatory reform in the railroad industry now. We all stand to benefit enormously as a consequence.

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DEPARTMENT OF TRANSPORTATION | NEWS

OFFICE OF THE SECRETARY

WASHINGTON, D.C. 20590

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REMARKS BY JOHN W. SNOW, ACTING ASSISTANT SECRETARY FOR CONGRESSIONAL AND INTERGOVERNMENTAL AFFAIRS, AT THE ANNUAL MEETING OF THE PRIVATE TRUCK COUNCIL OF AMERICA
FAIRMONT-ROOSEVELT HOTEL DALLAS, TEXAS
WEDNESDAY, APRIL 16, 1975

It is a great pleasure for me to be with you this afternoon. I bring you warm greetings from President Ford, along with his best wishes for a productive meeting.

Last year, when Deputy Secretary John W. Barnum addressed your Annual Meeting in New Orleans, the Nation was in the midst of a great national problem -- the energy crisis. Fuel was extremely scarce, prices were high and our economy was reeling from strong inflationary pressures. The problems affected all of us -- some more severely than others; none more severely than the trucking industry.

In the early months of 1974, these difficulties in large measure may have turned our national resolve into targets of opportunity. We began to realize that things would have to change. We no longer could be the great energy waster and we would have to pay more for energy use.

This is an important time in the history of transportation. Some change is a fact and the important issue before us now is the direction and pace of change in the future. I would like to review briefly with you today some issues and DOT activities which are germane to your interest.

During the gas shortage of 16 months ago, we monitored on a weekly basis the availability of transportation fuel to pinpoint problem areas. We worked with Federal energy officials in striving for more equitable fuel allocations to various segments of the transportation industry, particularly to independent truck owner-operators.

A major Departmental goal has been to reduce fuel use, especially in the amount of gasoline consumed in automobile travel.

The importance of the need to reduce energy consumption was recognized by the Congress when it adopted President Ford's recommendation for a lower national speed limit. The President has also personally asked the automobile industry to increase the fuel efficiency of automobiles and recommended other traffic control measures, such as carpooling.

The Department has been working for several months with auto manufacturers to improve the 1974 average fuel efficiency of new cars by 40% in 1980.

We are also proposing regulations that would require the States to certify that they are enforcing the permanent 55-mph national maximum speed limit on all public highways. That's a requirement of the Act that established the 55-mph speed limit. The regulations we are proposing -- with public comments due by April 21 -- would direct theStates to furnish supporting data that they are monitoring speeds and enforcing the limit. Failure to enforce could result in a withholding of Federal aid for highway projects.

The 55-mph speed limit produced two important benefits in 1974. It not only saved fuel, it saved lives. By the end of 1974, fatalities were reduced by more than 9,000 from the 12-month toll in 1973. Enforcement of the lower speed limit will continue to save lives.

As another way to reduce fuel use, we are asking State and local governments to develop short-range plans to control urban traffic. We would condition urban transportation and highway funding on the design and implementation of such plans. These plans deserve your support. In addition to fuel savings, they could also reduce the congestion that cuts into your operation costs and budget plans.

Another program of interest to you was launched just last month. Und er the auspices of the national Energy Resources Council, we are working with other Federal agencies to reduce the fuel consumed

by trucks and buses. The program involves voluntary cooperation among manufacturers, suppliers, trade organizations and vehicle users. It aims for a major improvement in commercial vehicle fuel economy -- perhaps up to an 18% gain in fuel efficiency of newly-built trucks and buses by 1980.

It is important for us to continue our national efforts to reduce energy consumption, but it is also important for us to continue our programs to improve safety conditions.

In this regard, I want to acknowledge the high degree of cooperation we have received from members of the private trucking industry. We've disagreed on some issues in the past, as you well know, and we may disagree again in the future. But, by and large, I am certain that our mutual quest for improved highway safety will continue. A few areas of our current work involve proposed minimum standards for brake systems, regulations for the safe transportation of hazardous materials, actions to prevent tire failures, and standards for exterior noise levels.

These and other goals were among those contemplated in the Transportation Safety Act of 1974, that was signed by President Ford early this year. That Act gave the Department new authority to issue regulations governing shipments of hazardous materials applicable to all modes of transportation and to shippers. In addition, the Act provided authority to the Secretary of Transportation to issue stiff penalties for the violation of hazardous materials regulations.

In the three and one-half months since passage of the Act, we have been working on regulatory actions that might be proposed. A finished product has not been produced, but when it is, I look for continued communications with the Council and other interested groups. Good regulations cannot be developed in a vacuum; we will need your input. I know that we will have your comments when our proposals are published.

While on the subject of safety, I'd like to mention one other issue -- truck tire failure.

Tire failures are of great concern to the Department, since blowouts can and often do cause accidents. Tire failures are the second leading cause of mechanical defect-related accidents; front tire failure accidents account for two-thirds of these accidents.

We are attempting to deal with two principal causes of tire failure: the practice of loading an axle beyond the manufacturer's rated capacity for the tires, and the failure of carriers to maintain adequate tire pressure. We are examining devices to improve vehicle control following tire failures, and we are developing our research on front tire failures and other methods of improving vehicle control.

In the environmental area, the Bureau of Motor Carrier Safety was required to issue enforcement regulations to complement noise standards prepared by the Environmental Protection Agency. Comments on the Bureau's proposed regulations, which were published on February 20, are due by May 15. Final EPA noise standards become effective October 15.

The proposed enforcement regulations also provide a basis for carriers to determine whether or not their vehicles comply with the EPA standards by spelling out the methodologies necessary to conduct EPA-mandated noise tests. I won't go into the specifics of this proposal, but I will encourage your review of the proposed regulations and the timely filing of your comments. As it now stands, the BMCS is gearing up for its exterior noise enforcement on and after October 15 -- if you haven't taken a reading of your fleet, I encourage you to do so.

As this important work goes forward, I can tell you that we are also preparing an omnibus highway bill that we hope to send to Congress in the near future. It will be tailored to meet both the realities of our national economic/energy situation and the urgent needs of our highway program.

This is, as you are well aware, a critical year for highway transportation legislation. Decisions must be made as to the future of the Highway Trust Fund, and programs and funding levels for fiscal years after 1976. In addition, it is clear that conditions since your last Annual Meeting -- as they impact on the environment, on energy and the economy -- require that we take a new look at the so-called traditional highway concepts.

While the Administration has not yet finalized its complete legislative package, I'd like to tell you about some of the features we are developing. A four-year highway proposal (1977-1980) is contemplated. It will emphasize the Federal interest in the Interstate Highway System. It will also recognize the primary State and local interest in other highway systems. And, we believe it will come to grips with the uncertainty surrounding the future of the Highway Trust Fund.

Under our proposal, the fund would be retained for financing the Interstate System only. All other Federal-aid highway programs would be financed out of general revenues. Our proposal also includes the consolidation of more than 30 categorical grant programs into four broad programs: the Interstate System, urban transportation, rural transportation and safety.

The financing structure would also change. For example, we would reduce Federal gasoline taxes going into the fund by 3 cents. Two cents of the gasoline tax would go into general revenues.

In addition, one cent of the gasoline tax would go to each State which increased its fuel tax a like amount. Revenues generated from the 1 cent Federal gasoline tax in States which do not increase their own tax level would go into general revenues.

Our proposal for a revised Highway Trust Fund will also involve a higher level of funding for the Interstate System than recent Interstate funding levels. This is a particularly important element of our program. Some 15% of Interstate mileage is not open to traffic. The astonishing realization is that the cost to complete that 15% is more than the total construction cost of the entire system as estimated back in 1956 when work was initially begun. Inflationary forces have contributed to this situation. Therefore, it is absolutely essential that we concentrate on completion of key Interstate routes.

We also viewed as essential a review of the vehicle size and weight limitations last year. We worked for support within the Administration and with others for swift passage of legislation providing some weight limitation relief.

The Department is also working to revise trip leasing regulations. We propose to permit private carriers to lease vehicles with drivers to for-hire carriers beyond the minimum 30-day lease requirement. This regulatory change is necessary, along with

a liberalization of rules on intercorporate hauling, to allow greater efficiency to be achieved in both private and for-hire carriage.

The benefits are many. Trip leasing would eliminate some back-hauls, save fuel, reduce the need for equipment, reduce the number of vehicles on the road, and lessen air and noise pollution. Furthermore, we believe there would be little adverse effect on for-hire carriage or the trucking system in its entirety. In a similar vein, we believe that greater freedom to engage in intercorporate hauling provides a major opportunity for improving economic efficiency, without creating an adverse diversionary impact on for-hire carriers.

A study we commissioned last year confirms our belief that legislative or regulatory changes are appropriate in these areas.

You are probably familiar with another study we undertook last year, principally in response to trucker difficulties resulting from the fuel shortage. We had received numerous complaints -- from independent truck owner-operators and others -- about the extent and diversity of State requirements for licenses, permits, fees and taxes connected with the legalization of trucking operations across State lines. We are completing this month the results of the study and we expect it will give us a better perspective of this complex problem as it relates to the carriers and the States. I look forward to having the Council's reaction to its findings.

There are several other issues I would like to discuss with you; they involve the overall health of the Nation's transportation industry and they are of direct concern to you.

The subject of railroads may not seem of vital interest to you. But you should have more than a passing interest in the railroad industry today. The future of the railroads, in large measure, can determine the future of every element of transportation.

As transportation industry leaders, you should be aware of the deeply troubled condition of railroads. Large parts of the system have deteriorated. Some Northeast and Midwest railroads are in bankruptcy, joined just recently by the Rock Island.

The rail situation is so precarious, in fact, that we are hearing cries from some Congressional leaders and others for outright nationalization of the industry. I should think you would want to analyze such proposals from the standpoint of your own interests.

We are confident that a streamlined and effective private sector rail system can emerge from the Northeast-Midwest restructuring process. However, this can only come about if Congress allows a paring down of the rail system into an efficient structure.

A streamlined railroad system can produce a healthy competitive balance between rail and truck, creating opportunities for the motor carrier industry. If railroads are nationalized, how long can trucks remain in the private sector?

That's why the Administration is engaged in efforts to restore the railroad industry to its rightful, and proper, place as an important element of our transportation system. We are soon going to present to the Congress a series of proposals that will strike at the roots of some of the industry's difficulties, hopefully, to prevent another Penn Central. Our proposals will be designed to eliminate overly restrictive regulatory practices and provide financial incentives to rationalize the rail system and modernize rail facilities.

In the meantime, we are also engaged in a major effort to review and assess the Preliminary System Plan produced by the U.S. Railway Association for the restructuring of the rail system in the Northeast-Midwest region. And, we are pursuing other rail restructuring issues and economic viability questions which we hope to translate into positive action programs for the revitalization of the industry.

We cannot confine these efforts to the railroad industry, however. The same archaic regulatory patchwork that saps the health of the railroads also contributes enormously to competitive difficulties in the motor carrier industry. We are going to press hard for changes in the regulatory structure so as to eliminate restrictions that stifle competition and cause operating inefficiencies.

At the same time, we are not proposing total deregulation. We do not support deregulation. We do support modifications in the existing system to bring about a better balance between regulation and free market forces. We believe there is room to permit a fuller interplay of free enterprise principles in the trucking industry.

While these proposals are still in the drafting stage, I can tell you that we intend to focus on the issues of pricing flexibility, entry limitations, certificate restrictions, commercial zones and restrictions on private carriage.

We have carefully examined the traditional argument that regulatory change will produce chaos in the industry. I can assure you that our proposals will be an appropriate adaptation to the needs of the marketplace and will not produce such disruption.

I must say that it is important to put to rest the charge that the Department of Transportation, as it pursues economic regulatory reform, is attempting to substitute its statutory responsibilities for those of our Federal transportation regulatory agencies.

Let me emphatically clear the air on this issue so that we can get on with a meaningful national regulatory reform dialogue. The Department is not attempting to inject itself as the new regulatory titan in our economic system. The time simply has arrived when we must rationally assess regulatory conditions in America today. We are not out to harm the system; we are aiming to improve it It can be improved. The sooner we extract ourselves from the cling-ism of the past, the sooner we can get on with making our system work better.

Indeed, the fact that the regulatory system has helped generate such a widespread move to private carriage suggests that the system is in need of repair. Yet, the legitimacy of the private carrier industry is under attack. Private carriage is vital to the performance of our transportation system. It's the competitive spur which is necessary for regular route and irregular route common carriage; it holds rates to a reasonable competitive level, it spurs innovation, and it meets the market test.

There are those who allege that the Department is pro-private carriage and against common carriage, that we are favoring private carriage to the disadvantage of the regulated carriers. Here, too, I must issue a balancing remark to this dialogue. We are interested in a competitive transportation system that utilizes each mode of transportation to achieve efficient, economic and reliable service. Aspects of our current regulatory system stand in the way of this objective and therefore must be changed.

Let it be understood, however, that we do have the deepest concern for the condition of our common carrier system. It is vital to our national commerce. We are seeking to strengthen the ability of the common carrier industry to adjust to changing market conditions and to make its full contribution to our national welfare. We are not -- as some have suggested -- going to throw the baby out with the bath water. We want to see a healthier baby and the year ahead can contribute to its health.

I hope that we have learned something since your last session in New Orleans; we have major challenges before us -- in the regulatory reform area, in obtaining better use of our energy resources, in improving safety. We can let 1975 slip us into a happy occasion in 1976. I welcome your help as we work toward that prospect.

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STATEMENT OF JOHN W. SNOW, ADMINISTRATOR, NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION, U. S. DEPARTMENT OF TRANSPORTATION, BEFORE THE HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION, SUBCOMMITTEE ON SURFACE TRANSPORTATION, ON MOTOR CARRIER REGULATORY REFORM, TUESDAY, SEPTEMBER 14, 1976.

Mr. Chairman and Members of the Subcommittee:

I thank you for this opportunity to appear before your Subcommittee to discuss the issue of motor carrier regulatory reform, the problems of the owner-operators, and the recent proposal of the Interstate Commerce Commission to introduce certain procedural reforms.

Our present system of motor carrier regulation is seriously deficient and stands in need of fundamental change. Federal regulation of motor carriers was initiated in 1935 when the ICC was given jurisdiction over a significant portion of this diverse and complex industry. It was a relatively young industry then, and needless to say, it was a time of severe economic depression. The times have changed, but the system of regulation has not changed. This essentially competitive industry is being regulated as if it were a public utility. The ICC regulates rates, controls entry and has imposed numerous restrictions limiting the particular markets a carrier can serve, the commodities it can carry, and even the roads over which carriers are permitted to operate. The result is high rates and serious economic wastes. Current regulation, rather than serving the public interest, serves primarily to benefit the regulated carriers by sheltering them from normal, healthy competition. It is a system that must be reformed and that reform must be thorough and comprehensive.

We recognize that the carriers have been operating under the present regulatory system for many years and that time is required for them to adjust their operations to a liberalized regulatory environment. Our bill is

carefully phased so the carriers will be able to make the necessary adjustments. The net result, we believe, will be an improved transportation system in which efficient, well-managed carriers will grow and prosper.

Our bill, the MCRA, provides essential and long overdue reforms. But other proposals that may be made by others could do so also. We have no excessive pride of authorship. The objective is far more important than the particular legislative vehicle for reaching it. Let me emphasize, however, that our proposal is the product of a serious effort to study the motor carrier industry and understand the effects of economic regulation on it.

The Department has conducted a great number of studies on these issues and we are submitting these for the record. In addition, we have participated in a number of proceedings before the ICC in which we have proposed the need for a less restrictive approach to regulation. The staff members of your Subcommittee have been very helpful in shaping the issues and indicating where more study is needed. We recognize that we do not have all the answers, but we firmly believe that we have carried the initial burden of proof in demonstrating the need for reform.

I shall first ask you to consider some facts which I think illustrate the problems with the current system of regulation. Then I shall discuss how our bill would meet these problems and improve regulation of motor carriers. In the months ahead I hope there will be more discussion of facts and of reform proposals.

The present system of regulation produces many wastes, inefficiencies, inequities, and plain absurdities. Let me set out a few examples.

1. A carrier operating between Minneapolis-St. Paul and Dallas is required by its route authority to travel 37 percent extra miles on trips between the two markets. In February 1974, during the height of the energy shortage, the ICC denied a request by the carrier, Consolidated Freightways, to travel directly between the two markets in order to eliminate excessive mileage. The request was denied on the grounds that this would enable the carrier to provide better service to shippers and thus would adversely affect competing carriers.

2. Many non-transportation business firms own their own trucking fleets. These are the so-called "private carriers." Private carriers may carry their own property but they may not carry property of others or even of their own subsidiaries. A firm interviewed in a recent study of private carriage uses its own trucks to make northbound shipments from North Carolina to New England. The trucks then return home empty. A subsidiary of this firm makes southbound shipments using the subsidiary's trucks from New England to Georgia. These trucks also return empty. The total annual mileage is approximately 330,000 miles, almost half of which is needlessly empty because of ICC restrictions on intercorporate hauling. This could be saved without any adverse effect on existing common carriage.

3. A shoe and hosiery chain with outlets in the West indicates that the freight rate on nylon hosiery from North Carolina is twice the rate for cotton hosiery although the transportation costs are identical.

4. A New York businessman tried to obtain authority to transport private automobiles and personal baggage from New York to Florida. It was to be a premium service designed for people who wanted to use their cars on vacation but who didn't want to accompany them on the Auto-Train and who didn't want to wait for their cars to be consolidated and shipped with new car orders destined for Florida. No comparable service existed. The businessman obtained his certificate but it took about two years and $5,000 in out-of-pocket expenses, and, according to the businessman, would have cost $70,000 in additional legal expenses had he not been a lawyer and able to handle his own case.

5. A Salt Lake City wholesaler of school and church furniture received the wrong size lampshades. When he attempted to send them back to the producer in Union City, Indiana, the shipment somehow ended up in Indianapolis. It stayed there for many weeks because no carrier had direct operating authority from Indianapolis to Union City. Eventually, the shades were routed back to Chicago, then on to Union City.

6. The carriage of most unprocessed agricultural goods is exempt from economic regulation, but such exempt carriers are not allowed to compete with regulated carriers for shipments of manufactured goods or even processed goods on their return trip. Agricultural carriers complain often about the empty backhauls that result because they cannot carry canned goods from the processor after delivering the basic agricultural ingredients.

These are but a few examples of the problems of a system of regulation that no longer serves the public interest. Unfortunately they are

not isolated cases but rather illustrate the pervasive waste and inefficiency resulting from our current restrictive and antiquated system of motor carrier regulation. In general terms there are two basic areas where reform is desperately needed: entry and pricing.

First, I will discuss entry. To operate as an interstate carrier of most manufactured or processed goods, a motor carrier must obtain authority from the Interstate Commerce Commission. These certificates of operating authority have been obtained in two ways. The great majority of today's operating rights were obtained via the "grandfather" clause of the Motor Carrier Act of 1935. That is, when the interstate motor carrier industry was brought under regulation in 1935, the existing 18,000 or more firms were granted operating authority.

New carriers, however, are required to meet the so-called "public convenience and necessity test." The Commission has interpreted this standard of public convenience and necessity to severely restrict entry into the motor carrier industry. The Commission's primary focus has not been upon the broad public interest in efficient, responsive transportation service, but rather upon the interests of the existing carriers. It is the Commission's policy that "existing carriers should be afforded the opportunity to transport all the traffic which they can handle adequately, economically, and efficiently in the territory they serve before new service is authorized" (110 M.C.C. 180, 184-185). In other words, a new applicant who is financially responsible and who offers a service desired by the public will be denied the opportunity to provide service if the existing carriers have the capacity to handle that service even

if they do not already do so. This interpretation applies even if the existing carriers will handle that service only at rates that are higher than those offered by the applicant. The Commission has ruled that the offering of a lower rate is irrelevant in its determination of whether an application is consistent with the public convenience and necessity.

The basic result of the entry policy of the ICC is the stifling of competition and the creation of monopoly power. In 1935, when the Motor Carrier Act was passed there were more than 18,000 firms. Through merger and attrition, that number has now dwindled to approximately 15,000. This shrinkage has occurred in a forty-year period when this country has seen unparalleled economic growth and when intercity truck traffic has grown almost ten-fold.

Fifteen thousand firms may seem like a great number, but the operating authority of virtually all is highly limited either in terms of commodities or territory. On high density routes where a great number of carriers were operating prior to the 1930's, there may be a dozen or more firms today. But on many routes only one or two firms may be authorized. This is particularly true in areas that have experienced significant growth in population or industrial activity. A study of the Rocky Mountain area found that one-fourth of the towns were served by only one carrier, and fully half by no more than two. Even in large metropolitan areas there are problems. Shippers in the Denver area reported that they were limited to two motor carriers on about 10 percent of their shipments. Shippers interviewed in the New Orleans area estimated that for more than half their shipments, no more than two motor carriers were available.

The restrictions placed on carriers' operating authorities not only limit competition, they create waste and inefficiency and add unnecessarily to the costs of transportation. We have already talked about route restrictions which add unnecessary mileage. In addition, according to ICC figures, 30 percent of all commodity restricted authorities -- the most prevalent kind -- provide only one-way authority. This is true even after allowing for combinations of grants to the same carrier. Carriers subject to such a one-way restriction may not legally carry a load on the return haul, and this means that the rate on the front haul must be higher than it would be otherwise.

These restrictions contribute to the problem of empty mileage. The best available evidence shows that over 25 percent of ICC regulated vehicles are traveling empty. Because of restrictions on whom they can serve and what they can carry, exempt carriers and private carriers have even worse problems with empty mileage. A recent DOT study of 40 firms engaged in private carriage shows that these carriers would save about 24 million vehicle miles annually if the prohibition against intercorporate hauling were removed. While it is true that some empty mileage is inevitable because of basic traffic imbalances, there is far more empty mileage than there should be because of regulatory restrictions which prevent trucks from carrying cargo on their return trips even when it is available.

The amount of shipment transfers between carriers called interlining is also increased by certificate restrictions. In many cases no single carrier has the necessary operating authority to carry a shipment its

entire length. Where this happens, two or more carriers must participate in the movement by transferring the cargo between carriers at selected interchange points along the way. Unneeded interlining increases the need to warehouse and store items, increases transportation times, and raises the costs of transportation.

Many applications for operating authority are made each year and a large fraction are granted. On the surface this would appear to indicate a liberal rather than a restrictive entry policy but the opposite is true. In recent years some 4,000 grants were made from about 5,000 applications, but the great majority of these grants were extensions of authority to existing carriers. In many cases these grants were necessitated by past restrictive policies. For example, a firm may have had authority to carry paint in two-gallon cans. The customer now decides to manufacture paint in five-gallon cans. The customer now decides to manufacture paint in five-gallon cans. The carrier needs additional authority to carry the five-gallon size. Grants of authority to continue to serve the same customer can hardly be construed as entry.

Only a few grants of authority are made each year to new carriers. In 1975 of the approximately 4,000 grants, less than 500 were to new carriers. Of these, 154 provided authority to carry only a single commodity: 163 were for a single origin. There were only 37 general commodity certificates granted. This is typical. In 1974 there were 30; in 1973, 31. And those few certificates which provide wide latitude in the goods that can be transported are severely limited as to the territory that can be served.

Besides the economic costs, there are the human costs of the present entry system. As we have indicated before, most of today's carriers can trace their origin back to rights that were grandfathered into the system in the 1930's. But what of the individuals or groups who did not have the luck or the foresight to be in the trucking business at the time the Motor Carrier Act was passed in 1935. Needless to say newcomers in the business society, including members of minority groups have been most disadvantaged by this system. They did not operate as motor carriers in the 1930's and therefore are barred from the system today. Estimates of minority participation in the motor carrier industry are about one percent, and they will not be allowed to enter the system in any real way unless significant changes are made in the entry rules. Our proposal would expand business opportunities for minorities and other capable newcomers.

The American Trucking Association recently made a filing to the ICC in connection with a proceeding to determine the correct accounting procedures to apply to certificate values. This filing ironically illustrates (unintentionally, I'm sure) many of the problems of today's entry -- or rather -- non-entry system. I would like to excerpt a few quotes from it.

1. "The vast majority of operating rights today arose under what is referred to as the 'grandfather' clause in the (Interstate Commerce) Act."

2. "Smaller carriers with limited operating authorities are finding it increasingly difficult to compete effectively in today's transportation

market place. . . The limited number of operating rights currently in existence, coupled with the rapidly growing public demand for motor carrier service, has created a need for carriers to seek out and acquire operating rights from other carriers."

3. "Virtually the only way for (a relatively small carrier) to obtain additional operating authorities is to buy them from other motor carriers."

4. "Recent acquisitions in the motor carrier industry indicate that amounts paid for operating authorities are approximately 15 percent to 20 percent of the annual revenue produced by these authorities."

The statement goes on to say that these payments are for the right to operate only. They do not even include "goodwill" earned through superior performance and market acceptance.

It would be difficult to find a more articulate and knowledgeable criticism of the existing entry system than this filing. For what this document says is that the vast majority of operating rights were granted over 40 years ago -- without benefit one might add of any special test -- and that the system has been virtually blocked to new entry since that time. Now the principal way to enter or expand is to buy rights that were once given freely by the government. These rights are now, by the industry's own estimates, worth billions of dollars, a benefit to the original "owner" of these rights, but a cost to the new carrier who must purchase them and a

cost to the ultimate consumer and shipper who must pay for them as part of his transportation costs. These rights have value only because they have been artifically restricted by the ICC.

Ratemaking is the other side of the problem. The rates of regulated carriers are set collusively. The Interstate Commerce Act contains an exemption from certain aspects of the antitrust laws and the carriers are allowed through industry associations called rate bureaus to engage in price fixing. Two steel companies cannot come together and set the price of steel, but all the motor carriers transporting steel can come together and set the price of transporting steel.

It is quite clear that there is little competition in ratemaking. The usual spur to competition, the threat of new entry is missing. Price competition among the existing carriers is virtually nonexistent because of rate making within the rate bureaus. There is the possibility of a carrier taking an "independent" action outside the rate bureau, but here the carrier must face the delay and cost of a complicated ICC proceeding. The threat of a shipper using private carriage provides some incentive for competition but the Commission has deliberately created inefficiencies in private carriage operations so as to raise their costs and diminish their competitive impact.

The result of this system of cartelized pricing and restricted entry is that rates are too high. Studies of what occurred when fresh and frozen poultry and frozen fruits and vegetables were exempted from regulation show how regulation has raised rates to the detriment of consumers.

These commodities were deregulated as a result of a Supreme Court decision which found that they fell within the agricultural exemption of the Act. The United States Department of Agriculture conducted intensive studies and found that after deregulation the rates fell 33 percent on poultry and 19 percent on fruits and vegetables and service improved dramatically.

Significantly, for both these commodities, the use of private carriage dropped substantially after deregulation. Under regulation many shippers had been forced to turn to private carriage to obtain service in small, out-of-the-way places which were not served adequately by regulated carriers. When the commodities were exempted, shippers found they could obtain the required service on a for-hire basis so the use of private carriage decreased. We expect that regulatory reform will similarly arrest the growth of private carriage of manufactured goods and increase the market share of the regulated, for-hire trucking industry.

In addition to raising rates above competitive levels, the regulated rate system does not provide a diversity of rates which would allow or encourage a diversity of service qualities. As a result carriers cannot tailor service to the particular needs of their customers. To cite an example: A California clothing manufacturer would like to use a service that provides faster than normal truck delivery but cannot get it even though he would be willing to pay a premium for it. He is forced to use air shipments which cost him 40-50% more than the normal truck rates. This is not an untypical example. Thousands of shippers are turning to private carriage because they cannot find the type of service they wish from the existing common carriers.

Rates under the present system do not reflect the cost of the service provided. For the most part, rates on the front haul and the back haul are the same even though it would make sense to lower the rates on the back haul, which is often empty, to attract more traffic. This deters economic development in rural areas because they are unable to take advantage of the lower real economic transportation costs which result from existing traffic imbalances. Under the current system rates for shorter distances are sometimes higher than the rates for longer distances even though both routes may be in the same direction - and even over the same highway.

Rates and entry are the two major problems but there are others. We have already mentioned the problem of intercorporate hauling by private carriers. There are also artificial restraints placed upon contract carriers which limit the growth of efficient, well-managed firms. The system of exemption for agricultural commodities is also archaic, irrational and frequently incomprehensible. For example, butter is regulated, buttermilk is not. An exempt trucker carrying tomatoes to a cannery cannot arrange with the shipper to carry canned tomatoes back to the growing area. These problems must be dealt with, and the Motor Carrier Reform Act does it in an equitable and sensible way. It is not a bill that simply turns the existing system on its head. The bill is carefully phased to avoid precipitous change and many safeguards are put in place to protect against any threat of cut throat competition or discriminatory pricing. We are confident that change of the sort

we propose would result in a healthier, stronger and more efficient industry -- an industry capable of earning an appropriate rate of return and capable of attracting needed capital.

Before discussing some of the provisions of our bill, I want to deal with two arguments that have been and probably will continue to be made against the specific reform provisions incorporated in it.

It has been argued that rural service will deteriorate because common carriers that now are required to provide service will abandon their rural customers. I think the opposite will happen and my extended testimony states why we think rural service will improve. Basically two facts must be kept in mind. First there is no evidence that the so-called common carrier obligation to serve is a burden to the carriers. Carriers have found it relatively easy to reduce or discontinue service to unprofitable places. Second, under our regulatory reform proposal agricultural carriers will be allowed to carry regulated goods to rural areas. This will increase the amount of service to rural areas.

If in the course of debate about regulatory reform the Congress becomes convinced that some form of special protection for rural shippers and receivers is required, then it would be appropriate to enact such protection. We believe that none is required and there is no evidence to the contrary. Nevertheless, if evidence is presented that shows with facts, figures and analysis - not merely often repeated allegations - that rural service requires special rate or service protection, then we

would certainly want to consider this evidence and make appropriate changes in our proposals. The evidence now available to us all points in the other direction and it is incumbent upon those of a different persuasion to come forth with facts and analysis.

Second, it is argued that the trucking industry would be unable to attract capital if regulatory reform is enacted and that the resulting chaotic conditions would lead to monopoly by large firms. We have carefully considered this argument and again invite those who make it to present facts and analyses instead of allegations. Our view of the situation is that well-managed and efficient firms will be able to attract capital in the same way as do firms in other industries. Moreover, we have been careful to phase the reform proposed by us over a period of years in order to give existing firms adequate time to make adjustments in their operations. This is discussed in the extended testimony.

We feel there can be little doubt that the direction of change in the Administration's bill, toward greater reliance on the market, is correct. Greater room for disagreement exists on the precise way to reach this objective, the path to follow or the proper timing for the phase-in. We are anxious to cooperate with the Committee, the industry and shippers to reach satisfactory resolution of these complex issues.

Let me turn now to discussion of the major provisions of our bill.

For entry, the bill would redirect the focus of the decision-making process of the Commission regarding entry and require the ICC to weigh in favor of an applicant if the new service would result in lower costs, greater efficiency, better service, or would satisfy a shipper's

preference for different combinations of rates and services. The Commission would also be required to grant entry if the applicant were "fit, willing, and able" and the revenue of the proposed service would cover the costs of the carrier for the particular service. I would point out that neither of these provisions provides "free entry". The first simply requires the Commission to look to the total public interest in determining whether to grant a certificate. The second provision requires the Commission to grant a certificate but only if the applicant is financially responsible and only if the rate he proposes is compensatory. Neither one of these provisions will allow "fly-by-night" operators who will charge unrealistically low rates into the market. These provisions, however, will allow knowledgeable, efficient, innovative and responsible competitors into the market.

In the pricing area, the bill proposes changes similar to what we proposed and which were recently enacted in the Railroad Revitalization and Regulatory Reform Act of 1976. Rates above variable cost could not be ruled unlawful because they are too low. Rate charges within a gradually expanding zone could not be suspended. The Commission, under our bill, could continue to declare any rate unlawful because it is too high, discriminatory, or preferential. The changes to the rate authority of the Commission are quite modest, but they would significantly increase competition.

Coupled to these changes, the bill would also reform the rate bureaus. Collective rate making on single-line rates would be forbidden.

Only participants in joint or interline rates could agree on those rates. These proposed changes are again similar to those adopted in the Railroad Revitalization Act.

The information we have submitted gives greater details about the bill. I would like to make a few general comments, however. As I indicated we have been very careful to phase this bill to avoid disruptions to the industry. We have been also very careful to design the bill so that service to small communities is not disrupted. We are confident that service to these communities will be increased. We have worked very hard in these two areas -- phasing and small communities. On the basis of the facts we have analyzed, we believe the bill correctly addresses these issues.

As I have indicated, we will submit extended comments on the problems of the regulation of motor carriers in a short time. At that time we will also submit detailed comments on the other motor carrier bills before this Subcommittee, but I think a few general comments might be helpful at this time. We believe that procedural reform is important, and we are pleased that the ICC submitted H.R. 15442 to introduce for motor carriers some of the procedural changes enacted for railroads in the Railroad Revitalization and Regulatory Reform Act. We have difficulties with some of the other proposals submitted by the Commission. But the important point is that procedural reform is not enough. Regulatory reform cannot be accomplished with procedural change alone. It attacks only the symptoms. We must get to the heart of the problem and decide just how much of the motor carrier industry we want regulated.

In closing let me restate our basic position. The Department has done a great deal of research in the motor carrier area. We have submitted these reports to this Committee. We firmly believe that this material demonstrates that the existing system of motor carrier regulation is not working well and is in need of comprehensive reform. We think we have met the burden of proving the case for reform, and the time has now come for the opponents of reform to come forward with facts and analyses rather than rhetoric. And if there is reason to change our recommendations, based on facts and analyses rather than slogans or allegations, we shall come forth with new proposals.

I will be happy to answer any of your questions. We at the Department look forward to working with this Committee as you continue your deliberations on the vitally important issue of motor carrier regulatory reform.

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