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RECENT ADDRESS

GOVERNMENT POLICY CONCERNING AIRLINE SUBSIDY

BY C. R. SMITH

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THE temptation is great to dwell upon a subject which is uppermost among the immediate problems of the airline industry—the urgent need for adequate airline rates. But because there has been so much analysis and discussion of this subject recently, I will say only this: That the airlines cannot be expected to meet the costs of 1957 with rates which approximate those of 1942, fifteen years ago.

I would like instead to discuss another subject, that of Federal subsidy for the airlines, for the establishment of sound public policy on that subject will have much to do with the future success of the carriers.

In the earlier days of pioneering, our business was one which presented some unusual financial problems. We were in the unique and unenviable position of losing money each year even if we were to sell one hundred per cent of the product manufactured. The costs of operating airplanes were high, their load carrying capacity was limited, and even the total of potential income could not meet the cost of operation.

Faced with that basic situation, we were kept in business only by the vision and courage of the national policy affecting air transportation. The government was willing to aid our business, by the payment of subsidy, until it could be self-sustaining. A similar policy of assistance, in another form, had previously accelerated the development of our railroad system.

We shall always be grateful for the aid in early days. We have done our best to justify the promise of aviation, that it would be a worthy and useful addition to the national system of transportation. We have, by diligent work and devotion to sound business principles, done our best to advance the time when air transportation could be self-sustaining. The domestic trunklines have in fact reached a position where all of their present operations are being conducted without subsidy. We are equally interested that subsidy will not again be required in the future.

May I state at this point my own view regarding the appropriate role of Federal subsidy. I think it will be generally agreed that Federal financial assistance should be provided only where there is a clear-cut need for such aid to accomplish some objective in the public interest—an objective that could not otherwise be adequately realized. Subsidy should *not* be used as a means for removing the normal managerial risks associated with a business enterprise. Nor should it be used as a substitute for timely and effective regulatory action by the government. Therefore, as any portion of the industry reaches a position where it has the inherent capability for self-sufficient operation—assuming sound management and sound regulation—I believe it should be removed from the protection of subsidy assistance.

It is difficult to discuss “the airlines” as a single group, with the implication that all sections of the industry have or will have identical problems. This is especially so when the discussion relates to the justification, or potential justification, for Federal subsidy. Generally, for the purpose of this

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discussion, the United States airlines can be divided into three groups: The overseas carriers, the local service carriers, and the domestic trunklines.

The overseas carriers: Our overseas airlines compete in the world market for international air traffic, and in that field they compete with the carriers of other nations. A high percentage of their competitors, the foreign flag lines, are in effect instruments of their nations' policies. Many of them are owned, wholly or in part, by the nations which they represent. Conditions of competition in the international field are, for that reason, different from those in the domestic field. Some of the foreign carriers can or do receive subsidy from their governments, in one form or another. For that reason our government should have the ability, I believe, to make subsidy available to United States overseas carriers if that should become necessary in order to maintain a suitable position in overseas commerce for the United States.

The total subsidy needed by the United States overseas carriers has been decreasing, and some of the routes are now on a subsidy-free basis. We may hope that, ultimately, the total of this subsidy can be eliminated, but, for the present at least, the basic legislation which makes subsidy possible for these carriers should be retained.

Local service carriers: This second group of carriers is certificated to serve the very short-haul routes and the smaller cities of the country; to provide a needed system of air transportation in many areas where air service cannot now be economically sustained by the available traffic, without aid from the government. Today it would be difficult for these carriers to make a living, or even to survive for long, without such aid from Federal subsidy. It is not clear that this situation will change soon, for the problem of profitable operation has been intensified by rising costs. These carriers provide a useful and needed public service, and government aid should continue to be available to the extent of their reasonable requirement.

It is important, of course, that such subsidy not be provided to underwrite local service competition on routes already adequately served on a self-sufficient basis by subsidy-free carriers. It should instead be provided only to support needed public service which could not otherwise be maintained.

Trunkline carriers: We come to the third classification of air carriers, the trunkline operators. They engage in business between the principal traffic centers of the country. They also serve many smaller communities, but the principal part of their traffic, and of their income, derives from traffic carried between the larger cities of the country.

All of these carriers, at some period in their corporate existence, have received subsidy aid from the government. None of these carriers receives subsidy at this time.

We can conclude, and I believe it to be a reasonable conclusion, that the subsidy paid during the early pioneering days, to all of the carriers involved, has proved to be a good investment for the government and for the country. But the real question, and one which concerns a national policy of basic importance, is whether or not the government should continue to leave the door open for possible resumption of subsidy to these trunkline carriers—to all or any of them. Obviously there must come a time when the trunkline carriers will be entirely "on their own," and thereafter free to receive the benefits of growth and good management, but obligated also to pay, in the usual way of business, for mistakes which may be made in the management of their business. The real question is "has that time now arrived?" I believe it has.

The first question which the business man would ask is: "Can the total of needed trunkline service in the United States be operated with reasonable profit, without subsidy aid from the government?" The investment banking firms and insurance companies have done much statistical work in this area, resulting from their interest in air transportation as a field for investment. I am sure that they would agree that, given adequate rates and without wasteful competition being imposed on the carriers, the total of the trunkline system should be able to operate profitably without government aid. That, I am sure, is the situation today. With a continuing growth of the business, which reasonably can be anticipated, there is every reason to conclude that the total of needed trunkline service should be capable of self-sustaining, profitable operation.

As a matter of fact, I believe that a good case can be made that the retention of subsidy for the trunkline carriers is apt to defeat the objective of a national system based on sound business economics, rather than otherwise.

First, I believe it to be the history of American business that, given the basic economic opportunity for profitable, self-sufficient operation, a company's overall financial position will in the long run, be weakened rather than strengthened if there is simultaneously an opportunity to call on the government for aid. Business men are not greatly different from other people. Historically they have done their best when the end result of their work is dependent on the skill with which they manage their enterprise. A business man dependent on government aid, or a business man with the knowledge that government aid may be available, is a bit like a young man entering business with the background aid of a financially strong family. It is not at all impossible to do well under such circumstances, but the history of American accomplishment stems rather from the efforts of individuals and organizations which are "on their own."

Second, on the principal routes there are usually two or more carriers. On some of the routes there are as many as eight carriers.

Some of these carriers have proven, unmistakably, that they can operate with profit, without subsidy from the government, provided transportation rates are reasonable and other aspects of Federal regulatory policy are sound. These carriers expect to operate without subsidy, and their plans are made on that basis. They receive no subsidy and expect none.

If, however, the government should elect to subsidize one of the carriers on the route, the competitive situation would be seriously changed. The carriers who formerly competed among themselves, on an equal, non-subsidized basis, would then find themselves competing against a carrier partly underwritten by the Treasury of the Federal Government.

It can scarcely be sound public policy to pit subsidized carriers against unsubsidized carriers. Competition which is financed with Federal funds is unlikely to be fair; indeed it cannot be fair, for certainly the resources of the Federal Government will outbalance any resources available to an individual carrier.

Those who are in the business of lending capital may view their risk as being minimized if repayment thereof is guaranteed by the "need" section of the Civil Aeronautics Act. I am not sure, however, that this is a sound financial conclusion, for the loans are apt to be to many companies in the field of air transportation, and it would be little comfort if one loan should be improved by the provision of subsidy, while many other loans are damaged by the difficulties of Federally financed competition. I am sure that many financial institutions could view air transportation as a better credit risk if air transportation should be governed by the usual rules of good business.

We come then to what I consider to be some sound conclusions:

1. The policy of the government, which provided aid for the carriers during their early pioneering days, was a wise policy and was beneficial to the national interest. As a result of that policy we have today the strong system of national and international air transportation with which you are familiar. Without that policy, certainly the time when that system of air transportation could be available would have been much longer delayed.

2. We should encourage the reduction of subsidy in all areas of air transportation, in keeping with the respective ability of each major category of carriers to operate self-sustaining service. But we should preserve the ability, through retention of the basic legislative authorization, to subsidize carriers engaged in overseas commerce, and in local service operation, when it is proven to be in the public interest to do so.

3. Domestic trunkline operations have now reached a position where, with sound management and sound regulation, self-sufficient operation should continue to be possible for the future. Subsidy should no longer be available for such operation. The trunkline industry as a whole will, in my opinion, be best off in the long run if the government adopted such a policy clearly and unequivocally.