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NEW AIR SERVICE AND DEREGULATION: A STUDY IN TRANSITION

MARVIN S. COHEN*

Note: The Editors are pleased to reproduce here the keynote address delivered by Chairman Marvin S. Cohen to the Thirteenth Annual Air Law Symposium in Dallas on March 22, 1979. Delivered in conjunction with the release on March 23 of the Board's Staff Report on Airline Service, this address represents the first official review of early experience under the Airline Deregulation Act of 1978.

A selection of the papers presented at the Symposium will be published in Volume 45, Number 1 of the Journal, Summer, 1979.

—The Editors

IT IS A PLEASURE to spend an evening with practicing lawyers. Having left the practice after fifteen happy years in Tucson, I often miss the acid camaraderie of the trial bar. My first trip to Dallas was in 1959 to attend an SMU symposium on condemnation law. I was particularly appreciative then of the efforts of Dallas County officials to protect me from the evils of demon rum. It was impossible to buy liquor by the drink—you could only purchase a whole bottle of whiskey. I recall, as I worked on the bottle that night, pondering on the infinite wisdom of government regulation of human conduct. And here we are twenty years later—and I finally have an opportunity to do some deregulating.

I bring you good tidings about the first six months under the Airline Deregulation Act of 1978. Dallas is a particularly fitting city for my remarks since the Texas experience with an open rate system was an important catalyst for the new law. Tonight I would

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like to present an overview of the changes in patterns of service that have occurred over the last year and to discuss the implication of these changes for small and medium-sized communities.

Before I do, a little background. There have traditionally been three types of scheduled air carriers in the business of transporting passengers in this country—trunks, local service airlines, and commuters or third level carriers. The trunks are the major airlines, United, American, TWA, Continental, Braniff, Delta, Eastern, Western, and National. The local service airlines such as Ozark, Allegheny, and Hughes Airwest developed after World War II, with federal government help, to serve small communities. But as jets became available, local service airlines, obeying the laws of economic evolution, bought jet airplanes and started moving to the larger markets. As they left small towns, a new phenomenon arose—unregulated by the CAB—the commuters or third level carriers which utilize small aircraft (nine to fifty seats) to serve small communities.

For forty years the Board controlled the shape of the national systems for all carriers except commuters. It closely controlled entry into the airline business, the routes which each airline was permitted to fly, and the fares they charged. I assume that the agency did its best to apportion out new authority but many of the criteria for carrier selection had nothing to do with creating efficient networks. Over the years, virtually all the carriers served markets that were marginally profitable, but most likely were not as profitable as routes they would have chosen had there been open access. While the certificated airlines deleted or suspended service to approximately 200 points over the years, regulated entry and exit generally prevented them from operating an economically rational system. With uniform high fares, airlines competed on service, raising costs to the high level of prices.

The Airline Deregulation Act of 1978¹ significantly reduced the barriers to entry and exit and set the stage for a much needed realignment of the structure of the total system. The flexibility of the new law enables airline managements to make major changes to their route systems more quickly than we could, and to tailor those changes to their specific needs.

¹ Pub. L. No. 95-504, 92 Stat. 1705 (1978).

The desire of the carriers to control their own destinies is vividly demonstrated by the industry's response to the unused authority provision of the Airline Deregulation Act. This provision permits any carrier meeting FAA safety certification requirements to apply for authority to begin service in any city-pair where the certificated incumbent has not provided at least five nonstop roundtrips a week for thirteen of the previous twenty-six-week period. Since November, new services have been instituted in about 200 markets. A number of certified carriers have used this provision for major expansions into new markets. For example, Braniff has added forty-seven new markets to its system and North Central and Hughes Airwest each have added eleven. In addition, the provision has served as an important vehicle for new entry into certificated interstate service. All four of the large intrastate carriers—PSA, Air California, Southwest, and Air Florida—have entered into major markets and seven commuter carriers have entered into numerous certificated markets.

What we are witnessing is a further evolution of the air transportation system. Newer third level carriers are providing services to the small towns and cities which the local service carriers have outgrown. Concurrently, the latter are expanding into many of the markets being vacated by the trunks while continuing to expand into competitive markets. I might add that with the cost of fuel escalating at an unprecedented rate, the ability to create a good fit between equipment and markets becomes essential to assuring high levels of service at reasonable cost to the public.

So far it appears that deregulation is consistent with a profitable industry. In 1978, passenger traffic was up sixteen percent over 1977 and 1978 operating profits about doubled those of the previous year. As we move into 1979, traffic growth remains strong, with February showing more than a twenty percent increase in passenger boardings over February of 1978. Although we can't say that this kind of expansion will continue indefinitely, we anticipate that the industry will continue to do well and certainly will do no worse than other unregulated industries in the event of a general economic downturn.

For me, however, the fundamental question is whether deregulation is benefitting consumers. My answer based on evidence to

date is an emphatic yes, although not everyone benefits to the same degree. We know that last year consumers saved approximately \$2.5 billion in real dollars through lower fares. We also are seeing more new, innovative low fares on the horizon, such as World Airways' \$100 transcontinental fare, Air Florida's \$50 Washington-Miami fare, and Texas International's new Washington-Houston/Dallas \$138 unrestricted roundtrip service.

But fares only are half of the equation. The other half is service. And although we don't hear anyone complaining about new lower fares, we hear a great deal from those communities that have lost some air service. The ability to offer a variety of fares and services requires the entry and exit freedom provided in the new law. In the absence of freedom for airlines to enter new markets, low fares would not survive over the long term because the discipline of competition would be lacking. Congress recognized that an open system could result in service cutbacks—particularly at some of our smaller communities—and therefore established a system that encourages commuter airlines, with the right equipment and the experience at providing small community service, to enter those markets. So although some cutbacks in service were anticipated, I am pleased to report that to date about ninety-eight percent of the traveling public has the same or more service available today than they had one year ago.

Significantly, now that we are six months into deregulation we find that, contrary to the prediction of many critics that all the carriers would shift service to denser markets, service is improving to the vast majority of communities. Statistics contained in the Board's *Staff Report on Airline Service* show a system-wide increase in service as measured by aircraft departures. From February 1, 1978, to February 1, 1979, this increase was 8.4 percent. The staff report also categorized service changes in terms of "hub" and "nonhub" airports. An analysis of all 891 communities receiving regularly scheduled air service shows that service to our smallest communities or nonhubs was up 5.2 percent over last year, and that service to small hubs increased by 8.4 percent. Not only is there more service to those communities but the quality of that service has improved as well. Thus we see that the greatest increase in frequencies—up 13.1 percent—was for service between very

small communities or nonhubs and medium hubs. Service between small hubs and large hubs was up 11.6 percent.

The nation's 151 hub airports account for 92.8 percent of the total air traffic. Total departures were up or stayed the same at 117 of these hubs. The remaining thirty-four experienced an average decline in total departures of just 6.9 percent. At the nation's 740 non-hub airports, service increased or remained constant at 459, while departures declined an average of 21.2 percent at the remaining 281. Incredibly perhaps, service cutbacks in total affected only two percent of the traveling public.

But what about communities that have lost air carriers? The report shows that seventy communities have lost all service from one or more airlines. Some airline service remains, though, at all seventy cities. At most of these points, the impact on frequency of service has not been very great. Indeed, at five cities service actually increased; at twenty-eight the decrease was five percent or less and only at twenty-one cities did service decline by more than fifteen percent. These figures tell us some interesting news about the emerging system.

At the smallest communities, we continue to see service being expanded at noncertificated points. By this I mean communities to which the CAB never licensed air service or at which the license was revoked or suspended for lack of service. Today, about 200 of those communities, which generally enplane under twenty passengers a day, are receiving frequent service with eight- to twenty-passenger aircraft linking them to the national air transportation network without government subsidy. Next, we have the group of small communities whose subsidized certificated service has been replaced with commuter service. The response of these communities is rather interesting. At first many of them were quite upset about the loss of larger aircraft—fifty seats or more—service by a certificated carrier. Yet these communities soon discovered that a schedule of four to six or more roundtrips a day with a fifteen-seat aircraft is far preferable to two roundtrips with a fifty-seat plane. I have heard time and time again, in my recent travels around the country to study small community service, how pleased communities such as Waco, Texas, Frederick, Maryland, and Salem, Oregon have been with replacement service. In twenty-five of thirty-seven

small communities studied last year by the Board's staff, passenger traffic improved considerably when a commuter with frequent service replaced a local service airline.

The third group of communities include the small- to medium-sized cities. It is from this group that we have heard some of the most vocal objections to deregulation. It appears that many of the objections have more to do with loss of *status* than with loss of *service*. Let me explain by way of a few examples. Providence, Rhode Island, was quite upset when American Airlines and National Airlines announced their intentions to terminate service. The city lost twelve weekly jet flights to New York City. But what was left? Over 380 weekly jet flights on Allegheny, Eastern, and United, including seventy-six flights to New York. In addition, TWA has just been awarded Pittsburgh-Providence dormant authority, providing the city with new trunk service. Shreveport, Louisiana, protested the departure of Braniff and Texas International which together accounted for only fifty-one out of 479 weekly jet flights. Within a few days of the announced pullouts, Frontier notified the community that it would be instituting service.

An example of justified concern is Charleston, West Virginia, where American has terminated service and United has cut its service fifty percent. Most upsetting to this small hub city is the loss of all nonstop service to Pittsburgh provided by United. While the concerns of the community are very understandable, it still has good service in many markets by Allegheny and Piedmont, and Allegheny has indicated that it will begin Charleston-Pittsburgh service when United departs at the end of June.

These few examples bring to the fore the central point of deregulation—and, by the way, this is a serious question—where are these airplanes going? When United takes equipment out of Charleston, it doesn't fly it into the Atlantic but puts it into service over other routes. Let's look for a moment at some of these changes. Take Kansas as an example. We find that from February 1, 1978, to February 1, 1979, Emporia lost all its service of forty-seven weekly flights and Lawrence lost fifty percent of its service. On the other hand, service of Goodland rose 188 percent, going from twenty-six weekly flights to seventy-five. Service to Garden City was up twenty-nine percent, Manhattan fifteen percent and the

larger city of Wichita up 17.5 percent. If we look at a map we quickly see that Lawrence is on a four lane divided highway twenty miles from Topeka and twenty miles from Kansas City. Emporia is about sixty miles from Topeka on a four lane highway. But Goodland, Garden City, and Manhattan aren't very near to anything. The closest hub for Goodland is Denver—over 160 miles on secondary roads. So what I see in Kansas is that service is going to the communities that need it the most, and who could ask for anything better? We see similar changes all over the country. For example, service to Dubuque was up twenty percent while it was down six percent at Waterloo, up twenty-four percent at Amarillo but down three percent at Abilene.

It is clear that all airlines, regardless of size, are placing equipment in the markets that have the greatest demand consistent with the most efficient operation of their system. This is how the industry ought to operate. Some cities will lose some service but in time the great majority of communities will get the level of service that matches demand. And importantly, the overall cost to the public of this improved service is already and will continue to be less than under full government regulation.

The deregulation experience to date has been quite rewarding and so far is living up to—if not exceeding—our expectations. The industry is providing more service and the quality of service is at least as high as it was when the Board used to second guess every move the carriers wanted to make. I believe that deregulation can properly be labeled a success if the industry performs at least as well as it did when regulated. The early indications are that it's doing better.

Now you might ask, if things are going so well, what are we doing in Washington. The answer is that we are keeping very busy working on the rough edges of the new system. Certain problems appear to be endemic to a transition from a regulated system to a market system. These include protecting the public from carriers exercising monopoly power before competitive forces can come into play, assuring that consumers have at their disposal an adequate process for disposing of complaints, and abolishing anti-competitive agreements within the industry that are not required for the delivery of convenient air transportation. But to date these problems have been relatively minor.

One transitional issue that is requiring a lot of our attention is setting the essential air service program in place. Because this is so closely related to the changes in service I just described, I would like to say a few words about it. The new law requires us to determine the essential level of air service for over 500 communities by October 24 of this year. This is no easy task, for although we are developing national guidelines for equipment type, number of markets, etc., we are finding that each community has unique characteristics which must be reflected in any final determination.

The development of this program has necessitated a little on the job training. For example, last December we gave permission to Texas International to terminate service at three points in New Mexico on less than the notice period required in the Act. Reasoning from the fact that two local commuter operators said they would pick up the service using smaller, more economical aircraft without subsidy, we felt TXI should not be held in an uneconomic service. What followed was about one month of rather erratic service at two of the three points and a flurry of communications to the Board from a justifiably upset public. We learned the important lesson from this episode that commuter carriers cannot double the size of their operations overnight. In that case we ordered the local service carrier to assure that essential service was provided. We are now providing for a mini-transition period so that if the commuter suffers growing pains the withdrawing local service carrier must take action to assure that essential service is maintained. This obligation will run for thirty days subject to renewal if the new operator appears to be having difficulty maintaining service.

The questions involved in the essential air service program are particularly thorny in the short run because of the limited supply of equipment. Right now there are approximately 1,289 aircraft in the commuter fleet. Of those, less than 700 have more than ten seats and there are only a few hundred in the fifteen-twenty seat range. So you can see, if the Board concluded that essential air service must be provided with at least fifteen seat aircraft, regardless of the number of daily passengers enplaned, we would be in an impossible situation. Similarly, if we were to find as a general rule that every point is entitled to be connected to two hubs, we again would be placing serious constraints on the capacity of the

system. This inevitably—as in any situation when demand exceeds supply—would lead to inflated costs and excessive federal subsidies. Our goal is, by working with the affected communities, to shape a service pattern that meets their perceived needs as best we can within the parameters established by the Airline Deregulation Act, and at the same time to preserve incentive for the airlines providing the service to operate profitably without subsidy.

Over the next three years the fleet of commuter aircraft will more than double. This will make our job much easier. Indeed the fact that orders with manufacturers are way up indicates to me that businessmen are optimistic about the potential for third level service and that over time the essential air service program will function very smoothly without much input from the CAB. And that is how I think this country's air transportation should be provided.

We are in the midst of one of the most exciting economic experiments in this country's long and exciting history. The Congress and the President were convinced that the private sector should not be shackled by unnecessary government intervention. They demonstrated real commitment to the free enterprise system that is the cornerstone of our society. So far that commitment is paying off for the public and the industry.

In six years the CAB will go out of business—the first major federal regulatory agency in history to do so. We hope that it will set a precedent for other economic regulators—like the ICC. While I'm obviously enjoying my stint in the federal employ, I look forward to rejoining you at the trial bar once the airlines are on their own.

