

1959

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Recommended Citation

L. H. Slotemaker, *Civil Aviation in Transition Towards Economic Self-sufficiency*, 26 J. AIR L. & COM. 209 (1959)

<https://scholar.smu.edu/jalc/vol26/iss2/6>

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CIVIL AVIATION IN TRANSITION TOWARDS ECONOMIC SELF-SUFFICIENCY¹

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SUMMARY

Large, fast jet aircraft will eventually make air travel cheaper and transport more passengers. At present the very heavy investments needed come largely from governmental sources, but the economic advantages offered by jets might make it possible to attract private investors.

A trend exists towards the elimination of wasteful competition between airlines: agreements have been reached between companies both in Europe and in the U.S. This can lead to more rational route patterns, higher load factors, and savings on sales organizations. This tendency has been started by the airlines themselves, not with the aim of setting up cartels, but to increase their service to the public by maximizing efficiency. In this way airline operation may be made a self-sufficient activity, and private investments in civil aviation be encouraged.

I was asked to make a short speech (of about ten minutes) on the financing of the new, very expensive jet planes.

But I have changed the title of my speech, because I rather prefer to try and place the subject in its true perspective, which is, in my opinion, that civil aviation is now in transition from a subsidized and government-controlled industry towards greater economic self-sufficiency, making it much more attractive for private investors. However, the change of title will not make my speech any longer. And I will now try to explain why we can regard the air transport industry as being in a state of transition.

First of all, there is the switch-over from piston-powered aircraft to the much faster and larger jet planes. These planes, for various reasons, can be expected to operate more economically: they will be able to fly more hours a year for a greater number of years. It is significant that U.S. commercial banks, in a number of loan agreements for the financing of jets, have sanctioned a 10-year maximum amortization period (as against 5 to 7 years for piston-engined planes).

With longer amortization periods and lower operating costs the cost per ton/mile promises to be quite a bit lower than before.

The larger jet planes will also provide the way to cheaper mass transportation. It is true that since April 1st of this year a small surcharge on jet fares has been introduced, but this surcharge, rather than affect the traffic (jets are now the great attraction to the traveling public), will create additional revenues for the carriers concerned and thus will help meet initial costs. This surcharge in my opinion should therefore be regarded as only temporary.

I think that as soon as more precise facts are known about the costs of jet operations and jets have become a common feature in air transportation—i.e. after a certain transition period—the surcharge will not only disap-

¹ Presented at the XVIIth Congress of the International Chamber of Commerce in Washington, D. C., April 24, 1959.

pear but a general decrease of fares will follow, and this decrease will be a stimulant to an unprecedented growth of traffic.

However—and now I come to the problem of finance in this completely new era, the jet age—enormous investments are necessary, not merely with regard to the purchase of these jet planes but ground equipment and new workshops are also required. Then pilots and other personnel will have to be trained in the new techniques of operating and maintaining the jet planes.

Investment requirements for the U.S. airline industry are estimated at over \$3 billion, of which about \$2.5 billion is for flight equipment. For the non-U.S. carriers I estimate this amount at another \$1 billion, of which \$750 million is for European airlines.

To the degree this money does not come from sources as depreciation, retained earnings and sale of surplus equipment, it has to come either from governments or from private investors.

Government investment means governmental control of an industry which—like shipping—should be run on a basis of private enterprise, as already pointed out by M. Georges-Picot in his introductory statement and we should not forget that these same Governments, during the present transition period, are faced with enormous investments in the infrastructure to make jet operations possible: much longer runways are needed, new approach systems have to be developed, and bigger terminal buildings must be erected. To some extent the aviation industry as a whole is already paying directly or indirectly for ground and air navigation facilities out of its present very meager profits—if any. And because their profit margin is so small, the airlines cannot be expected to make a sizable further contribution for the time being.

Coming back to equipment financing, what about the private investors? They will be interested only if the industry is run on a sound commercial basis, paying its own way and promising a reasonable profit.

With but few exceptions the international air transport industry has not yet reached that stage. Civil aviation, generally speaking, is still a government affair: in many cases there are government subsidies, government ownership or participation, government protection and government control.

The economic advantages of jet operations, however, might alter the picture as far as subsidies and therefore government control is concerned—after a transition period, of course. Costs are likely to decrease, while revenue can be stimulated by opening up new sources of traffic, attracted by lower rates and fares. Here I am not only thinking of the fare level for jets. It is reasonable to expect a rate-differential for piston-engined aircraft; this means still lower fares for this type of plane providing a new incentive to a modern feature: the inclusive tours, for which a considerable market is opening up. This is one reason why one need not fear too much that the introduction of jets will result in an over-capacity.

And there is still a further most promising possibility to make civil aviation a self-supporting industry, namely by eliminating wasteful competition. This could be achieved in the foreseeable future by the airlines through their joint efforts. And here we come to still another field where civil aviation is in transition.

Some forms of cooperation already exist. One has only to think of the well known Scandinavian Airlines Consortium. Further, in October last year an agreement was signed between SAS and Swissair, both of which face many similar problems such as their re-equipment programs, maintenance organizations, etc. The basis of the agreement is the conviction shared by the two carriers that their investments can be reduced and operational economy improved by a co-ordinated equipment policy and joint utilization of workshops and technical and operational organizations.

Another interesting agreement has been made between Pan American Airways and National Airlines. The latter is unique involving as it does exchanges of stock and equipment leasing. One advantage of this agreement is that National can reduce its equipment bill. The leasing, furthermore, helps NAL in the Florida winter season and PanAm in the transatlantic summer peak.

Other plans for even more far-reaching cooperation are now being studied, such as combinations between European airlines.

The airlines are thus turning away from their Governments towards mutual cooperation and consequently to a system of free enterprises flying on their own power. And it is interesting to note that here the individual airlines are taking the initiative; it is not a government venture.

Admittedly the difficulties of establishing such forms of cooperation are enormous, but the advantages to be realized are even greater. To understand this, one has only to look at the present situation in Europe.

The European network of air services is not primarily adapted to the needs of the intra-European traveler, but is rather a feeder system for the many and geographically divided intercontinental operations. The route-map of Europe reveals the existing route pattern as a series of big cities with routes radiating from them ("hubs and spokes"). This is a consequence of nationalism—each carrier concentrating its efforts on its own main cities. Any combine, on the other hand, would make possible common network adequately adapted to the needs of the public, with flights properly spread over the day or week and without duplications, but with more connections and with higher frequencies. All this would increase load factors and thus revenues.

As far as the expenditure side is concerned, the scope here is immense: with a close cooperation between carriers we will see an increased annual utilization of aircraft, combined and therefore more efficient maintenance and overhaul units, combined purchases and cost-saving standardization. Also a joint sales organization will bring considerable savings. Just walk along Fifth Avenue in New York and notice the expensive separate sales offices of I do not know how many airlines, mostly offering the same possibilities and facilities for the same price.

At this point I think it is good to say that the idea underlying such cooperation is not at all the formation of huge international cartels. The main purpose is cooperating to lower costs and to improve services to the ultimate consumer, the passenger and the sender of freight.

The advantages of eliminating wasteful competition by way of combined efforts are so crystal clear that Governments can hardly refuse to let their carriers join forces with airlines of other nations. Actually the intergovernmental European Civil Aviation Conference has already formulated recommendations to that effect and with great foresight the International Chamber of Commerce has advocated such a course in a number of resolutions.

A certain degree of voluntary coordination of airline operations, not by the Governments, but by the airlines themselves, combined with the promising economic advantages of jet operation, may therefore—after a certain transition period—lead to a self-supporting industry. Thus civil aviation will become of increasing interest to the private investor.