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## Committee Report to the Senate on Separation of Air-Mail Pay from Subsidy

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# COMMITTEE REPORT TO THE SENATE ON SEPARATION OF AIR-MAIL PAY FROM SUBSIDY\*

By EDWIN C. JOHNSON

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Interstate and Foreign Commerce.

S.436, "THE AIR MAIL SUBSIDY SEPARATION ACT OF 1951"\*\*\*

**T**HE enactment of this bill (S. 436) will occasion a major change in policy of the Federal Government toward the development of commercial air transportation by privately owned and managed airlines of the United States. It will provide for the determination of payments to airlines for the transportation of mail and authorize separate payments of subsidies to airlines when justified to carry out national interest objectives. Accordingly, the Post Office Department will be relieved of paying airline subsidies.

The basic purpose of the legislation is not to eliminate airline subsidies in their entirety but to disclose their extent and character. To the extent they have contributed to the deficit in the Post Office Department's budget this will be eliminated. Moreover, it will return to Congress its constitutional responsibility to review the justification for continued direct subsidy grants to the certificated air carriers, an impossibility under the Civil Aeronautics Act of 1938. However, it is not intended to alter the fundamental objective of that act, which is to provide Government support to foster the development and control of an air transportation system which will adequately serve the needs of our commerce, the national defense, and postal service, and to bring stability, through controlled competition, out of the chaos that was developing in the industry before 1938. In all of these objectives, the legislative program carries the specific endorsement of the Hoover Commission.

The bill replaces section 406 of the Civil Aeronautics Act of 1938 with an entirely new section. Payments for the transportation of air mail will continue to be made out of funds appropriated to the Post Office Department. Mail rates are initially set by the bill for

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\* Senate Report No. 629, 82nd Congress, first session. Edited slightly.

\*\* With only minor amendments to S. 436 as reported out by the Senate Committee on Interstate and Foreign Commerce, the bill was passed by the Senate on September 19, 1951 and referred to the House of Representatives.

domestic and for overseas mail services.<sup>1</sup> These rates are subject to modification from the outset and subsequently may be adjusted from time to time by the Civil Aeronautics Board on the basis of cost. Rates for foreign air services by United States carriers will be set by the Postmaster General.

Such subsidy grants as may be justified will be determined by the Board and payable to certificated air carriers from funds appropriated to the Board for that purpose. They may be awarded to support an appropriate air transportation system in the interest of the national defense, the economic development, and the air commerce of the United States. If the national defense of the country makes it advisable to augment civil aviation facilities and services beyond their natural economic level, this objective should be recognized as a proper security cost. Undoubtedly, the essentiality of many schedules, routes, and entire carrier systems will require careful review by the Board. In the foreign field dependence on subsidy may well be justified and, following maritime precedent, contracts up to 5 years in length are authorized to cover subsidy requirements for foreign air transportation, with an appropriate recapture clause in event of excess earnings.

The effective date for the separation of subsidy from air-mail pay for domestic and overseas air services is July 1, 1952, and July 1, 1953, for air-mail transportation to foreign countries.

The bill amends the 1938 act (1) to require the approval of the Postmaster General before the Board may issue a new certificate of public convenience and necessity authorizing the transportation of mail only and (2) to require the Postmaster General to dispatch by aircraft all mail bearing air-mail postage except under unusual conditions where the mail would be unduly delayed if routed by air.

Section 406 of the Civil Aeronautics Act of 1938 directs the Civil Aeronautics Board to fix fair and reasonable rates for the transportation of mail by aircraft, including an undisclosed additional amount, when required, for subsidy purposes. The 1938 act does not specifically require the Board to publish how much of a particular rate is for "service" and how much is additional "need" subsidy, and the Board has never done so. However, in a few mail rate proceedings the Board has found that the carrier did not require "subsidy" and so fixed what it designated to be a "service" rate.

No other promotional public utility statute is known to commingle a service payment with direct subsidy grants in the manner of the Civil Aeronautics Act in such a way as to keep the two elements

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<sup>1</sup> The act defines air transportation in sec. 1 (10) as "interstate, overseas, or foreign air transportation or the transportation of mail by aircraft." Interstate, overseas, and foreign air transportation are further defined in sec. 1 (20). "Overseas" means transportation between a place in the United States proper and a place in a territory or possession of the United States or between places in two such Territories or possessions, but "interstate" includes transportation between places in the same Territory or possessions.

completely hidden. Prior to 1936, ocean steamship companies were subsidized in a comparable manner through the mechanism of mail payment, but this led to abuses and was replaced by the Merchant Marine Act of 1936 with provisions for direct subsidies on the basis of construction and operating differential costs. The Interstate Commerce Commission fixes fair and reasonable rates for the transportation of mail by railroad without authority to include subsidy in such rates.

#### SUPPORT FOR IMMEDIATE SEPARATION

For many years, committees of Congress, executive departments, and interested private groups have contended that they are entitled to know the extent of the Government's commitments of promotional grants to the airlines.

During the 2 years that your committee has been studying this problem, pressures have grown steadily in favor of immediate legislation to separate air-mail pay from airline subsidies. In general, it may be said that all interested groups that appeared before your committee during its recent hearings, with the exception of the feeder airlines, favored immediate action. The Hoover Commission, the large airline companies, the Air Transport Association, various labor groups, business and taxpayer associations, and representatives of surface forms of transport joined in this chorus. While generally not opposing legislation, witnesses representing the newest and less firmly established feeder airlines expressed great concern lest separation legislation interfere with adequate subsidy support for them.

Since neither the Board nor other interested parties had presented any adequate legislative and administrative program, your committee was forced to develop its own approach. Extensive staff studies were conducted and a preliminary study was made for the committee by an independent national firm of accountants and management engineers, Ernst & Ernst, covering the principles and technical standards which they recommended should be incorporated in any legislation to accomplish separation.

Realizing that the only realistic need for subsidies which could be demonstrated was through relating in specific figures the losses incurred in serving nonmetropolitan areas the chairman of the committee asked the Senate Appropriations Committee in May 1950, for an appropriation to conduct special studies along this line. By allocating revenues and expenses including compensatory mail pay to all of these communities served it was anticipated a clear picture would be had of excess service, inadequate service, duplications and the need for improvement in the traffic pattern. For these purposes \$200,000 was authorized in the General Appropriations Act of 1951 (P. L. 759), and on the floor of the Senate a request to include the international problems affecting separation was recognized and included.

Out of the \$200,000 appropriated to your committee to cover its contracts to competent engineers and accountants, the following contracts were made:

Ernst & Ernst—Allocation of Subsidy to Airline Communities..	\$145,000
Ernst & Ernst—Mail Rate Structure Based on First Class	
Passenger Fares .....	5,000
Aircraft Consulting Service—Factual International Studies, etc.	10,000
Aviation Advisory Service—Subsidy Policies of	
12 foreign countries .....	6,500
Balance unexpended .....	\$ 33,500

Out of these surveys and the 99 days of hearings in which everyone interested in the subject was enabled to present his views, your committee feels competent to recommend legislation to separate airline mail pay from subsidy payments with full confidence and assurance that the splendid airline industry of the United States, which has developed until it leads the whole world, will not be injured but on the contrary will be made stronger and more self-reliant.

#### INITIAL CLASS MAIL RATES

Five classes of initial compensatory mail rates for domestic and overseas airlines are set up in section 406 (a) (1) of the bill for the sole purpose of insuring that the legislation will separate mail pay from subsidy on the date specified in the bill, and not permit the old system of commingling mail pay and subsidy to drag on. These rates are 45 cents, 60 cents, 75 cents, 90 cents, and \$1.80 a ton-mile and are intended to apply to intrastate, interstate, and overseas air transportation of mail. These are generous rates which shall be employed on the effective date if the Board has not found it possible to set other rates.

Your committee concurs in the opinion expressed by many witnesses who appeared at the hearings and objected to Congress reverting to the practice of establishing specific transportation rates. If the bill, however, had left the Board to fix the initial rates after "notice and hearing," under the procedures established by the Civil Aeronautics Act and the Administrative Procedures Act, any affected airline might invoke his rights of judicial review and delay at length the proceeding. This would mean that the old system of combined mail and subsidy payments would have to be continued indefinitely and there also would be confusion and possible impairment of the mail service during the transition period.

Your committee has followed the precedent of the Railway Mail Act of 1916 which established initial rates for various classes of railway mail and at the same time directed the Interstate Commerce Commission to launch an investigation with authority to revise the rates set by that act. This is what is proposed by S. 436, as reported by your committee.

The only action that the Civil Aeronautics Board must take before these initial rates can be employed is the classification of carriers into

the five classes provided in the bill according to the standards provided. The classification is to be made by the Board "on the basis of types of communities served, services rendered, and route patterns." This initial classification of carriers is authorized without notice and hearing. The bill, however, specifically provides that any carrier may petition for reclassification and may be heard thereon.

As part of the initial class rates, your committee has provided a 15-pound minimum weight provision in recognition of the overhead expenses involved in handling small dispatches of mail and in providing regular standby service for the mail even though mail loads are not always available.<sup>2</sup>

As we have said, these initial statutory rates are intended only to accelerate the transition to compensatory service rates for domestic mail. We do not envisage that these rates should remain in effect interminably or that the Board should countenance unduly delaying procedures by the carriers in such adjustment of these initial rates as may subsequently be determined to be necessary. The Board is authorized to initiate proceedings at any time and to replace the initial rates, as of any date after starting a proceeding, with its own rates as determined in accordance with the cost standard specified.

#### *Directive Against Delay and Withholding Mail*

Under the existing act, the relations between the Post Office and the airlines have been generally satisfactory. The very policy of commingling mail pay with subsidy needs in the 1938 act puts the Postmaster General in a position where it makes little difference to his over-all budget whether he places the mail on a low- or high-cost carrier. To the extent that mail is withheld from a high-rate carrier, its rate must be further increased for the mail it does carry so as to meet its over-all financial "needs." Under these circumstances, the Postmaster General pursued the commendable practice of delivering mail to competing carriers in a manner that would best expedite its delivery. A rule of thumb was followed that, whenever two carriers had schedules that would deliver the mail within 1 hour, the mail traffic would then be divided between them.

Most of the smaller airlines which normally have higher unit costs and would expect to receive higher mail rates expressed great fear at the hearings of your committee that the Postmaster General might

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<sup>2</sup> Whenever mail is dispatched the minimum provision will operate in this manner. Each shipment of mail consisting of the closed pouches and outside pieces sent as a single dispatch to one destination post office will be considered to weigh not less than 15 pounds. For example, if mail is dispatched at city A on a flight to three cities, cities B, C, and D, the weight of the dispatch to each city will be considered to be not less than 15 pounds, or a minimum total of 45 pounds for the three dispatches. The rate paid for each dispatch will then be computed at the airport-to-airport mileage to the city to which it is addressed. The committee is informed that the recent average weight of all domestic air mail so dispatched is about 11.6 pounds and, although some consolidation of dispatches of mail may be expected (and at the same time not delay the delivery of mail or withhold it from any carrier), this minimum provision should more than double the pay on dispatches to or from more than 300 to 400 smaller airline cities.

change this practice for the sake of postal economy. These witnesses pointed out that this attitude would deprive them of all mail traffic whenever they competed directly with lower-cost carriers. Your committee believes this would be a calamity, and would make impracticable different rates for classes of carriers because of the significant extent of competition between them.

As one solution, your committee considered adopting a uniform, two-element, weight-and-distance-block, mail-rate structure similar to that now used for fixing the rates of air-express shipments. It also considered the feasibility of equalizing mail rates between carriers on competing trips, as suggested at the hearing by Mr. C. R. Smith, president of American Airlines, but was advised that this suggestion would introduce "extremely complicated procedures." Your committee, after due deliberation, concluded that to work out a universal rate structure along either of these proposals, or otherwise could best be undertaken by the Board within the framework of the cost standard contained in the bill.

For the Post Office to withhold all mail from a competing carrier in order solely to utilize a lower-cost carrier would, in the opinion of your committee, be an unsound practice which could seriously disturb the present system of privately operated air-transport systems. Your committee, therefore, decided that in order to prevent any such possible discrimination by the Postmaster General it should place a direct statutory mandate in the bill. Thus, section 406 (a) (1) provides that the Postmaster General shall not delay mail or withhold it from an air carrier because the rates for such mail may be higher than the rates payable to a competing air carrier. The public is entitled to the earliest feasible delivery of this mail, and this has been and should continue to be the practice of the Postmaster General. The Postmaster General is not required to dispatch mail on every plane departure because express authority is given to him in section 406 (a) (1) to designate the schedules which he requires for the best postal service; prompt delivery is the controlling standard.

#### RATE-MAKING STANDARDS FOR DOMESTIC MAIL

One of the most controversial issues which developed during the course of the hearings was the question of the standards to be applied in establishing compensatory rates for the transportation of mail domestically. This is the heart of the problem of separating mail rates from subsidy. To the extent that a proper standard for such determination is not incorporated, the bill will fail of its purpose.

The basic product of an airline is the sale of space and lift capacity in its transport aircraft. Some of that space is sold to passengers, some for the carriage of mail, some for the carriage of freight, some for the carriage of express. Because the carrier must make provisions for extra loads of both mail and passengers in order to perform adequately his obligations to the public at peak periods, he must also have avail-

able a certain amount of unused space. This means that at slack times of the day or in off seasons the total capacity of the aircraft will not be used and that the over-all utilization of the aircraft will be considerably below that for which the airplane is capable.

Many of the proponents of subsidy-separation legislation urged the adoption of a rigid cost standard which would require that compensatory rates not exceed the fully allocated cost of the air carriers in providing the mail service, plus a reasonable return on the investment specifically devoted to that service. It was urged in support of this position that in no other way could it be made certain that the compensatory rates established by the Board would not include some element of subsidy. In other words, the adoption of a rigid cost standard was regarded as a prerequisite to the full accomplishment of the major purpose of the legislation, namely, separation of mail pay and subsidy.

The air carriers, on the other hand, vigorously opposed the adoption of such an inflexible standard. They pointed out, and presented the testimony of expert witnesses, that in an industry such as the air transport industry, where 80 percent or more of the total costs are joint (i. e., are attributable to all classes of traffic carried), it is impossible to determine "the" cost of carrying any one class of traffic. They insisted that allocation formulas, no matter how carefully developed, will produce results that are at best arbitrary and that it is "impossible to come up with anything that would have any practical value in fixing air-mail rates."

The air carriers also insisted that, apart from the impossibility of determining costs on any accurate basis, there are many other important considerations which must be taken into account in establishing compensatory rates. They referred to numerous considerations affecting the value of the service rendered by the carriers, including such things as the power of the Postmaster General to require the establishment of schedules for the benefit of mail service; the authority of the Postmaster General to fix regulations for the handling of mail and the enforcement thereof with administrative fines. They urge that value-of-service considerations should be given substantial weight.

Because of the importance of this matter, and in view of the vigor with which objections were made to the use of the cost standard, it has been necessary to give careful consideration to the problem.

### *The Cost Standard*

Upon initial consideration it might appear that the same principle should apply to payments for the carriage of mail as exists in many other areas where the Government deals with private interests on a cost-plus basis. The procedure might seem to be extremely simple: It would merely be that the carrier is entitled to recover all its properly allocated costs for performing the service, including a fair return on investment. As further consideration is given to the question,

however, it becomes apparent that the problems are complex and difficult. A simple cost-plus formula would of necessity have to be determined on a retroactive basis. This has two overwhelming disadvantages — first, it provides the carrier with no incentive for reducing costs; second, it does not give the carrier any certainty as to what his future income from the carriage of the mail might be.

It is, of course, not too difficult to determine in respect of each service the cost which may be specifically identified therewith. That is, those activities of a carrier which are devoted exclusively to the carriage of the mail could be determined and assigned thereto. However, the sum of these costs represents only a small fraction of the total cost to the carrier. Ernst & Ernst ascertained in the course of their engineering studies that the exclusive costs assignable to the mail service were only about six-tenths of 1 percent of total expenses, and to the passenger service slightly less than 15 percent. Thus, 85 percent of the aggregate costs are common to all the services collectively. There is, therefore, a very large proportion of common costs which must be shared in some way by all the products sold by the carrier. It is precisely here that the difficulty lies. How should the common costs be allocated among the various services which the air carrier sells? The mail, together with passengers, enjoys top priority; freight, express, and all other secondary matter can be off-loaded so that these two primary services can be served. This is as it should be; but it means that the mail must bear a fair share of the common costs of operating the entire service.

The central argument advanced against a cost standard is that there does not exist any objective method by which to allocate the common or joint costs among both the primary and secondary services; that any method of allocation, whether it be upon the basis of ton-miles, weight, space, revenue, or any other yardstick, represents only the judgment of the agency or individual adopting the particular method. Under such circumstances, it is further contended that a "synthetic" average cost of air-mail service, though almost wholly speculative and unreliable, would take on the appearance of scientific reliability, following the pattern of the "big lie technique as practiced by Hitler and Stalin."

What these critics of a cost approach to air-mail-service rates fail to recognize is that the pricing of joint products is determined primarily by economic forces which operate under competitive market conditions. Witnesses went at length into the pricing processes of such joint-product industries as meat packing and the marketing of petroleum products, pointing out that the market prices of such joint products are governed not by apportioned costs but by competitive conditions and the relative strengths of the various product demands. As applied to that kind of setting, their conclusions as to the limited significance of apportioned costs in determining the actual market prices which can be realized for particular joint products is demon-

strably true. Here the compulsions of the market place rather than any close measurement of particular costs are controlling.

However, the analogy to the conditions of air-mail service is not sound. By its very nature, the Post Office is the sole purchaser and user of the air-mail service, and it could not well be otherwise.<sup>3</sup> The postal service is a Government monopoly. Hence, the conditions required for competitive price determination in a commercial market do not apply, and it is idle to draw conclusions on the basis of a hypothetical situation which does not exist in fact.

When it is said by the critics to be "literally impossible to make an objective separation of the costs of the several products of a joint-cost industry" this does not mean that costs cannot be apportioned by some standard of measurement, for obviously they can be. The real issue is whether a significant cost analysis and an equitable allocation can be made in the particular circumstances of the air-mail transport service.

Up to a year ago, the CAB apparently employed only the most superficial cost analysis by types of services. The Board looked upon a carefully analyzed cost determination by types of services as a difficult task involving controversial policy decisions which it considered not essential to its functions in administering the "need" provisions of the act. However, in the recent "Big Four" mail-rate case, where a rate not involving subsidy was at issue, the Board's staff undertook an extremely detailed cost determination based in part upon original cost studies made by the carriers. The classification of services and the allocations of joint costs developed were summarized by the Chairman of the Board in his testimony to the committee.

Your committee could have spent many hundreds of thousands of dollars with engineers and accountants trying to find a sound procedure for allocating airline costs by types of services. However, it seems to us that the development of a satisfactory cost analysis is a matter of evolution which can best be developed by the Board as an expert administrative agency, after giving thorough consideration to conflicting views on all aspects of the problem.

While critics of a cost standard for air-mail service rates may always insist that there is something inherently reliable and impracticable about such a procedure in rate-making, because it is based upon judgment, your committee notes that Government rate-regulating agencies in comparable circumstances, with the approval of the courts, are making increasing use of cost analyses and allocations in their determinations. This is not to say, of course, that every rate problem can or should be readily resolved by some mechanical costing process,

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<sup>3</sup> A closer approach to competitive market conditions in the air-mail service would be operative if the Post Office were to make contracts for the transportation of air-mail on the basis of competitive bidding by the airlines. There is not much doubt, however, that if this policy were to be adopted the resultant air-mail service rates might be considerably lower than as determined in accordance with the cost standard prescribed.

nor does S. 436 require adherence to any particular cost formula. The I.C.C. has frequently found it necessary in rate situations to take account of competitive and demand conditions, especially where commercial traffic is involved. We also note that the I.C.C. has given particular emphasis to cost studies and procedures in fixing the rates of railway mail pay, and it is not our understanding that disproportionately higher rates have been allowed above costs in recognition of the great value of the mail service to the country.

### *The Value of Service Concept*

Because of the asserted lack of objective standards in allocating common or joint costs there have been many proponents, including most air carriers, of the recommendation that separation of the mail rate from subsidy should be accomplished under a standard of "value of service." A considered decision to adopt a cost standard requires that the proposed value-of-service standard be examined and that the committee reasons be stated for rejecting it. In general, this standard is one which looks at the price to be paid from the purchaser's point of view — what the service is worth to him. It is the principle generally followed in a free market in pricing competitive products for sale. The price is set at a level which is low enough to create mass demand, yet high enough to assure a profit. All prices must be in excess of out-of-pocket costs and the failure of some commodities to meet their fully distributed costs is offset by the fact that other commodities pay more than their fully distributed costs.

The difficulty with the concept of value of service as applied to the air-mail service, however, is what has been mentioned above — there is only one customer or user — the United States post office. Since the Government is the sole user, the usual competitive market factors by which to measure the value of service in practical terms are lacking. The post office is now required to tender air mail to the airlines, as it should be, and this requirement is further strengthened by section 4 of the bill. As there is no satisfactory available competitive form of transportation (the post office cannot use the nonsubsidized irregular airlines), there is no way of determining what the optimum price for carrying it should be to attract the greatest volume. The real consumer is the public who mails the letters and air parcel post-packages, and it pays the postage rates fixed by the Congress; consequently, the carrier cannot increase the volume of the mail service through price adjustment to the consuming public. Subject to periodic fluctuations and directional unbalances, mail loads remain relatively stable until the postage rate for air mail is adjusted by the Congress.

As a further argument for the value-of-service concept it was urged that this standard is necessary so that such factors as priorities accorded to air mail over other airline traffic, arrangements of schedules for the convenience of the post office, and other special characteristics of the mail service requirements will be appropriately recognized in

fixing air-mail rates. Considerations such as these, however, do not require the use of a value standard with all of its vagaries. To the extent that allowances should be made for factors such as actual priorities accorded to the mails, adjustments are not precluded by a cost standard and they can, indeed, more appropriately and specifically be made under a cost standard than they could be under a value standard.

In one way or another it seems likely that under any value-of-service concept, emphasis will shift to a consideration of the over-all financial requirements of the carriers, with the result that carrier need would continue to be a controlling factor in the determination of airmail rates as it does now under the existing provisions of section 406 (b) of the Civil Aeronautics Act. Such an outcome would defeat the essential purpose of the proposed legislation which is intended to effect a definite separation of compensatory air-mail services rates from subsidy payments to carriers whose commercial operations may not be entirely self-supporting but which are nevertheless considered to be essential in the national interest.

#### *Postal Revenue as Measure of Value*

It has been suggested that air-mail service rates might be measured on a value-of-service basis according to what the users of the postal service actually pay for such service as reflected by the air-mail postage revenues taken in by the post office. But this is not really a measure of the value of the mail transportation service performed by the airlines, even after adjustment of the gross revenues to account for the ground expenses incurred by the post office in handling air mail. The Post Office Department cannot be regarded merely as an intermediary in a commercial transaction between the carriers and the users of the air-mail postal service. Postal revenues are the result of whatever congressional policies may be adopted with respect to postage rates, and these policy considerations are of such nature that postal revenues are no valid measure of the value of the transportation service rendered by the airlines — or by the railroads either for that matter.

#### *Ernst & Ernst Proposal to Base Mail Rates on First-Class Passenger Fares*<sup>3a</sup>

A relatively simple solution to the problem of finding a proper limiting criterion for determining mail service rates was put forth by Messrs. Ernst & Ernst. It has much to recommend it because of its simplicity and also because the passenger-fare level has appeal as a generous ceiling for mail rates, thus guarding against the obvious inequity of establishing compensatory mail rates at a level higher than the charge made for premium services provided in carrying passengers.

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<sup>3a</sup> See page 358 of this issue.

Ernst & Ernst took the position that reliance upon cost in fixing compensatory rates was impractical and urged instead that mail rates be established at the level of first-class passenger fares, less an allowance for expenses which are attributable exclusively to passenger service and are not duplicated in nature by expenses directly chargeable to the mail service. The theory underlying this proposal was that the mail and first-class passenger services are the two premium services performed by the air carriers; that passenger fares are established on a commercial basis, with due allowance for all of the influences affecting commercial pricing, and yet are subject to the ultimate supervision of the CAB.

The Ernst & Ernst view was supported by a number of the air carriers who contended that first-class passenger fares are one of the best measures of the value of the mail service which they perform for the Government. The Board opposed the proposal as a mail-rate standard, pointing out that passenger fares are not a satisfactory measure of costs and that adjustments of such fares traditionally lag more than a year behind major changes in costs. The chairman of this committee suggested that air-coach fares at 45 cents a ton-mile, and not first-class fares, would be more appropriate as the basic or list price from which to adjust downward to obtain an equitable compensatory mail-pay rate.

#### *The Air-Freight, Air-Express Standard*

In view of the apparent similarity between freight traffic and mail traffic, certain proponents of subsidy separation legislation urged that mail rates should be based primarily on air-freight rates. It was not clear from their testimony whether these witnesses proposed to apply the air-freight rates, as such, to mail shipments, or whether they would base mail rates upon the average revenue produced by air freight. The airlines produced samplings of the results of applying air-freight rates to mail shipments and showed that the cost to the Government would greatly exceed the average revenue from air-freight shipments and would even, in many cases, greatly exceed the "need" mail rates presently in effect. It was also shown that air-express rates to the public, as applied to actual mail shipments, would produce results nearly as unpredictable and varied as those derived from applying air-freight rates.

#### *Representative Hinshaw's Proposal — the Weight of Mail Enplained*

One of the most novel proposals submitted to your committee was that presented by Congressman Carl Hinshaw. His proposal would set a flat pound rate whereby each carrier, depending on its class, would be paid either 25 cents or 50 cents for each pound of mail carried irrespective of distance. In addition to its simplicity, this proposal represented our way of reflecting the greater costs per mile

of short-haul as against long-haul movements. The rate as urged by Representative Hinshaw, if figured on a ton-mile basis, would result in approximately 45 cents per ton-mile for the average length of a mail haul, which is 1,170 miles. However, it would work out at 25 cents per ton-mile for hauls of 2,000 miles, which might be an underpayment to the long-haul carrier. The same pound rate, as applied to very short hauls, might result in excessive payment. For a 100-mile haul, the rate would yield \$5 per ton-mile.<sup>4</sup>

An interesting proposal presented to the committee was that of Mr. J. H. Carmichael, president of Capital Airlines, who stressed the fact that the mail rates applicable to the smaller carriers should be identical with the rate paid to the Big Four carriers for the same competitive hauls. Otherwise, he believed that the pressure of economy would force the Postmaster General to utilize the cheaper carrier exclusively. He therefore recommended a two-element rate containing distance blocks and weight blocks, so as to provide a higher return per mile for short-haul, lightweight shipments and a lower return per ton-mile for long-haul, heavy shipments.

The committee was impressed with this proposal and gave it careful consideration. A variation thereof was prepared for our consideration which followed the air express rate structure and was intended to produce about the same average revenue as air express.<sup>5</sup> While the committee does not believe that the solution advanced by Mr. Carmichael should be the exclusive method prescribed by law for determining compensatory rates, it might well be one of the rate structures available for the Board's consideration. S. 436 will permit the Board to adopt such a method if found desirable.

Lastly, Mr. C. R. Smith, president of American Airlines, offered a partial solution to the problem presented by Mr. Carmichael. He

<sup>4</sup> Another proposal by Mrs. Lucile S. Keyes, an economist specializing in air transportation, was introduced as S. 1756. That bill provided basically that mail rates should be the costs derived by allocating to each unit of mail traffic a proportion of common costs equal to that allocated to each comparable unit of nonmail traffic. However, the bill would allow an increase in such rates if the Board found such increase necessary to support the mail service required by the Post Office or necessary to avoid higher over-all unit costs of the carrier. In some situations a rate lower than distributed costs would be set by the limiting provision that the rate could never exceed the value of service to the Postmaster General as measured by the cost of other available comparable services. Lastly, no rate would be fixed at less than the added cost to the carrier for carrying the mail. The proposal was meant to avoid the undue rigidity of prescribing fully distributed cost as a universal rate-making standard, while avoiding also the undue looseness of leaving the determination of compensatory mail rates entirely up to the regulatory authority.

<sup>5</sup> The block mail-rate structure considered was based on 35 cents per ton-mile haul (the average yield at this time to the airlines for air express) plus \$2 for each dispatch for terminal handling expenses (the approximate amount now estimated by the Railway Express Co. as their terminal expenses in handling air express), and with \$2.50 as the minimum charge (present minimum for air express). The weight of mail dispatched was divided into rate blocks: 0 to 15 pounds, 15 to 50 pounds, and 50 through 100 pounds, and another block for each additional 100 pounds or major fraction thereof. This structure produced rates ranging from \$2.50, or \$3.33 a ton-mile, for the smallest weight and shortest distance block, up to \$45.75 or 36 cents a ton-mile for distances over 2,400 miles and dispatches, 50 through 100 pounds.

suggested that when two carriers in different mail-rate classes operate directly parallel services, the higher rate carrier, in order to share on equal terms in the mail traffic, should be permitted to reduce his mail rate to that of the other carrier.

### *CAB Proposal of Allocated Cost Standard*

The CAB, in testifying before the committee, recommended that mail rates should be based on costs as ascertained and allocated by it in contested rate proceedings to the various services performed. While the Board recognized that costs could not be measured with mathematical precision, it urged that cost determinations worked out by the Board would bring about the fairest results to all concerned. The Chairman of the CAB testified that the Board presently believed that a classification of carriers for mail-rate purposes was essential because of extreme variations in unit operating costs and volume of service performed, but that five classes should be provided.

The testimony of the Board showed the growing maturity of its own thinking in cost analysis, as was further demonstrated in its recent order in the Big Four case. A final rate of 45 cents per ton-mile, proposed in this order by the Board for American, Eastern, United, and TWA, has been accepted by the Carriers. This decision as to what the allowable costs should be, was made after years of preparation and many conferences with the carriers and with representatives of the Postmaster General.

The Board's general attitude toward the problem of allocations meets with the hearty approval of this committee. Their open-minded approach and clear thinking is shown in the following passages taken from the Board's order issued on August 7, 1951, in the Big Four case:

The Board fully recognizes the innumerable difficulties inherent in any attempt to cost the mail service as one of several common services. It is further recognized that there are other methods of costing the mail which can be considered reasonable. Our responsibility was to settle upon a method which we considered the most reasonable. As of this time, in the present stage of development of the industry generally, and the Big Four in particular, the mail costing techniques and principles adopted in this proceeding currently constitute the Board's best judgment as to the most reasonable method of costing the mail. The costing techniques developed here represent a marked step forward in relation to the less-refined allocations employed by the Board previously. Over the future years further refinements in techniques of costing the mail will undoubtedly be developed. With additional studies, certain costs that are now treated as common may prove to be identified with a specific service. Furthermore, changes in methods may become essential to adapt the costing techniques to the changes in the stage of development of the industry.

It is also highly probable that over the future years further refinements can be developed in the construction of rate formulas. Various forms of block rates or two-part rates might well be found

more appropriate in the future in determining payments for carrying the mail since they might reflect more accurately the cost characteristics of the mail service. If sharp increases in mail volume should develop as a result, for example, of the movement of all first-class mail over substantial distances by air, some further recognition to the effect of such volume changes on the mail cost would appear to be appropriate. A modification of the costing techniques would be particularly essential if any change were developed in the priority characteristics of the mail and passenger service in reference to the other services. It should be noted, of course, that the 45-cent mail rate was intended to give full recognition to the present priority characteristics of the mail service.

*Standard of Assigned and Apportioned Costs Adopted by  
Committee*

The committee, after studying the many proposals, arrived at the conclusion that any recognition of a value-of-service concept for the determination of compensatory mail rates would only open wide the door to an endless variety of intangible contentions for justifying unduly higher mail rates. Furthermore, your committee decided that it would not be proper, in view of the express purpose of the legislation to eliminate subsidy from the mail rates, to adopt merely the simple "fair and reasonable" standard presently contained in the Railway Mail Pay Act of 1916. The committee felt that a definite cost standard should be adopted to govern the Board in establishing compensatory rates which would assure the elimination of subsidy, and concluded that "fairly assigned and apportioned" expresses a cost standard that will be appropriate and fair to both the carriers and the Government. This is to be found in the language recommended by the Board.

The committee, therefore, included in section 406 (a) (2) the requirement that all rates determined by the Board "shall be based upon the experienced costs for mail transportation services rendered and upon projected costs for such services to be rendered, under honest, economical, and efficient management," and specifically requires that cost be "fairly assigned and apportioned to such mail services, including a fair return on that portion of the total investment which is used and useful in such mail services." By the phrase "based on" we wish to emphasize that the rates shall be determined solely upon the basis of fairly apportioned costs as this is the only statutory standard provided the Board. However, we specifically recognize that rates for future periods shall give due consideration to costs projected into the future.

The cost standard adopted by your committee authorizes the Board to determine costs and fix rates in accordance with the statutory standard specified for individual air carriers or by classes of air carriers, routes or types of services. This permits the Board to apportion experienced and projected costs among the various services performed

in a manner which will bring about the fairest and most equitable result to everybody concerned. Of course, specific added costs for performing the mail or other kind of service must be assigned to that particular service.

Authority to so classify carriers, routes, and services for rate-making purposes is an essential power to provide administrative flexibility and to permit the Board to maintain different rate levels for different classes of carriers. Any requirement that an entire industry must furnish its services to the Government at uniform prices is improper. Your committee does not insist upon the Board maintaining different rate levels for specified classes of carriers. On the contrary, it recognizes that there may be advantages in establishing a uniform block-type rate structure for the entire industry, which automatically takes into account the inherent differences in cost levels between carriers. We, however, believe that at this time it is essential to permit the Board to continue class rates as long as necessary. The adoption of a uniform rate structure for an industry with as many varied operating units as air transport will require much study on the part of the Board. Any suggestion that a single ton-mile rate based entirely on the actual costs of the lowest cost carrier should be universally applied, even to the smallest high-cost operators, seems clearly unfair.

Neither does your committee regard a ton-mile or a pound-mile unit as the only accurate measure of mail service performed, and accordingly has vested discretion in the Board, as it now has, to adopt other units of measurement for mail-rate purposes. There is precedent for this discretion. The ICC is not bound to any single standard in fixing rates for the transportation of mail by railroads nor is the Postmaster General so bound in fixing mail rates by steamship or by star routes.

The Board is specifically authorized to initiate proceedings for the modification of mail rates whenever it may appear that the existing rates are not fair and reasonable in terms of the cost standard provided.

The committee is convinced that this standard is an eminently fair one and will result in the receipt of fair and reasonable compensation by the air carriers in return for services rendered. We believe it grants to the Board necessary flexibility in administering the rate program to meet current problems as they may arise, and the changing conditions of the industry. We do not give sanction to a would-be service rate which contains subsidy in disguise.

#### INTERNATIONAL AIR TRANSPORTATION

##### *Disclosure of Subsidies to United States International Airlines*

Arguments were vigorously made before your committee that in the case of international air transportation subsidy separation should be "deferred indefinitely." This argument was based primarily upon

a desire to avoid damage to our international air transport system through the revelation of subsidies paid to our international airlines, since the same treatment would not apply to their foreign competitors. It was pointed out that foreign governments do not make a practice of publishing all of the subsidy data affecting their carriers; that the competitors of our carriers are, for the most part, government-owned; and that they receive advantages from their governments of substantial monetary value which are not revealed. These advantages take many forms, such as acquisition of equipment, either free or on very favorable terms; grants of capital funds without repayment, or upon unusually favorable terms; and government absorption of foreign-exchange losses. This being the case, it was argued that the United States carrier would be made to appear heavily subsidized as compared with his foreign competitors, which would place our carrier and the United States Government at a very substantial disadvantage in maintaining satisfactory aviation relationships between the United States and other countries.

Bilateral aviation agreements between governments provide for control of our air carriers' rates and traffic capacity. These agreements provide that if the foreign government is dissatisfied with the rate our carrier is charging or believes that our carrier is operating an unduly large amount of service to that country, it may request consultation with the U. S. Government. In these consultations the revelation of substantial subsidies to our carriers, unaccompanied by similar data with respect to their foreign competitors, would make it difficult for the United States negotiators to defend a reduction in passenger fares or air freight rates introduced to expand our carriers' business, or an increase in capacity designed to accomplish the same purpose.

There can be no question but that this Government has a great stake in the maintenance of its international commercial air transport system. It is privately owned and efficiently operated and is without doubt the finest and most extensive in the world. It serves our far-flung national interests by operating an aggregate of over 108,119 miles of air routes to 87 different jurisdictions on all continents, flying 538 aircraft which are generally the most efficient presently available. It is important that the Congress not unwittingly enact legislation which might impair the continued operation and development of this system. Your committee has been deeply conscious of its responsibility here, but at the same time has been zealous to find a way to secure the benefits of subsidy separation for the Post Office and the airlines in this field.

There can also be no question but that subsidy separation in the international field involves many problems which are not present in the domestic field. Our international carriers are in competition with foreign operators over which the Congress has only a limited control.

Our carriers operate into many foreign countries whose views and policies with respect to international air transportation are not necessarily the same as ours. Our entire international air transport system is based upon an aggregation of bilateral aviation agreements — 44 of them — which not only establish basic rights to operate scheduled commercial services, but also spell out in some detail, as mentioned above, the economic standards which must be observed by our carriers in providing their service. The success of our carriers is dependent upon the continued effectiveness of this system of bilateral agreements and their administration in such a way as to permit development of air transport services in accordance with the principles of American enterprise.

With these special characteristics of international air transportation in mind, your committee received, in executive session, important testimony designed to explain fully the reasons why extreme caution had to be exercised in providing for subsidy separation in the international field, and this testimony was considered very carefully by your committee. In such a session, on June 26, 1951, Mr. J. Weldon Jones, Assistant Director of the Bureau of the Budget, presented the views of the President, as follows:

Special policy questions have been raised with respect to the treatment of international carriers in any such program of subsidy separation. The executive agencies principally concerned with this subject have studied this matter very carefully in recent months, and their views have been presented to the President.

After carefully considering these views, the President feels that the advantages of subsidy separation outweigh such special problems as may exist with respect to international carriers. Accordingly, the President feels that information on the subsidy paid to international carriers should be publicly available, and that those carriers should be fully subject to legislation in this field.

While your committee was thus concerned about the difficulties presented in separating subsidy in the international field, it agrees with the President that it should not consent to the indefinite deferment of that part of the subsidy separation program. The manifest advantages in disclosing to the Congress and to the public any subsidies granted to our international carriers outweigh any temporary set-backs which may result from such a disclosure, and the authorization of forthright subsidy contracts, as provided by the bill to meet the recognized national interest objectives in foreign air transport, will provide the necessary stability for development. These contracts are discussed in another section of this report.

In the event that information developed under this legislation should be withheld in the national interest, section 1104 of the present Civil Aeronautics Act will continue to authorize such withholding. Under that section any person may object to the public disclosure of information obtained by the Board. When such an objection is made, the Board is required to withhold the information from the public

and its disclosure would adversely affect the interests of the applicant and is not required in the interest of the public. In addition, the Board is authorized to withhold publication of records containing secret information affecting national defense. It is the opinion of the committee that this section gives to the Board ample authority to safeguard the national interest.

*International Air Carriers to Be Treated Differently from Domestic*

The distinctions between the conditions under which our international and domestic airlines operate, which were mentioned at the beginning of this section of the report, require, however, that the international carriers be treated somewhat differently than the domestic carriers are treated.

The United States-flag airlines strongly urged the committee to recommend legislation which would provide that U. S. carriers be paid the Universal Postal Union rate for the transportation of United States mail. They pointed out that if this were done the United States would be adopting the practice followed by most foreign countries in paying their carriers the maximum UPU rate and would avoid any discrimination in the rates paid to United States carriers and their foreign competitors for the carriage of our mail. Also, by following this course, the Postmaster General could avoid being placed in the anomalous position of either paying the United States carriers less for transporting United States mail than he paid to a foreign carrier, or of being compelled to withhold mail from foreign airlines or of breaking his practice of paying them the quoted maximum UPU rates. These witnesses countered the argument that the UPU letter-mail rate might include some subsidy by pointing out that it was agreed to at a Congress of representatives of all nations of the world and since foreign postal administrations were paying our carriers this rate it could hardly be a subsidy rate.

This proposal was vigorously opposed by other witnesses on the ground that the UPU rates are rates negotiated between nations and are not based upon elaborate cost studies or fixed by an expert regulatory agency. According to these witnesses the UPU rate for letter mail is unduly high, the rate having been established at \$2.86 a ton-mile, while the over-all ton-mile costs of most airlines range from 90 cents a ton-mile to \$1.40 a ton-mile for the major operators and on up for smaller inter-European services. These witnesses recommended that the rates of the international carriers should be fixed in the same way and on the basis of the same considerations as domestic rates are to be made.

Your committee did not entirely agree with either one of these points of view.

*Universal Postal Union Rates*

Your committee could not reach any conclusions with respect to the establishment of the compensation to be paid by our Government to our carriers for transporting United States mail without careful consideration of the Universal Postal Union, its procedures and the rate structure which it has established, and of the importance of our relationship with the UPU.

The Universal Postal Union is an international organization dealing with postal affairs which was organized in 1874 and has been responsible for the unrestrained movement of the mails from country to country since that time. At the present time it comprises all of the countries of the world on both sides of the iron curtain (hearings, p. 602). Every 5 years these countries meet together in a Congress. The United States has been represented by the Postmaster General or officials of his Department and has always taken a leading role. From these Congresses has emerged a loose, but time-proven, body of regulations contained in the Universal Postal Union Convention which govern the international exchange of mail and postal services within the postal territory of the Union.

The scope of the UPU Convention is extensive and complete. Provisions of the Convention define the types of services permitted in international postal affairs, the physical characteristics of mail, conditions of service, rules for service, liability, postal rates, transportation charges, rules governing disposition of revenue from postage and fees, methods of settling international accounts, and certain guaranties, the most important of which is the guaranty of liberty of transit for the mail throughout the whole extent of the Union. The Convention itself and the various congresses have always been marked for their lack of political interference. They are dedicated solely to the free, rapid, and efficient transit of the mail.

As is indicated above, the UPU Convention fixes the maximum transportation charges to be paid by one country for the use of air services operated by an airline of another country. For example, it fixes the maximum rates that the United States Post Office may have to pay the United Kingdom for the use of British Overseas Airways in the transportation of United States mail. Different maximum rates are fixed for different types of service and different categories of mail. These rates are determined by negotiation among the countries who participate in the UPU Congress. They are subject to change either at the congress of the Universal Postal Union, which meet every 5 years, or through the observance of special procedures in the interim between these congresses. In recent years the UPU and its working committees have sought the advice of ICAO as to the cost of transporting international air mail.

At the present time the maximum transportation charges are 6 gold francs per ton kilometer for letter mail for areas other than the

European Continent (class B), 3 gold francs per ton kilometer for letter mail within Europe (class A); 1.25 gold francs per ton kilometer for parcel post, and 1 gold franc per ton kilometer for newspapers. In terms of United States currency and units of measure, these transportation charges are \$2.86 per ton-mile outside the European area (class B); \$1.43 per ton-mile within the European area; 60 cents per ton-mile for parcel post; and 48 cents per ton-mile for newspapers. If this maximum rate structure had been applied to United States mail carried by United States flag carriers the yield to our airlines in their trans-Atlantic services would have ranged from \$2.13 to \$2.28 per ton-mile in 1949. This includes mail carried in Europe at the \$1.43 rate.

These are the maximum rates which our carriers can secure for the transportation of mail for foreign governments. In practice, the carriage of air-mail between foreign postal administrations is arranged in this way. For example, the postal administration of the United Kingdom quotes a rate to our Post Office for the transportation of United States mail on British Overseas Airways (BOAC). The rate quoted may not exceed the applicable maximum rate specified in the UPU Convention and this is the rate usually quoted. It should be emphasized that there is nothing in the Convention, however, to prevent the United States Post Office legally from rejecting the transit rate quoted for service over BOAC, or any other foreign airline, because the rate is considered to be too high.

The convention does not require the U. S. Post Office to tender any specific amount of mail to BOAC or any other foreign airline, and many foreign countries are reported to use their own airlines to the fullest extent possible. In the case of the United States, only about 4 percent of our air mail going to foreign countries is transported by foreign airlines. Informal agreements are said to exist between European airlines and postal administrations for the carriage of mail, in consideration of preferential treatment, at less than UPU maximum rates. Such agreements have not been encouraged, and our Post Office Department has been a champion of high maximum rates because this has been to its advantage. This is so because we operate regular air service over most of the trade routes of the world, and United States airlines have carried more mail of foreign postal administration than foreign carriers have transported of our mail. In the fiscal year 1950, the United States Post Office utilized the services of 12 foreign airlines to carry 847,042 ton-miles of United States mail at a cost of \$2,151,289, or an average of \$2.54 a ton-mile. During this same year, United States-flag carriers transported 4,827,468 ton-miles of foreign countries' mail and received \$10,873,846, or an average of \$2.25 per ton-mile. Thus, if the United States Post Office should attempt to have our mail carried by foreign carriers at lower than the maximum UPU rates we could expect a reciprocal reduction to be imposed on our carriers for the foreign mail they

carry. Thus, the net gain to our Post Office which under the above figures for the fiscal year 1950 was about \$8,000,0000, would be reduced proportionally.

*Mail Rate Structure Adopted for United States International Airlines*

Your committee studied, painstakingly and objectively, the present methods of making mail rates for international transportation by air and steamship, the terms of the Universal Postal Convention, the operation of the Congresses of that Union, and the establishment of United States policy with respect to the Union.

It was recognized at the outset that the conclusions of the United States Congress with respect to compensation for United States airlines might have a very substantial effect upon the actions of the Universal Postal Union Congress as well as upon the relationships between our carriers and foreign postal administrations. If an unreasonably low rate were fixed for our air carriers for transporting United States mail, it might well impel the Universal Postal Union Congress to make a drastic reduction in UPU rates. While we might stand to lose our favorable postal balance, we would probably gain in other respects. Moreover, since many of the foreign competitors of our airlines are paid the maximum UPU rate by their own governments for transporting their mail, the establishment of a substantially lower rate for United States carriers might create a false appearance as to the relatively higher offsetting subsidies required by our airlines as compared with those of their foreign competitors. On the other hand, if an unreasonably high rate were fixed for the transportation of United States mail by United States carriers, it would call into question the soundness of the UPU rate structure which the United States has actively supported and would put our carriers in a position where they would have to render mail service for foreign postal administrations at a lesser cost than they do for our own post office. Furthermore, even if the UPU rate for letter mail is thought to be high, your committee is informed that at the UPU Congress to be held in June of 1952, this rate may be appropriately adjusted, for there is considerable agitation to lower this rate. On the other hand, the UPU rates for the other categories of mail may, in some instances, be too low since some of them are substantially below the average ton-mile cost of the lowest cost American-flag carrier. These rates may also be subject to adjustment at next year's UPU Congress.

From our study of these questions, two basic principles emerged which, in the opinion of your committee, had to be incorporated in any legislation dealing with mail rates for our international carriers. In the first place, it seemed essential to recognize the UPU rate structure for what it is, because it is established by a distinguished international body of which the United States is an important member. However, we concluded that the UPU rate structure should be

recognized only for what it is — a system of maximum rates — and provided that none of our carriers should receive a rate higher than the applicable Universal Postal Union rate. Certainly, there can be no objection to the adoption of this principle.

Secondly, it seemed essential that the United States Post Office Department should be put in a position of not having to discriminate against our own carriers by paying to foreign carriers a higher rate than it pays to a United States carrier for performing the same service with respect to the same category of mail. Your committee would regard any practice which involves the United States Government paying a United States citizen less than it pays a foreign citizen for the performance of the same service as unsound and unconscionable. In the maritime field the Postmaster General voluntarily pays both foreign and United States-flag steamship companies the same rates for transporting international mail. Certainly no further argument is needed to support this principle.

These two basic principles we wrote into the bill as section 406 (d), and provided that, effective July 1, 1953, the Postmaster General shall determine rates which will not exceed the applicable UPU rates and will not be less than any rates paid by the United States to foreign carriers for similar service.

Your committee believes that the rates for the carriage of mail by United States-flag carriers should be fixed by a responsible Cabinet officer with full cognizance of cost and also of the political and international considerations involved in international air transport. The bill provides that the Postmaster General can secure complete cost data on international air transportation from the Civil Aeronautics Board in any manner he requires. He will be expected to be mindful of the cost of rendering the mail service and the standards for establishing costs for the domestic mail service when he sets the mail rates for the foreign service. These rates are to be set at not less than cost and somewhere between the amount he pays to foreign-flag carriers for similar services and the maximum Universal Postal Union rates. The Postmaster will have strong incentives to keep the rates at or near costs, but on the other hand will have to reflect administration responsibility toward international air transportation policy, which comes generally under the control of the President by section 801 of the Civil Aeronautics Act.

In adopting these principles your committee has followed the practice established by the Congress many years ago in providing for payments to our steamship companies for the transportation of United States mail. By the act of February 14, 1929 (39 U. S. C. 654), Congress gave the Postmaster General power to fix the rates for the transportation of mail by United States and foreign vessels. United States vessels were to receive a maximum of 80 cents a pound for letters and postcards and 8 cents a pound for other articles including parcel post. No cost or other standard was written into this act. In the case of

foreign vessels, he is directed to pay not in excess of the rates established by the UPU Convention.

Since that time the Postmaster General has followed in practice in the maritime field the principles adopted by your committee. He has issued various orders establishing rates for the transportation of mail by United States and foreign vessels. The current order provides for payment of the same rates for the transportation of mail by foreign or United States vessels, and with respect to the bulk of the mail transported these rates coincide with the rates established by the Universal Postal Union. However, the Postmaster General has seen fit to pay less than the UPU rate for the transportation of mail within certain very long-distance ranges. Thus in the maritime field he, in effect, is following the practice contemplated by the present bill in making certain departures below the maximum UPU rates.

The minimum provision specified by your committee does not automatically bind the Postmaster General to pay the maximum UPU rates. He is bound only when he voluntarily permits United States mail to be transported by foreign carriers at the UPU maximum and then only to the extent that the services so rendered are deemed similar. As we have seen, the UPU Convention itself does not prohibit the United States Post Office, or any other postal administration for that matter, from quoting lower rates unilaterally or from negotiating for the carriage of mail at rates lower than the UPU maximum.

It has been suggested that this minimum provision would result in transferring the power to fix rates for United States mail from the United States Post Office Department to foreign postal administrations because our Post Office would have no control over the rate quoted by a foreign postal administration for the use of its carriers. Of course, he has no control over what foreign postal administrations will quote, but the United States Postmaster General does have control over the extent to which he uses foreign carriers. If the Post Office Department were to decide to pay foreign carriers a rate equal to 50 percent of the established UPU rate for carrying United States mail, he could make that determination completely effective. It is again emphasized that the UPU rates are maximum rates and that no international obligation binds him to pay them. If a particular foreign postal administration objected to receiving the low rates he so established, he could refrain from shipping United States mail over the carrier of that foreign postal administration. It seems likely, however, that foreign postal administrations would see advantage under these circumstances in accepting the rate the Postmaster General was willing to pay. He not only can do this, but he is doing it now with respect to the transportation of mail by steamship within very long-distance ranges.

In providing that the lowest rate paid by the United States to foreign-flag carriers for "similar services" will be the minimum rate which the Postmaster General must pay United States-flag carriers,

administrative discretion has been vested in the Postmaster General. The committee has not deemed it practical to limit the application of this provision to only those instances where a foreign-flag carrier transports United States mail in parallel point-to-point competition with an American-flag carrier. The Postmaster General has been given the authority to determine when the services rendered by a United States and a foreign-flag carrier over the same or different routes are to be deemed similar. While this may lead to some controversies, the Postmaster General can set up administrative standards which will facilitate application. It is expected that there will be many instances when the Postmaster General will find that there are no similar services being rendered by a foreign-flag airline and in such instances he has complete discretion to fix the rate to be paid United States-flag carriers with no controlling minimum.

#### *Transfer of Rate-Making Authority to Postmaster General*

In giving the Postmaster General authority to fix the mail rates for United States carriers your committee is proposing a substantial change in existing law. At the present time the Civil Aeronautics Board fixes the rates for the transportation of mail for both United States international and domestic carriers, but under this bill will continue to do so only for the domestic carriers.

One objection made to transferring the power to fix these rates to the Postmaster General is that he is the shipper of the mail and in his zeal to reduce his cost he may pay the carrier an inadequate or an unconstitutional rate. However, there are several factors which would prevent such arbitrary action. The Postmaster General cannot, as mentioned above, pay the United States carriers less than he pays foreign carriers for similar services. Also, the committee has provided at the end of the proposed section 406 (g) that the Postmaster General may secure cost data from the Board to guide him in carrying out his rate-making function. This procedure will relieve him of the necessity of setting up his own cost analysis section and of duplicating the work of the Board. Finally, there is no evidence that the Postmaster General has departed unreasonably from UPU rates or otherwise dealt unfairly with the steamship companies whose compensation for the transportation of mail he has fixed for many years.

There are important reasons to justify Congress giving this power to the Postmaster General in the case of international air carriers as it did in the case of surface vessels. He has full responsibility for dealing with foreign nations in international postal matters, and is in charge of the United States participation in the Universal Postal Union. Moreover, he has the power to fix the rates he proposes to pay the foreign air carriers, up to the maximum limits specified in the UPU Convention. In view of the interrelationship of these already existing responsibilities, it seemed essential to transfer this function to him

where the responsibility for fixing the level of rates to be paid to American-flag international carriers will fall directly on a member of the President's Cabinet.

*One-Year Deferment of Subsidy to United States International Airlines*

Since present mail payments to our international airlines undoubtedly contain a substantial element of subsidy, several witnesses pointed out that subsidy separation in this field would be of greatest benefit in cutting down deficits in the Post Office Department's budget. However, no convincing arguments were advanced to indicate that subsidy separation in the international field was a matter of great urgency, or that any substantial savings to the Government as a whole could be expected immediately. The Chairman of the Board strongly urged a 1-year delay in requiring subsidy separation in the international field in order that the Board might give its full attention to the domestic problems of subsidy separation and thereby gain experience in administering the new subsidy provisions of the bill before tackling the more delicate problems of separate subsidy grants for foreign operations.

There are other good reasons for deferring the effectiveness of subsidy separation in the international field for a year after the domestic separation becomes effective. A year's deferment will permit the UPU air-mail transit rates to be reviewed at the next UPU Congress to be held at Brussels in June 1952, and for any revised UPU rates to become effective January 1, 1953, 6 months before the effective date recommended in S. 436 for the international carriers. This time lag will permit our representatives at the Brussels Congress to give due weight to the congressional policies contained in this legislation, if enacted, in presenting the position of the United States at the UPU Congress.

In view of the practical reasons advanced by the Board for deferring 1 year, the committee decided to follow this course and to give the Board a fair opportunity to accomplish the domestic portion of the program before it becomes necessary to begin on the international aspects. It should be noted that the President approved of this delay, as did the Secretary of Commerce, who appeared before your committee.

SUBSIDIES FOR ESSENTIAL AIR TRANSPORTATION

*Policies Governing Subsidies*

It is not the purpose of S. 436 to stop the payment of essential subsidy grants to airlines rendering service found to be essential for the continuation and development of an air transportation system to meet our national objectives. Accordingly, the bill provides that subsidy grants may be made by the Civil Aeronautics Board for sub-

stantially the same objectives as are specified in the present "need" clause of section 406 (b) of the act, which authorizes the Board to include subsidies in mail payments. The important change made by S. 436, as reported, is to require the subsidy payments to be identified and covered separately by an appropriation to the Board for this specific purpose.

Subsidy payments are provided for in section 406 (g) (1) for the purpose of "maintaining and continuing the development of air transportation (including the introduction of new and improved types of commercial aircraft) to the extent and of the character and quality required to promote the economic development, the national defense, and the air commerce of the United States." One important deletion and several clarifying phrases have been added to the language of the existing section 406 (b) of the 1938 act. The postal service has been deleted as one of the three principal bases for subsidy, inasmuch as the requirements of the postal service are intended to be taken care of in the provisions for service mail rates. Specific mention is made of the introduction of new and improved types of commercial aircraft as a basis for subsidy. This has heretofore only been implied. The phrase "to promote the economic development" of the United States has been added. All subsidy determinations must continue to be made by the Board against the standard of "honest, economical, and efficient management," as presently found in the act.

The three national-interest objectives for airline subsidy grants, as amended by the bill recommended by your committee, do not pertain to the mail service performed and are separable from each other. Any Federal grants to foster them should identify the objective or objectives to which they are directed. While these objectives may not always be susceptible of exact valuation in precise dollar terms, explicit designations of purpose nevertheless are desirable.

By these changes the committee does not mean to suggest that subsidies should be conferred either more liberally or more restrictively than they have been heretofore; our air rather has been to state more clearly and explicitly the public purposes for which subsidies may be justified under the revised act.

#### *Community Approach and Withdrawal of Subsidies*

No doubt Congress will insist on keeping subsidy grants to an essential minimum, but this does not necessarily mean that drastic curtailment of airline subsidies can be expected immediately. However, the Civil Aeronautics Board must now become a salesman of its own subsidy promotional program. Its responsibilities become immeasurably greater. After determining the proper amount and kind of subsidy that should be paid each petitioning air carrier, the Board must justify this amount, first to the Bureau of the Budget and finally to the Congress.

The early studies of your committee indicated what has since been confirmed:

\* \* \* airlines carrying only a long-haul business and servicing only a few high-density points could operate profitably without subsidy; or, to put it another way, that the certificate requirement compelling the airlines to serve a large number of small stations, or to carry predominantly short-haul traffic absorbed most of the profits earned in the long-haul high-density business and was the basic reason why subsidy was required.

No practical way to implement the identification of subsidies with loss communities had been developed by the Board or the industry until the committee advanced the "community" approach — in fact, an appalling lack of available information as to the profitability of individual stations was found in the industry. Consequently, this committee had Messrs. Ernst & Ernst make an intensive engineering study to devise a practical way of allocating airline subsidies to the communities served at a loss. The detailed results were given to the CAB and were also made available to all interested persons.

This community approach was advanced by your committee for the protection of the airline industry and for the protection of the Board. It would provide a better understanding of the economies of the airline structure on the part of the committees of Congress, the CAB staff, and everyone else concerned with the operation of and competition from the airlines. It was not devised, as some witnesses intimated, as some cruel method of torture. It was devised to be of help, to be constructive, and to form the basis of working out many of the difficulties that the Board will face in justifying and distributing subsidies.

The CAB concluded, nevertheless, and testified before your committee that it wanted no legislative mandate to employ the community approach and no accounting requirements to implement it. The airline industry itself either opposed or showed little enthusiasm and several witnesses expressed a fear that the accounting requirements would be unduly burdensome. Your committee concluded that it should let the Board struggle with its increased responsibilities as it saw fit and without attempting to impose this helping approach upon it or the industry.

Your committee believes it to be highly desirable that the Board have authority to discontinue subsidy payments for service by those carriers or segments of carriers which are found to be no longer required in the interest of the national defense, the economic development, or the air commerce of the United States. If the operation of a route is no longer contributing to one or more of the objectives of the subsidy provision, there can be little point in subsidizing its continuance, irrespective of the fact that a certificate is outstanding for such operations. Section 406 (g), therefore, provides that the mere holding of a certificate of public convenience and necessity

authorizing the conduct of air services shall not be deemed conclusive as to whether any such service is sufficiently required in the interest of the national defense or the air commerce of the United States to justify the amount of subsidy that would be required to enable the air carrier to continue such service. If a certificated mail carrier chooses to continue to operate the route it would be entitled to mail compensation but not subsidy for its operations, unless or until service was suspended or abandoned.

Since the withdrawal of subsidy may be tantamount to compelling abandonment of service, the provision goes on to provide that, when an issue of withdrawal of subsidy is raised, the Board is required to give notice thereof to interested parties, including communities in the United States receiving such service, and to permit them to be heard. If the Board then decides that the need for such service does not justify the amount of subsidy that would be required to continue it, the final order denying such amount shall be accompanied by an authorization for the carrier to abandon such service any time within 6 months from the date of the order. It is not intended to require communities to be made parties to every subsidy proceeding where the amount of subsidy required is in dispute, but only when the issue is the amount of subsidy required to prevent abandonment of service to a community. This provision is intended to apply in situations where complete abandonment of airline service to a community is threatened, and not to a mere reduction of service to minimum standards of adequacy.

A carrier is given one year after being denied subsidy to decide whether to suspend or abandon the route or continue it in operation without subsidy. This should give the carrier sufficient time to experiment with route and service revisions and to make a final and binding managerial decision. The entire provision is intended to shift substantial responsibility to the carrier to suggest changes in route patterns which it deems necessary. As long as a certificate creates the presumption that a service should be subsidized, management may be loath to make any changes in the route pattern even though the service may have ceased to be necessary. Your committee believes that when a service or route is no longer justified in the national interest, a provision such as this should spur management to ask the Board for authority to abandon the route or service.

### *Subsidy Contracts for International Carriers*

The character, extent, and value of our international air-transport system has already been discussed to some extent. The vast development of our international air service in recent years — in the interests of the commerce, the postal service, and the national defense — has been made possible largely through subsidy programs authorized by Congress in the Civil Aeronautics Act of 1938. The record made by

these carriers in providing air transport in the defense of the United States is well recognized.

While the basic subsidy policy of the 1938 act has been continued in S. 436 for all our certificated airlines, your committee recommends a special provision designed to make subsidization more stable for international United States-flag carriers. Section 406 (f) of the bill authorizes the Board, upon request of an air carrier entitled to subsidy of its foreign air transportation, to enter into a contract with that carrier for a period not to exceed 10 years.<sup>6</sup> This contract would provide for the continued payment of the agreed scale of subsidy over the period of the contract, and would require the carrier to continue to provide the subsidized services during the period of the contract. In addition, the carrier would undertake to return to the United States at the end of the contract one-half of all of its profits from such foreign air transportation which exceed an average of 10 percent per annum of the capital investment of the carrier.

This provision follows directly a similar provision of the Merchant Marine Act of 1936, which has worked well for the merchant marine and has enabled the United States to recapture from the subsidized carriers many millions of dollars since the close of the war. The provision has great advantages. To the carrier it gives certainty as to the amount of its support over a substantial period of time, which is particularly necessary in foreign air transport where the carrier is required to make large investments and other commitments in foreign countries. The international carriers, unlike the domestic airlines, would not have support generated from communities all along their routes in their requests for subsidy grants. As far as the Government is concerned, it gains from increased stability in the international air-transport system, as well as from the incentive toward efficiency which is created by the contract. The carrier is told, in effect, that if it operates with greater efficiency during the contract period and reduces its need for subsidy, the Government will not promptly reduce the subsidy, as is the case under existing law, but will permit the carrier to share the rewards of its own good work.

The unsettled state of the world makes it essential that the United States maintain these important lines of communication operated by our international airlines, as well as the aircraft, personnel, and equipment which maintain them. Since World War II, an additional problem has come to the fore. Competition from foreign airlines in recent years has become extensive and keen. In the case of air transport, as in the merchant marine, the task of American operators is made considerably more difficult by the fact that American wage levels and other individual items of cost are considerably higher than those prevailing in comparable foreign operations. The American carriers,

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<sup>6</sup> As passed by the Senate on September 19, 1951, S. 436 provided for subsidy contracts for "foreign air transportation" up to five (5) years and for "interstate and overseas air transportation" up to three (3) years.

through increased efficiency, large volume of operation, and the maintenance of modern fleets have managed to keep their over-all cost levels per unit of service on a par with their foreign competitors. In view of these circumstances it may be necessary to continue for some years a subsidization program for our international airline operations.

#### ANTICIPATED FINANCIAL RESULTS

The only additional administrative costs that the enactment of S. 436 will require will be for the employment of a slightly increased personnel in the CAB and in the Post Office Department. A disbursing section in the Board will be required to handle the accounting and disbursing of funds for the subsidy grants. Your committee understands that the determination of compensatory mail rates by the Board for domestic and overseas air transportation will not increase the Board's workload or require additional personnel. Accounting and technical personnel now required to handle mail rate proceedings under the "need" section of the existing act can be employed for this purpose and also in handling subsidy proceedings under the new bill.

Additional responsibilities are given to the Postmaster General by the proposed bill, particularly in the setting up of mail rates for United States-flag carriers engaged in foreign air transportation. This will involve some additional workload but since the CAB has been directed to furnish the Postmaster General with such cost data as he may reasonably require and in the form he requires it, the increase in the staff of the Postmaster General need not be large.

The greatest savings that are anticipated by the enactment of this bill will be realized by the Post Office Department which will no longer pay subsidies to the carriers. Your committee is not in a position to make a firm estimate as to how much this bill will reduce the appropriations of the Post Office Department, but it has been furnished with two tentative estimates. The first is for a recent past year showing a saving to the Post Office Department of about \$34,000,000 for domestic mail service, and \$24,000,000 for foreign mail service, including overseas. These figures would represent a saving of about 55 percent for domestic service and approximately 40 percent for foreign mail service. The second estimate for the fiscal years 1951, combined both domestic and foreign air mail and indicated a total savings of about \$47 to \$50 million.

Your committee is not in a position to estimate how much of the foregoing savings to the Post Office Department may also be saved to the taxpayer. The result in this respect will depend upon the extent to which separate subsidy grants are made to the airlines.