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NATIONAL TRANSPORTATION POLICY

REPORT OF A TASK FORCE TO THE PRESIDENT OF THE UNITED STATES

NOVEMBER 1964

November 16, 1964

The President
The White House
Washington, D. C. 20500

Dear Mr. President:

Herewith I present to you the report of the Task Force on Transportation Policy.

The Task Force was unanimously of the opinion that American transportation policy has been deficient in two major respects: first, the use of rate regulation and restrictions on entry rather than competition has raised rates and lowered utilization of many transport facilities; second, investment in transportation has often been allocated in a fashion not wholly in accord with the public interest. Accordingly, we have framed a program which is mainly concerned with policies in these areas.

We are keenly aware of the honor of serving on the Task Force, and we hope that our efforts may be of service to your Administration and to the Nation.

Respectfully yours,

George W. Hilton

George W. Hilton
Chairman

TASK FORCE ON TRANSPORTATION POLICY

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PREFACE

Transport expenditures in the United States exceed $100 billion annually. The industry consumes nearly half of our total output of energy. It employs directly more than nine million people. Transport permeates the economy. Virtually all other industries -- manufacturing, agricultural, extractive and service industries alike -- are heavily dependent on transport. Consumers depend on transport for much of their recreation and for much of their freedom in choosing where to live. Workers depend on it not only for access to their jobs but for much of their freedom to choose between jobs. The economic health of transport is, therefore, of vital concern to the U.S. Government.

When account is taken of the increased demands for transport services that are generated by a growing population and a growing economy, the need to develop a national transport policy consistent with the circumstances and opportunities of a dynamic and highly developed industrial society becomes apparent.

The United States now has a massive, flexible transport system linking all parts of the nation together. That system has been built within the confines of present policy. Why, then, is a new policy needed? First, it will eliminate inefficiencies which retard growth, impair the ability of American industry to compete abroad, and depress the standard of living at home. Second, it will reduce the deep entanglement of governmental agencies as advocates, promoters, protectors and regulators of private interests which conflicts with our liberal international policies and contravenes the precepts we advance to the less developed and the non-free nations. Advocacy of "equal opportunities for all and special privileges for none" is particularly appropriate in transport. Finally, it will save governmental funds needed to achieve real social benefits but now flowing into unproductive channels.

Thus there is need for drastic revision of national transport policy, geared to contemporary realities. What are these contemporary realities?

(1) The transport industry has been transformed by technology, growth of market, massive investments and competition. A nationwide system is in operation. Virtually all shippers and travellers have a wide range of choice of modes, routes and destinations. The old notion that transport is a natural monopoly is no longer relevant.

(2) The extension of the number and variety of transport alternatives makes comprehensive regulation administratively infeasible.

(3) The problems of the nation are now vastly different. We are a highly developed country experiencing accelerated technological change. A prime requisite of further progress is flexibility to respond to such change. Detailed and complex regulations which serve to diminish adaptability to change discourage general economic expansion.

The new transport environment requires that we emphasize the efficient accomplishment of the primary mission of the transport system, which is to meet the demands generated by the economy. This objective will be achieved only if we:

(1) Place greater reliance on market forces and less on public regulation in guiding the development of the private transport sector, and

(2) Rigorously evaluate costs and benefits in the allocation of public funds for the enhancement of the transport system.

The transport system that develops under this policy will have strength and flexibility--and will serve the nation at lowest cost consistent with the demands put upon it.

To implement this policy, the task force has made recommendations ranging the entire spectrum of transport problems. These recommendations call for:

(1) Establishment of a Department of Transportation.

(2) The curtailment of Government subsidies and creation of a mechanism --the Federal Transport Investment Review Board--for harmonizing the expenditure of public funds with the stated objectives of an integrated transport policy.

(3) Relaxation of rate regulation by the Interstate Commerce Commission so that the rate structure will more nearly reflect the technological and competitive conditions which determine the alternatives faced by the shipping and travelling public.

(4) Wider application of user charges in air, water, and highway transport on grounds of equity, public revenue needs and the improvement of public investment decisions.

(5) Purchase of transport services by the Government at lowest cost compatible with adequate service.

(6) Removal of legal barriers to entry and abandonment on the part of common carriers.

(7) Enlargement of the authority of the Interagency Committee on Transport Mergers which would permit the Committee to develop and present before the regulatory agencies alternatives to mergers proposed by the carriers and to evaluate and suggest alternatives to merger.

(8) Drastic reduction and alteration of operating and construction subsidies in the maritime industry.

The task force feels that immediate legislative action to correct current deficiencies can be initiated along the following lines:

<u>Investment</u>

(1) Divert some funds from the Highway Trust Fund to the new Federal fund for the development of outdoor recreational facilities--at least 1 percent immediately, 5 percent or more within five years.

(2) Divert some of the funds now expended on the inland waterways to the rehabilitation of major ports.

(3) Terminate the Federal-aid Airport Program.

<u>Rates</u>

(1) Eliminate most of the authority of the Interstate Commerce Commission to regulate minimum rates of all carriers under its jurisdiction.

(2) Repeal the "long haul, short haul" provision of the Interstate Commerce Act.

(3) Eliminate the "rule of three" and other limitations on bulk commodities that may be transported on the waterways without loss of the exemption.

(4) Amend the Interstate Commerce Act to eliminate the requirements in Parts I, II, III, and IV that carriers maintain rates based on "reasonable classifications".

(5) Amend the Interstate Commerce Act to require rail and highway carriers to accept shipper-owned or -leased equipment for transport. The law should be amended to permit shippers to lease equipment among themselves as well as to and from car-leasing companies without regulation of leasing terms.

(6) Amend the Interstate Commerce and Federal Aviation Acts to provide that in rate cases where the complainant is a carrier, the burden of proof as to the reasonableness of the rate shall be on the complaining carrier.

(7) Amend the Interstate Commerce and Federal Aviation Acts to deny carriers the right to request suspension of proposed rates.

(8) Amend the Interstate Commerce Act to give the railroads and bus companies complete freedom in setting intercity passenger fares.

(9) Amend the Federal Aviation Act to eliminate rate regulation of all unsubsidized domestic air passenger transport.

User Charges and Subsidies

(1) Terminate subsidies for helicopter operations.

(2) Levy an initial tax of 2 cents per gallon on all fuel used on the inland waterways.

(3) Increase the tax on highway diesel fuel from 4 to 7 cents per gallon, the weight tax on trucks over 26,000 pounds gross weight by an additional $2 per thousand pounds, and on tread rubber by an additional 5 cents per pound.

(4) Extend the 2 cents per gallon tax on aviation gasoline to jet fuels for commercial aviation. Continue the 5 percent tax on passenger travel by air and extend it to air freight. Increase the gasoline tax for general aviation to 10 cents a gallon and extend it to jet fuels; impose annual license fees averaging $1,000 per aircraft (varying with weight).

Mergers

(1) Revise the Interstate Commerce Act to require the Commission to give dominant weight in mergers to the effect of the merger on

adequate transport service to the public.

(3) Revise the Interstate Commerce Act to substitute more flexible alternatives for the protection of affected employees to the present provision of a 4 year guarantee of equivalent employment.

(3) Revise the Interstate Commerce Act to give greater influence to equity and other junior security holders in bringing about reorganization.

Operating Rights

Permit complete freedom of entry to new firms and permit existing firms to adjust routes, direction of movements and commodities carried in response to demand. Reduce impediments to exit and to abandonment of facilities and discontinuance of service for all modes.

International Maritime

(1) Discontinue the operating subsidy for passenger ships. No new subsidy contracts for such ships should be made and existing contracts should be renegotiated to terminate them as speedily as possible with compensation for undue hardship otherwise imposed on operators and crews. Contract settlement terms should protect operators against losses and a modest portion of subsidy savings may be used to assist displaced seamen.

(2) Eliminate the concept of the essential trade route and allow cargo line operators wide latitude in scheduling their operations. Relieve them of the requirement to operate American-built vessels exclusively and to use only American yards for repair and maintenance.

(3) Reduce new obligational authority for ship construction subsidies immediately by one-third and the remainder by one-fifth per year so as to terminate in five years.

(4) Eliminate cargo preference either immediately or in steps of, say 10 percentage points annually.

(5) Eliminate the requirement of filing rates 30 days in advance of effectiveness.

I. SUMMARY OF RECOMMENDATIONS

A. Organization and Procedures

1. Establish a Department of Transportation.

2. Build up a permanent organization for continuous policy formulation and revision in the Office of the Under Secretary of Commerce for Transportation. This should become a core element in the recommended Department of Transportation.

3. Establish a Federal Transport (advisory) Investment Review Board, to coordinate the Federal transport investment budget and long-run transport investment planning; to eliminate inconsistencies in the methods now employed to determine the extent and distribution of transport investment; and to provide a means of efficiently adjusting transport investment to economy-wide objectives of reducing unemployment or redistributing income.

4. Establish, under the chairmanship of the proposed Department of Transportation, an interagency committee to formulate executive branch positions for presentation to the regulatory agencies in important rate cases and in important cases involving operating rights.

5. Enlarge the authority of the Interagency Committee on Transport Mergers.

B. Investment Policy

1. Examine the Federal-aid highway program projected for the post-1972 period in terms of (a) least-cost elimination of bottlenecks; (b) possible reduction of need in view of the completion of the Interstate Highway System already planned; (c) greater flexibility, particularly avoidance of high-volume design on light-density routes in sparsely-settled areas and excessive geometric design standards in urban areas, especially when the result is impairment or destruction of neighborhoods or aesthetic values.

2. Continue the Highway Trust Fund, but be alert to the prospect that a combination of increasing revenues and reduced benefits derivable from additional highway investments may make possible a diversion of some of the Funds' resources as at least part payment for the indirect costs thrust upon governments by the existence and use of the Interstate System. Because of the close connection between the use of highways and the use of recreational facilities, some of the Highway Trust Fund should be diverted immediately to the new Federal fund for the development of outdoor recreational facilities: at least 1 percent immediately, and 5 percent or more within five years.

3. Place interstate toll roads on an economic and financial parity with those portions of the Interstate System now financed by the Highway Trust Fund.

4. Make an exception to the criterion of limiting estimated aggregate benefits to those accruing directly to individual private users in cases where transport investment is an indispensable tool for changing the whole face of the economy, as in Appalachia.

5. Instruct the Department of Commerce to examine the appropriateness of present forms of transport ownership and control in cases where the transport investment problem may be complicated by organizational weaknesses or fragmentation and overlapping of responsibilities.

6. Begin immediately to relate investment in the Federal airways to revenues that can be obtained from user charges.

7. Give greater attention to the rehabilitation and improvement of major ports. Divert some of the funds now expended on additions to the inland waterways to this objective.

C. Rate Policy

1. Eliminate the authority of the Interstate Commerce Commission to regulate minimum rates of all carriers under its jurisdiction.

2. Repeal paragraph (1) Section 4 (the "long haul, short haul" provision) of the Interstate Commerce Act.

3. Eliminate the "rule of three" respecting the number of bulk commodities that may be transported on the waterways in a single tow without loss of the exemption.

4. Repeal the provision limiting the bulk exemption to commodities handled by water carriers on June 1, 1939.

5. Amend the Interstate Commerce Act to eliminate the requirements in Parts I, II, III, and IV that carriers maintain rates based on "reasonable classifications."

6. Amend the Interstate Commerce Act to require rail and highway carriers to accept shipper-owned or -leased equipment for transport. Shippers should be permitted to lease equipment among themselves and to and from car-leasing companies without regulation. Rates charged for hauling shipper-owned or -leased freight cars or trailers should be commensurate to the service being provided and should not take account of the nature of the commodities being hauled.

7. Instruct the Department of Commerce to initiate proceedings before the Interstate Commerce Commission to eliminate from TOFC tariffs, either specifically or by reference, the requirement that Plans III and IV TOFC rates be applied only on mixed loads.

8. Amend the Interstate Commerce and Federal Aviation Acts to provide that in rate cases where the complainant is a carrier, the burden of proof as to the reasonableness of the rate shall be on the complaining carrier.

9. Amend the Interstate Commerce and Federal Aviation Acts to deny carriers the right to request suspension of proposed rates. The right of shippers to request suspension would remain unimpaired.

10. Amend the Interstate Commerce Act to give the railroads complete freedom in setting intercity passenger fares.

11. Amend the Interstate Commerce Act to allow management complete freedom in setting intercity bus passenger fares.

12. Amend the Federal Aviation Act to eliminate rate regulation of all unsubsidized domestic air passenger transport.

13. Urge the Civil Aeronautics Board to encourage the setting of rates for subsidized air transport at the highest level compatible with maximizing carrier net revenue.

D. User Charges and Subsidy Policy

1. Instruct the Department of Commerce with the assistance of the Federal Aviation Agency, the Civil Aeronautics Board, the Treasury, and the Bureau of the Budget to continue efforts to quantify benefits received by various categories of users of aviation facilities.

2. Renew recommendations to the Congress for airway user charges.

3. Create an Airways Trust Fund with provisions for linking of user charge revenues and new Federal expenditures on additions and improvements to the Federal airways.

4. Terminate the Federal-Aid Airport program.

5. Urge greater cooperation between the Civil Aeronautics Board and the Federal Aviation Agency in relating changes in commercial aviation operations, especially of the subsidized local service carriers, to the development of airports and related airways system improvements.

6. Terminate subsidies for helicopter operations.

7. Urge the Board to continue the evolutionary development of its Class Rate Plan for subsidies to local service airlines, to develop similar plans for Alaska and Hawaii subsidized operations, to enforce its use-it-or-lose-it policy, and to revise use-it-or-lose-it standards progressively so that deficit operations will be eventually eliminated.

8. Levy an initial tax of 2 cents per gallon on all fuel used on the inland waterways.

9. Instruct the Department of Commerce to update and elaborate its studies of inland waterway costs and revenues and to develop a more nearly compensatory schedule of charges.

10. Create a Waterways Trust Fund with provisions for ultimate linking of user charge revenues and new Federal expenditures on additions and improvements to the inland waterways system.

11. Recommend increases (a) in the tax on diesel fuel from 4 to 7 cents per gallon, (b) in the weight tax on trucks over 26,000 pounds gross weight by an additional $2 per thousand pounds, and (c) on tread rubber by an additional 5 cents per pound.

12. Instruct the Department of Commerce to continue its studies of accelerated highway wear likely to result from liberalized truck size and weight limits and to recommend any necessary further adjustments in user charges.

13. Instruct the Secretary of Commerce to participate directly in all stages of any study of highway needs for the period beyond 1972.

14. Instruct the Department of Commerce to explore the possibilities of developing schedules of differential user charges to control peak traffic loads (congestion) on the highways.

E. <u>Government Purchase of Transportation</u>

1. Direct all Government agencies to procure transport at the lowest cost compatible with adequate service.

2. Resist efforts to make any major change in Section 22 of the Interstate Commerce Act.

F. <u>Merger Policy</u>

1. Endorse railroad mergers when merger appears to be the best means of achieving improvements or disinvestment.

2. Revise Section 20b, Part I, of the Interstate Commerce Act to give greater influence to equity and other junior security holders in bringing about reorganization.

3. Revise Section 5(2)(c) of the Interstate Commerce Act to provide that in evaluating any proposed merger the Commission must give dominant weight to the effect of the merger upon adequate transport service to the public.

4. Revise Section 5(2)(f) of Part I of the Interstate Commerce Act which now requires that employees of merged carriers not be put in "a worse position with respect to employment" for a period of 4 years after merger. Alternatives to the fixed time period, such as liberalized severance pay, special retraining programs and compulsory retirement should be explored.

5. Continue the policy of preventing all intermodal mergers.

6. Once minimum rate and entry control are removed, amend Section 5, Part I, of the Interstate Commerce Act to remove all restrictions on intermodal mergers. This removal should be accompanied by repeal of Section 5a of the Interstate Commerce Act (Reed-Bulwinkle Act). Transport mergers should be subjected to the full sanctions of the Clayton Act.

7. Exempt all freight forwarder activities from regulation.

G. Operating Rights

(i) Surface Transport

1. Permit freedom of entry to new firms who can obtain adequate public liability insurance and meet safety requirements, as rapidly as rate deregulation is effectuated.

2. Permit existing firms to adjust routes, direction of movements and commodities carried in response to demand.

3. Reduce impediments to exit and to abandonment of facilities and discontinuance of service for all modes.

4. Amend the Interstate Commerce Act to provide similar automatic right to bus companies to discontinue service.

5. Assign to the interagency committee, established under the chairmanship of the proposed Department of Transportation, responsibility to formulate executive branch positions for presentation to the regulatory agencies in important surface transport cases involving operating rights, entry and exit.

(ii) Air Transport

1. Eliminate ultimately all barriers to entry into the industry and to participation on particular routes. Simultaneously, remove all restrictions on exit, abandonment and discontinuance.

2. Permit immediately the trunk carriers to discontinue service on low traffic segments. Transfer these segments to the local service carriers, even if subsidy is transitionally increased.

3. Encourage the Civil Aeronautics Board to lift restrictions against skip-stop operations for local service as well as trunk carriers.

4. Discourage the Board from imposing any minimum number of round trips per day to low traffic points on subsidized carriers. The small, unsubsidized taxi operator serving a few pairs of points offers a much more satisfactory solution.

5. Urge the Board not to certificate a subsidized carrier between points where existing air taxi service is satisfactorily meeting needs.

6. Assign to the interagency committee, established under the chairmanship of the proposed Department of Transportation, responsibility to formulate executive branch positions for presentation to the regulatory agencies in important air transport cases involving operating rights, entry and exit.

H. International Maritime Policy

1. Abandon the present method of computing the operating subsidy.

2. Discontinue the operating subsidy to passenger and combination ships with substantial passenger accommodations. Contract settlement terms should protect operators against losses and a modest portion of subsidy savings may be used to assist displaced seamen.

3. Eliminate the concept of the essential trade route and allow cargo line operators wide latitude in scheduling their operations.

4. Reduce the operating subsidies by the amount of the passenger ship subsidy as quickly as possible in accordance with recommendation 2.

5. Base the amount of subsidies beyond the first six years on the experience of the transition period and set it at a level designed to sustain a volume of U.S. flag service sufficient to exert a beneficial influence on operating efficiency and freight rates.

6. Renegotiate existing cargo liner subsidy contracts so as to transfer operations to the new program without undue hardship or undue windfall benefits to the operators.

7. Reduce new obligational authority for construction subsidies immediately by one-third and the remainder by one-fifth per year so as to terminate in five years.

8. Devote some portion of the remaining obligational authority to facilitate adjustment of yards and workers. The residual should then be used to subsidize "transition-period construction" on terms calculated to provide a real competitive incentive to management and labor.

9. Do not require ship operators to utilize American-built vessels. Operators should also be permitted to have their vessels maintained and repaired abroad.

10. Exclude hovercraft from the foreign bottom provision if they are determined to be marine vessels.

11. Eliminate cargo preference either immediately or in steps of, say 10 percentage points annually.

12. Urge the Federal Maritime Commission to use its power to approve or disapprove conference agreements as a means of influencing conference rate decisions.

13. Require subsidized U.S. carriers that choose to participate in conferences to comply with Federal Maritime Commission guidelines on conference policy as the price of immunity from antitrust prosecution.

14. Continue and enforce the Bonner Act's limitations on dual rate contracts.

15. Eliminate the legal requirement of filing shipping rates 30 days in advance of their effectiveness.

16. Eliminate pooling agreements to the fullest extent practicable--there is a presumption that if they are worth the trouble to establish and discipline they are monopolistic.

17. Clarify the antitrust status of shipper associations to encourage their participation in conference rate making.

18. Avoid U.S. participation in any international organization or discussion directed toward making the conference system more effective.

II. INTRODUCTION

Transport expenditures in the United States exceed $100 billion annually. The industry consumes nearly half of our total output of energy. It employs directly more than nine million people. In addition, vast supplier industries and the service industries that maintain and regulate the vehicles, highways, airways and terminals which make up the transport complex provide substantial additional employment and claim major shares of our resources. Virtually all other industries -- manufacturing, agricultural, extractive and service industries alike -- are heavily dependent on transport. Consumers depend on transport for much of their recreation and for much of their freedom in choosing where to live. Workers depend on it not only for access to their jobs but for much of their freedom to choose between jobs. The economic health of the transport industry is, therefore, of vital concern to the U.S. Government.

Increased demand for services will confront the industry, say by 1980: a population of more than 250 million, the most mobile on earth; and a gross national product likely to exceed $1 trillion, requiring fast, economic and widespread distribution. In view of these prospects, it becomes doubly clear that we need to develop a national transport policy consistent with the circumstances and opportunities of a dynamic and highly developed industrial society.

The United States now has a massive, flexible transport system linking all parts of the nation together. That system has been built within the confines of present policy. Why, then, is a new policy needed? First, present policy is internally inconsistent -- it is not a policy but many fragments of policy. It includes inefficiencies which retard growth, impair the ability of American industry to compete abroad, and depress the standard of living at home. Its deep entanglement of governmental agencies as advocates, promoters, protectors and regulators of private interests conflict with our liberal international policies and contravenes the precepts we advance to the less developed and the non-free nations. Finally, it will save Government funds needed to achieve real social benefits but now flowing into unproductive channels.

Thus there is need for drastic revision of national transport policy; geared to contemporary realities.

A. A Look at the Past

Current policies reflect convictions that long ago became rigid. They derive from an appraisal of the transport industry as it was in the nineteenth century, and as it was believed to be in the pre-war years, not as it is now and has been for at least 25 years.

The policy of the nineteenth century had a deeper motive than simply the desire for a commercially efficient transport system. Throughout that period, the most compelling domestic need was to advance the settlement, development and unification of the vast territories of the United States. For more than one hundred years the response of our Government has been promotion of transport, with more and more regulation superimposed to protect the public against monopolistic exploitation.

No other instrument of public policy then seemed to promise as prompt, sizeable and widely diffused returns in economic development and social betterment as subsidy of transport.

Whether the resulting policies and programs, on balance, were best for the United States in the nineteenth century need not be answered here. The question of alternatives would have to be weighed. In any event, no reasonably good alternative seems to have occurred to nineteenth century leaders. For us, the more important question goes to the appropriateness of these time-honored policies to the solution of mid-twentieth century problems.

For three main reasons the answer is "no":

(1) The transport industry has been transformed by technology, growth of market, massive investments and competition. A nationwide system is in operation. In some instances there is physical redundancy. Virtually all shippers and travellers have a wide range of choice of modes, routes and destinations. The old notion that transport is a natural monopoly is no longer relevant and hence the basic rationale for direct regulation of the monopoly type is gone.

(2) The extension of the number and variety of transport alternatives makes comprehensive regulation administratively infeasible and this in turn creates serious and growing distortions between the regulated and unregulated segments of the transport industry.

(3) The problems of the nation are now vastly different. We are a highly developed country experiencing accelerated technological change. A prime requisite of further progress is flexibility in management to respond to the accelerated growth of technology. Detailed and complex regulations which serve to obstruct the promptness and effectiveness of responses to market signals are, therefore, obsolete as a means of encouraging general economic expansion or specific regional development.

B. The Transportation Message of 1962 and its Effects

Policy obsolescence was recognized by President Kennedy in his special message on transport when he said that "Federal policies must be re-shaped in the most fundamental and far reaching fashion. . . ." He emphasized urgency: "If direct and decisive action is not taken in the near future, . . . undesirable developments that confront us now will cause permanent loss of essential services or require even more difficult and costly solutions in the not-too-distant future."

The new national transport policy consisted of: (1) "reliance on unsubsidized privately owned facilities, operating under the incentives of private profit and the checks of competition to the maximum extent practicable . . .", (2) "less reliance on the restraints of regulation . . .", and (3) "users of transportation [to pay] the full cost of the services they use, whether those services are provided privately or publicly."

To make a practical beginning on policy reforms, President Kennedy listed specific recommendations for some 50 administrative and legislative actions. Legislation was for the most part embodied in three major bills promptly submitted to the 87th Congress: The Urban Mass Transportation Act of 1962 (dealing with Federal aids for public mass transit development), the Transportation Act of 1962 (dealing with rates), and H.R. 11584, and omnibus bill incorporating other major legislative recommendations. A few proposals were in bills already before the Congress or were submitted separately (e.g., in the Federal-Aid Highway Act of 1962).

Hearings begun during the latter part of the 87th Congress were continued in the 88th Congress when the major bills were reintroduced, but no further action was taken, possibly because testimony evoked such strongly hostile, though conflicting views.

In July 1964, however, Congress passed the Urban Mass Transportation Act authorizing $375 million in Federal grants-in-aid over a three-year period to assist urban areas in revitalizing and expanding public mass transport systems. The Congress has just appropriated $60 million for grants and $5 million for loans for the mass transit program.

During 1963 and 1964, Chairman Harris of the House Commerce Committee made efforts to salvage parts of the other two administration bills, but his efforts (reflected in H.R. 9903, 88th Congress, 2nd Session) have been frustrated by the intransigent opposition of the water and motor carriers, joined by certain large shippers and some local public agencies, principally port authorities.

Other legislation fared better. The investment credit provisions of the Internal Revenue Act of 1962 gave transportation companies, among others, substantial tax savings as an incentive to increase capital investments. The railroads alone have received benefits totaling several hundred million dollars already. Also in 1962, Congress increased from 5 to 7 years the period for applying prior year losses to reduce current income for tax purposes. This change, applicable to all regulated public utilities, has particularly benefitted the railroads. At the same time the Treasury Department revised its depreciation guidelines, affording transport companies, especially the railroads, substantial additional assistance through more realistic tax write-off terms for vehicles and facilities.

The Federal-Aid Highway Act of 1962 incorporated four additional Presidential proposals: (1) relocation aids for families and businesses displaced by highway construction, (2) earmarking of additional highway trust funds revenues for research and planning, (3) more extensive use of secondary funds for urban roads, and (4) tightened requirements for coordination of highway and other transport planning in urban areas.

In the time available, we have not been able to ascertain the precise extent to which recommended administrative actions have been carried out. There has been clear evidence of progress. For example, the chairmen of the regulatory agencies have been meeting regularly on common problems. The Interagency Committee on Transport Mergers developed new merger criteria and has been advising the Department of Justice on merger applications being presented to the regulatory agencies. We believe this Committee should be strengthened, its scope greatly enlarged, and its powers of initiative increased as indicated later.

In the remaining paragraphs of this introduction, we have distilled from the succeeding chapters, where issues and findings are developed in detail, a statement of objectives and an overall policy statement highlighting important assumptions and implications.

C. Transport Objectives

The principal objective of transport policy reform is economic because transport is, first of all, the servant of our commerce and industry. Its impact is made largely through other economic activities. Its duty is to carry goods and people swiftly, safely and as cheaply as the quality and variety of services demanded will permit. In fulfilling this objective well, the transport system will, under most circumstances, also make its maximum contribution to the mobility of people in their social, recreational, and other non-economic pursuits, and to the special tasks of Government, including national defense and delivery of the mail.

Thus directed, transport will also make respectable contributions toward the achievement of other national goals, both economic and non-economic. These purposes, however, should seldom be allowed to deflect the transport industry from the efficient accomplishment of its primary mission. Exceptions should be tolerated only (1) on convincing demonstration that non-transport purposes cannot be served by more direct and less costly means, and (2) when any burdens in higher transport costs or poorer services can be shown not to exceed the benefits accruing to other objectives.

D. Statement of Policy

To meet the core objective of efficiency, national transport policies should give greater freedom to the forces of the market which have shaped other industries so effectively and place less reliance on Government regulation and promotion. This is true for three main reasons:

(1) As already stated, transport is now sufficiently competitive to protect the public interest without detailed regulation.

(2) Even if the inconsistencies of present policies should be removed by increasing the scope of regulation, it is administratively infeasible to regulate many thousands of firms operating under widely differing and rapidly changing circumstances.

(3) The next step forward is to simplify, rationalize, and largely liquidate direct intervention and substitute a few overall policies in place of the growing mesh of detailed and direct ones. Detailed Government intervention in transport grew up during a period in which the railroads, in particular, were expected to act as spearheads in developing our economy, its regions and industries. Now that our economic welfare no longer depends on one means of transport, our complex transport system will best serve the Great Society if it operates generally with highest attainable efficiency. Government influence on it, therefore, is most fittingly exercised by general and pervasive policies rather than administrative and regulatory interference with individual business decisions.

The transport system that develops under this policy will have strength and flexibility. Successful enterprises will be cost- and service-conscious. Profits will depend on management ingenuity and customer satisfaction rather than on the props of public subsidy and regulation. Jobs will be secure and rewarding as they cannot be in inefficient and declining industries.

E. Underlying Assumptions

Three assumptions underlying the basic policies and specific actions recommended in this report must be emphasized: (1) The reformulation of Government policy and consequent changes in Government programs and in the transport industry itself, cannot be accomplished overnight. Changes must be staged; they will be evolutionary. Some will generate relatively minor dislocations and can be initiated promptly; others must be carefully planned, introduced gradually or postponed, and may require transitional public aids. (2) The specifics of this new transport policy are integral parts of a program to which only total commitment can assure success. For example, relaxation of public restraints on mergers can be accepted only if preponderant weight is given public interest criteria in evaluating merger proposals and if parallel and progressive relaxation of public regulation -- particularly of entry, operating rights and rates -- is vigorously supported. Similarly, the retrenchment of rate regulation recommended here cannot be vigorously endorsed unless new attitudes and standards on mergers are adopted. (3) Transport policy must be the dynamic response of Government to the constantly changing conditions in the transport industry and in the whole economy. Policy is not made "once and for all," but demands continuing review as policy changes take effect and as new problems arise, demanding new or revised policies and programs. A permanent organization for continuous policy formulation and revision should be built up in the Office of the Under Secretary of Commerce for Transportation. It can at any time become a core element in a Department of Transportation which this report earnestly recommends.

The members of the transportation task force are impressed by several statements made by President Kennedy concerning the future. "No simple

Federal solution," he said, "can end the problems of any particular company or mode of transportation . . . no just and comprehensive set of goals . . . can be quickly or easily reached . . . research and analysis, going far beyond our present findings, will be required before we know enough about the costs and other characteristics of various forms of transportation to guarantee the achievement of these objectives in full."

In this spirit, we have reviewed the principles of the 1962 Message and we endorse them. We have also reviewed all of its major recommendations. Our findings and conclusions are stated in the following chapters of this report.

III. INVESTMENT POLICY

A. General Considerations

The appropriate policy goal for public transport investment is a "transport plant" that will perform economically all socially needed transport services. It is a long jump, however, from a statement of this goal to its implementation.

Among other difficulties is that of determining how much transport investment should be undertaken in the public and how much in the private sector. A distinction must be made between the procedures by which optimum investment is likely to be achieved in each of the two sectors. Private transport companies are subject to very different conditions when making investment decisions from those faced by public authorities or governmental agencies. The most fundamental difference is that private companies must normally meet more stringent financial and profit tests than Government. While considerations of economic efficiency should not be absent from Government decisions, it seems highly probable, and quite properly in many instances, that efficiency will play a less critical role in public than in private evaluations.

Public investments in transport development are enormous. Including expenditures on development of military standby capacity, they are estimated to be $7 billion annually, possibly more. Even without the military expenditures, they come close to $6 billion per year.

Obviously, Government is a major decision maker in U.S. transport investment. The direction of Government investment expenditures can shape the development of the U.S. transport system in crucial ways.

If not made with care, these expenditures can defeat objectives sought by other Government programs and policies. Inadequately conceived or poorly executed, they can weaken or even prevent the healthy development of a transport system suited to the nation's growing needs.

Public investment in transport should be made primarily on the basis of a showing that the benefits to the United States exceed the investment costs. There are, however, several problems in making these calculations. First, there are indirect, secondary or diffused benefits from investment in transport, such as contributions to economic growth, national unity, safety, defense, etc. These are often intangible and always hard to quantify. Their definition depends on the point of view. In a nation well provided with transport, these benefits can easily be overstated and usually are,by those advocating the particular expenditures.

Second, expansion of some federally supported transport investments may also entail social costs which must be deducted from benefits. For example, the undesirability of being "across the tracks" may now be matched by "near the expressway or the airport." Transport investment may dislocate families and cause other disruptions which must be counted against expected benefits.

Third, most relevant benefits and some relevant costs accrue only in the future and must,therefore,be discounted for proper comparison with costs and benefits arising immediately and, equally important, for comparison with alternative uses of the same funds. This involves the difficult problem of selecting an appropriate rate of discount. Often the present value of future benefits is exaggerated by the use of too low a rate.

Most transport benefits derive directly from the economic advantages accruing to or through the direct users of transport. Consequently estimated revenues from the prices charged or chargeable to individual users are the best general measures of benefits.

In some instances, however, transport investment may be justified by social benefits in the form of reduced unemployment or redistribution of income. These are best evaluated by a full systems analysis, i.e., an analysis comprehending all direct and indirect benefits as well as alternative means of achieving them. In general, evaluation procedures for transport, as well as other Government investments, should move toward greater reliance on this approach and less upon calculations restricted to particular projects.

At present, there is no comprehensive review or comparative evaluation of Federal investment programs in transportation. Each program agency formulates expenditure plans in terms of the needs of the mode or area for which it has responsibility. Its plans reflect the desires of its industry clientele, previous year appropriations, and budget targets established in reference to the agency's overall program. Although these plans are analyzed, agency by agency, by the Bureau of the Budget, there is no effective process of inter-program comparison and evaluation. How do we know that Federal expenditures of $3 billion on highways, $750 million on the merchant marine, $300 million on the inland waterways, $780 million on the airways are equally well spent? Does the last dollar or the 1 billionth dollar spent on highways produce as much benefit as the last of the $780 million spent on the airways? We do not know. And even if all are worthy, we do not know what priorities should be established to use best the limited funds available for public investment in transport.

B. Special Investment Problems

A number of specialized problems arise in this area because of the extreme diversity of transport investment and the great variety of investors, public and private, who are expected to carry out national investment programs.

(1) The largest Federal transport investment is made in the Interstate Highway System. The present program for the Interstate System, involving investments until 1972, entails the completion of an articulated structure of highways which had already been planned, except for relatively minor details, before any construction or financing were undertaken. Post-1972 highway needs provide an opportunity to avoid certain weaknesses of the present program, as well as to shift the emphasis away from basic structure toward refinements and improvements. The standards of the present program have been too inflexible, especially in sparsely-settled areas, for a "first round" program. This defect may be alleviated by the growth of future traffic with respect to highways now existing or planned, but should not be repeated in a new program. Conversely, there is a need for more attention to the existence of bottlenecks--especially in urban and suburban areas where growth is expected to be rapid--and for careful attention to the relative costs and timing of programs to eliminate them.

(2) This last observation has specific relevance for the Highway Trust Fund. We believe that this Fund should be continued, in spite of the forceful arguments which can be made against earmarking of revenues. Our argument for earmarking, in the form of the Highway Fund, is that this device underscores the fact that so-called taxes whose proceeds are used to maintain and improve the highway system are, in fact, prices charged to users of highway service and not sources of support for general Government

expenditures. But we are aware of the danger that ever-larger receipts of the Highway Trust Fund might be devoted automatically to highway construction even when other uses should have higher public priority. Therefore we support the idea of a Highway Fund only as an interim method of financing the Federal contribution to highway investment. Moreover, we do not believe that the payment of the costs of highways should, in and of itself, absolve motor vehicle owners from contributions to the cost of related or general government activities.

(3) Toll roads present a special problem within the general highway classification. Most toll roads were built, or at least financed, before construction of the Interstate System was well under way. For the time being at least, toll roads seem to be more interesting as a historical survival than as a popular method of financing new highway construction. Indeed, it can be argued that holders of toll road bonds have already made their bargains and should receive their interest, or take their losses, without recourse to the Federal Government.

But this conclusion does not take account of a number of complications: (a) The least successful toll road in the United States, the West Virginia Turnpike, cuts through the heart of Appalachia. As long as the Turnpike continues to earn less than its debt service, prudent management must try to set tolls with the sole objective of minimizing losses, even at the expense of maximum utilization of the highway. This is obviously inconsistent with the President's Program for Appalachia. (b) Where toll roads are successful, this very success may indicate a volume of traffic in need of additional facilities. Presumably these facilities would often be provided free as part of the Interstate System. The expenditures that would maximize the usefulness of the System, therefore, might also jeopardize the earning capacity of existing toll roads. (c) In a few instances, toll revenues have been far more than adequate to service bond issues. Toll roads which yield such returns are in effect earning monopoly profits. (d) In States that built toll roads in advance of the Interstate System, users are now effectively paying twice: in tolls, and by payments of Federal excise taxes toward the support of the Highway Trust Fund and hence, eventually, toward defraying the costs of the Interstate System.

(4) Although we have expressed our opposition to the inclusion of intangible, generalized benefits in analyses of the value of transport investments, we believe that exceptions do exist. For example, in evaluating such major projects as the highway program for Appalachia, transport analysis must be extended to recognize that the dominant purpose of the whole program, including its highway component, is a direct attack on chronic regional poverty. Therefore the deliberate intention is to provide transport facilities which are beyond the financial capacity or immediate traffic needs of the region. Transport expenditures may be warranted in such circumstances if alternative expenditures have been analyzed and found to be more costly relative to anticipated results.

(5) We have already noted that we do not believe in the doctrine, appropriate to a sparsely-populated pioneering society, that transport improvements necessarily bring net indirect advantages. In particular, in a country as crowded, and as prosperous, as ours, the Federal Government should be willing to find at least some funds for protecting social and aesthetic values from the destruction which may result from least-cost transport investment. Even moderately more costly alternatives without deleterious side effects should be carefully considered in preference to less expensive

construction. Non-economic values cannot be quantified in this instance; but they should not, on that account, be ignored.

(6) Passing from highways to rails, the most urgent immediate investment problem involves the future of all rail passenger transport in the Northeast Corridor. We believe that a satisfactory solution to this problem, with its attendant effects on needs for highway and airport facilities in the area, may require new forms of operation and even of ownership. These might include: (a) leasing of the appropriate facilities to one or more private operators, not excluding the railroad companies now owning and operating the properties; (b) an interstate authority or authorities; (c) direct Federal operation. Moreover, with reference to existing rights-of-way and other permanent facilities, Government acquisition for conversion to non-railroad uses should be encouraged in many cases.

(7) With respect to airways, present user charges do not serve as a measure of the desirability of the service. Both commercial and general aviation provide benefits mainly to those at the upper end of the income scale. Often both are exceptionally wasteful of investment funds, as well as destructive of the peace and quiet of the public. New investment is a close substitute for many operating expenditures in airways and even in airports. So the airways subsidy problem cannot be examined solely in terms of investment. Users of airways should be permitted to have a voice in the level of facilities provided and maintained, but only to the extent that they are willing to pay for them.

(8) The major investment problem on the waterways derives from a combination of massive over-investment on improving river channels and under-investment, or misallocated investment, in certain major ports.

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contrast between billion-dollar river projects to provide navigation benefits to sparsely-settled areas, on the one hand, and the forlorn and archaic appearance of many basic port facilities, on the other, is indeed striking. Technical obsolescence of many port facilities repels traffic, drying up sources of funds for improvement. The dual objective of a Federal program should be increased efficiency of ports and reduced terminal costs for the waterborne commerce of the United States. These goals are hard to achieve under present conditions because the problem of funds has been vastly complicated by the fragmentation of responsibility among local authorities, the States, various Federal agencies, and private interests.

Recommendations

1. Establish a Federal Transport Investment Review Board, to coordinate the Federal transport investment budget and long-run transport investment planning; to eliminate inconsistencies in the methods now employed to determine the extent and distribution of transport investment; and to provide a means of efficiently adjusting transport investment to economy-wide objectives of reducing unemployment or redistributing income.

2. Instruct the Secretary of Commerce to participate in any study of post-1972 highway needs with a view to assuring implementation of the criteria of (a) least-cost elimination of bottlenecks; (b) possible shrinkage in total size in view of the prior completion of the basic structure of the Interstate Highway System; (c) greater flexibility, in terms particularly of avoiding the application of the most advanced principles of high-volume design to light-density routes in sparsely-settled areas, as well as the application of excessive geometric design standards in urban areas, especially where impairment or destruction of neighborhoods or esthetic values would otherwise result.

3. Continue the Highway Trust Fund, but be alert to the prospect that a combination of increasing revenues and reduced benefits derivable from continuing highway investments may make possible a diversion of some of the Fund's resources as at least part payment for the indirect costs thrust upon governments by the existence and use of the Interstate System. Furthermore, because of the close connection between the use of highways and the use of recreational facilities, some of the Highway Trust Fund should be diverted immediately to the new Federal fund for the development of outdoor recreational facilities. The task force would suggest that this diversion be at least 1 percent immediately, and rise to 5 percent or more within five years' time.

4. Place interstate toll roads on an economic and financial parity with those portions of the Interstate System now financed by the Highway Trust Fund. This could be achieved immediately by Federal purchase of all existing toll roads. In any event, money in the Highway Trust Fund should be used to purchase toll roads whenever needed additional free highway capacity could be provided less expensively in this manner than by new construction. Also, the Federal Government could offer to purchase toll roads whenever it appeared that efficiency in the use of existing highways or in the allocation of new highway investments was suffering from the need to protect bondholders.

5. Make an exception to the criteria of summing benefits to individual private users in cases where transport investment is an indispensable tool for changing the whole face of the economy, as in Appalachia. But carefully restrict these exceptions--to exclude, in particular, such investments in high-income areas as those that may be contemplated for the Northeast Corridor Project.

6. Instruct the Department of Commerce to examine the appropriateness of present forms of transport ownership and control in cases where the transport investment problem may be complicated by organizational weaknesses or fragmentation and overlapping of responsibilities. For example, some form of public ownership or operation may prove to be essential, along with public investment, in case it should be decided to make a public commitment to the Northeast Corridor Project; moreover, the economic problems of some of our ports may prove to be insoluble unless lines of authority are more clearly drawn and more closely related to over-all investment responsibilities.

7. Begin immediately to relate investment in the Federal airways to revenues that can be obtained from user charges.

8. Give greater attention to the rehabilitation and improvement of major ports. Some of the funds now devoted to additions to the inland waterways could profitably be diverted to this objective.

IV. RATE POLICY

A. General Considerations

Rate regulation stands at the very heart of relationships between different modes of transport, crucially affecting the division of traffic between modes and thereby the overall efficiency of the transport system. An eventual goal of public transport policy should be the elimination of most or even all minimum rate regulation and the use of market forces rather than regulation to establish most transport charges. Certain practical economic, social and political problems, however, preclude the early achievement of this objective or hasty movements in its direction.

The problems that have been built into the transport system cannot be solved at one stroke. Even their gradual solution, step by step, will not be possible without painful disruptions, both inside and outside the transport industry. Wherever long-prevailing regulation has built up a rate structure substantially different from free market rates, industrial location patterns are likely to have developed which would be seriously disrupted by an abrupt change in rate policy. Moreover, some rate regulation can be used to protect carriers with "inherent advantages" from short-run rate cutting of less efficient carriers. In each situation the short-run interests of consumers and shippers must be balanced against the longer-term interests of consumers and the more efficient carriers.

We state, therefore, a price policy toward which the Federal Government should strive as an ultimate goal. Practical problems prohibit the immediate achievement of this goal but, at the least, public action should move in the proposed direction.

B. Freight Rates

We believe it possible to begin now a program of legislative reform that by successive steps will approach the long-run goal of greater reliance on competitive forces to determine transport rates. "Value of service" rates based on the value of the commodity are obsolete now that the effective ceiling on rail value of service is established by the costs of moving goods by road and inland waterway, and especially by private and unregulated truck. This is particularly true in respect to large differences in rates between commodities. Rates imposed on some commodities return revenues much higher than costs in order to permit the transport of others at rates much below costs. This is largely outmoded in an economy that has achieved ubiquity of transport service and a high level of diversification in both geographic and product sense. Accordingly, we should reorient our national transport policy toward the elimination of rates based on the value of commodities, moving toward rates more closely related to the costs of efficient transport.

The task force also finds that legislative and regulatory change is badly needed to improve equipment utilization, particularly in rail transport. At the present time freight car utilization (movement) averages well below three hours a day. Yet crippling freight car shortages are faced by many regions of the country during parts of the year. We believe this is partly the result of the system of individual carrier ownership of freight cars which does not provide incentive for investment in new equipment. Often cars are off owners' lines for many months. The supply of rolling stock is not a function that necessitates regulatory controls, and consequently payment for the use of rolling stock does not need to be included in regulated rates. Neither the demand nor the supply side of the market for rolling stock exhibits public utility characteristics. Moreover, the present system, whereby shippers who provide their own freight cars are required to pay regular tariff charges based on the commodity or commodities being shipped, and then in return are paid mileage allowances by the carriers, is unnecessarily cumbersome and discourages shippers from the use of specialized equipment appropriate to their needs.

Before making and explaining specific recommendations, we wish to emphasize that we would for the present make no changes in Sections 2 and 3 of the Interstate Commerce Act, or in similar provisions of Parts II, III and IV of the Act, which afford protection against personal and place discrimination.

Recommendations

1. Eliminate the authority of the Interstate Commerce Commission to regulate minimum rates of all carriers under its jurisdiction. This freedom should be achieved gradually--for example it might be subject to the proviso that during the first five years, the Commission may, upon protest in specific cases, limit reductions to a cumulative amount of 15 percent per year of any rate in effect on January 1, 1965. In this case, immunity from regulatory review would apply to actions reducing rates to not less than 85 percent of base rates in the first year, not less than 70 percent of base rates in the second year, not less than 55 percent in the third, etc. Rates reduced by this means, i.e., without regulatory review, should not be permitted to be increased under any circumstances for two years and thereafter only if, following an Interstate Commerce Commission hearing, it is found that proposed increases rest upon changed conditions other than the elimination of competition from other modes. These limitations on rate increases amount, in effect, to an extension of the present limitations on railroad rate setting in water-competitive situations contained in paragraph (2) Section 4 of the Interstate Commerce Act.

2. Repeal paragraph (1) Section 4 (the "long haul, short haul" provision) of the Interstate Commerce Act. This provision was designed to protect intermediate points without competitive services from higher rates than are enjoyed by more distant points having transport alternatives.

3. Eliminate the "rule of three" and any similar limitation on the number of bulk commodities that may be transported on the waterways in a single tow without loss of the exemption. (A mix of not more than three exempt commodities per tow now enjoys the exemption.)

4. Repeal the provision limiting the bulk exemption to commodities handled by water carriers on June 1, 1939.

5. Establish, under the chairmanship of the proposed Department of Transportation, an interagency committee to formulate executive branch positions for presentation to the regulatory agencies in important rate cases as well as to formulate and present executive branch positions on other important regulatory issues.

6. Amend the Interstate Commerce Act to eliminate the requirements in Parts I, II, III, and IV that carriers maintain rates based on "reasonable classifications". This will make unnecessary the introduction of evidence in rate cases pertaining to the value of the commodity as a justification of rates above appropriate costs. It will also foster so-called "FAK" or freight-all-kinds rates, a major achievement in rate simplification.

7. Amend the Interstate Commerce Act to require rail and road carriers to accept shipper-owned or -leased equipment for transport. Moreover, the law should permit shippers to lease equipment among themselves and to and from car-leasing companies freely and without regulation of leasing terms. Rates charged for hauling shipper-owned or leased freight cars or trailers should be commensurate to the service being provided and should not take account of the nature of the commodities being hauled. Plan IV TOFC already provides a precedent for rates of this kind.

8. Instruct the Department of Commerce to initiate proceedings before the Interstate Commerce Commission to eliminate from TOFC tariffs, either specifically or by reference, the requirement that Plans III and IV TOFC rates be applied only on mixed loads. This is to permit the application of Plans III and IV to trailers and containers regardless of contents.

9. Amend the Interstate Commerce and Federal Aviation Acts to provide that in rate cases where the complainant is a carrier, the burden of proof as to the reasonableness of the rate shall be on the complaining carrier. In the past, the burden of proof has been imposed on those proposing changes in rates. This has enabled competing carriers to impede rate changes unnecessarily.

10. Amend the Interstate Commerce and Federal Aviation Acts to deny carriers the right to request suspension of proposed rates. Carriers did not have this right before 1940; since then the overwhelming majority of suspensions have been instigated by competing carriers opposing rate reductions. Suspension proceedings are costly and inordinately time-consuming. Thus, suspension procedure works in most cases to the disadvantage of shippers. The right of shippers to request suspension would remain unimpaired.

C. Passenger Rates

During the past 70 years, the travelling public has shifted from virtually complete dependence on railroad trains to almost equally complete dependence on the privately-owned automobile for intercity transport. About 95 percent of intercity trips were made by train in the late 19th century; about 90 percent are now made by automobile. Barring an important change in the variety of means of transport available, the public seems likely to continue to move predominantly by automobile in the foreseeable future. Consequently, intercity public passenger transport no longer has important problems of monopoly, and increasing reliance can safely be placed upon the price system in allocating resources.

(1) Railroads - The long decline in rail passenger volume, together with rising costs and the difficulty of dropping passenger trains, involved the railroads in their greatest single source of losses. The passenger deficit reached a peak of $723,670,000 in 1957 and regularly throughout the postwar period absorbed between 35 and 49 percent of net railway operating income from freight. The Transportation Act of 1958 has facilitated, though perhaps not sufficiently, the discontinuance of passenger trains.

Recommendation

Amend the Interstate Commerce Act to give the railroads complete freedom in setting intercity passenger fares. We urge that the States be encouraged to follow suit. It cannot be argued that maximum rate regulation protects the public from excessive fares, nor can it be argued that minimum rate regulation assures profitability of intercity passenger service to the carriers under modern competitive conditions.

(2) Busses - Among intercity common carriers, bus service seems assured the dominant role in surface passenger transport for the foreseeable future. Even though many States have granted motor carriers

of passengers exclusive rights on certain routes, and even though there are only two major national bus networks, there are so many alternatives to bus service that the industry presents no serious problems of monopoly. In addition, this is not an industry of heavy fixed costs or the other usual characteristics of technological monopoly.

Recommendation

Amend the Interstate Commerce Act to allow management complete freedom in setting intercity bus passenger fares.

(3) Airlines - Air transport is characterized by exceptionally dynamic growth and does not involve the large geographically fixed investments of the railroads. Consequently, the task force does not see need for continued rate regulation, except for the carriers still receiving subsidy.

Recommendations

1. Amend the Federal Aviation Act to eliminate rate regulation of all unsubsidized domestic air passenger transport.

2. Urge the Civil Aeronautics Board to encourage the setting of rates for subsidized air transport at the highest level compatible with maximizing carrier net revenue.

V. USER CHARGES AND DIRECT SUBSIDY POLICY

A. General Considerations

If economic demand for transport is to be the primary guide for transport decision making, in the public as well as the private sector, users of transport facilities should be required to pay for them in amounts commensurate with the costs incurred in their provision and use. The presence of subsidies (whether direct or in the form of user charges below Government costs) favors some carriers and regions at the expense of others, and results in higher than necessary total cost for the provision of transport service. Subsidy and user charge policies, therefore, should be designed to bring private outlays and total costs of transport closer together.

B. Problems of Implementation

In moving toward a more nearly pervasive equivalence of private outlays and social costs, we must recognize that part of past public transport investment was not based on this test, part was designed to produce benefits beyond the realm of transportation, and part has become obsolete as a result of economic and technical change. In many situations, therefore, the assignment of costs to current users is inherently arbitrary. Charges to be assessed against users of these facilities should at least fully reflect the costs of current operation and maintenance. Future public investments in transport facilities should be predicated on eventual full recapture of capital costs as well as maintenance and operating costs.

The imposition of user charges for the first time, an increase in existing user charges, or a reduction in special benefits to particular modes of transport or categories of users may well result in hardship. To facilitate adjustment, it may be desirable to raise user charges (or reduce special benefits) to appropriate levels over a period not exceeding five years.

C. Airways

Enough work has been done on estimating amounts that may fairly be charged special beneficiaries of investments in aviation facilities to start on a comprehensive program to equate private outlays and social costs. User charges can be imposed where none now exist, and existing charges can be moderately increased without fear of doing injustice. As charges are further increased and revenues approach full recoupment, more precise determinations will be required both as to appropriate total charges and as to division of charges among categories of users. The following recommendations reflect this situation.

Recommendations

1. Instruct the Department of Commerce with the assistance of the Federal Aviation Agency, the Civil Aeronautics Board, the Treasury, and the Bureau of the Budget to continue efforts to quantify benefits received by various categories of users of aviation facilities, to explore alternative collection techniques and to devote more research to incremental costs incurred on behalf of certain users who create peak traffic.

2. Renew recommendations to the Congress for airway user charges. As a beginning, the 2 cents per gallon tax on aviation gasoline should be extended to jet fuels for commercial aviation and the 5 percent tax on passenger travel by air should be continued and extended to air freight. Business and recreational flying (general aviation) pays only the 2 cents per gallon gasoline tax and thus pays only a minuscule portion of its share of system costs. Initially, the gasoline tax for general aviation should be increased to 10 cents a gallon and extended to jet fuels and supplemented by annual license fees averaging $1,000 per aircraft (varying with weight).

3. Create an Airways Trust Fund with provisions for ultimate linking of user charge revenues and new Federal expenditures on additions and improvements to the Federal airways similar to the Byrd Amendment in the highway program. Transfer existing aviation gasoline taxes to this fund from the Highway Trust Fund. We do not believe that this earmarking of Federal revenue is a sound long-run device but as an expedient for bringing public expenditures in this area into an appropriate relationship to benefits received it should be adopted.

D. Airports

Since World War II, the Federal Government has made substantial grants-in-aid to localties for the construction of airports in order to develop a national airport system. Further extensions of this system now redound almost exclusively to the benefit of local communities and should be financed by them. General aviation airports which in the past have also been federally supported are not, in our view, sufficiently beneficial to the general public to warrant Federal aid.

Recommendations

1. Terminate the Federal Aid Airport program.

2. Urge greater cooperation between the Civil Aeronautics Board and the Federal Aviation Agency in relating changes in commercial aviation operations, especially of the subsidized local service carriers, to the development of airports and related airways system improvements. Policy can only be fully implemented by the creation of a Department of Transportation and the transfer of the operating subsidy program (until it has been phased out) from the Civil Aeronautics Board to this Department as the 1961 reorganization did with respect to maritime subsidies.

E. Airline Operating Subsidies

An efficient and dynamic local air transportation system responsive to public and private demand, requires a progressive reduction of Federal operating subsidies. We believe that the 50 percent reduction in operating subsidies envisioned by the CAB in its 1963 report, "Airline Subsidy Reduction Program" can be substantially bettered.

Recommendations

1. Terminate subsidies for helicopter operations. The benefits of this long-continued experiment are largely confined to upper income travellers well able to pay the full costs of such services.

2. Urge the Board to continue the evolutionary development of its Class Rate Plan for subsidies to local service airlines so as to relate subsidies more closely to actual deficit segments, and to develop similar plans for Alaska and Hawaii subsidized operations. The Board should also be urged to enforce its use-it-or-lose-it policy and to revise use-it-or-lose-it standards progressively so that deficit operations will be eventually eliminated unless benefitting localities are willing to make up the deficits.

F. Waterways

Sufficiently detailed information is also available to initiate waterways user charges. A beginning should be made by imposing a small tax on all fuel used on the waterways. This will not materially affect users and will not recoup more than a fraction of system operating and maintenance costs.

New waterways investments, however, should be allowed to go forward only if full incremental costs can be recovered.

Recommendations

1. Levy an initial tax of 2 cents per gallon on all fuel used on the inland waterways.

2. Instruct the Department of Commerce to update and elaborate its studies of inland waterway costs and revenues and to develop a more nearly compensatory schedule of charges.

3. Create a Waterways Trust Fund with provisions for ultimate linking of user charge revenues and new Federal expenditures on additions and improvements to the inland waterways system similar to the Byrd Amendment in the highway program. (See further comments concerning the Airways Trust Fund above.)

G. Highways

Highway users in the aggregate come closer to reimbursing the Federal Government for its initial facilities investment than do either airway or waterway users. Particular categories of highway users, however, clearly do not pay an equitable share of Federal-aid highway expenditures. Many peak-hour users of urban streets and highways pay substantially less than a fair share of the costs incurred on their behalf. Nevertheless, urban highway users in general are subsidizing the construction of Federal-aid roads in rural areas.

Another category of users not paying its full share of costs is intercity trucks operating on diesel fuel, taxed only 4 cents per gallon. Increased user charges to this category should be obtained in connection with any increase in size and weight limits or permission to operate multiple bottoms of the Interstate System. These changes will yield public benefits through fuller utilization of the capacity of the Interstate System.

Recommendations

1. Recommend increases (a) in the tax on diesel fuel from 4 to 7 cents per gallon, (b) in the weight tax on trucks over 26,000 pounds gross weight by an additional $2 per thousand pounds, and (c) on tread rubber by an additional 5 cents per pound. This will restructure highway user charges in the direction of equity, but it will not produce revenues adequate to meet expected increases in the cost of completing the Interstate System.

2. Instruct the Department of Commerce to continue its studies of accelerated highway wear likely to result from liberalized truck size and weight limits and to recommend any necessary further adjustments in user charges on heavy trucks by December 31, 1965.

3. Instruct the Secretary of Commerce to assure, by participating in any study of highway needs for the period beyond 1972, a proper relationship between costs and user charges.

4. Instruct the Department of Commerce to explore the possibilities of developing schedules of differential user charges to control peak traffic loads (congestion).

VI. GOVERNMENT PURCHASE OF TRANSPORTATION

Carriers of all modes vie with each other for the transport business of the United States Government. Rivalry has increased in pace with the expansion of Government activities, especially since World War II. Inevitably, pressures have developed in the carriers' efforts to retain a "fair share" of the Government's business or to increase it. The argument has been made repeatedly that each mode, and in some instances each carrier, is entitled to a share of the Government's business for the same reasons advanced in defense of public subsidies: to keep the carriers strong during peacetime so that they can be of maximum service to the nation in times of national emergency; to assure facilities and services adequate to the requirements of the Postal Service; to build national prestige, or to make a contribution toward balancing our international accounts.

These arguments, in extreme form, are a distorted interpretation of the national transport policy expressed in almost identical terms in all basic transport legislation. For example, the statement of National Transportation Policy in the Interstate Commerce Act directs regulation "all to the end of developing, coordinating, and preserving a national transportation system . . . adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense." Obviously the intent of the law is that the national transport system meet the needs of the Postal Service and of the national defense, not that the use of transport by the Postal Service and the national defense be modified in order to support the transport system or any of its elements.

Our present national transport system has ample capacity to meet the changing needs of commerce, the Postal Service and national defense, with possible minor and transitional exceptions. The Task Force does not subscribe to the argument that the needs of the two governmental activities require the allocation of the Government's transport business in a manner designed to foster the industry.

The United States Government is the largest user of the nation's transport facilities. More than $4 billion is expended annually to transport goods and people on Government account. The Department of Defense alone spends $2 billion annually on transport; the Post Office Department, more than $700 million and the Department of Agriculture, $350 million. As in the case of Government expenditures generally, maximum shares of the revenues stemming from them are looked upon by transportation companies and their organized employees, and by counterpart Government program agencies, as being of critical importance to their economic well-being. This, in no small measure, accounts for the distortion of the statutory statements of purpose.

The important effect has been that the Government, over a long period of time and increasingly, has paid more for transport services. Moreover, many of the services obtained have been of lower quality (and some of higher than needed quality) in terms of speed, frequency of schedules, alternative routings, protection of goods, and ancillary services than would have been the case if the Government had directed its transport procurement to the lowest cost adequate service available.

Finally, in a discussion of Government procurement something needs to be said about the controversial provision of the Interstate Commerce Act (Section 22) under which the United States Government obtains transportation of its personnel and property at rates below those published by the carriers for non-Government traffic and without regulatory proceedings. The Task Force believes that the arguments advanced against this provision do not have sufficient merit to justify a policy change, either in the present context or in the context of the policies recommended elsewhere in this report. One important argument in favor of retaining Section 22 is the freedom which it gives to the carriers and the Government to experiment with rates, services, documentation and related practices.

Recommendations

1. Direct all Government agencies to procure transport at the lowest cost compatible with adequate service.

2. Resist efforts to make any major change in Section 22 of the Interstate Commerce Act.

VII. MERGER POLICY

A. General Considerations

Regulation of mergers should be consistent with the general objectives of transport policy and must, therefore, be considered in that broader context.

We have noted the massive growth of our transport system, the development of new modes and improved methods, and consequent lessened need to use transport as a device for promotion of economic growth and other national objectives. In the future, merger policy should give greater recognition to these changed conditions, and it should also be adjusted to reflect the changes in rate policy and in policy dealing with entry and operating rights recommended previously in this report.

B. Railroads

Public policy questions raised by rail merger proposals are complex. Giving public policy a cast of leniency toward rail mergers might step up the pace of modernization and ease the burden of uneconomic public service obligations still carried by the railroads. Clearly, however, merger must not be evaluated only on the basis of the financial strengths and weaknesses of merger candidates or on possible improvements that would follow merger. Merger will do nothing for areas served by carriers not attractive to merger partners. Moreover, under present circumstances, the benefits produced by mergers through the elimination of duplicative main lines and other redundant facilities and services may not be passed on to the general public because much of the increased cash flow may simply be withdrawn to pay fixed charges and retire debt--debt no longer reflecting earning power and often little more than a legal and financial encumbrance. In the absence of a close correlation between debt and the economic viability of underlying "assets", the maintenance of this debt via mergers--or by any other means--is contrary to the public interest. Reorganization may be preferable to mergers of weak carriers designed primarily to protect security holders, management and labor.

Alternatives to more lenient merger policy should also be considered. They include giving the railroads greater freedom to discontinue service and abandon lines. This would tend to preserve whatever intra-modal main line competition may exist.

The recommendations made below and elsewhere in this report are designed to bring about conditions more favorable to modernization and cost reduction which will benefit both the railroads and their users.

Recommendations

1. Enlarge the authority of the Interagency Committee on Transport Mergers. This should permit the Committee to develop and present before the regulatories alternatives to mergers proposed by the carriers and to evaluate and suggest alternatives to merger.

2. Endorse railroad mergers when merger appears to be the best means of achieving improvements or disinvestment.

3. Revise Section 20b, Part I, of the Interstate Commerce Act to give greater influence to equity and other junior security holders in bringing about reorganization.

4. Revise Section 5(2)(c) of the Interstate Commerce Act to provide that in evaluating any proposed merger the Commission must give dominant weight to the effect of the merger upon adequate transport service to the public, with special reference to the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed merger. The Commission should also be required to consider the interest of the carrier employees affected.

5. Revise Section 5(2)(f) of Part I of the Interstate Commerce Act which now requires that employees of merged carriers not be put in "a worse position with respect to employment" for a period of 4 years after merger. Alternatives to the fixed time period, such as liberalized severance pay, special retraining programs and compulsory retirement should be explored. Care should be taken to make these programs consistent with similar programs being undertaken to meet similar problems elsewhere in the economy.

C. Trucking

Merger in the trucking industry does not constitute a critical problem. The industry characteristics are such that mergers are unlikely to present problems of monopoly. In any case the trend towards mergers of a decade ago has slowed because of the limited opportunities for improving efficiency of trucking by enlarging the firm. If the recommendations for freedom of entry and greater freedom of rate making are adopted, it should not be necessary to place any special restrictions on truck mergers.

D. Air Transportation

The task force believes that the number of air carriers providing domestic trunk line service is not excessive and that the number should not be reduced by merger. For the time being improvements in the route structure of the carriers should take place mainly through certification and decertification procedures rather than through mergers.

E. Intermodal Mergers and Acquisitions

In the present context of Government regulation of common carriers, the task force considers intermodal mergers to be generally contrary to the public interest. We believe this to be true because such mergers would tend to fortify any tendency to monopoly that may inhere in a more relaxed policy toward intra-modal mergers, and also because they would tend to make the regulatory process more complex and burdensome. Some of the advantages of transport integration for users might also be achieved without intermodal mergers by encouraging the concentration of non-transport functions in the hands of freight forwarders.

We also believe that carriers should be permitted to enter non-transport activities. This open door policy seems especially desirable to the extent that particular transport sectors, such as the railroads, face a problem of disinvestment in connection with presently redundant transport facilities.

Once entry controls and minimum price regulation have been eliminated, our objections to intermodal mergers would no longer be pertinent. If anyone in the United States can enter the common-carrier trucking industry, subject only to appropriate standards of safety and public liability, it would seem illogical and contrary to the goals of flexibility and experimentation which are stressed throughout this report to forbid railroads to operate trucks.

Recommendations

1. Continue the policy of preventing all intermodal mergers.

2. Once minimum rate and entry control are removed, amend Section 5, Part I, of the Interstate Commerce Act to remove all restrictions on intermodal mergers. This removal should be accompanied by repeal of Section 5a of the Interstate Commerce Act (Reed-Bulwinkle Act) which grants carrier rate associations immunity from antitrust prosecution for collusive rate making. Transport mergers should also be subjected to the full sanctions of the Clayton Act.

3. Exempt all freight forwarder activities from regulation.

VIII. OPERATING RIGHTS

A. Entry and Exit in Surface Transport

The present restrictions on operating rights are largely the result of public regulation of other aspects of transport. These restrictions have been heavily influenced by the historical problems of the railroads. There is little chance that new rail carriers will appear. Entry, in any event, is restricted not so much by regulation as by the economics of the industry itself. In trucking, and inland and coastal waterway operations, on the other hand, entry is severely inhibited by regulation rather than by the economic characteristics of the industries themselves. Economically there is no limitation on the mobility of capital from one route or service to another in motor and water transport. It is the institution of the certificate of public convenience and necessity which serves effectively to prevent such mobility.

In particular, restriction of entry has been a consequence of rate regulation. Rates held high, across the board or for specific commodities or routes, generate either excess profit or excess capacity or other forms of misallocation of resources. These in turn encourage illegal and so-called grey area operations, leading to pressures for intensified regulation. In the absence of restrictive regulation, resources would flow both in and out of the industry, keeping rates reasonably close to the cost of efficient operators.

We again emphasize the interrelationship of our policy recommendations. Specifically, entry control should not be completely dismantled in the absence of commensurate reductions in rate control. Dropping entry regulation would only aggravate excess capacity.

Exit is a potential problem in transport wherever regulation compels the continuation of unprofitable activities. In its extreme form exit means the total disappearance of a transport firm; more commonly it means the withdrawal of capital through abandonment of facilities and discontinuance of services with related reductions in employment.

The problem of abandonment is concentrated in the railroad industry, where an estimated 35 percent of the national mileage is so lightly utilized that abandonment should be contemplated. The problem of discontinuance is found in less aggravated form, at the State level, in bus operations.

Public policy should aim to facilitate required disinvestment and to increase utilization of capacity where abandonment or discontinuance is not required. This reference to disinvestment is to be understood in terms of a dynamic transport system in which substantial new investment will continue to be necessary both to meet expanding demand and to assure rapid absorption of new technology. We expect large net additions to investment in highway transport. The railroad industry can be expected to continue making large cost-saving investments, but it also needs considerable disinvestment as already noted.

Recommendations

1. Permit freedom of entry to new firms who can obtain adequate public liability insurance and meet safety requirements, as rapidly as rate deregulation is effectuated. (In dealing with problems of highway use, no distinction should be made between private and public, or between new and existing carriers.) This implies repeal of the Jones Act which restricts domestic shipping to U.S. built, owned and crewed vessels. Repeal would benefit Alaskan, Hawaiian and Puerto Rican trade as well as important segments of the U.S. lumber industry.

2. Permit existing firms to adjust routes, direction of movements and commodities carried in response to demand. In highway transport, carriers are usually limited by regulation to a few commodities on rigidly fixed routes and sometimes even to direction of movement. This leads to aggravation of the imbalance in traffic flow, i.e., the "back-haul" problem and the inflation of costs and rates. The "back-haul" problem is a striking example of regulation preventing full utilization of capacity in an effort

to preserve archaic value-of-service structures. Competitive forces would tend to break down value-of-service rates and fill up capacity as a consequence. If necessary, legislation should be introduced to prohibit the Interstate Commerce Commission from limiting truck operations to one direction, to a limited number of commodities, to rigidly restricted routes or through limited gateways.

3. Reduce impediments to exit and to abandonment of facilities and discontinuance of service for all modes. This problem is now mainly important for the railroads because of their relative decline and because of restrictions on abandonment. At present a railroad must secure a certificate of public convenience and necessity to abandon a line. The concept of public convenience and necessity is vague. The Commission is typically confronted with reasonably specific data on losses, but by only general statements concerning demand. Moreover, since the investment in a railroad's right-of-way is mainly irrecoverable, abandonment is the last resort. The ubiquity of truck transport is at once the principal cause of railroad abandonment and the principal reason why abandonment of rail service will no longer leave communities without transport. Consequently, we recommend that railroads be granted the right to abandon lines with adequate notice--presumably 90 days. The ICC's current policy of establishing priority of purchase for anyone wishing to acquire abandoned facilities for further operation should be continued.

4. Grant to the railroads a similar right to discontinue trains and ferries. The Transportation Act of 1958 represented a distinct advance over existing State jurisdiction by placing complete and final authority in the ICC. The present system is not intolerable. There have, however, been examples of long delays in authorization to discontinue hopelessly uneconomic passenger trains.

5. Amend the Interstate Commerce Act to provide similar automatic right to bus companies to discontinue service, regardless of the opposition of State regulatory authorities. If the present ICC regulation of passenger train discontinuance is retained, bus companies should be provided with a procedure parallel to Section 13a(2) whereby they might appeal to the ICC for discontinuance of services required by State authorities.

6. Establish, under the chairmanship of the proposed Department of Transportation, an effective, permanent instrument by which the transport policy of the executive branch can be presented in such regulatory cases involving operating rights as occur after adoption of other recommended policies. This should be the same instrumentality recommended in connection with rate cases.

B. Entry and Exit in Air Transport

At present, virtually all domestic air carriers require a certificate of public convenience and necessity from the Civil Aeronautics Board. The Federal Aviation Act authorizes the Civil Aeronautics Board to issue a certificate but only on a finding that the public convenience and necessity requires the contemplated service.

A carrier's certificate usually specifies the routes and the precise points to be served, and in effect, denies the right to provide scheduled service to any other points. The number of carriers regularly serving any market is rigidly limited for long periods. The certificate not only protects the carriers' markets but also usually requires that he serve all points in his protected markets.

Consequently, monopolistic profits can exist in one market while sub-marginal returns are realized in another and management is prevented from shifting resources so as to avoid losses and provide the public with additional service where it is needed. Since no regulatory agency can be promptly responsive to the changing needs of the economy, major distortions in the use of the nation's aviation resources are inevitable. Uneconomic markets are served at the expense of the most lucrative markets whose earnings are devoted in part to cross-subsidization. Management is denied the opportunity to develop the most efficient route patterns.

These problems are complicated by the arbitrary division of air service between trunk and local carriers adopted by the Civil Aeronautics Board in 1945 and by the large operating subsidies still being paid to the local service carriers. The continuation of subsidies and the segmentation of operating rights can only be justified in terms of the "infant industry" doctrine which now seems clearly inappropriate with respect to both the local service carriers and the domestic trunk lines.

Recommendations

1. Eliminate ultimately all barriers to entry into the industry and to participation on particular routes. Simultaneously, remove all restrictions on exit, abandonment and discontinuance. These measures may create or aggravate pressures for subsidized service, but progressively more rigorous standards of subsidy eligibility should help to meet this problem.

2. Permit immediately the trunk carriers to discontinue service on low traffic segments. Transfer these segments to the local service carriers, even if subsidy is transitionally increased. A tightened use-it-or-lose-it policy and additional tests of public convenience and necessity (such as the proximity of all-weather highways permitting travel to other airports served by trunk carriers) should mitigate this problem.

3. Encourage the Civil Aeronautics Board to lift restrictions against skip-stop operations for local service as well as trunk carriers.

4. Discourage the Board from imposing any minimum number of round trips per day to low traffic points on subsidized carriers. Development of these markets depends not so much on the number of round trips performed as upon the timing of arrivals and departures. In many instances the major carriers cannot meet this problem taking into account total system requirements. The small, unsubsidized taxi operator serving a few pairs of points offers a much more satisfactory solution.

5. Urge the Board not to certificate a subsidized carrier between points where eixsting air taxi service is satisfactorily meeting needs.

6. Assign to the interagency committee, established under the chairmanship of the proposed Department of Transportation, responsibility to formulate executive branch positions for presentation to the regulatory agencies in important cases involving operating rights, entry and exit. (See Chapter IV, Recommendation 5.)

IX. INTERNATIONAL MARITIME POLICY

A. General Considerations

International transport policy faces problems crucially differing from those encountered domestically--mainly for two reasons:

1. American carriers in international service compete with foreign carriers whose cost structure is determined largely by the economic structure of their home countries, typically involving far lower wage levels. American aircraft producers and operators, like producers of many agricultural and industrial goods exported on a large scale, have been able to offset the wage differential by higher productivity and generally have lower unit costs than their foreign competitors. In shipbuilding and operating, however, the United States has been at a severe disadvantage ever since sailing ships became outmoded.

2. As international transport is conducted largely outside the territory of any one nation, unilateral Government regulation of it is narrowly limited and involves complex problems in international relations. Governments often attempt to influence international transport through subsidies, restriction of traffic rights, tax measures and by support of international cartels. Many of these interventions interfere with the functioning of the market, reduce the efficiency of transport, increase tax burdens, and give rise to political friction with friendly nations, including our closest allies.

In air transport, restrictions arise primarily abroad. In maritime transport, U. S. Government interference exceeds that of any other major maritime nation, except the U.S.S.R., and beclouds the posture of the United States as promoter of relatively free and competitive enterprise and of increasing international commerce, economic integration and political cohesion among free nations.

Practices which lead to inefficiencies and increased international tension should be reduced by all countries to the minimum compatible with overriding national interests. To make progress in this direction should be a major objective of the U.S. international transport policy. In pursuing this objective, we should seek maximum opportunity to exploit our superior capability in aviation and to decrease inefficient employment of resources in maritime activities. This policy will bring the benefits of more efficient international transport to American and foreign shippers and travelers.

Maritime policy has been a source of continuous concern since the recovery of the merchant shipping capabilities of principal maritime nations after World War II. Every administration has initiated studies of maritime policy with a view to making revisions which would improve the position of U.S. flag carriers and, at the same time, reduce subsidies being provided unavailingly by the U.S. taxpayer. Maritime policy is accordingly scrutinized in considerable detail in this report.

B. International Relations Implications

It must be recognized that our maritime policy has been a significant source of friction in relations with friendly nations. Although some of the policy changes recommended will further irritate some major shipping countries, notably proposed efforts to bring pressures to bear on the conferences, most of the policies proposed below will provide powerful bargaining counters for international negotiations.

The shipping nations which will resent a U.S. policy of limiting conference power over freight markets will highly welcome the withdrawal of cargo preference and passenger service subsidies and the limitation of cargo operating subsidies. The shipbuilding countries will equally welcome the termination of construction subsidies. Some important nations will benefit on both counts. Indeed, such benefits to foreign countries are great enough to give rise to the idea that the proposed policy changes might be used in outright bargaining for concessions on other fronts.

It cannot be emphasized too strongly that every one of these changes is proposed because it is in the interest of the United States and for no other reason. At the same time advantages in foreign relations should be sought by a broad-gauge emphasis on the economic principles guiding U.S. policy, challenging our friends to base their own international economic policies on similarly enlightened principles in areas where their comparative disadvantage is equally clear, as it is, for example, in the construction of aircraft and provision of air service, or in the production of low-cost farm products, coal and electronic equipment. An appropriate international forum should be chosen to further these ends. If enabling legislation is required to permit representatives of the United States to bargain on these matters, it should be recommened.

The Department of State must explain the purposes and powers of the United States Government and, if possible, negotiate accommodations with the principal nations concerned. We have, of course, the wherewithal to maintain a large position in shipping and shipbuilding but, recognizing our comparative cost disadvantage, we should refrain from using this potential power. We should leave leadership in these fields to nations better equipped to supply vessels and maritime transport at lower cost especially if they in turn eliminate barriers which obstruct full participation of the United States in their commerce.

At the same time, we cannot reasonably be expected to let other nations exploit their advantage in shipping by cartelization without restraint, at the expense of the trade of the United States and other countries largely dependent on services of the leading maritime nations. Indeed the lowest freight rates compatible with competitively controlled costs and a reasonable return serve the interest of the entire community of free nations.

On this basis we should be able to rally other nations to our position, especially the new nations who have been complaining about exploitation by maritime conferences, and also to extract a return from the benefits which our maritime policy changes will bring to others. Their primary justification, however, remains in the fact that they free our own budgetary and economic resources for more productive employment.

C. Support of Maritime Industries

A number of U.S. Government programs are designed to support the shipping and shipbuilding industries. The present programs provide one ship for the price of two and one ton-mile of transportation on an American liner for the price of two ton-miles in a foreign bottom.

At the core of present programs are the operating and construction differential subsidies, maintained in substantially their present form since 1936. In recent years, these programs have become more costly. In addition they have been supplemented by others, notably flag preference for Government and certain Government-financed traffic, loan guarantees, tax abatement for ship replacement reserves, and vessel trade-in privileges.

Reservation of domestic shipping to the U.S. flag, which has long existed, also is designed to support the maritime and shipbuilding industries.

The entire complex of programs attempts to offset the disadvantage arising from American costs. The methods of subsidy computation, however, tend to increase rather than reduce this disadvantage as they eliminate incentives for adjustment of ship and yard operations to American cost conditions. Consequently, the burdens imposed on the budget and the national economy have increased sharply and threaten to increase further. At the same time, benefits originally sought have become and are becoming more and more questionable because of military, technological and economic changes to which the program is not sufficiently adapted.

According to Maritime Administration estimates, a direct Government outlay of some $400 million per year for operating and construction subsidies and for freight rate differentials on some of the preference cargoes provides at present about 12,000 shipyard jobs and "considerably less than full-time employment" for 50,000 men in the seafaring labor force; that is an annual cost to the Government of about $7,000 per job. These expenditures are said to enable U.S. flag ships to carry about 25 to 30% of U.S. general cargo trade (exports and imports) plus 5% of dry bulk cargo trade.[1/] The Maritime Administration further estimates that the cost of these programs, if unchanged, will mount to about $800 million by 1985 and the number of ships and jobs and the American share in U.S. trade will drop substantially.

1/ In 1962 this added up to about 13.5 percent of total ocean-borne dry cargo exports and imports, but only 7 percent of total non-preference cargo.

Moreover, these estimates do not include direct costs to the Government from high rates paid for its own cargoes, from ship trade-in allowances, mortgage guarantees and tax abatement. Nor do they take account of the substantial burden arising for the American economy directly from high rates paid in cabotage trades and indirectly through other reverberations of the subsidy policy, including the retardation of technological progress in foreign and domestic shipping. Estimates of the total cost to the Government and the economy from other sources vary widely but uniformly are much higher than those of the Maritime Administration. Its figures on cargo volume of U.S. flag ships, on the other hand, include a large proportion retained only because of cargo preference. In 1962 this was 54 percent of all dry cargo carried by U.S. flag ships.

Yet, even the Maritime Administration's data provide ample justification for the conclusion that the merchant marine and shipyard support programs should be cut back and so revised as to reduce the burden on the American economy and to yield more value for each dollar spent by the Government.

D. National Security

The prospective need for ship capacity to support military action was the most important force behind the Merchant Marine Acts of 1916 and 1936. Military needs are still asserted by many who propose to maintain or enlarge the present programs. This claim is not supported, however, by the relevant facts of today, the most important of which may be summarized as follows:

1. Strategic planning increasingly emphasizes early and rapid deployment as the best means to limit conflicts and reduce casualties and other costs. This is to be achieved by prepositioning of equipment and supplies and by an already large and rapidly expanding airlift capacity designed to

carry virtually all personnel and substantial proportions of dry cargo movements for even a sizeable military confrontation.

2. Even in the relatively improbable event of a large and prolonged overseas war, the U.S. military capability would not depend on a U.S. merchant marine of present size, let alone a larger one, because --

a) through commercial charter, cooperation of allied governments and, if necessary, seizure, the United States and its allies could employ by far the major part of the world fleet, regardless of flag;

b) personnel movement still would rely almost entirely on airlift;

c) present U.S. flag dry cargo tonnage (including the reserve fleet) is itself far larger than probable peak needs; for example, it is several times larger than the peak needs experienced during the Korean War;

d) U.S. flag tanker capacity can be supplemented by U.S.-controlled tonnage under foreign flags, with most of the crews retainable.

3. In an unlimited nuclear war, ship capacity is not likely to be the major bottleneck.

4. Shipping needs for supply of war industries and of civilian requirements during an emergency are reduced by existing stockpiles.

5. There is no military need for subsidy of commercial shipyard capacity because --

a) the availability of ship capacity described above makes it unlikely that new ships will be needed rapidly even in the improbable event of a large and prolonged war;

b) subsidized merchant ship construction accounts for less than 20 percent of current shipyard activity;

c) experience during World War II shows that new shipbuilding capacity and work forces can be provided very rapidly from scratch.

In view of these facts, there is no longer any general military justification for continuation of ship operating or shipbuilding subsidies.[1/] If there is any specific military need, it cannot be of large proportion and it should be met under the administration and budgetary responsibility of the Department of Defense. Vague assertions of defense requirements should no longer be permitted to "justify" general merchant marine programs not required by other national interests.

E. <u>Non-Military National Interests</u>

The second reason for support of a U.S. merchant marine always has been the desire to have some sizeable part of the U.S. foreign trade carried by American ships. To burden the economy with expenditures for this purpose would be irrational if less expensive sea transport under foreign flags was unquestionably available to carry U.S. trade promptly and efficiently. By and large, it is available and actually carries by far the larger proportion of U.S. exports and imports.

1/ Current programs do not support the one type of sea transport which is of the greatest military significance--tanker movement of liquid fuels--and yet there is no Defense Department indication that access to such capacity is inadequate.

Generally, there is no reason to expect discrimination against American trade for nationalistic or competitive purposes. Foreign importers (or exporters) are as vitally interested in efficient and economical movement of goods from (or to) the United States as are the American exporters (or importers). Moreover, carriers of various foreign nations are in competition on virtually every significant route, including carriers of nations far more importantly concerned with the shipping business itself than with production of or trade in the goods carried.

Limitations on the effectiveness of this competition arise, however, from the conference system and from impediments to technological progress and efficiency in the U.S. merchant marine. The conference system is in direct conflict with the basic antitrust position of U.S. economic policy and it can be tolerated only with adequate safeguards. While there is little prospect that the conference system can be abolished, its abuses can be curtailed and American interest in efficient sea transport can be safeguarded.

The power to influence conference behavior and to accelerate the adoption of cost reducing techniques can direct U.S. maritime progress to the service of real national interests. Achievement of these interests does not depend so much on the size of the U.S. merchant fleet as on its efficiency, flexibility and enterprise. The subsidy program should be so redesigned as to stimulate more efficient operating practices and the adoption of cost-reducing technical improvements. This would serve the real purpose of facilitating our foreign trade. It would also more effectively contribute to national prestige which often is cited as a separate reason for the maintenance of U.S. flag shipping. No matter on how many masts it raises the flag, the American merchant marine damages the nation's prestige because of its heavy dependence on subsidy rather than efficiency and excellence of performance. Our efforts to negotiate reduced barriers against international travel and trade are severely handicapped by our protectionist policies.

Finally, reference must be made to one more aspect of national interest in the merchant marine--the creation of jobs for American workers. Under the present system, this involves a subsidy of more than $7,000 per man-year. Clearly, this is an uneconomic way of providing jobs and the equivalent of the, in fact modest, volume of employment at stake can be provided elsewhere at less cost as improvements of maritime programs reduce maritime employment.

F. The Operating Differential Subsidy

The shipping lines covered by operating differential subsidy receive each year cash payments equal to the difference between (a) whatever they have spent for crew wages and subsistence, maintenance and repairs, certain supplies and insurance, and (b) what they would have had to spend for the same purposes and for the same size and manner of operation if wages and prices paid had been equal to the estimated average wages and prices paid by the specific foreign competitors on each specific route served. This procedure has a number of highly uneconomic consequences:

1. The costs which the operators bear are largely independent of their own actions. If they spend more, the Government pays any major difference; if they spend less, the Government gets the major benefit. The operators have little incentive (a) to resist increases in wages and prices of subsidized items, (b) to employ subsidized cost factors as

efficiently as possible, and (c) to adjust their operating methods to the American cost structure. Recapture and re-recapture provisions further weaken the tie of operators' profits to efficiency.

2. To avoid unpredictable Government liabilities, the operating differential subsidy can be paid only to the most nearly predictable type of shipping--the regular liner operation which, throughout the world, carries far less dry cargo than the more flexible irregular tramp trades and specialized bulk carrier operations.

3. To discharge its responsibility as dispenser of Government funds, the administering agency supervises (as best it can) business decisions which normally are the sole responsibility of management. Its approval--at least formal--is needed specifically for:

-- the routes to be served ("essential trade routes");
-- the ports of call;
-- the minimum and maximum number of sailings;
-- the specifications of vessels;
-- the manning scale and crew wages; and
-- numerous other operating and financial matters.

The fact that the administering agencies have usually endorsed most of the operators' decisions has not prevented this system from hampering a business which should be operated flexibly and from obscuring the true division of responsibility between Government and operators to the detriment of effectiveness and efficiency in the discharge of both governmental and management functions.

4. With wage differentials on the average accounting for approximately 85% of the subsidy, the Government is a silent partner in wage bargaining and all other labor-management disputes.

5. Since passenger and combination liners require a large catering staff (about two-thirds of the crew as against one-fifth for cargo ships), they absorb about one-third of the operating subsidy (equivalent to about $250 per passenger) without making any significant contribution to the real or supposed purpose of the program.

6. The intimate involvement of administering agencies in the affairs of the industry has led them to identify the operators' interest with the national interest. As a result, they have, at least until recently, required or encouraged subsidized operators to adhere to conferences so as to help keep freight rates relatively high at the expense of the U.S. economy whose freight payments go predominantly to foreign operators.

To eliminate some of these weaknesses and minimize the others, the operating differential subsidy program needs to be radically improved. Design of a substitute program involves numerous and intricate details that cannot be worked out by a temporary task force of part-time consultants. Some basic guidelines, however, can be defined.

Recommendations

1. Abandon the present method of computing the operating subsidy. Any new method should be designed to allow wider scope for management initiative, reward efficiency and penalize inefficiency, and should require much less Government involvement in ordinary business decisions.

Three general alternatives to the current subsidy formula are under discussion: determination of the subsidy by competitive bidding; determination of subsidy on the basis of the difference between average costs of American and foreign operators in amounts related to dollars of revenue and ton-miles of cargo; establishment of a "capital subsidy" by providing vessels free or at very low prices.

The possibilities of basing subsidies on competitive bidding are promising, but neither of the other methods seem promising to the task force. Much further analysis is needed to develop a completely workable bidding system, but in general, we would suggest contracts of several years' duration for successful U.S. bidders who agreed to: (a) employ U.S. citizens as seamen,

~~(b)~~ serve broadly defined trade areas (e.g., Atlantic Ocean) and (c) provide some minimum annual capacity (say in ton-miles) within the area to be served. In revising the subsidy formula, the existing recapture, tax preference and mortgage guaranty provisions should be eliminated.

2. Discontinue the operating subsidy to passenger and combination ships with substantial passenger accommodations. No new subsidy contracts for such ships should be made and existing contracts should be renegotiated to terminate them as speedily as possible with compensation for undue hardship otherwise imposed on operators and crews. Contract settlement terms should protect operators against losses and a modest portion of subsidy savings may be used to assist displaced seamen. A significant number of them can readily qualify for skilled jobs on shore, but others may need retraining or relocation or both, and for some early retirement might be the best solution.

3. Eliminate the concept of the essential trade route and allow cargo line operators wide latitude in scheduling their operations. Relieve them of the requirement to operate American-built vessels exclusively and to use only American yards for repair and maintenance.

4. Reduce the operating subsidies by the amount of the passenger ship subsidy as quickly as possible in accordance with recommendation 2. During the first six years of the new program, the remainder of the operating subsidy should not be permitted to exceed this amount. The subsidy should be apportioned biennially by the administering agency among broadly defined areas so as to assure, as far as possible, the maximum beneficial influence on freight rates payable by American exporters and importers. The total volume of operations subsidized will depend on the improvements in operating efficiency for which the program provides incentives and which will affect the subsidy required.

5. Base the amount of subsidies beyond the first six years on the experience of the transition period and set it at a level designed to sustain a volume of U.S. flag service sufficient to exert a beneficial influence on operating efficiency and freight rates but not larger than necessary for this purpose.

6. Renegotiate existing cargo liner subsidy contracts so as to transfer operations to the new program without undue hardship or undue windfall benefits to the operators. Compensation which may have to be made to achieve a fair transition should be of a one-time rather than continuing nature so as to preserve the basic characteristics of the new program.

G. The Construction Differential Subsidy

To be eligible for subsidy or to serve in domestic trades, operators must now utilize only vessels built, maintained and repaired in American shipyards.[1] After World War II, the Government sold war-built vessels to them at favorable prices. Where these are unusable (notably in passenger service) or need to be replaced, acquisition of new vessels is subsidized so as to reduce the operator's cost to the world market level. U.S. yards have been assured of the business without real foreign competition; hence management and labor have had little incentive to adjust operations so as to reduce costs.

The estimated cost differential has now risen to 55% of construction cost (60% for passenger vessels); annual subsidy requirements have mounted to about $120 million per year and will continue to increase substantially under present programs for replacement of war-built ships. Construction is also supported by Government allowances on the trade-in of replaced vessels, mortgage guarantees and tax concessions on operators' funds.

Where a vessel was built has no bearing on the shipping services performed. The construction program's sole function is to support the shipbuilding industry. It is intended to preserve active shipyard capacity for national security. National security needs for this capacity have disappeared, as was shown above. Consequently, this expenditure of public funds to support grossly uneconomic operations should be terminated as quickly as possible, subject only to honoring contractual obligations and avoiding or compensating for undue hardship to shipyard owners and workers.

The hardship problem is not of large proportion. About two-thirds of private shipyard activity is supported by Navy and some other Government

1/ Special legislation permits foreign vessels to carry West Coast lumber to Puerto Rico if U.S. vessels are not available at competitive rates. This exception might well be broadened.

orders. Work on merchant vessels sustained by subsidy supports only about one-fifth of private shipyard work and the employment of about 12,000 to 15,000 workers, and work for domestic services supported only by cabotage is substantially smaller.

Transition and termination measures will have to be worked out in detail. Meanwhile the following suggestions may serve as guidelines.

Recommendations

1. Reduce new obligational authority immediately by one-third and the remainder by one-fifth per year so as to terminate in five years.

2. Devote some portion of the remaining obligational authority to facilitate adjustment of yards and workers. The residual should then be used to subsidize "transition-period construction" on terms calculated to provide a real competitive incentive to management and labor. The vessels to be built under this transition program should be procured by the Maritime Administration and sold or leased to U.S. operators by competitive bidding. Any individual vessel that could not be procured on the reduced subsidy terms from U.S. yards should be ordered abroad.

3. Do not require ship operators to utilize American-built vessels. Operators should also be permitted to have their vessels maintained and repaired abroad.

4. Exclude hovercraft from the foreign bottom provision if they are determined to be marine vessels. Their construction and operation should be free from economic regulation or subsidization.

H. Cargo Preference Provisions

Approximately $150 million a year (about as much as either of the two subsidies) is now being paid by the Government for Government-sponsored cargoes which under cargo preference laws must be shipped by U.S. flag vessels. About one-third of this amount is normally recovered by charging recipient countries with freight at world market rates payable in their own currencies of which the United States already holds excessively large amounts. The arrangement has a number of serious disadvantages and does not make a useful contribution to U.S. merchant marine policy. Specifically:

1. The principle of cargo preference contradicts the basic U.S. position in favor the freedom of the seas and elimination of international trade restrictions, offends major shipping nations who are among our close allies, and encourages other countries to follow the same policy.

2. While at present providing employment for U.S. flag ships, cargo preference undermines the basic purpose of merchant marine policy because --

a) the U.S. tramps, which carry over half of preference dry cargoes, are war-built ships with high operating cost, do not add to the competitive strength of the merchant marine, and are obsolete;

b) the U.S. liners which carry the remainder (at least 40 percent of their overall 1962 tonnage and considerably more outbound) are thereby diverted from competing with foreign operators for non-preference cargo, especially U.S. export cargo, so that the real purpose of the operating differential subsidy is to some appreciable extent nullified.

3. Cargo preference raises the cost to the Government of transporting aid cargo and Government-owned cargoes because, insofar as shiploads are involved, U.S. tramp operators are the only ones who can bid and they operate inefficient vessels of wartime construction.

<u>Recommendation</u>

Eliminate cargo preference either immediately or in steps of, say 10 percentage points annually. Owners of tramps that are no longer employable should be allowed to sell their vessels on the world market. Some of the budgetary savings might be devoted to retraining and placement of displaced seamen in other jobs or to retirement.

I. Maritime Rate Policy

Assuring economic pricing of maritime services is made difficult by the interaction of three elements:

1. The interests of other sovereign states which are importantly involved;

2. The concept of freedom of the seas which is essential to the broader interests of the United States; and

3. The conference system which is well established and invulnerable to frontal attack by the United States.

It does not follow, however, that the United States is powerless in this area. A number of available policy devices may serve to exert pressure on the maritime rate structure so as to bring and keep it more nearly in line with the cost of efficient service, which would stimulate international trade and thus serve the primary interest of the United States in this field.

Eliminating the restriction of subsidized carriers to their own "essential trade route," a measure already proposed above because of its intrinsic merits, would also reduce the power of conferences to exclude outsiders from their markets. Flexible operation of independent liners, bulk carriers, and other tramps likewise would reduce the power of conferences to maintain uneconomically high rates and should be encouraged. Permitting U.S. operators to buy vessels abroad, another measure recommended above for other reasons, would work in the same direction. So would opposition to collusive agreements among berth operators to discourage bulk and tramp operators from topping off with "liner cargo."

Above all, the vulnerability of American conference members, at least, provides the U.S. Government with decisive power to influence conference action. As long as the problem is to prevent excessive rates, it is not essential that foreign flag operators be subject to these laws. The following recommendations suggest means by which the power stemming from the antitrust laws can be effectively employed.

Recommendations

1. Urge the Federal Maritime Commission to use its power to approve or disapprove conference agreements as a means of influencing conference rate decisions. It could, for example, apply a method similar to that pursued by the Civil Aeronautics Board and, after consultations with other interested agencies, indicate in advance of major conference deliberations that certain results would not be acceptable.

2. Require subsidized U.S. carriers that choose to participate in conferences to comply with Federal Maritime Commission guidelines on conference policy as the price of immunity from antitrust prosecution.

3. Continue and enforce the Bonner Act's limitations on dual rate contracts.

4. Eliminate the legal requirement of filing rates 30 days in advance of their effectiveness (introduced in 1962 and operating often as a bar to rate adjustment). In practice, this requirement discriminates against U.S. flag carriers.

5. Eliminate pooling agreements to the fullest extent practicable--there is a presumption that if they are worth the trouble to establish and discipline they are monopolistic. The Federal Maritime Commission, supported by Commerce, State and Justice, should continue surveillance of existing pools aimed at elimination of those found to be detrimental to U.S. commerce or contrary to the public interest. The State Department through international consultation should continue efforts both to eliminate underlying causes which create demand for pools and to facilitate corrective action.

6. Clarify the antitrust status of shipper associations to encourage their participation in conference rate making. Afford them antitrust immunity if necessary.

7. Avoid U.S. participation in any international organization or discussion directed toward making the conference system more effective.

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U.S. policy on international air transport was reviewed in depth only two years ago and therefore has not been reexamined here. This is not to say that all problems were solved. Moreover, in a fast growing industry like international air transport new problems are constantly arising. More detailed investigation of emerging problems may be in order within the next few years.