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OBJECTIVES AND STRATEGIES FOR AIRLINE PRICING

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THE recent appearance in this Journal of several articles on airline rates and fares highlights the increased attention being devoted to this subject by both the carriers and the Civil Aeronautics Board.¹ This paper also deals with airline rate and fare policy but rather than discussing particular types of rates and fares or the criteria used by the Civil Aeronautics Board in approving fare structures and levels, the primary focus here is to attempt a broad outline of the relationship of price policy to the total airline economic objectives and to develop the bare bones of a strategy for price policy which may be useful in the next few years. In the interest of narrowing the problem as much as possible, discussion is confined to the passenger fares and the 16 domestic trunkline carriers.²

In the past important economic decisions affecting the air transport industry have frequently been made, both by the carriers and by the CAB, on the basis of current shortrun industry conditions.³ Those conditions have had a habit of changing rapidly and dramatically. The present situation happens to be a period of unusual prosperity for the carriers in marked contrast with the situation existing three, or even

¹ Jones and Davis—*The Air Coach Experiment and National Air Transportation Policy*—Parts I and II, Fall and Winter 1950-51, and Keyes—*Recent Rate Policy of the Civil Aeronautics Board*—Winter 1951.

² The discussion here has purposely been kept brief and the statements and conclusions generalized. No attempt has been made to write a detailed brief in support of specific action. Rather the purpose is to promote further discussion and investigation in the broad area of the relationship of pricing to the overall objectives for air transportation.

³ Perhaps the outstanding example of this type of decision was the Board's series of cases on local service carriers. Originally conceived as short-run experiments, the rationale of a secondary route system was developed only after the experiment failed on economic grounds. With respect to the carriers, the air freight rate war in 1947-48 appears to have been conducted largely on short-term, largely non-economic considerations.

two, years ago. Yet, there is no assurance that these favorable conditions will continue. Both within the industry and within the economy as a whole, the elements of less favorable economic conditions exist.⁴ Decisions on airline prices, however, although frequently of an *ad hoc* nature tend to have an effect for relatively long periods of time. The legal process for changing prices is slow and further, the price structure is so intermeshed that minor alterations soon develop into major surgery. As the importance of airline prices increases, it is necessary that pricing decisions to meet short-run situations be made within the framework of long-term objectives for the air transport industry and that pricing strategies be developed for achieving those objectives.

The objectives for air transportation from the standpoint of the industry and of the public interest are not in serious conflict. The development and expansion of the industry continues, as it has since 1938, to be a *desideratum*. Expansion and further development would clearly be of value to national defense and in addition would bring about the commercial and social advantages which the speed of air transportation can provide. But, although expansion for its own sake has in the past been regarded as an objective, the present state of the industry and its relationship to other transportation agencies makes it appear that further expansion of the air transportation system should be somewhat more purposeful as to direction. Specifically, having been brought to its present state of development through generous government support, increasing attention should be directed to the development of air transportation in those fields where purely economic or commercial considerations justify its expansion. An exception to this general proposition might be made in the case of the expansion of the industry purely for national defense purposes where the value of expansion in terms of increased military striking power can be clearly perceived.⁵ Otherwise, however, it would appear to be desirable that the trunk airline system should be allowed to expand through its own efforts and in those directions where commercial considerations dictate.

Certain existing trends in the industry should assist in the attainment of this objective. For example, the trend since World War II has been in the direction of providing service to marginal points through a secondary airline network which is clearly not self-supporting. The support of this secondary system by the government is based

⁴ A curtailment of the mobilization program and a softening in the rate of activity in the national economy could easily have seriously adverse effects upon airline traffic. Indeed, the peak in the traffic boom appears to have been passed in March 1951. This is not to say that traffic since March has not been highly satisfactory. On the other hand, after allowing for seasonal factors, the startling rate of increase in traffic which has taken place over the last year appears to be at an end.

⁵ It would probably be preferable to have national defense airlift potential needed for an emergency available within the military establishment, provided that this could be accomplished effectively and economically. To the extent that this cannot be accomplished, it may be necessary to create additional reserve airlift potential within the civil air transport system. If this is done, the subsidy necessary to support the additional lift potential should be specifically designated.

upon an amalgam of political and social considerations rather than on economic justification. So long as this trend continues, the expansion of the trunk airline system will lie in more intensive operations of the existing route pattern rather than through an extension of that pattern. Although individual members of the airline industry continue to oppose this general trend on the basis that the secondary carriers constitute a potential threat of eventual competition, the policy seems well established.⁶

The expansion of the trunkline system as a desirable objective raises questions of whether the present degree of government assistance to the trunkline carriers should be increased, decreased or kept approximately constant. The principle that the trunkline carriers should be brought to a point of self-sufficiency as rapidly as possible now receives general support both inside and outside the industry. There are obvious political advantages for the carriers in achieving this goal. There are other intangible advantages relative to the abnormal effects of subsidy on carrier management which make the realization of this condition desirable.⁷ It would appear, therefore, that expansion should not be bought through increased operating subsidy but rather that the existing level of subsidy should be reduced.

In addition to direct operating subsidization as furnished through mail pay, the carriers now receive a considerable volume of free services from the government in the way of weather information, airway traffic control, navigational aids and the like.⁸ Over the past few years various groups, including the Congressional appropriations committees, have proposed that the airlines pay reasonable fees for these government-furnished services. It is obvious that before the airline system can be regarded as self supporting some reimbursement to the government for these services must be made. In view of the subsidy element in mail pay, the argument has been made that the imposition of service fees on the carriers would in effect be simply a bookkeeping transaction involving the transfer of money from one branch of the government to another. But the favorable financial position of many of the carriers at present and of the trunkline industry as a whole, will, if it continues, invalidate this argument. The imposition of service fees could be absorbed as operating expenses.⁹

⁶ See for example the recent speech of Chairman Nyrop before the Local Service Carriers Conference at Purdue University, July 1951, mimeographed.

⁷ See, for example, O'Connell—*Mail Pay Compensation under the Civil Aeronautics Act*—*Indiana Law Journal*—Fall 1949.

⁸ It has been estimated that under an appropriate allocation, the cost of such government-furnished services so far as the certificated domestic carriers are concerned is about \$25 million a year. This figure includes local service operators. It has generally been suggested that charges to the carriers should not initially attempt to recover this entire amount but that service fees should be progressively increased over a period of time, starting with an initial recovery of approximately \$8 million a year.

⁹ In the case of some of the carriers the imposition of fees for government-furnished services would be partially or wholly off-set by reductions in income or excess profits taxes. Thus the total effect upon net revenues would probably be considerably below the figures indicated in footnote 8.

Self-Sufficient Expansion

The objective for trunkline air transportation over the next few years may thus be summarized as directed expansion on a self-sufficient basis. Such expansion should be directed to those areas where the airlines have a natural economic advantage and should embrace programs both for reducing or eliminating direct operating subsidies and at the same time requiring the carriers to pay reasonable charges for government-furnished services. The achievement of this objective would seem to be in close alignment with the general trend of national transportation policy over the past few years and would furnish a sound foundation, based on economic realities, for the airline industry.

There are, of course, a number of avenues by which this objective might be attained and it is doubtful whether any single approach to the problem is adequate. There are those who believe that the principal key to the problem lies in the airline route pattern, using that term in its broadest meaning to embrace the degree of competition, type and the number of points served and the relationship between carriers. The importance of the route pattern clearly cannot be ignored. The fact remains, however, that the legal and procedural safeguards for maintaining the *status quo* in the route pattern make changes in the route pattern a drawn-out process. Not even the creation of the secondary airline system over the past few years mentioned above has basically altered the trunkline pattern. The injection of the equipment interchange has been a significant step. A few obviously uneconomic points have been abandoned or transferred to the secondary carriers but few fundamental changes have been made. Nor is it probable that the future will see dramatic changes. Changed competitive conditions will probably occur more because of carrier action in installing new equipment, improving scheduling and the like rather than through readjustments by the Civil Aeronautics Board. The fact is that, basically, the route pattern is a good one with only peripheral imperfections. Present indications seem to point to a period of relative route stability.¹⁰

The importance of mail rates including subsidy as a key element in the airline economic equation will almost certainly decline in the period ahead. Heretofore, with the exception of a brief period during World War II, mail rates have been a major balancing element between profit and loss. As commercial revenues are able to absorb a larger share of expenses or cover all expenses, commercial fares will come to occupy the role once played by mail rates. The current controversy raging over the separation of mail pay and subsidy appears

¹⁰ For example, the Board recently suspended action on an investigation into the degree of competition which exists on the Washington-Chicago route. Similar investigations are proceeding through the Board at a leisurely rate. The celebrated National Investigation, insofar as it contemplated a possible dismemberment of the carrier, has likewise been terminated without action, although the question of interchange between National and carriers serving Latin America remains in issue.

to be a concluding rather than an introductory chapter in the history of mail rates as a dominant economic factor for the trunkline carriers. The gradual development of industry sympathy for the idea of separation is in and of itself an indication of the declining importance of subsidy. It is significant that the current debate centers principally around ways and means of effecting separation rather than the principle itself.

Defining the Ingredients for Expansion

The necessary ingredients for an expansion of air transport in the directions and under the conditions noted above are not difficult to define. A good relationship must be maintained between costs and revenues. The market must be constantly expanded. Finally, sufficient stability in traffic and earnings and general economic conditions must be present to permit the formulation of relatively long-term plans for expansion including the ordering of equipment. It is obvious that commercial fare policy is an important factor in this type of equation. Before discussing the factor of fares, however, attention will first be given to the question of industry stability.

Over the last 10 years the economic fortunes of the trunkline carriers have fluctuated widely and rapidly. The post-war plans of many of the carriers were drastically curtailed not only because of financial inability to carry out expansion programs but also because the market needed to support expanded and on-order facilities failed to keep pace and actually contracted. There can be no doubt that the feast-or-famine characteristics of the airline cycle seriously impeded the orderly progress of development of the industry in the post-war period. Only within the last year has the industry as a whole recovered from the shattering effects of the airline's private post-war depression.

Many of the carriers were saved from the full consequences of the post-war depression only through substantially increased mail rates. With the separation of mail pay and subsidy and with consequent closer control of annual subsidy appropriations by the Congress, recourse to the Federal Treasury may well be a more difficult and more time-consuming palliative for future emergencies. It is essential, therefore, that the industry be not only allowed but encouraged to establish during periods of favorable earnings reasonable reserves against future emergencies.

Although the carriers receive unusually favorable treatment under the existing excess profits tax law, there is no assurance that this treatment will result in the buildup of the type of reserves which appear to be necessary.¹¹ Indeed, the retained profits provisions of the Internal Revenue Code make difficult the creation of adequate reserves. It now seems improbable that there will be any change in the Excess Profits Tax during the present year. Future examination of the excess profits tax provisions with respect to the airlines should be expanded to

¹¹ See PL 774—81st, Chap. 932, 2nd Sess. Title IV, Sec. 402 and 458.

embrace the feasibility of special reserve provisions for the air carriers during periods of relative prosperity. In connection with the funding provisions provided for merchant shipping in the Merchant Marine Act of 1936, the Treasury Department has taken the position that these provisions provide hidden subsidy for the industry. The suggestion that airlines be permitted to build up special reserves either to meet future losses or for the purchase of new equipment is not intended to provide the carriers with a new form of subsidy — concealed or apparent. Rather, the suggestion is made in recognition of the fact that the existing tax laws may weigh heavily on industries where profitability fluctuates sharply and where the buying of capital equipment at a particular time is frequently a requirement to continued successful operation. Although the creation of such reserves is probably not the sole solution to the problem of greater economic stability, the establishment of such reserves could be an important step in assisting the expansion of the industry.

It may be questioned whether even with greater economic stability the airline industry will be capable cost and revenue-wise of meeting the objectives set forth above including the creation of reserves against future contingencies. Profitable operations and hence the ability of the industry to proceed on a self-supporting basis, will depend both on the cost levels which can be attained and on the volume of traffic and revenue which can be generated.

Through increased efficiency in operations and through the installation of more economic equipment, the airlines have in the last three years been able to lower their unit capacity costs — cost per available ton mile — despite increases, in some cases drastic increases, in the cost of wages, supplies, parts, material and services. This considerable feat, sometimes lost sight of in the maze of statistics on the industry, is a reflection of generally tighter managerial control, and of improved productivity of labor. In part, it also reflects the efficiency of the new equipment placed in service and of the economies inherent in larger scale operation and in intensive use of fixed airline plant and overhead personnel. Many of the ingredients of airline costs have risen considerably in the last few months. Further increases are in prospect. It is still too early to say whether these increases have been so great as to reverse the downward trend of unit capacity costs. An offsetting factor will almost certainly be the large volume of new equipment scheduled for delivery over the next few years. This equipment should assist either in holding the unit cost line or in continuing its downward trend through offsetting increases in the price of various services and supplies which the airlines buy.¹²

¹² The following figures indicate, for the domestic trunk-lines, operating costs in cents per available ton-mile.

1948	30.40¢ per available ton mile
1949	28.91
1950	27.75
1951	
(1st Q. only)	27.69

Source: CAB Form 41 and Recurrent reports of traffic and mileage

Other factors both favorable and unfavorable can be expected to affect airline unit costs in the near future. The availability to the carriers of government contracts for transportation, training, maintenance, etc., should be a favorable factor since such contracts in the past have typically absorbed a considerable portion of normal airline overhead. Unfavorable factors include the necessity of absorbing new personnel, the development of operating bottlenecks as plant and capacity are used more intensively and a somewhat reduced pressure for cost control bred both by the excess profits law and by high volumes of traffic. On balance, however, it would seem probable that airline unit capacity costs over the next two to three years have a good chance either of remaining at existing levels or of declining to still lower levels.

During the latter part of 1950 and during all of 1951 to date the combination of steady or declining unit capacity costs plus the rapid buildup in traffic volume has brought about a rapid reduction in revenue ton mile costs.¹³ In consequence profits have likewise increased rapidly, especially since the increased traffic was secured for the most part at unit revenues only slightly lower than those previously in effect.¹⁴ The increase in traffic volume over the last year is usually ascribed to the Korean incident and the consequent mobilization program. Certainly, a great deal of the traffic increase can be accounted for because of these factors. Other stimulating factors appear to have been a relatively good safety record, a high level of general economic activity and the gradual expansion of coach services.

New Capacity Requires Profitable Load Factors

The carriers have been quick to interpret the traffic increase as a portent of permanently increased volume. On this basis and because of their improved financial condition and prospects, extensive orders have been placed for new equipment. When this equipment has been delivered and is in service, the capacity of the carriers will have been increased substantially even though existing obsolete aircraft are retired. The test of the carriers' ability to maintain a steady rate of expansion will be whether this new capacity can be operated at prof-

¹³ The following figures indicate, for the domestic trunk-lines, operating costs in cents per revenue ton mile.

1948	58.24¢ per revenue ton mile	
1949	53.79	
1950	47.91	Source: CAB Form 41 and Recur-
1951		rent reports
(1st Q. only)	46.09	

¹⁴ The following figures indicate yields per passenger mile for the domestic trunk-lines.

1949	1st Quarter	5.86¢ per passenger mile	
	2nd Quarter	5.76	
	3rd Quarter	5.68	
	4th Quarter	5.73	
1950	1st Quarter	5.66	
	2nd Quarter	5.53	Source: CAB Form 41
	3rd Quarter	5.42	and recurrent reports
	4th Quarter	5.58	

itable load factors. It will be at this point when decisions concerning pricing will become crucial.

Basically, airline fares are today calculated on the basis of 6.18 cents a passenger mile with mileage being calculated through all certificated points. There are numerous deviations both from standard mileage calculations and from the standard rate per mile and, of course, the mileage of the carrier having the shortest route between two given points sets the fare, other carriers with longer mileage meeting the fare and obtaining a yield lower than 6.18 cents. The present basic airline fare structure and level is the result of a number of revisions made to a pattern of fares developed during World War II. There is no particular magic about the level of 6.18 cents. It is simply the arithmetic product of three 10% fare increases added to the basic level which existed during the latter days of the war.

On top of the basic fare structure and level there has been superimposed a series of promotional discounts and special fares, including a round-trip discount, half fare for children, and so so-called "family" fare. Generally speaking, these discounts are system-wide. In addition, there has grown up, especially since the fall of 1948, a structure of excursion and coach fares available only between specific points or for certain seasons of the year.

A further generalization which may be made concerning the fare structure is that it is built on a straight mileage basis with no taper in the rate per mile as distance increases. Exceptions to this generalization exists as for example the injection of a slight taper into the trans-continental coach fares and the numerous instances of so-called common fares — that is, the charging of the same price for transportation to two terminals which are not the same distance from the point of origin.¹⁵ In addition, no attempt is made in the structure to have differential charges for light traffic density routes or route points.

It is thus apparent that the present fare structure of the industry is far from being one which is basically tailored to the cost of handling different blocks and classes of traffic. Rather, value of service seems to have been the dominant factor in setting the present fare pattern. Nor is this surprising since until recently a fare level based on cost would have been so high as to curtail traffic volumes. The subsidy provisions of the Civil Aeronautics Act were designed to permit, and indeed virtually guaranteed, adherence to value of service as the dominant approach to commercial rate-making.¹⁶

As pointed out so clearly in the excellent article by Dr. Keyes which appeared in this Journal recently,¹⁷ the principal concern of the

¹⁵ The West Coast Common Fare Investigation is now well advanced through the procedural machinery. Generally speaking the position of Public Counsel has been critical of the existing common fare structure. The carriers have opposed changes in the structure, basing their opposition in part on the common fares of the railroads.

¹⁶ Until recent years, the Board seldom questioned the level of structures of the carriers' fares in mail rate proceedings.

¹⁷ *Op. cit.*

Board in the rate field over the past few years has been the maximization of the net revenues of the carriers, so as to reduce mail pay requirements. In this connection the attention of the Board has been increasingly focused on the cost aspects of the pricing structure.¹⁸ Although individually the carriers are acutely aware of the relationship between total revenues and total costs (price level), there has been considerable reluctance in approaching the price structure from the standpoint of differential charges based on cost considerations. This does not mean that the carriers are not conscious of the wide cost differences in handling different classes of traffic. There is almost complete unanimity among the carriers, for example, as to the high unit cost of serving short-haul traffic.¹⁹ There is a good appreciation of the general impact of what might be described as the "boarding" costs per passenger, irrespective of the length of haul. But thus far these general concepts have not been translated into alterations in the fare structure. Competitive stale-mate appears to have been the most powerful single deterrent.²⁰ A second and more subtle deterrent apparently is the fear that too close adherence to strict cost standards will lead to fares which are unrealistically high for some classes of traffic (value of service will be exceeded for a major portion of the market). Finally, straight mileage fares have a competitive advantage for the long-haul carriers vis a vis short-haul carriers who cannot support losses on short-haul traffic through more lucrative long-haul traffic. Since the value of air service tends to increase with distance, in contrast with decreasing costs, the long-haul carriers are in a highly favorable position.

Within reasonable limits increased attention to and emphasis on cost considerations in the structure of airline fares would correspond closely with the broad objectives postulated above for the trunk-line system, namely the expansion of the system into areas where it has an economic advantage. It would be easy for the trend to a cost-tailored price structure to be conducted so hastily or so haphazardly as to seriously disrupt existing markets. But granted a realistic approach, a price structure which corresponded more closely than at present to actual cost configurations for various types of traffic is clearly desirable.

Need to Evolve a Price Structure

Although such a trend may be posited as a pricing objective, its accomplishment is a matter of considerable difficulty. Determining

¹⁸ This has been particularly true with respect to various proposals for coach service and with respect to summer excursion fares to Florida, first filed in 1948 and first effective in 1949.

¹⁹ For example, see the exhibits of American Airlines in the Transcontinental Coach case in which there appears a detailed analysis of the cost of handling traffic having varying lengths of haul.

²⁰ The carriers appear to be willing to charge somewhat higher fares than the industry average over non-competitive segments or in non-competitive areas. For example, the Northeast fare level north of Boston and on its Cape Cod route is well above the industry average. These higher fares and similar ones on other carriers, reflect in part the relatively sparsity of traffic and also the fact that the traffic is, in general, short-haul.

the proximate cost characteristics of particular traffic is in itself a formidable task. There is danger than an attempt to reach the goal will end only in a protracted debate among the accountants and cost analysts. Unfortunately, costing is an inexact science. The problem must, therefore, be approached in a spirit of compromise by both the carriers and the Board. The important thing is that a broad program of investigation and price structure modification be begun and that it be moved forward as an evolutionary, rather than a revolutionary, process.²¹

The exact nature of an airline price structure tailored more directly to costs cannot be foreseen at present. It seems likely that it would involve alternatively either some kind of terminal charge or else a fare per mile which declined (tapered) with distance.

Parallel to and closely related to a program for modifying, on an evolutionary basis, the structure of airline fares, examination must be given to the fare level, and particularly to the feasibility of a dual price level. The considerably expanded volume of trunk airline capacity which will be available within the next two years has been noted above. It is doubtful whether complete reliance can be placed upon an expanding first-class travel market for sufficient volume to fill this capacity.

Since the inauguration of coach service there has been a clear division of opinion among the carriers as to the ultimate role of such service and the generally desirable level of airline fares.

A majority of the industry appears to favor, certainly for the short-term, the maintenance of at least the existing fare level with coach services and other promotional fares so segregated and restricted as to bring about minimum diversion from first class service and a minimum impact upon the first class fare level. A minority group of carriers appears to believe that average airline fares must be reduced in the interest of broadening the market. It is perhaps significant that most of the carriers making up this minority group have been faced, over the past few years, with unusually severe competitive problems. Typically, they have had the task of breaking into a market where an existing carrier was already entrenched. The volume of traffic which the new carrier could attract through usual airline promotional devices was simply not sufficient to permit profitable operations under a reasonable schedule pattern. These carriers believed that in a broadened market, where new traffic was being generated, they would be on a more equal footing with the established carrier. The obvious way to

²¹ In this connection it seems doubtful whether the usual type of formal investigation is a satisfactory method of working out revisions in the fare structure such as those contemplated. Almost of necessity formal proceedings, fitted out with the usual legal trappings of orders, hearings, cross-examination, briefs and oral argument, develop into adversary proceedings, with strongly held and conflicting positions held respectively by Public Counsel and the carriers. It seems possible that at least initially a more informal approach would prove more effective in developing a sounder fare structure.

broaden the market was through price reduction. To be sure, not all carriers faced with acute competitive problems reacted in this way and some carriers which favor reductions in the price level have been relatively successful in attracting a larger share of the first-class market since the early days of their certification. The generalization is strongly tinged by the over-all marketing approach of the individual managements.

The relative success of most of the coach services operated by the certificated carriers combined with the successful operations of certain of the irregular carriers suggests that there is indeed a broad airline market below the economic level usually regarded as first-class travellers. It is difficult to tell on the basis of existing experience the extent to which transfer and diversion takes place between these two market segments. It is apparent, however, that substantial volume of business is available which is willing and able to move at approximately a 6 cent level and which is not subject to diversion. At the same time, there are obvious limitations on the size of this market and the degree to which it can be expanded. It is significant that down to the outbreak of the Korean incident, the increase in total airline traffic which had taken place since the dark days of 1948 could be largely ascribed to the traffic handled on the coach services and other promotional fares offered by the carriers.

Dual Fare Preferable to General Reduction

The desirability of retaining a high proportion of firm first-class traffic while at the same time providing an expanded volume of total air traffic suggests that ultimately a dual fare level may be preferable to a general reduction in fare levels. The continued availability of a large proportion of existing 6 cent traffic would permit reductions in second-class fares to lower levels than as though a single level fare system were in effect. As in the case of fare structures, the exact levels of a dual fare system and the spread between the levels cannot be forecasted at the present time. The question of spread would appear to depend largely upon the transferability of customers from one class to another because of price differentials or because of service restrictions. The nature of desirable restrictions and the degree of spread can in all probability only be determined through trial and error.

Assuming that the coach or lower fare services are provided in high density equipment, and that such service is confined to relatively long-haul traffic, such services should be as profitable to the carriers as the first class service at equivalent load factors. It has been alternatively suggested that in the interest of high aircraft utilization, coach services be operated with the same equipment which is used for first-class traffic during peak hours and that the lower fare services be confined to off-peak periods. Under some circumstances and for certain carriers such a proposal might well have merit. On the other hand, the oper-

ation of low fare services at inconvenient times would seem to reduce the likelihood of sufficiently high load factors in low density equipment to make for profitable operations.

The establishment of a dual fare level in conjunction with a general trend in the price structure to correspond more closely with cost characteristics would appear to constitute the basic pricing objectives for the industry over the next few years. Both elements would be aimed at achieving the broader objectives set forth above for the industry. It is of particular importance that short-term conditions not divert the attention of the Board or the carriers from these broad objectives. Because of the close parallel between the current situation and the situation existing at the beginning of World War II it is interesting to recite briefly the action of the Board at that time with respect to passenger fares.

Immediately following Pearl Harbor there were growing demands by the military for airline equipment. Small blocs of transport planes — either those in airline service or those on order but not yet delivered to the carriers — were siphoned off to the military or to lend-lease. During the first six months of 1942 at a time when they were losing capacity, the airlines as a direct result of the war were experiencing unprecedented traffic loads. In May 1942, six months after Pearl Harbor, the domestic airline fleet was reduced to 165 aircraft, or approximately one-half its pre-Pearl Harbor level. In July 1942 the carriers in an effort to curtail demand which exceeded their available capacity and to maximize revenues, removed all promotional fares including the round-trip discount, children's one-half fares and the 15% discount granted to air-travel plan accounts. Throughout the latter half of 1942, despite rising costs and curtailed capacity, airline profits rose perceptibly, particularly for the larger carriers.

Flat Reduction Was Short-Term Method

During the same period, the Civil Aeronautics Board on several occasions put the airlines on notice that it intended to examine the level of passenger fares and express rates in the light of current and prospective high airline earnings. In March 1943 the Board required eleven of the carriers to show cause why they should not reduce passenger fares by a flat 10%. The response of the carriers was varied. Generally speaking, the Big Four which were showing the most favorable profits, agreed after a period of trading and negotiation with the Board to a fare reduction which approximated 8%. The remaining carriers covered by the show cause order were not in such a favorable condition. They were faced with mail rate cases which promised to reduce greatly their mail revenues, their capacity was sharply restricted and traffic was taxing that capacity to its limits. They could see little economic or other justification for a decrease in passenger fares. Being at least partly competitive with the route structures and hence the fare

pattern of the Big Four, however, these smaller carriers generally speaking had no choice but to follow the fare reductions.²²

The fact that fare reductions were ordered by the Board on a straight-line basis made their impact on the various carriers widely different. The apparent justification for the ordered reductions was to reduce profits and as a public relations gesture. Neither justification was well calculated to the industry or to bring its price structure into accord with the basic economic characteristics of the industry. The reduction was based, in brief, on short-run considerations.

Although there is no indication at present that the Board is contemplating any fare reductions (indeed the evidence points in the other direction) there is likewise little indication that it is developing and implementing vigorously a long-term fare program in cooperation with the industry. In the absence of such a program, the danger of *ad hoc* pricing decisions is increased.

Neither the Board nor the carriers should feel embarrassed at the present time by a period of favorable earnings provided that in part at least such earnings are being devoted to a general strengthening of the industry and so long as reasonable progress is being made toward achieving the basic objectives of the industry for the next few years.

²² At the same time numerous readjustments and recalculations were made in the mileage factors used to compute rates so that in addition to a lower level of fares, there also came into being a basically new fare structure which for the first time was relatively uniform for the air transport system as a whole.