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## AIRLINE SUBSIDIES— PURPOSE, CAUSE AND CONTROL

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### INTRODUCTION

OVER the past several decades, subsidy—on an ever increasing scale—has become a seemingly necessary component of the national economy. Over this span of time this form of public expenditure has evolved into many forms. In terms of individual annual appropriations, they may range from a few million to many millions of dollars. Those dollars identified with scheduled airline operations comprise one of the smallest identifiable subsidies.

Yet in spite of its relatively small percentage of the total, airline subsidies annually attract the most detailed and persistent scrutiny. There appear to be two basic reasons for this attention:

1. With the possible exception of maritime subsidies, appropriations supporting scheduled airline services are the most clearly identified.
2. It is the *only* subsidy devoted to a highly competitive business—transportation.

Over the years following the passage of the Civil Aeronautics Act of 1938, subsidy payments in support of the scheduled domestic and international air services have ranged from a high of \$83,774,000 in 1950, to a post-war low of \$19.7 million in 1946.

For Fiscal Year 1960, the Civil Aeronautics Board has estimated that no subsidy will be paid in support of services rendered by any domestic trunk line or to any international airline. Only certain of the Alaskan Airlines, the three helicopter operators and the thirteen local service airlines are scheduled to receive supplemental or subsidy payments.

Yet subsidy appropriations made so far for Fiscal Year 1960 total \$60,300,000 or \$41 million more than for the low year reached in 1946. The bulk of this year's appropriations will be paid to the local service airlines in support of scheduled air services to about 540 cities throughout the nation, of which more than 300 are solely dependent upon local service airlines for their scheduled air services. Present indications are that appropriations made for Fiscal 1960 will not be adequate to meet the year's commitments and that a supplemental appropriation will in all likelihood be required after Congress reconvenes.

Moreover, the subsidy total over the years ahead promises to increase. Depending upon what additional service obligations are assigned to the local

carrier group, the subsidy total may reach a high of between \$75,000,000 and \$80,000,000 *unless* certain actions are taken to offset or arrest what otherwise appears to be an inescapable trend. This latter figure may in itself be low if the demand for scheduled air services by an increasing number of smaller communities increases as it has over the past two to five years.

Certainly this trend toward higher annual subsidy appropriations is a matter of grave concern, but there is nothing mysterious or insidious about the trend. It is simply that the local carriers have become an increasingly popular and integral part of the economic life of a steadily increasing list of cities and communities making up the overall national economy. The demand for the service appears to parallel the increasing competition between cities for new industry in their own struggle for economic survival and their increasing isolation brought about by the steady and persistent curtailment of rail service.

The following pages are devoted to an analysis and evaluation of the subsidy devoted to support of scheduled air service to intermediate sized cities and communities. Of even greater importance, a way is sought to reduce and ultimately eliminate this particular form of subsidy. Due to the complex nature of the subject the article has been divided into two parts.

Part I is concerned only with background, an analysis of the purpose of this subsidy, why it is increasing and why it has not yet reached its peak.

Part II is devoted to a program designed to control the present upward trend, to reduce the total and ultimately eliminate this form of subsidy. The program advanced promises to be controversial. Part II deals frankly with the subject of subsidized competition, a more equitable share in total commercial revenues and a general overhauling of present day concepts.

## PART I

### WHY AIRLINE SUBSIDY IS INCREASING

The increase in subsidy requirements—both that experienced recently and that forecast—is simply the product of three major influences:

1. The local airlines are being assigned service responsibilities to an ever-increasing number of intermediate cities—*sometimes at points not even sought by the airline involved*—where commercial revenue potential cannot possibly be sufficient to meet the cost of performing the service, and
2. The local airlines are at long last being permitted to make a belated but unnecessarily expensive transition to post-war aircraft, generally without adequate financing or working capital, and
3. Eleven of the thirteen local airlines have past period earnings due them for periods extending back to as long as nearly five years. This accumulation of money due and ultimately payable, plus the recognized need for prompt provision of higher debt servicing requirements and a higher allowance for profit as a product of higher capital, higher interest costs and a steadily increasing investment base, will all combine to increase, temporarily at least, the net subsidy requirements.

The usual inflationary forces are, of course, at work in the local airlines just as they are in any other business in the nation today. But these forces have been for the most part met through modest rate increases, a continued and encouraging annual increase in commercial revenues over present systems, by steadily improving efficiency and productivity, and a maturing

management group. *The basic cause for the increase in the total subsidy appropriation is beyond the control of the local airline managements and is to be found almost exclusively in the triple factors cited above.* How high the total will go and how long any given plateau will remain are dependent upon the corrective actions taken to arrest or reverse the trend.

#### THE PURPOSE OF SUBSIDY AND ITS BENEFICIARIES

At the risk of over-simplification, it must seem:

1. There exists a federal policy that the national economy requires scheduled airline service to both large and intermediate populations.
2. There is recognition of the obvious fact that commercial revenues from a number of the smaller communities will, at least at the outset, be insufficient to offset the cost of providing the service. Hence, supplemental funds or subsidy is provided in amounts necessary to make up the difference plus providing a fair return on the investment necessary to provide the service.
3. So long as this federal policy remains in force, and so long as expansion of the policy in compliance with demands for increased service is continued, then service in markets incapable of generating sufficient commercial revenues must either be provided by a government agency or a private contractor. In either case supplemental funds will be required.

It seems logical to reason, therefore, that the local service airlines are, in fact, merely the instruments of a worthwhile and necessary federal policy and function as contractors in the fulfillment of that policy. *Payments made to the providers of the service through the Civil Aeronautics Board are, therefore, payments for services rendered in the form of an indirect subsidy to the communities receiving those services.*

#### COMMUNITY DEMANDS AND THE EFFECT ON SUBSIDY

The basic point to be made here is that if a local service function is to be provided by private entities and if they, in turn, are limited simply to serving markets which do not generate sufficient revenues to pay for the service, then supplemental funds are required. The only alternative obviously is either to abandon the concept and with it the service or to operate the service as a special function of the government.

The former is extremely unlikely in view of (a) the more than 300 communities solely dependent upon the local airlines for scheduled air service, (b) the steady curtailment and abandonment of rail or alternative transportation media, and (c) the smaller cities' desperate struggle for economic survival, which in turn is based upon the continuing urgency of attracting new industry to their communities. With regard especially to this last point, there is instance after instance on record where existing air service—*provided solely by a local service airline*—was a condition precedent to the selection of the community as the site for a new plant or facility!

Operation of scheduled airline service as a function of government would require supporting funds in amounts which would dwarf the supplementing funds required today or anticipated under private operation.

As a measure of the role played by the local airlines in a community's economy and the effect that this role has had in shaping the demands of an increasing number of other communities for service, it may be well to

establish the number of points added each year to the local service systems over the past eleven years. The following table illustrates this development:

	<i>New Points Certificated</i>	<i>Total Points Served</i>	<i>Average Population<sup>1</sup></i>	<i>Subsidy per Passenger (\$)</i>
1949	—	—	13,699	21.20
1950	—	—	—	16.53
1951	—	338	20,984	12.55
1952	(8)	330	22,428	13.08
1953	9	339	22,111	12.70
1954	(1)	338	22,946	9.76
1955	3	341	27,630	7.25
1956	18	359	29,782	7.66
1957	13	372	28,939	7.47
1958	10	382	29,624	7.09
1959 <sup>2</sup>	42	424	28,805	7.03

Thus, in 1959 alone, the Civil Aeronautics Board certificated exclusive local airline service to 47 points in an unprecedented expansion of local services. Without a single exception, the communities seeking this new or additional service were completely and directly supported by their community leaders and by either or both their Congressmen and Senators. In one case alone<sup>3</sup> nine Senators and ten Congressmen (8 states) appeared before the Civil Aeronautics Board in oral argument in support of the expressed objectives and demands of their communities. Certification in this case was accomplished even though the Board estimated \$5,000,000 of additional subsidy would be required to support the services sought by the communities.

To effectively comprehend the impact of this one case alone—and there were several during calendar year 1959—consider that the services contemplated under this certification on an annual basis will comprise only 8.5%<sup>4</sup> of the total plane mileage operated by the local airlines over the balance of the United States this year.<sup>5</sup> Yet, the forecast subsidy required to support the operation based upon the Board's estimate, comprises 13% of the entire local service subsidy requirements for Fiscal 1960. Moreover, the cities benefiting from the certification comprise—from a standpoint of population—only 1% of the community populations receiving air services from the local airlines.

The case described in the foregoing is admittedly an outstanding example; but to varying degrees the example is being repeated in case after case. It is this often forceful and ever-insistent phenomenon of public demand which is the greatest single contributor to increased subsidy. In the final analysis the Board is simply an arm of the Congress and an instrument of the people. That it should respond to demands from both these sources for scheduled air services certainly should cause neither surprise nor concern. That both emotions will be present when a final accounting is made, there is little doubt. Nevertheless, the Congress and the communities they serve cannot on the one hand demand that the Board render air operating certificates to their communities where a known large increase in the subsidy bill is required, and then on the other hand be critical of the bill submitted to it in payment for the resulting services.

<sup>1</sup> Cities served exclusively by the local airlines.

<sup>2</sup> For year ending September 30, 1959.

<sup>3</sup> The Seven States Area Case, Docket 7454 et al.

<sup>4</sup> Based on an assumed 1.5 round trips per day over the new routes involved.

<sup>5</sup> Based on 12 months ending September 1959.

## THE BELATED TRANSITION TO POST-WAR PRESSURIZED AIRCRAFT

For some years it has been apparent that the DC-3 had to be replaced. Initially purchased at bargain basement prices with ready access to cheap and plentiful surplus spare parts, the DC-3 was the obvious airplane with which to launch the local service concept. Moreover, the traveling public still accepted the DC-3 as a satisfactory transportation medium.

Over the thirteen years of local service airline operation, the communities and the user have become increasingly insistent in their demands for more modern and pressurized equipment. Over this span of time also, surplus stores of DC-3 spare parts have gradually disappeared, thus necessitating purchase of spare parts under today's manufacturing costs in individual job lots—a substantially more costly situation.

At the outset, local service wages paid maintenance, flight and passenger service personnel were somewhat below the trunk-line average. This generally is not true today. Since there is no apparent way to further increase the productive capacity of the DC-3,<sup>6</sup> unit operating costs have increased to the extent that the DC-3 is becoming increasingly uneconomic under any circumstances.

For these reasons, both the Board and the airlines have moved toward a steady replacement of the DC-3 with post-war aircraft. In preparation for this the Board sponsored and the Congress passed legislation making it possible to procure the aircraft through guaranteeing loans where other credit was not available. In addition the Board launched a series of area investigations for the purpose of "over-hauling" the airlines' route systems—strengthening these routes where possible by certification into more productive markets—but basically to create a more favorable operating situation for the introduction of the new and larger aircraft.

These worthwhile but long-range actions by the Board in themselves are destined to temporarily increase the subsidy requirements for two not-so-surprising reasons:

1. In the introduction of any new aircraft there is a "learning curve period" when costs are higher than they will be as personnel become more experienced.
2. The new aircraft being purchased not only have a higher capacity, but cannot be economically operated over the same short stage-lengths which characterized the DC-3 use. Time is required to absorb these new aircraft—time both from the standpoint of completing the system "up-dating" process through which the Board is progressing, but time too for revenues, measured in terms of public use, to catch up with the increased capacity being offered.

While the so-called "Area Investigations" were conceived with the idea of strengthening the Local Service route structures thus enabling them to make more economic use of the new equipment and to serve more dense travel markets, the cases took a somewhat surprising turn. The Board—and the local airlines—had not counted on the pent-up demand for new services from a great many communities within the geographical limits established for each area. What was originally intended to be a cleaning up or streamlining of the individual route structures, became in addition the forum for a multitude of new service requests.

Starting in the westward part of the nation and moving progressively eastward, certifications to date have largely been to relatively sparsely settled and isolated communities. Due to the insistent demand for new serv-

<sup>6</sup> Operated generally in a 21-passenger configuration by the trunk lines, the local carriers have modified these aircraft to 24-28 passenger configuration.

ices—which in a great many cases have been based upon public need other than a proven ability to provide sufficient commercial revenues to pay for the service—the improvements made in the local systems have been generally submerged in the additional costs incurred to provide the new services. As these area investigations center on the more densely populated areas East of the Mississippi, the impact of certifications to new cities will become less apparent, and the benefits to be gained by relaxing restrictions and opportunities to serve the more dense travel markets will become more apparent.

New aircraft being introduced in increasing numbers are being asked, therefore, to perform a type of service for which they clearly were not designed and should not reasonably be expected to perform. While this situation is being steadily corrected in part, correction is lagging behind implementation and is contributing heavily to learning and transition costs.

#### EARNINGS—THEIR FUTURE IMPACT ON SUBSIDY

The third factor which will serve to increase the subsidy bill concerns the matter of a fair return on the investment dedicated to providing the certificated services.

Through 1958, during the twenty years following passage of the Civil Aeronautics Act, mail and public service payments to all the airlines have been based upon an assumed 8% net return after taxes on the investment base "used and useful in the conduct of air transportation." Investment base as used in this context is investment from any source—equity or debt—which clearly is used to produce scheduled air services.

For the most part, this original rate of return was based upon the cost of procuring capital with which to keep pace with a tremendously dynamic growth. In 1957 the Board set down for hearing a case commonly referred to as the "Local Airline Rate of Return Case." Its purpose was to determine whether or not the traditional rate should be revised. During 1958 and 1959, with this case still not completed, the Board increased the rate to 9.5% after taxes as an interim measure in recognition of the increased cost of procuring capital. The Hearing Examiner assigned to the rate of return case meanwhile has recommended that the rate of return for the local airlines be increased to 12.5% after taxes. Oral argument before the Board will be heard early in 1960, and a decision reached presumably during the first half of 1960.

Without in any way attempting to forecast the outcome of the case before the Board, it is evident that the rate of return must be increased and has in fact been increased in the most recent settlements made.<sup>7</sup> It is also evident that the cost of both debt and equity capital has increased over the last two years particularly. Over this same span of time the investments of the local airlines have been sharply increased, both as a result of increased service obligations assigned to them and as a product of the new, more expensive equipment operated over many of the routes. The equipment transition has by no means been completed and in fact is just getting under way. In time the additional revenues generated by the new equipment will meet and offset the increased cost obligations incurred in their introduction. But until commercial revenues increase to this point and until such time as the local service carriers are permitted to participate in the more dense travel markets there will be an increase in the subsidy support required for their operation.

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<sup>7</sup> Mohawk, Southern, Pacific, et al.

## WHAT NOT TO DO ABOUT SUBSIDY

From the combination of factors reflected up to this point—additional service responsibilities, the initially and temporary expensive transition to post-war equipment, and an examination and correction for profit provision—it must be evident that the subsidy payments are going to increase to a substantial extent, *unless* a program is evolved to offset the increased requirements or there is a positive curtailment of the services which in themselves constitute the major cause for increased federal support.

It is appropriate at this point to devote some space to two common but wholly impractical means of controlling or eliminating the present subsidy obligations of the government. These are—generally expressed:

1. That services now being performed which require subsidy support be eliminated, and that there be no further certification to communities unless it can be demonstrated that subsidy will not be required.
2. That the trunk airlines be required to serve a fair share of the subsidized community points, thus absorbing a portion of the cost of providing service to all communities.

*I—The Likelihood of Service Elimination*

Elimination of service to subsidized communities is neither practical nor likely. Neither is it possible to declare a moratorium on future service pleas of communities yet unserved any more than it has been possible over the past two and three years to say "no" to earnest and justified pleas for certification. Scheduled airline services are today too deeply a part of a community's economic life. With the steady withdrawal or curtailment and in some cases complete elimination of rail service to a significant number of communities, scheduled air services often are the only regular common carrier service remaining.

Curtailement or suspension of scheduled air services may be feasible at localities which fail to meet certain minimum support criteria; but this course of action is dependent upon the development of a set of standard measurements to determine a community's continuing eligibility for scheduled air services. Certainly such a course of action—unless most carefully conceived—is at best difficult and politically potent. Moreover, there are growing signs that State aviation departments or similar bodies are exercising an increasing authority over continuation of service to points in their states which the Civil Aeronautics Board has decreed does not meet scheduled service qualifications and subsequently suspended. In the absence of legislation which clearly establishes state-federal boundaries of authority, such a procedure of suspension of service can become an increasingly costly process in terms of continued subsidy support from the Federal Treasury. The Federal Aviation Act does not deal with this matter of State-Federal jurisdiction and requirements, nor does any other law appear to meet what promises to become an increasingly difficult problem.

The establishment of specific service eligibility requirements, while necessary, is no less difficult for the Board than it is for the Congress. Such factors as isolation, access to other transportation media, the national defense, and proximity to existing air services at neighboring airports are controlling factors and dictate therefore the process of individual judgment and decision.

So long as the Board is subject, as it unmistakably is, to community demands for service, then without at least a starting point designed to establish at least a lower limit of service eligible for subsidy support, there can be no really effective control over the total annual subsidy bill. There



is an equal need for the establishment of a higher limit of eligibility. This is dealt with in Part II.

The Board in recent years has taken two significant, although understandably cautious, actions designed to establish at least the lower limits of service eligibility. The first action was an outgrowth of the legislation permanently certificating the local service airlines. Here the Board established a policy which in effect decreed that communities generating less than five boarding passengers per day would be temporarily certificated for limited additional periods of time; all others certificated before a certain date received permanent certifications.

The second Board action is reflected in a recent route proceeding<sup>8</sup> and in various speeches and actions in subsequent proceedings. Here the Board for the first time enunciated a "use-it-or-lose-it" policy. This policy, in effect, requires that a given route must produce an average of at least five passengers per flight operated, and that each community served must generate at least five passengers daily—the equivalent of 2.5 passengers per departure.

This cautious policy, while most necessary, is by no means the answer to subsidy control. It merely serves to slow down the upward subsidy trend, and establishes a bench-mark from which to work. Obviously, the standards specified in the policy could be increased to produce any desired impact on the total subsidy requirements; but the end product of progressively higher standards would inevitably mean the progressive elimination of service to a proportionately greater number of communities. It is unlikely that the standards will be increased within the foreseeable future, short of a specific Congressional directive to do so.

In summary, therefore, while certain savings can be and are being realized through the medium of establishing productive objectives in order to retain service, the overall effect of the policy as it stands at present will be simply to slow-down the upward subsidy trend. The complete elimination of these services requiring subsidy is no more likely than is a moratorium on further certifications to the increasing number of cities demanding air service in the future.

## II—Replacement by Trunk Airlines

Just as elimination of services to the smaller communities is not the answer to subsidy reduction without there being a major shift in federal policy, neither is it feasible to require the *trunk* airlines to serve communities where either the trunkline has evidenced an unwillingness to serve or where such service because of subsidy requirements would at best be of a token nature.

There is an understandable temptation to require the trunk airlines to perform services which taken separately would not meet normal operating costs. Under this concept profits from one of the dense markets would pay for the unprofitable operation. There are a number of sound reasons, however, why this policy would be both damaging and tremendously costly.

As a first point of analysis it may be well to review the theory—which is still sound—under which the local service airlines were first brought into being in 1946. Basically, the theory was that scheduled air services to smaller cities and communities should be provided by a new class of airlines—a type of airline which would be devoted primarily to a short haul function as opposed to long haul and using equipment designed primarily for service involving off-line points. This type airline would, it was reasoned, devote more specific energies and emphasis and ingenuity to the development of short haul or daily commuter type traffic.

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<sup>8</sup> The Seven States Area Case, *supra* note 3.

The role of the trunk airline, under this concept, would in turn be that of specializing in the long-haul business between major cities and connecting the principal marketing areas of the nation. The trunk lines could be expected to devote their primary energies and capital to the development of that business; and because of that emphasis could not be expected to develop or otherwise adequately serve the less dense markets and smaller cities.

Whether this concept was wise or not is moot at this point. Because with the passage of time, the trunk airlines to varying degrees have been progressively replaced at 94 points. In almost every case, the replacement has been followed by modest to tremendous increases in the number of persons using the scheduled airline services and the amount of goods shipped by air to and from these cities.

There is nothing magic about these five, ten and twenty-fold increases in patronage. It is simply the product of schedules being operated at the right times of the day at a frequency designed to breed repetitive travel habits and a specialized and often devoted sensitivity to the community needs and service requirements. It would be impossible to revert now to a concept that the trunks should be required to take back some of these cities and provide a quantum of service to which the community needs have been geared *even if the trunks were able to do so*—which they are not.

The evolution taking place over the past decade in the scheduled airline industry is by no means limited to the simple matter of the local airlines replacing the trunk lines at certain cities, although the replacement policy has had a tremendously significant impact on the economic independence and well-being of the trunks. The function of replacement together with the Board's efforts over this same period of time to make all the trunk airlines self-sufficient have joined to make it *impossible* for the trunks to perform the services rendered by the local airlines.

As part of the background to this situation it is submitted that perhaps the most important single action occurring over the past decade was issuance of Executive Reorganization Order No. 10 in October 1953. This Order was intended to place a clear label on those funds designated as specific payment for the carriage of mail and on those supplemental funds designated as subsidy support for services rendered. It accomplished this purpose. It also drew a clear line of distinction between the "have" and "have not" airlines.

Executive Order No. 10 generated yet another evolutionary force. It focused the attention of both the Congress and the Civil Aeronautics Board on the subsidy question which for Fiscal Year 1952 for the entire industry totalled \$63.5 million. Where attention was there before, the inability to isolate subsidy or to measure the size of the problem in terms of specifics was a source of considerable frustration and concern. Now it was devoid of any cover. Buried before in the annual postal appropriation and deficit, it was now a part of the Board's budget to be justified each year before an inquisitive and not always receptive Congress.

The Board now launched a series of formal route hearings or proceedings. Although cloaked in the traditional robes of "public convenience and necessity" it soon became clear that the proceedings were largely designed to reduce and to ultimately eliminate the annual subsidy bill. As a corollary to these proceedings the local carriers continued to expand their services and as a significant part of that expansion replaced the trunk lines at many of the intermediate cities.

Over the past ten years the "big four"—all potentially self-sufficient by 1953—have been relieved of a number of intermediate points and up to 1959-

received at best only small token route awards. By contrast, the vast majority of new major route awards have gone to the "have-not" carriers or what was formerly the regional airlines.

Thus, through three mergers or acquisitions and numerous route awards, the regional airlines have disappeared from the transportation scene and only trunk airlines remain of the "grandfather" airlines originally certificated in the pre-war years.

But as a result of this evolutionary process three facts emerged:

1. The "grandfather" or trunk airlines are now advertised as all being "off" subsidy.
2. Very few major markets remain today which are served by only one airline.
3. A tremendous struggle for both supremacy and survival has only begun between the trunk airlines.

All three of these points have individual significance when considering the possibility of the trunk airlines being *required* to provide certain local airline type service. As evidence of the impact that each of the points made here have on the question of replacement, certain basic concerns must be given weight.

First of all, the statements which have been made to the effect that all the domestic trunk lines are now "off" subsidy are true only to the extent that subsidy payments are *not planned* for any of them. But two of the trunk lines have reported serious losses over each of the past three years. Others either reported losses or only minor earnings during the "depression" years of 1957 and more particularly 1958.

Of significance here is the fact that the trunks in deepest financial trouble today are the ones whose systems are an insoluble mixture of both short-haul and long-haul obligations. And almost without exception, the trunk lines who for whatever reason have been slow to seek replacement by a local service carrier are the ones who have lost ground and operated at losses or (for them) below average profits.

Quite clearly, it has been a CAB objective to create route systems for the regional or smaller trunk airlines which had the potential to operate without subsidy. It is equally clear that Congress supported—even encouraged—this objective. To varying degrees the Board has been successful in its objective. The objective is completely attainable, however, only as an increasingly clear line is drawn between emphasis on long-haul as opposed to emphasis on short haul.

Reversion to a policy *requiring* service to smaller cities and in short haul markets by the trunk airlines as a means of reducing subsidy would have as its inevitable result an *increase* in the national subsidy bill if the quality and quantum of service to intermediate cities is to be maintained. If the service texture is not to be maintained and encouraged, then the original policy leading to creation of the local airlines must be judged to have been an error. Congress emphatically refuted any possible judgment of error in philosophy in 1955 when by an overwhelming margin it passed legislation over the CAB's objections directing the Board to permanently certificate the local airlines.

#### THE BENEFITS AND IMPACT OF TRUNKLINE COMPETITION

As mentioned earlier, the Board's attempts to place the erstwhile regional airlines in a self-sufficient position have resulted in there being very few major markets remaining in which there are not two or more trunk airlines. This has, in turn, ignited a terrific competitive struggle for both supremacy and survival.

This is a grim struggle. Airlines enjoying a monopoly as the sole airline in a market are today called upon to defend that market against one or more newly certificated airlines. The defending airline as often as not has been certificated into new markets which it must seek in turn to penetrate. Both the defending airline and those seeking to establish themselves in new markets must follow the same pattern—they must use the newest equipment available to them, schedules must be set at optimum and competitive times of the day, and a proportionately greater amount of time and energy per sales dollar generated must be devoted to either maintain or obtain positions in the now competitive markets.

There have been two major by-products of this struggle:

1. An equipment race unparalleled in any transportation system and unlikely to be duplicated.
2. A deterioration of service in the mass short-haul markets and at intermediate cities or off-line points.

Out of the hundreds of millions of dollars spent for new pure jets and prop-jets by the trunk airlines, it is truly significant that not one of these types can operate economically below an average stage length of between 300 and 400 miles at modest or average load factors. Moreover, with the phasing out of two engined transport aircraft such as the Martin and the Convair, the aircraft remaining in the trunk line fleets are hardly designed to effectively perform short haul services on any economical basis. And the trunk lines have no orders for and seemingly no plans for an aircraft which will provide these needed short haul services.

Both as a result of emphasis in the long haul markets and a phasing out of two engine aircraft, a steady deterioration has taken place in many of the mass short-haul markets. This deterioration has been submerged to some extent by certification of other trunks in the market where the market serves simply as "entry mileage" to a major point. This deterioration will gain momentum over the next five years as new equipment orders are filled and as older equipment types are phased out.

The inescapable fact is that as competitive forces have been set to work in the long-haul markets, primary emphasis by all the trunks have been in these markets. While the public has unmistakably *benefited* from this competition in the long-haul markets, just as surely it has *suffered* in the short haul markets. The trunk lines have little energy or capital left for continued emphasis in these short haul markets. This is particularly true in the East and will become increasingly so throughout the country. It is most unlikely that this trend will be either arrested or reversed. If this be so, then any reasoning that the trunks should be required to ease the subsidy burden is fallacious.

#### CONCLUSIONS

Up to this point it would appear that the following conclusions may be reached:

1. That intermediate sized community requirements for scheduled air services have been and are being met through continued certifications of the local airlines.
2. That extension of service to small communities requiring subsidy support, together with the costs related to introduction of new and post-war pressurized equipment, a resulting increased investment base as related to debt servicing and required earnings are producing initially higher subsidy appropriations.
3. That subsidy requirements have not yet reached a peak and will not

- until (a) "learning curves" associated with introduction of new equipment have leveled, (b) services certificated to date and to come as a result of other proceedings under way have been fully implemented, and (c) public use of the new equipment and services over new routes over-takes the increased capacity being offered.
4. That while there should be definite criteria established to determine a city's continuing eligibility for scheduled air service, such cases must necessarily be weighed against special considerations such as isolation from other common carrier media. And even so, the savings to be realized from such eliminations will not alone be sufficient to arrest the subsidy trend.
  5. That the combination of rail curtailment and withdrawal or suspension increases the need for local airline service to communities. The policy enunciated early in the post-war years therefore is more necessary even today than it was at its inception.
  6. The trunk lines are devoting a majority of their time and energies to the long haul dense travel markets. In addition to their being incapable or rendering significant short haul service they are not keeping pace with the requirements of the dense short haul markets from which the local airlines have been barred from participating.

#### SUBSIDY CAN BE REDUCED WITH REAL BENEFITS TO THE PUBLIC

The purpose of that expressed in the preceding pages has been to point up certain facts which should not surprise any one. Basically, the antidote for arresting and reversing the subsidy trend is to increase the local airlines' opportunities to generate more commercial revenues in sizable amounts; otherwise, unless there is a complete reversal of the federal policies which have brought the local service airlines into being and caused them to register a growth little short of phenomenal, the annual appropriations for subsidy support of service to the smaller cities is going to increase. It is going to increase anyway over the next two or three years regardless of corrective actions taken, since any apparent measures will take time to develop.

Certainly, action is required; and the action taken, if carefully reasoned, can be tremendously beneficial to the majority of the nation's population. Responsibility for doing this does not rest in any one single area—at least as far as things go in a creative sense. The burden of developing a program is on the local airlines; but the Civil Aeronautics Board and to a lesser extent the Congress may be called upon to develop the means by which commercial revenues can be increased and costs reduced. Short of suspension of services to an increasingly higher percentage of the communities, this is the only way to control, reduce and ultimately eliminate subsidy.

The local service airlines, it is believed, must take the initiative—indeed it is their responsibility to do so—and offer a program for reducing subsidy requirements with a minimum impact on services to cities producing or who inherently promise to produce reasonable commercial revenues. The Board has the responsibility to encourage such a program, act upon it quickly—even in summary fashion—and to see to it that the local carriers' earnings are of a quantity sufficient to warrant the additional capital necessary to maintain today's momentum and quality of service thus enabling the local airlines to develop the maximum commercial revenue potential in their cities and systems; the Congress has the responsibility of monitoring the overall program, analyzing it where necessary and to enact appropriate legislation where required.