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AIRLINE DEREGULATION

STATUS

On October 27, 1977, the Senate Commerce Committee voted 11-2 to report the Air Transportation Regulatory Reform Act of 1977. The bill approved, an amended fourth draft that was heavily rewritten during eighteen markup sessions over a period of three months, is a composite compromise of bills originally introduced by Senators Kennedy (D-Mass.) and Cannon (D-Nev.). A Senate floor vote is expected early in the second session of the 95th Congress. In the House, the Aviation Subcommittee of the Committee on Public Works and Transportation completed hearings in October on two similar bills, HR 8813 (Congressman Glenn Anderson, D-Calif., and five principal cosponsors) and HR 9297 (Congressman Levitas, D-Ga.). Markup of these bills and another airline reform bill, HR 9588 (Congressman Crane, R-Ill.), will be the subcommittee's first order of business in 1978.

BACKGROUND

The Civil Aeronautics Board (CAB), an independent regulatory commission with an annual budget of $22 million was established under the Civil Aeronautics Act of 1938 and continued with little change by the Federal Aviation Act of 1958. In creating the Board, Congress determined that the orderly development of civil aviation required that it be subject to public utility-type regulation to promote the development of a nationwide air transportation system capable of meeting the needs of commerce, the postal service, and the national defense. While the 1938 Act, as amended and reinforced in 1958, contemplated a degree of competition, the

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concept of competition was qualified by statutory injunctions to find public convenience and necessity before the CAB can assign routes and which allow a policy of competition only to the extent necessary to assure sound development of a nation-wide air transportation system.

The desirability of establishing a coordinated system gave a substantial initial advantage to airlines that already serviced existing routes and could thus more readily offer connecting service to new communities.

The Board has broad authority, not subject to review or approval by the President or by any department or agency of government, to regulate the civil air transport industry within the United States and between the United States and foreign countries in the interests of the foreign and domestic commerce of the United States, the postal service, and the national defense.

POWERS OF THE CAB

1) grants authorizations, called "certificates," to airlines to fly certain air routes;

2) approves or disapproves all rate increases or decreases proposed by the airlines;

3) grants subsidies to air carriers to finance the costs of providing necessary air service to communities when the volume of traffic is insufficient to meet the costs of such service;

4) approves or disapproves all proposed mergers, interlocking relationships, and agreements between air carriers, taking into consideration the interests of travelers, shippers, and other air carriers which may be adversely affected.

The present system of economic regulation has remained unchanged since 1938. However, the demand for air transportation has increased at an average annual rate of about 15 percent to the point that the market is now more than 240 times larger, when measured by revenue-passenger miles, than in 1938. But the rates of expansion that characterized the 1950's and 1960's have not carried into the present decade, and it is widely thought that they will not be resumed.

Today, there are 298 airlines in the country. Eighty-six new airlines have joined the market since 1938, but the CAB has never granted a new domestic airline the "trunk certificate" required by law to fly major interstate routes. Since 1950, seventy-nine airlines have filed for trunk certificates, often to serve

new routes at lower fares, but not one has been granted. This does not mean that any one airline has what genuinely can be called a monopoly of business. No carrier has more than 20 percent of the market. United Airlines leads the field with 19.9 percent, followed by American with 14.2 percent and Delta with 12.3 percent.

Of the top thirty industries in the United States, the airlines are last in rate of return of investment with profit margins running at 3 to 4 percent, and the future holds many economic uncertainties. Some airlines suffer from a lack of major capital investment. Many aircraft are approaching technological obsolescence and are fuel inefficient, while fuel prices have risen dramatically since the beginning of the decade. The airlines are facing increasing pressure from the Environmental Protection Agency to reduce the noise and pollution levels of aircraft.

LEGISLATIVE HISTORY

At the beginning of 1975, Senator Kennedy, then chairman of the Subcommittee on Administrative Practice and Procedure of the Senate Judiciary Committee, conducted a series of hearings on the regulatory policy of the CAB. The hearings were prompted by new CAB guidelines that would have ended low trans-Atlantic charter fares. In response to the hearings, the CAB set up a regulatory review committee which issued a report advocating deregulation. In addition, the Ford administration drafted a deregulation bill which was introduced "by request" in the Senate by Senators Magnuson (D-Wash.) and Pearson (R-Kan.) on October 22, 1975. The administration bill allowed airlines to abandon unprofitable routes under certain conditions; allowed airlines to raise rates 10 percent a year without CAB interference; allowed airlines to reduce rates 20 percent the first year, 40 percent the second and without limit thereafter unless CAB determined that the rates for a particular airline were below its operating costs; reduced CAB's control over airline route selection; and speeded CAB decisions on route applications.

In January of 1976, the Kennedy subcommittee issued a report advocating deregulation and the Senate Commerce Committee began hearings on the Ford Administration bill in April. Senator Kennedy (with Senators Buckley, Hugh Scott, and Hart as cosponsors) introduced his own tough deregulation bill on May 3, 1976, and Congressman Roncalio submitted an identical bill in the House on the same day. Congressman Glenn Anderson's Subcommittee on Aviation of the House Public Works and Transportation Committee undertook hearings in May on a moderate reform bill introduced by Anderson and Congressman Snyder. In June, Senators Cannon and Pearson introduced "by request" a limited reform bill drawn up by CAB. Senator Cannon added his version to the list of bills on September 20.

In the spring of 1977, Senator Cannon's Subcommittee on Aviation of the Senate Commerce, Science and Transportation Committee opened hearings on what had become the two major airline deregulation proposals in the Senate: S689, introduced by Senators Kennedy and Cannon as a combination of their original separate bills; and S292, introduced by Senators Pearson and Baker. In the House, Congressman Anderson (with Congressmen Harold Johnson, Roncalio, Ertel, Fary, and Mineta as cosponsors) introduced HR 8813 on August 5, 1977. The House subcommittee held field hearings in California, Pennsylvania, and Illinois during the summer, and Capitol Hill hearings in October. In the same month, Congressman Levitas introduced a weaker reform bill, HR 9297 which was closely followed by HR 9588 (Congressman Crane), a bill similar to S689 and a compromise of the pending House and Senate bills.

As stated before, the Senate Commerce Committee reported the Air Transportation Regulatory Reform Act of 1977, a bill based on S689 but heavily rewritten and amended during eighteen markup sessions. Senate supporters of the bill want to begin floor debate, which promises to be as lengthy and complex as the markup sessions, as soon as possible during the new session. The House has the three deregulation bills (HR 8813, HR 9297, HR 9588), plus the reported Senate bill, to consider during markup sessions which are due to begin early in the new session.

MAJOR PROVISIONS OF THE AIR TRANSPORTATION ACT OF 1977

DECLARATION OF POLICY

Under current law, the CAB is directed to promote the growth and development of the aviation industry. Throughout the substantive provisions of the Act, the CAB is required to find either "public interest" or "public convenience and necessity" as a prerequisite to all official decisions. Any carrier applying to the CAB for a route must show that the proposed route will be consistent with the public convenience and necessity (PCN). These two important qualifications are defined to mean: fostering of sound economic conditions; promotion of adequate, economical, and efficient service; and competition to the extent necessary to assure sound development.

The Senate bill redefines public interest and PCN to place a greater emphasis on the competitive free market. The new definitions: actual and potential competition to provide low fares and variety of air service, encouragement of new carriers, and an opportunity for efficient and well-managed airlines to earn a reasonable return on investment. Under the current Act, the CAB continually engages in a kind of juggling routine; it tries to parcel out air routes so that airlines already certificated have a fair and reasonable share of the market according

to the size of the company and CAB's decision about what routes are necessary. Under the Senate bill, the airlines, while allowed to make more route decisions themselves, would also be subject to the economic risks of a more competitive market.

AIRLINE ENTRY INTO NEW ROUTES AND THE CERTIFICATION

Under current law, the CAB has broad authority to impose restrictions on entry into new markets. Restrictions have been imposed to limit the number of carriers in the industry, the routes they are permitted to fly, and where they may pick up passengers. An applicant now must show that a proposed new route is required by PCN, and the burden of proof is on the applicant to show PCN. Carriers wishing to provide new service must go through a lengthy application procedure with an undertain outcome. In addition, an applicant must show that he is "fit, willing and able (FWA, able to operate and manage an airline) to provide air transportation and to conform to the provisions of the Act and the rules, regulations, and requirements of the Board.

As stated before, a CAB certificate is an airline's authorization to service an air route. Certificates specify the terminal points and intermediate points, if any, between which the transportation is authorized and the service to be rendered. A "point" may be either a given city or adjacent ones, or it may be the airport through which service is provided. In general, an airline receives a certificate to serve a route which usually includes a number of points along the route. Once certificated, a carrier is obligated to provide only minimal service, and it is fairly easy to abandon points according to the way the law has been in-interpreted. CAB statistics from 1976 reveal that 124 of the top 500 non-stop origin and destination markets presently certificated are dormant, that is, not being served.

The Board is Prohibited from imposing conditions which restrict the right of an air carrier to add to or change schedules, equipment, accommodations, and facilities for performing the authorized service as the development of the business and the demands of the service shall require. The Board may alter, amend, modify, or suspend a certificate in whole or in part if it finds that the public convenience and necessity so require. The Board has used this provision to suspend points served by one carrier, to substitute the services of another carrier on appropriate findings of need, and to order service to a fairly wide geographical area through a regional airport.

Under the Senate bill, an applicant need merely demonstrate that a proposed new route is consistent with PCN, not required by it. As stated before, the new definition of PCN includes an encouragement of free-market competition. Section 401(d) of the new bill further defines what is included under PCN by stating that innovative service, low fares, the avoidance of excessive

domination, and the "diversion of revenue or traffic from another air carrier" are not in themselves inconsistent with PCN. Airlines would be able to use fares, not just frills, to compete with each other. The burden of proof of PCN would still be on the applicant, and the proposed bill adds a further requirement for carrier entry. In order to guard against new airlines which have managed to pass the FWA requirement but whose financial stability might be questionable, the Senate bill includes a provision which would require airlines, especially new and small airlines, to have substantial liability insurance and a "performance bond" or security to travelers and shippers for failure to provide contracted services.

The most significant section of the Senate bill, the automatic market entry provision, would go into effect at the beginning of 1979 if the bill is passed in the second session of the 95th Congress. The automatic market provision applies to all certificated carriers, including charter lines, who provided 100 million air service miles (ASM) in scheduled service within the prior year; to all intrastate carriers who provided 125 million ASM in intrastate service during the calendar year preceding July 1, 1978; and to Alaskan turbojet carriers who provided service during the twelve month period preceding July 1, 1977. The provision applies to continental U.S. routes and routes to Alaska and Puerto Rico. Airlines would be able to enter one new route, not exceeding 3,000 miles, per year until 1981, when they could enter two new routes, totalling not more then 3,000 miles, per year. The carriers would indicate their choices by the first of the year, and the CAB would have to declare its decision by the first of March. The CAB would approve these applications on the basis of the financial and FWA test; but, of course, the PCN test would not be a consideration since market competition would be regarded as consistent with PCN. Each year the CAB must grant all requests for the same route; after that approval, each route would be closed to the entry of new competitors for two years. When an airline's request is granted, that airline must agree to provide service for a minimum of eighteen consecutive months.

The bill provides for two protective devices to insure some stability in the airline business during the period of transition from a totally regulated system to a partial free-market system. The first would protect air routes from competition for some years, although the five biggest airlines (United, American, Eastern, Delta, TWA) would not be able to protect any of their routes. Under the automatic entry provision, competitors could enter only three routes of the second five largest airlines (Braniff, Continental, National, Northwest, Western) in 1979, and only four in 1980. Competitors could enter only two routes now serviced by the smaller local airlines during each year of the period 1979-1981. After 1981, all routes of all carriers of any size would be open to competition. The second protective device would

enable each carrier to designate three specific routes in 1979 as closed to automatic entry, three in 1980, three in 1981, two in 1982 and one in 1983. The CAB would retain a limited right to declare a route ineligible for competitive entry because of unusual circumstances and if the entry caused "harm to the national air transportation system" or substantial reduction to small town service.

In the case of "dormant authority" (that is, an air route which has been awarded to a carrier but which is not being regularly served by that carrier), the Senate bill provides that a new carrier can apply for and be awarded that air route if it passes the usual FWA, PCN, and financial tests. There would be no minimum service requirement for the new carrier. It is estimated that 85 percent of all routes already certificated come under the classification of dormant authority. Most of these are short routes.

EXIT FROM MARKETS

Under current law, carriers may petition the CAB for permission to discontinue service. Exit from a route may be allowed if there is inadequate consumer use of the service, but carriers are sometimes required to continue low-profit services if the CAB finds that it is in the public interest to maintain them.

Under the Senate bill, a carrier must give the CAB and any affected community ninety days notice that it intends to terminate or suspend service to a point which it is required to serve. The CAB would be able to prohibit termination or suspension for ninety more days or until it could find an alternate carrier to take on the route, and this prohibition could be extended until such service is found. The airline prohibited from exiting would be subsidized by the CAB if the route is not profitable.

FARES

Under current law the CAB has broad authority to set rates, and it uses this authority to determine whether any fare increase or decrease proposed by the airlines is consistent with the PCN. As general fare policy, the CAB must take the following into consideration: the effect of rates upon movement of traffic; its own duty to promote an adequate and efficient transportation at lowest cost; the inherent advantages of air traffic; and the need of each honest, economical and efficient carrier to obtain sufficient revenue. The CAB has the same rate authority over cargo and charter rates, although it has not historically regulated them to the same extent.

If passed into law, the Senate bill would require the CAB to consider the need of an air carrier for profit, the desirability

of off-peak prices, and the desirability of competitive pricing. After July 1, 1979, the CAB would be able to disallow a fare as too high only if it is more than 5 percent above the "standard industry fare level," the current profit-making fare adjusted semi-annually by cost index. The CAB would be able to disallow any fare as too low only if it is more than 35 percent below the standard industry fare level or if it violates the antitrust laws. The 35 percent standard may be increased after July 1, 1979, to allow even lower prices. The CAB's policy over charter and cargo fares would be unchanged.

SUBSIDY PROGRAM

Under current law, the CAB parcels out government subsidies to airlines based on the "need of each such carrier...for compensation...sufficient to insure the performance of such service."

The Senate bill would establish a new subsidy program based upon community need rather than carrier need. The CAB would be directed to provide subsidy compensation needed to ensure "essential minimum service" to "eligible points," that is, to small communities isolated from the major air traffic lanes that the airlines regard as unprofitable or not worth the trouble. By July 1, 1979, the CAB, after consultation with local and state officials, would establish standards of eligibility of points, taking into consideration the relative isolation of a community and the possibilities for alternative transportation. All points currently receiving air service would be guaranteed continued service until July 1, 1988, under the new subsidy program. This provision would guarantee an essential minimum service for these points of no fewer than two round trips per day, five days each week. After July 1, 1982, the CAB could transfer the subsidy to a new carrier if that carrier can show that he can provide substantially better service for the same price or a lower price. Thus, a degree of competition would be included in service to small communities because even though a community was being served by only one local service airline subsidized by the CAB, a new airline could take over the market if it could prove its case to the CAB. However, each local service airline would have a guarantee of the opportunity to serve a point for two years before another airline could attempt to supplant it. The CAB would partially base all such decisions on the desirability of having an integrated air system in each area and the comparative experience of airlines seeking the subsidized service to any area. The current subsidy program, based on carrier need, would be phased out gradually and terminated on July 1, 1985.

TRANSITIONAL LABOR PROTECTIVE PROVISION

This provision was designed to protect airline employees who might lose their jobs if the new competitive market did force inefficient airlines out of business. Under the bill, all employees, except officers of the airline companies, with at least four years experience by the date of enactment of the bill and whose jobs were lost by the bankruptcy of their employers, or whose jobs were lost during a period during which 15 percent of their fellow employees were laid off, would be eligible for unemployment compensation to insure that they would not be in "substantially worse financial position with respect to wages and fringe benefits" for three years. The employee would receive relocation expenses and compensation for the forced sale of his home. Certificated carriers would have to give such an employee priority when hiring new employees. This provision would be in force for ten years after the date of enactment of the bill. During the markup sessions, this section of the bill was hotly debated. Opponents have said that they will renew the fight on the floor of the Senate.

WILL FARES GO UP OR DOWN?

Proponents of easing CAB's regulatory authority contend that the airline industry exists under a market situation where service and "frill" competition has taken the place of a normal price competition. This lessening of essential service competition has been exacerbated by the prohibition against the entrance of new airlines that might be expected to set the pace in innovation and hard work. In California and Texas, large intrastate airlines, unregulated by the CAB, have been successful in offering basic air transportation at substantially lower fares (about half of CAB's fares) by enplaning more passengers per flight and achieving higher levels of productivity.

Further, proponents point to a report done by the GAO on February 18, 1977, which concluded that consumers could save $1.4 billion annually if the airlines operated under less regulation. Since the cost of flying a plane from one point to another is fixed, profits are a result of high load density, which could be increased if airlines were allowed to attract more passengers by offering lower fares. The experience of a number of small intrastate airlines has shown that lower fares induce people to abandon their cars and other forms of transportation for low-cost air transportation.

Opponents of regulatory reform contend that deregulation will produce a period of cut-throat price competition after which fares will inevitably rise. They contend that the GAO report made a

number of unwarranted assumptions which can be contradicted by CAB's own statistics. The successes of the large intrastate airlines are not directly transformable into a nationwide business system. For example, most of the intrastate operations are in dense traffic markets without an obligation to provide continuing service to smaller markets; their operations are confined to a relatively limited geographical area resulting in little, if any, crew positioning and crew layovers; and the nature of their operations (turn-around commuter service) lends itself to high equipment utilization and employee productivity, dense seating configurations, minimal ground handling and onboard amenities and service, and standardization of aircraft.

ARE THE AIRLINES STABLE ENOUGH FINANCIALLY TO SURVIVE REFORM?

Proponents of deregulation argue that reform will allow airlines to make a reasonable return on their investment for the first time. Return on investment for airlines for the last five years was only 3.6 percent, which makes the airline industry one of the least profitable American businesses. Under the current act, the airlines are allowed a 12 percent return on investment, a goal that the airlines as a group have not been able to reach in the last twelve years. Competition would allow more aggressive financial strategy and would force management to become more efficient.

Both proponents and opponents of reform argue that the poor financial portfolios of the airlines make nationalization a possibility, as has happened to the railroads. Proponents contend that many airlines have been overly protected by the umbrella of government regulation and that this has allowed their inefficient operations to remain afloat financially. They concede that reform might force some of the poorly-managed airlines out of business but argue that such is the nature of the free-enterprise system. The surviving companies would take over the abandoned routes, thereby supplying consumers with better and cheaper service while increasing their own profits.

Opponents of reform, which include most of the financial institutions that finance loans and investments for the airlines, argue that the uncertain market situation caused by reform would make many investors reluctant to finance new investments for the airlines. They argue that regulatory reform could better be endured by a more financially stable and profitable industry, but that the airline picture is already too clouded and uncertain. Major capital investments are already scarce. Many workhorse

aircraft are not only fuel inefficient but approaching technological obsolescence. The boom in airline travel is over and profit margins are likely to decline even farther.

Thus, many airlines would face bankruptcy and the entire air transportation industry would be disrupted.

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