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NATIONAL POLICY TOWARD
COMMERCIAL AVIATION — SOME
BASIC PROBLEMS

By Lucile Sheppard Keyes

Wellesley, B.A., 1940; Radcliffe, M.A., 1942; Radcliffe, Ph.D.
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Entry into Air Transportation.”

It is possible that at least one desirable result may come out of the
financial difficulties recently confronting the nation’s scheduled air-
lines. These difficulties may bring to the attention of the public, and
of Congress, some fundamental policy problems the solution of which is
necessary to the development of a rational governmental policy toward
commercial air transport. A great deal of discussion, of varying degrees
of disinterestedness, has already been provoked by these difficulties, but
there is danger that this discussion may either cease, as a result of the
remedial action already taken by the Civil Aeronautics Board, or con-
tinue to be directed to what are essentially temporary and superficial is-
sues — such as who was to blame for the “crisis” and what immediate
remedies should have been applied.

Neither of these questions necessarily involves problems of basic
policy, and both can be answered without their solution.

The more fundamental problems which may be raised in connec-
tion with the airline “crisis” have existed at least since the formulation
of the Civil Aeronautics Act, and will persist even though the losses of
the airlines have disappeared. In this article, there will be briefly con-
sidered three basic problems which are brought into relief by the recent
airline difficulties: (1) the problem of the extent to which the Govern-
ment should support financially the operations of the scheduled air-
lines; (2) the problem of ultimate responsibility for the profitable
operation of the scheduled airlines at any given level of support; and
(3) the problem of the practical implications and general desirability
of the regime of protective economic regulation embodied in the Civil
Aeronautics Act.

THE EXTENT OF GOVERNMENT SUPPORT OF THE AIRLINES

The extent to which the Federal Government is justified in contrib-
uting to the financial support of the scheduled airlines can be deter-
mined only on the basis of a calculation of the extent to which the
national need for their services exceeds or deviates from the amount or
character of such service which can be maintained by current demand (there being included here, of course, the legitimate demands of the Post Office). Thus it is evident that some definition of national requirements is a necessary starting-point for the development of a rational support program. The complete lack of such a definition is the root of much confusion with regard to the treatment of recent carrier losses as well as with regard to long-range Government action.

The Civil Aeronautics Act itself provides no definition of the nation's needs for air transport from the point of view of the national defense, the postal service, or commerce. Indeed, the framers of the Act were seemingly little if at all concerned with this all-important question. In retrospect, it appears that they were primarily interested in devising a means whereby the mail carriers, then as now in financial straits, could be rescued from their plight and protected from such embarrassment in the future. Although it cannot be doubted that this immediate objective was by some, at least, conceived as directly related to — indeed, vaguely identified with — the promotion of an air transport industry in accordance with national need, the fact remains that there was (and is) no necessary equivalence between the amount and type of air transportation provided by the scheduled carriers and that which an independent consideration of the nation's needs would prove to be required. In the absence of such an independent consideration, the program of Government support embodied in the Act was left without adequate orientation.

It was obviously not up to the Act's administrators to develop their own autonomous notions of the air transport requirements of the defense, mails and commerce of the United States;¹ at all events, they did not do so. Thus the administration of the support program became a matter of carrying into effect so far as possible the intent of Congress which the words of the Act did little to reveal. Accordingly, mail rates on existing routes were set so as to enable the carriers profitably to continue service at the then existing level. Since the framers of the Act apparently expected that aid would be given to operations on new routes as well as to those on routes already established, but failed to provide a specific guide for the selection of such new routes, the Board adopted the most logical possible extension of the general standard for support in effect accepted by the legislators. They had evidently endorsed support of existing scheduled air services to the extent required to maintain them at a profit; it was therefore only reasonable to suppose that they would endorse the support of new routes which could be profitably operated at rates of mail pay not too far out of line with those generally required by existing services.

¹ For an illuminating discussion by the Board of its own limited conception of its primary task, see the Letter from the Chairman of the Civil Aeronautics Board in further response to Senate Resolution No. 228, Senate Document No. 206, Part 2, 77th Cong., 2d Sess., September 2, 1942.
The Board's own conception of this standard is indicated by the following statement in an early route decision:

"It is our belief that unless exceptional circumstances, such as the particular importance of a route from the standpoint of the national defense, exist in a given case, this relationship [i.e., the relationship between costs and commercial revenues] should not initially impose upon the Government an unduly large proportion of the total operating cost. Conditions surrounding the operation of any service receiving a certificate should also be such as to justify an anticipation that commercial revenues will show a continuing tendency to increase, with a consequent progressive decrease in the degree of the carrier's dependence on the Government."  

In view of the fact that the Board itself has never vouchsafed any general definition of what would constitute an "unduly large proportion" of costs, and in the light of the decisions actually made in new route cases, it appears that the criterion employed by the Board led in general to the certification of such routes as were anticipated to require a rate of mail payment of the same general order of magnitude as those required on the grandfather routes, and to show promise of eventual financial self-sufficiency.  

The latter requirement is perhaps not so clearly related as the former to the apparent intent of the framers of the Act; nevertheless, it reflects a not unreasonable inference from the Congressional mandate to promote "sound economic conditions" in air transport. Recognizing that the legislators had been primarily interested in extending a helping hand to the mail carriers, rather than in assuring the maintenance of a certain volume or type of air transport conceived to be required by national policy, the Board evidently concluded that the program of support was essentially a temporary expedi-

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2 Northwest Airlines, Inc., Certificate of Public Convenience and Necessity (Duluth-Twin Cities Operation), 1 CAA 573, 579 (1940).

3 The actual result of the Board's policy is indicated by the following table, which shows, for domestic air mail service, a considerable increase in miles of route and revenue mail miles flown accompanied by a decrease in the cost per revenue mail mile to the Post Office Department, notwithstanding the substantial increase in the total cost of the service to the Department. (Cost figures for the latter part of the period covered are subject to substantial upward readjustment as a result of retroactive mail pay orders by the Board.)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Miles of air mail routes</th>
<th>Revenue mail miles flown (millions)</th>
<th>Cost of Service (millions of dollars)</th>
<th>Cost of revenue mail mile (cents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>37,080</td>
<td>52.1</td>
<td>17.0</td>
<td>32.6</td>
</tr>
<tr>
<td>1940</td>
<td>37,943</td>
<td>59.2</td>
<td>19.4</td>
<td>32.8</td>
</tr>
<tr>
<td>1941</td>
<td>43,411</td>
<td>75.7</td>
<td>20.7</td>
<td>27.3</td>
</tr>
<tr>
<td>1942</td>
<td>44,623</td>
<td>89.3</td>
<td>23.5</td>
<td>26.3</td>
</tr>
<tr>
<td>1943</td>
<td>45,304</td>
<td>89.0</td>
<td>23.3</td>
<td>26.2</td>
</tr>
<tr>
<td>1944</td>
<td>49,492</td>
<td>107.7</td>
<td>28.4</td>
<td>26.4</td>
</tr>
<tr>
<td>1945</td>
<td>56,849</td>
<td>166.6</td>
<td>35.5</td>
<td>21.8</td>
</tr>
<tr>
<td>1946</td>
<td>57,377</td>
<td>221.7</td>
<td>26.8</td>
<td>12.1</td>
</tr>
<tr>
<td>1947</td>
<td>102,454</td>
<td>314.5b</td>
<td>21.7b</td>
<td>6.9</td>
</tr>
<tr>
<td>1948</td>
<td>130,093</td>
<td>321.7b</td>
<td>35.2b</td>
<td>10.9</td>
</tr>
</tbody>
</table>

* Does not include any amount for increased rates on air mail routes pending before the Civil Aeronautics Board.

b Subject to final adjustment.

ent to tide these carriers over until such time as they could "stand on their own bottoms."

The mere formulation of a standard for passing on new routes thus presented no insuperable obstacle to the administrators of the Act. In an article in this Journal, Mr. James M. Landis has pointed out the essential ambiguity of the support standard provided by the statute itself, and seems to attribute to this ambiguity a causative role in the present difficulties of the airlines.4 In fact the certification of "weak" routes complained of by Mr. Landis seems to have resulted from errors in the forecasting of costs and revenues, that is, from erroneous practical application of the adopted criterion, rather than from the inherent indefiniteness of the Act itself.5 Such mistakes could be made no matter how specific a mandate was provided by law. The really important question here is whether or not the standard employed by the Board and suggested by Congress is an acceptable guide for the satisfaction of the nation's needs.

As long as the liability of the Government to the carriers determined by this standard was within the limits foreseen by the Board, and as long as this liability continued proportionally to decrease because of the growing self-sufficiency of the carriers, the meaning and implications of the support program could be readily ignored. It had always been true that the amount and type of service supplied had been very largely determined by the carriers themselves, and that the Government had simply furnished the funds necessary to support this service. The postwar situation in which the rates of mail pay previously determined by the Board proved wholly inadequate to support the capacity supplied may serve to bring public attention to bear on the question of just what the taxpayer is obligated to pay to the carriers and why.

Again the mere formulation of a definite standard to determine this liability is not at all difficult. It is perfectly feasible to solve the problem of past, present and possible future deficits of certificated airlines by simply measuring the proper liability of the Government by the size of the deficits—as Mr. Landis phrases it, by putting both past and future operations on a "cost plus basis." 6

In dealing with the recent financial difficulties of the certificated carriers, the Board appears to have been guided in substance by this principle, and has indicated its conviction that the law imposes upon it

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4 Landis, Air Routes Under the Civil Aeronautics Act, 15 J. Air L. & C. 295 (1948)

5 It seems likely that these mistakes have occurred at least in part as a result of the Board's piecemeal approach to the issues confronting it, which may have brought about too much reliance on the contentions of the parties to each route proceeding without adequate advance independent analysis of the economic problems involved. On this, see Sweeney, Policy Formation by the Civil Aeronautics Board, 16 J. Air L. & C. 127, 159 (1949).

6 Landis, op. cit., p. 296.
an obligation so to act.\textsuperscript{7} This course of action, as has already been pointed out by many, may indeed be defended as the only one consistent with the rationale underlying the Act and its past administration.\textsuperscript{8}

However, this fact itself suggests the fundamental defectiveness of this rationale. For one thing, if such a course is actually required by law, then there is in principle no limit to the Government's possible obligation to the carriers. Since these companies can always overexpand relative to any previously fixed rate of mail pay, the Board being powerless to prevent overexpansion of capacity on routes already certified,\textsuperscript{9} the Government is in the unenviable position of having given a blank check to airline managements.

Recognizing this, Mr. Landis has recommended that a "budget" be drawn up for certificated air transport in general and for each particular carrier, an expedient which would effectively prevent the Government's being annually presented with an indeterminate bill for airline services.\textsuperscript{10} But this expedient evidently does not go to the heart of the matter. Mr. Landis, it will be noted, has offered no suggestion as to the objectives which should determine the over-all size and carrier distribution of this "budget."

It is submitted that the proper extent and direction of Government aid cannot be ascertained without a thorough study of the needs of the

\textsuperscript{7} In this connection, see the Board's \textit{Economic Program for 1949}, February 21, 1949, pp. 5-10, wherein the Board's mail rate program is justified in terms of the objective of "placing of revenues of the United States civil air carriers in a healthy relation to their operating expenses" (p. 6), and it is stated (p. 5) that this program "represents a reaffirmation by the Board of its interpretation of the obligations imposed upon it by Section 406(b) of the Civil Aeronautics Act of 1938 ... ".

\textsuperscript{8} It has been suggested that retroactive mail rate increases covering substantial periods of time (with their uncomfortably clear "cost-plus" implications) can be avoided once the Board is up to date in its mail pay cases and can deal promptly with carrier applications for higher mail rates. The Board now holds (and apparently has been sustained by the Supreme Court in its contention) that it is not authorized to put into effect a new rate for a period for which a final rate had been fixed by the Board and in which an application for higher mail pay (with respect to this period) was not pending. Nevertheless, \textit{if the accepted objective governing the size of mail pay is to enable the carrier "under honest, economical and efficient management" at least to break even, and it turns out that a final rate previously fixed by the Board is not adequate to achieve this objective, it would seem that this result would merely represent an error on the part of the Board and that the carrier should be entitled to recover the difference between its mail receipts and its break-even need whether or not an application for higher pay had been filed or, if filed, disposed of.}

\textsuperscript{9} See, for example, \textit{SURVIVAL IN THE AIR AGE}, A Report by the President's Air Policy Commission, (Washington, G. P. O., 1948), pp. 100-101: "The revenue from passengers and cargo, plus a revenue for the carriage of the mail roughly equal to the passenger rate, will not support the operations of many of the companies. If they are to continue in operation and start again up the ladder toward self-sufficiency the Government will have to increase the mail rates. "There is no need to change the law in this respect. It already is drawn to cover exactly such a situation." (Emphasis supplied.)

\textsuperscript{10} As CAB Chairman Joseph J. O'Connell, Jr. has pointed out, the Board has legal power to make disallowances in mail rate cases for over-scheduling—at least with regard to "need rate" carriers. See O'Connell, \textit{Legal Problems in Revising the Air Route Pattern}, 15 J. Air L. & C. 397, 405. This presumes some level of scheduling beyond which the Board is not obligated to support the carrier. If the deficit is taken as the definitive measure of the federal obligation, then there is no logical basis for such disallowances.

\textsuperscript{10} Landis, op. cit., p. 301.
nation from the point of view of the national defense, commerce, the postal service and whatever other aspects of the national interest are considered relevant. The major defect of the Civil Aeronautics Act is not its failure to provide definite guides for the administrators. As we have seen, this failure can be easily remedied by the improvisation of policy standards based on the apparent intent of the framers of the Act. The fundamental defect consists in the fact that these standards are not related to a definite concept of national requirements; thus their application may well not result in the fulfilment of these requirements. Without the prior definition of the nation's needs, who can say whether the funds spent in promotion are extravagantly large or dangerously small? How is it to be decided whether a drastic program of retrenchment is in order, with perhaps the revocation of certificates now outstanding and the disappearance of certain companies from the field, or whether the Board should rather liberalize its criterion for the support of new routes and services and embark on a course of nationwide or even worldwide expansion? From a broader point of view, how can it be decided whether to continue to offer direct aid to only the carriers presently certificated, to enlarge this program to include, for example, the exclusive cargo carriers, to shift direct aid entirely to the latter group, or to cease to give any direct aid at all?

It is beyond the scope of the present article even to propose an agenda for an investigation into the nation's air transport needs. Nevertheless, brief mention of some of the problems which such an investigation would have to include will serve to indicate both the importance of the questions involved and the inadequacy of previous considerations of these issues.

**National Defense Requirements**

In the formulation of national policy toward civil air transport, the first necessity would seem to be a clear and complete definition of the requirements of the national defense. So far as is indicated by public records, no serious attempt has yet been made to provide such a definition, despite the fact that it appears to be all but impossible to justify any Government aid to commercial air transport except on the basis of defense needs. Whatever may have been the case in the past, it seems that under present conditions the nation might safely rely on unsubs-

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11 The National Military Establishment is only now undertaking to define in a comprehensive manner its position with respect to civil air transport policy. After being requested by the Senate Committee on Interstate and Foreign Commerce to present the views of the military on this subject, the Under Secretary of Defense informed the Committee that a study was being initiated to determine the Establishment's "present definition of the 'present and future needs of the national defense' as that phrase is used in the Civil Aeronautics Act of 1938," and asked the Committee to postpone the appearance of a witness representing the military until this study had been completed. The Under Secretary also stated that "the resultant findings may have a profound effect upon our position with respect to several of the most important issues before your Committee." Letter from Under Secretary of Defense Early to the Chairman of the Senate Committee on Interstate and Foreign Commerce, June 6, 1949.
dized enterprise to fulfill its commercial needs for air transport, just as it does with regard to commodities in general. The Post Office does indeed require some quantity of air transport service for the carriage of air mail, and thus there is justified the payment to air carriers of an amount just sufficient to obtain the needed transportation. But it is difficult to see why any payment in excess of this amount should be made in the interest of the postal service. In the foreign field, it may be thought politically necessary to promote United States-flag civil air transport beyond the present commercial need for such service, or necessary from a military point of view to subsidize routes having strategic value in wartime. However, there seems to be no comparable argument for subsidizing domestic air transportation.

It may be noted here that some arguments (related to the national defense) which could be used to justify Government aid to air carriers in the past may well have now lost their force. For example, the maintenance of an aircraft industry on the scale required by defense considerations may now be assured by direct military demand; the manufacturing capacity necessary to supply the scheduled carriers with equipment is by comparison of small importance. The rate of aeronautical technical progress needed to maintain the advanced position of the United States is apparently much faster than could be supported by the commercial carriers, at least without a very large increase in Government aid. Here again, more direct methods of promotion seem to be far better adapted to the achievement of the objective. The nucleus of managerial personnel and "know-how" to organize the expanded military air cargo operations which might be necessary in the event of war are now directly available in the Military Air Transport Service. Finally, it is significant that both the President's Air Policy Commission and the joint Congressional Aviation Policy Board have relied principally on the asserted necessity of maintaining a "reserve fleet" (of unstated size) of airplanes (of unstated type) to demonstrate the present importance of civil air transport to the national defense.

A clear definition of national defense requirements is needed not only to decide whether and to what extent aid should be given to air carriers, but also to determine which types of carriage should receive aid and by what means support is to be given. If, for example, the requirements of the military should be found to consist solely of the need for a reserve fleet of cargo planes, larger in number than can at present be supported by current demand, then it might well be that the funds now spent to support the passenger service of the certificated airlines should be diverted to, say, the development and production of

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12 In this connection, it is important to note that there may be little actual subsidy included in the mail payments made now and in the past to the certificated carriers. The determination of the amount of the subsidy, even though on a necessarily approximate basis, is essential in order to discover what amount and type of air transportation could be supported without subsidy.
a more efficient cargo plane than is now in use.\textsuperscript{13} In this event the inclusion of an element of subsidy in the mail payment would be hard to justify. Without such a clear definition, there is no way to judge whether the policy of aid now in being or any other proposed policy is adapted to the fulfilment of national need; more important than this, there is no assurance that this need will be fulfilled.

\textbf{Responsibility for Profitable Operation of the Airlines}

Because it assigns to the Board the role of protector and promoter of the financial welfare of the certificated air carriers, the Civil Aeronautics Act may be interpreted as laying upon that agency the ultimate responsibility for profitable operation of the airlines at any given level of Government support. This interpretation, coupled with the fact that the law leaves with the carriers the power to make almost all important economic decisions, has resulted in confusion and buck-passing with respect to the recent losses of the airlines.\textsuperscript{14}

The problem at issue here is related to, but distinct from, the question of whether the Government is or is not obligated to make up any deficits which the carriers may incur. If indeed the Government

\footnotesize{\textsuperscript{13} The President's Air Policy Commission has concluded that a project for the development of a cargo plane which "can operate on a profitable basis" is the "soundest way to build up a pool of cargo planes for an emergency." \textit{Survival in the Air Age}, p. 115.}

\footnotesize{\textsuperscript{14} For example, the President of United Air Lines is able with apparent logic to make the following statement: "During the past 18 months, the domestic air transport companies have suffered a loss of $36,000,000. The Civil Aeronautics Act has a declaration of policy from which I quote: 'Assures the highest degree of safety in and fosters sound economic conditions . . .' Sound economic conditions do not produce such tremendous financial losses. That, in itself, would reflect against the Civil Aeronautics Board." \textit{Patterson, Stewardship of the Airlines by the Civil Aeronautics Board}, 15 J. Air L. & C. 390, 393 (1948).}

This unfortunate division of responsibility is not confined to situations where, as in the airline field, the regulators administer direct support as well as economic controls; it occurs wherever the regulators are given a protective as well as a policing role. For example, in discussing the economic results of regulation in the railroad field, Mr. K. T. Healy has remarked: "It might be said that the most harmful single thing which has resulted from regulation has been the growth of an attitude among many managements and financiers that their properties are somehow due this 'fair return', regardless of almost anything that may happen, and that if they do not get it a gross injustice has been done them. In turn this leads to a failure on their part to do the constructive thing for themselves by way of 'sharpening their pencils' and improving their costs, rates, and services to meet new conditions. Any aggressive business in other fields expects to do that, rather than to fall back on the fact that its plant represents a certain investment value and should therefore automatically earn certain profits." \textit{Kent T. Healy, The Economics of Transportation in America} (Copyright 1940, by the Ronald Press Company, New York), p. 519.

And again: "It is true, of course, that the regulatory control does require the railroads to present their story in public and formally defend their proposals before a tribunal. To that extent the regulatory procedure is a bother to management, as well as, in a sense, an affront to its prestige. But what is far more significant is the tendency foragements to use the Commission as somebody to blame for all that has gone wrong or all which they do that is distasteful. In the course of table talk the Commission has had more than a little responsibility heaped on its shoulders for things with which it has never had the remotest connection. To serve as a butt for reproof may be one of the functions that the Commission has to accept in the line of duty, but it has the unfortunate effect, as far as progress in the railroad industry is concerned, of confusing the issue of where responsibility lies and who must lead toward the improvements of the future." \textit{Ibid.}, p. 842.
is so obligated, then it is evident that, whatever the predetermined rate of mail pay, the ultimate economic responsibility lies with the Board; it is also evident that the Board should be given power commensurate with this responsibility. This point will be taken up at a later stage of the discussion.

The question here is rather one of the managerial decisions as to routes, schedules, equipment, etc., which are all-important factors in determining the financial results of airline operation at any given level of Government support. Aside from the possible use of the mail rate as a club to control the managerial decisions of the carriers, the Board's power in this connection consists largely of (1) its authority to approve or disapprove the initiation of new routes and to choose among applicant carriers the company which it deems best suited, from the standpoint of the public interest, to operate such routes; (2) its authority over commercial rates; (3) its authority to pass on such alterations in the physical character of existing services as the addition of new intermediate points or the initiation of non-stop operations; and (4) its authority to pass on proposed inter-carrier transactions such as agreements, consolidations, and route transfers.\(^1\)

It should at once be noted that these powers have been used in the past largely as a means of preventing individual carrier actions that the Board expected to have serious financial consequences for other air transport companies. The maintenance or initiation of genuine competition between carriers—which the Board has rightly interpreted as involving the provision by different firms of genuinely substitutable services\(^2\)—has been a secondary aim, in that it has never, so far as available advance evidence has indicated to the Board, been allowed to overrule the primary consideration of the protection of the revenues of affected carriers. If the recent financial straits of the airlines were in part due to the authorization of "too many" competitive routes by the Board, this appears again to be the result of inaccurate forecasting of cost and demand conditions rather than of intent on the part of the administrators.

\(^1\) The power to suspend or modify certificates may also prove to be usable in this connection. This possibility is discussed below.
\(^2\) It has been suggested (1) that the framers of the Act included in its policy statement a favorable reference to competition "only as a soothing antidote to the prevalent fears of monopoly" and (2) that the framers of the Act did indeed have in mind the promotion of some form of "competition," but that it was the gentlemanly emulation between essentially non-competitive services which was extolled by the Federal Aviation Commission. See, for example, Wohlstetter, Re-Ordering the National Air Map—How Can it Be Accomplished Under the Civil Aeronautics Act?, 15 J. Air L. & C. 466, 469 (1948). Either of these suggestions may conceivably be true; yet it seems to the present writer that the only definite conclusion as to the type of competition envisaged by the legislators which can be drawn from the public record is that, whether genuine or imaginary, economic or spiritual, this competition was to be consistent with the preservation of the financial welfare of the affected air carriers at substantially their existing level of operations (i.e., without bankruptcy and reorganization). From this point of view, the Board's policy of permitting competition just to the extent which it believed would be consistent with that degree of protection of the revenues of the affected carriers seems to be entirely in accord with the intent of Congress.
In the opinion of this writer, the statutory powers given to the Board over airline economic decisions were not intended to be used to "plan" an air transport network in accordance with any preconceived "map." In the first place, the initiative for such decisions was left entirely in the hands of the carriers; in the second place, the powers possessed by the Board, in common with those powers generally held by transportation regulatory agencies in this country, are far better adapted to the protection of the regulatees from competitive inroads than to the positive achievement of such a "plan"; and in the third place, an examination of the record reveals that the intent of the Act's framers was primarily protection rather than "planning."

Nevertheless, the fact that the Board is in some sense supposed to be responsible for the financial results of airline operation has given rise to a conception of its duties which goes far beyond the role given to it by the framers of the Act. Thus, much attention has recently been devoted to the possibilities of "remaking the air map," on the initiative of the Board, by such means as the revocation, modification, or suspension of certificates now outstanding, or through its power to approve or disapprove inter-carrier transactions such as consolidations and route transfers; and the Board itself has undertaken "an exhaustive study of the existing route pattern" in accordance with the recommendations of the President's Air Policy Commission and the joint Congressional Aviation Policy Board.

An optimistic point of view with regard to the usefulness of the "tools" (i.e. statutory powers) now available to the Board has been expressed by Mr. Joseph J. O'Connell, Jr., Chairman of the C. A. B.; but even Mr. O'Connell recognizes that, at least in the short run, "the Board, without the active co-operation of the industry, can probably do very little," and that the Board's "tools" for a long-run "rationalization" of the industry "take a long time to use because of the requirements of 'due process.'" Regarding the Board's powers over route transfers and consolidations, it is clear that the initiative under the

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17 One of the most unfortunate features of the transportation industry is that some of its supply characteristics are readily susceptible of representation on a geographical map. This attribute is unfortunate in that it invites oversimplification of the problems involved in adjusting the supply of diverse transport services in accordance with the complex and changing demands for these services, problems which are rendered even more complicated by the changing technological conditions which affect the cost and service characteristics of the various types of transport. Thus the industry presents a tempting field to those persons who are addicted to the concept of detailed, product-by-product "economic planning."

18 The Board, of course, has statutory power to initiate investigations, to institute enforcement proceedings, etc. This kind of initiative is obviously not the same thing as that reserved to the carriers.

19 A contrary conclusion has apparently been reached by Mr. Louis E. Black, Jr. in his article on Realignment of the Domestic Airline Route Pattern—Part II., 16 J. Air L. & C. 20, 32-34 (1949). Yet the weakness of the evidence offered in support of his position plus the author's recognition that the airlines "wrote their own ticket" in the 1938 Act seem to favor the views of the present writer.


21 O'Connell, op. cit., p. 401.
Act lies with the carriers themselves, and that so long as this is true the Board must rely on the profit incentive of the carriers to bring about any "rationalization" of the industry. It is also clear that within the framework of protective regulation and need rate subsidy, and without the exercise of some extralegal compulsion by the Board, the profit motive cannot be expected to cause carrier managements to relinquish "personal and . . . corporate ambitions" to the extent required for the most efficient organization of the industry. Mr. O'Connell, though he professes to find this situation "difficult to analyze," seems to recognize the need for some outside pressure to bring about the "revision of the air route pattern" which he thinks necessary; the recently instituted investigation of the possibility of dismembering the National route system may be taken as more than a hint to private management to take some action; and Mr. O'Connell's mention of "further tools" which may be employed in this connection as a threat of further pressure in the event of failure of "voluntary" action.

With respect to the only direct method of pressure now open to the Board, however, Mr. O'Connell is less hopeful than, say, Mr. Landis. This direct method is, of course, the use of the Board's power to determine mail rates as a club to compel carrier action which it believes to be desirable—a means of persuasion which, it will be noted, is not open to other regulatory bodies and is quite outside the presently accepted scope of economic regulation. The Board itself has taken the position that it has no Constitutional obligation to provide a "fair return" on the entire investment of any company; that its Constitutional obligation is met when the mail payment is sufficient to cover costs allocable to the mail service, there being included in these costs a return on the carrier's facilities used and useful in this service. Mr. O'Connell, discussing the possible use of the mail pay "tool" primarily as a remedy for "over-scheduling" rather than as a means for forcing route transfers, takes the view that even for this purpose the Board "probably" cannot reduce, or threaten to reduce, mail payments to "service-rate" carriers.

However, even if the range of discretion allowed to the Board by the courts should prove sufficient to enable it to force the reallocation of routes and even the dissolution of certain existing companies, it is evident that what is proposed is not regulation in any accepted sense, but the assumption of managerial powers and duties. As Mr. Wohlstetter has pointed out, Mr. Landis' proposal for the use of the mail rate to expedite route transfers amounts, in effect, to a revocation of the certificate of the carrier from which a route is transferred, and such

22 See Wohlstetter, op. cit., especially pp. 470-474.
23 O'Connell, op. cit., p. 403.
24 Ibid.
25 Ibid., p. 404.
26 See, for example, Eastern Air Lines, Inc., Mail Rate Proceeding, 3 C.A.B. 733, 752-756 (1942).
27 O'Connell, op. cit., p. 405.
revocation is not permitted by the Act for any reason other than wilful violation of the Act or the regulations, etc., issued under it or of the terms of the certificate.\(^{28}\) In this connection, Mr. Landis himself has proposed that the Board be given power to revoke certificates on the mere ground of the non-existence of public convenience and necessity,\(^{29}\) and Mr. O'Connell has significantly remarked that he "would not be bashful about requesting the power [of revocation] because of any theories which may exist with respect to the sanctity in perpetuity of a certificate of public convenience and necessity."\(^{30}\)

The Board's present powers of revocation thus appear to be relatively useless as instruments of "planning." Mr. O'Connell has suggested that the powers of suspension and modification of certificates may prove to be of value here, and Mr. Black has proposed an exceedingly drastic use of the suspension power to "remake the air map";\(^{31}\) but the use of these powers to accomplish route reallocations or the cessation of certificated operations is again difficult to reconcile with the intent of the Act. The instance cited by Mr. O'Connell of the use of the alteration power exemplifies regulatory protection of the revenues of a certificated line rather than service reduction in the interest of efficiency.\(^{32}\)

The choice, then, is between granting to the Board, either by legislation or by reinterpretation of the Act so as to change its character completely, unprecedented power over the airlines, or relying on the profit motive without outside compulsion. The latter is recommended by Mr. Wohlstetter; but he seems to rest his case more on conformity to the Act than on probable effectiveness.\(^{33}\) Mr. Landis seems more aware of the practical limitations of this method and, although he lays particular stress on the subsidized nature of the airline industry as blocking transfers which would contribute to efficiency,\(^{34}\) he recognizes that the problem also arises in other regulated fields.\(^{35}\) The fact is that with protective regulation, one of the key features of which is entry control geared to the preservation of the revenues of existing firms, and a fortiori with a program of need rate subsidy, the profit incentive cannot be expected to accomplish the changes in systemwise


As Mr. Wohlstetter points out, Congress in conditioning the mail payment on "honest, economical and efficient management" undoubtedly had in mind the "internal operation of the air carrier" rather than what he terms "external uneconomy." Wohlstetter, op. cit., p. 470.

\(^{29}\) Landis, op. cit., p. 297.

\(^{30}\) O'Connell, loc. cit.

\(^{31}\) Black, op. cit., pp. 36-38.

\(^{32}\) O'Connell, op. cit., p. 404.

\(^{33}\) Wohlstetter, op. cit., p. 474.

\(^{34}\) Landis, op. cit., p. 300: "... so long as mail pay remains what it is, the price of an inefficient system will remain too high to permit reasonable integration with another system, and the program of merger and consolidation will remain at a standstill."

\(^{35}\) Ibid., p. 299: "As the history of the railroads abundantly illustrates, some propulsive force from outside is necessary if real progress is to be made." (Emphasis supplied.)
distribution of output that changes in demands, techniques, or relative efficiency of various managements require if production is to be best organized. The high prices which must be paid by acquiring carriers to effect desirable route transfers are a direct reflection of this fact. For protection and/or need rate subsidy give a value to the accident of temporal priority which does not exist in an unregulated, unsubsidized field.36

In his much-discussed dissenting opinion in the United-Western Acquisition case, Mr. Landis seems to limit his proposal for the use of the mail-pay power as a club to the control of the price paid in route transfers.37 So limited, this procedure obviously would serve further to weaken the incentives for the initiation of such transactions. In his article in this Journal, however, Mr. Landis appears to take more seriously the implications of the acceptance of Governmental responsibility for the efficient organization of the scheduled air transport industry and to recognize that this responsibility must involve a continuing power of readjustment which cannot be exercised with the framework of traditional regulation. The following passage indicates how far Mr. Landis feels compelled to go in this direction:

"How can we best operate the system that has been created, is the real question at issue. And this involves the standing of the different systems, rates, equipment and safety. But routes can never quite be forgotten. The development of equipment alone calls for their constant rewriting. And systems must be brought to some kind of internal balance. The very shift in the nature of the problem may forcibly evolve a different type of technique—of planning rather than adjudication, of less reliance on legal shibboleths and more attention to the public return to be had from public investment. It still will require a broad gamble to be made by the public, but after all these years the extent and nature of that gamble and the portion of it that the public, as against private groups,

36 With respect to motor transport regulation, Mr. Healy has remarked: "One of the noteworthy results of all this has been to give value to a certified motor transportation company over and above any good will or going-concern value which it may have had before. Previously, with free entry into the business, an existing carrier might have a value due to its good reputation, accounts, contacts, and the like, but it cost no more than the investment in new facilities and the building up of a rival organization to start in competition with that carrier. Today the chances are that permission could not be obtained to compete with the original carrier, so that if the prospective operator were still insistent upon going into business he would have to buy an already existing line which held a certificate, in order to fulfill his desire. Part of the purchase price would then represent equipment, at its depreciated value, and good will, and part would represent a price set on the value of the certificate." Healy, op. cit., p. 547.

37 United-Western, Acquisition of Air Carrier Property, 8 CAB 298, 342 (1947): "The doctrine I advocate would relate allowable sales and purchase prices to a criterion of investment and would furnish standards against which the efficiency and economy of management could be measured and subsidy granted or denied management dependent upon its conformance to these standards. For with such a standard in existence the unwillingness of management to dispose of an un-economic route at a price that is fair because it is bottomed on investment would be the basis of a charge of lack of economy that would justify reduction in subsidy." (Emphasis supplied.) This substitution of Governmental compulsion for market incentives Mr. Landis impolitely describes as a way to "correct the inertia of management and restrain its greed." Ibid.
should bear ought to be capable of being made more precise. Otherwise a change in public temper may dry up not only private but public funds, and a more serious blow to the future of air transportation cannot be imagined." (Emphasis supplied.) 38

The present writer would put the problem in a slightly different way. Efficient operation of the airline system requires at the very least that power and responsibility be put unequivocally in the same hands. If the Government is to bear this responsibility, then the Government should have powers which measure up to it. If there is to be a continuing cost-plus program of subsidy, it is eminently just and desirable that the Government assume complete control of the subsidized enterprises. If the taxpayer is to underwrite anybody's mistakes, they should be those of his own appointees and not those of a group of managers not responsible to him. If, on the other hand, private managements are to bear this responsibility, then the private economic incentives making for efficiency should be freed from the dulling effect of protective regulation and need rate subsidy, and the power of management to act should be disencumbered of the obstacles placed in its path by such regulation.

There seems to be no obvious reason why a satisfactory aid program cannot be worked out which does not involve need rate support of particular airlines or in any sense justify protection of the revenues of particular companies from competitive inroads. 39 The present writer is inclined to believe that such a program would be almost sure to bring about better economic results — in terms of both static efficiency and dynamic progress — than Government "planning" and close supervision of airline operation. However, the essential point to be made here is that so long as the proper objectives of Government support and consequently also the proper method of its administration are not clearly determined, the problem of the proper aims and means of economic control will be hopelessly obscured.

Protective Regulation

It has been noted that the Civil Aeronautics Act may be interpreted as putting upon the Board ultimate responsibility for the profitable operation of the air carriers at any given level of Government

38 Landis, op. cit., p. 301. Mr. Black also seems to recognize the drastic difference in the relationship between Government and carriers which he proposes and that embodied in the traditional regulatory process. Thus, his proposal for wholesale suspension and selective reactivation of certificates is accompanied by a recommendation that the Board act in the light of a prior policy determination regarding "to what extent the airlines should be treated as nationalized industries" (Black's italics). Black, op. cit., p. 36. At the very least, it would seem that a decision of such tremendous significance and possibly representing such a complete break with established precedent should be left up to Congress.

39 The following methods of aid which do not involve such support may be mentioned as examples: (1) direct Government financing of research into and development of lower-cost types of aircraft and engines; (2) lease of planes to carriers at less-than-cost rates of rental; (3) preferential tax treatment; (4) provision of navigational aids at less than cost. The appropriate methods of support will of course depend on the nature of the aims to be achieved.
support. There are in principle two ways in which the Board may
approach this responsibility: (1) detailed control of airline operations
with a view to keeping over-all expenditures within the limits of un-
restricted commercial demand and predetermined Government-granted
revenues; and (2) preservation and improvement of the commercial
revenues of the several supported carriers through restriction of com-
petitive action by means of protective regulation. Thus the present
financial crisis has given rise to two distinct groups of proposals for
administrative action. The one group, discussed in the preceding sec-
tion, would broaden the Board's powers to improve efficiency; the
other, which will now be taken up, concerns itself with more effective
action along the lines of protection of commercial revenues.

First of all, it should be emphasized that this latter line of action
is far more in keeping with the basic rationale of the Civil Aeronautics
Act and with the spirit in which it has so far been administered, than
the line which leads to Governmental "planning." Thus it requires
no such drastic break with precedent as is envisaged by, for example,
Mr. Landis and Mr. Black. This writer has little doubt that the
economic regulatory powers given to the Board by the Act were de-
signed as a means of protection of the revenues of the carriers; and it is
undeniable that these powers are far better adapted to, and have been
used for, this purpose rather than for "planning." The present regu-
laratory system, with its primary emphasis on protection of the regulatees
from competition, was "sold" partly on the basis of the same vague
identification of the financial welfare of particular carriers with the
satisfaction of national need which has obscured the problem of Gov-
ernment aid.

Secondly, it is necessary to realize that the effective implementation
of this protective aim is essentially in contradiction both with the
achievement of the most efficient systemwise organization of air trans-
port (a point which has been touched upon above) and, more impor-
tant still, with the preservation of maximum competitive incentives for
progress in the airline industry. The fact may be simply stated: Since
competitive incentives to any firm are in direct proportion to the pos-
sible inroads on revenues which may be brought about by the inde-
pendent actions of its competitors, and also to the possible gains which
may be made at the expense of these competitors, these incentives are
in inverse proportion to the degree of protection afforded to the reve-
nues of the carrier itself and to those of its competitors by regulatory
restrictions.

So long as demand continued to advance in substantially all sectors
of the air transport market at a rate sufficient to absorb the supplied
capacity within predetermined Government support levels, this con-
tradiction did not become apparent. Thus the limited protective pow-
er of and liberal economic policy followed by the Board—as exempli-
fied in its relatively unrestricted certification policy and its general
opposition to inter-carrier agreements dividing markets, controlling schedules and preventing independent rate action—could be temporarily reconciled with the fundamental protective aim. In a word, a more restrictive course of action did not appear to be necessary to keep the carriers from going bankrupt.

Accordingly, the recent financial “crisis” has given rise to proposals for (1) the placing of administrative policy on a more restrictive basis; and (2) the extension of the Board’s statutory authority to give it greater power to quash competition.

The policy changes called for are indeed shifts of emphasis rather than reversals. As has been noted with respect to certification, the liberal policies heretofore followed have never been allowed to overrule the basic protective principle; thus the shift to a more restrictive basis is a logical adherence to basic precedent rather than a new departure. In this category of proposals we may put: (a) the Board’s recent proposal for an inter-carrier agreement on a uniform increase of 10 percent in commercial rates—a proposal involving outright Government sponsorship of concerted rate action by the carriers; (b) the suggestion that the mail-pay club be used to limit schedules of competitive carriers, thus constituting it “a useful weapon in setting the quantum of competition which should exist over certain routes”; (c) the proposal, mentioned with obvious trepidation by Mr. O’Connell, that “the Board encourage the carriers to try a system of temporary schedule control or pooling”; (d) some suggestions for stricter economic control of air common carriers previously exempted from much of Title IV of the Civil Aeronautics Act; (e) Mr. O’Connell’s suggestion that the power to suspend or modify certificates be used to protect the revenues of carriers from inroads arising from increased service by competition over already certificated routes; and (f) perhaps some of the recent suggestions for certification based on a predetermined “air map.”

Similarly, the proposed extensions of statutory power represent a logical development of the rationale of the Act. As an example of such a proposal, one may cite the recommendation, put forward by the

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40 A brief account of the conference of carrier representatives sponsored by the Board in this connection may be found in an Associated Press story which appeared in the Christian Science Monitor of August 20, 1948.
41 O’Connell, op. cit., p. 405.
42 Ibid., p. 407.
43 Ibid., p. 404. This procedure is here exemplified by a Board action restricting the certificate of Pan American so that it could not operate a “shuttle service” between Puerto Rico and the Virgin Islands in competition with Caribbean Atlantic. Caribbean Area Case, 8 C.A.B. ... (Serial E-1981, July 20, 1948).
44 In the preceding section, these proposals were discussed on the assumption that they were intended to be genuine attempts to plan routes and systemwise organization in terms of maximum operating efficiency. However, they may just as well represent attempts to allocate territories among carriers with a view to minimum inter-carrier competition for protective purposes. In view of the general tenor of the context, it would perhaps be correct to place the “map” proposal of the President’s Air Policy Commission in the latter class. SURVIVAL IN THE AIR AGE, pp. 110-111.
President's Air Policy Commission and others, that the Board be given economic regulatory power over air contract carriers.\textsuperscript{45}

If all these proposals had been put into practice, they might or might not have been effective \textit{in the present instance} to improve the commercial revenues of the mail carriers to an extent sufficient to make operations profitable at the then existing mail rates. It is always possible that at some time in the future—if not now—this policy would not suffice to achieve this objective. Neither these measures nor the extensive power over the industry envisaged by the "planners" can assure the complete control of cost and demand factors which would be necessary to guarantee the carriers against losses at any given mail rate. This guarantee can be made only by means of a cost-plus subsidy.

Protective regulation can, however, shore up the commercial revenues of the supported companies so that (a) any predetermined mail rates would be more likely to be adequate to assure the profitability of all the carriers and (b) the liability of the Government would be smaller at the end of any operating period under a cost-plus arrangement. The resulting reduction in Government expenditures is made at the expense of the airline users by restricting their ability to choose between competitive services and/or by increasing the price of a given service as compared with what it would be in the absence of protection. Aside from the questionable justice of this procedure, it is evidently objectionable in that it makes impossible the calculation of the real cost of the support program, which includes not only direct payments by the Government\textsuperscript{46} but an indeterminable amount borne by the travelling and shipping public. Nevertheless, so long as Government payments are based on the "need" of particular carriers, there will be a tendency for Government officials to sponsor protective regulation as a means of reducing the direct expenditures involved in the support program.

One might conclude that from the point of view of economic efficiency as well as from that of fiscal clarity a regime of full Government planning would be more desirable than the continuance or extension of the present policy of regulatory protection. However, it can also be argued that still better results could probably be obtained by aban-

\textsuperscript{45} \textit{Ibid}, p. 112.

\textsuperscript{46} An additional factor which obscures the cost of the support program is the hitherto unsolved problem of how much of the mail payments as now determined should be regarded as necessary cost of the mail service. In principle, all direct payments in excess of the minimum necessary to obtain an amount of mail service which has been found on an independent basis to be desirable should be regarded as subsidy. In practice, it is exceedingly difficult to calculate this minimum necessary cost, since, in the first place, the very routes on which mail payments are made have not been chosen primarily on the basis of postal need. Secondly, the minimum which would be necessary to obtain the desired type of mail service \textit{over these routes} can probably not be \textit{precisely} calculated. It is beyond the scope of this article to go into the various theoretical and practical difficulties involved; however, the main point to be made is that without an independent definition of the desirable amount and type of mail service, and a route-by-route determination of the least expensive way to obtain this service, no defensible division can be made between mail cost and subsidy.
doning both planning and protection for a regime of competition the
regulation of which would be largely directed to keeping competitive
endeavor within desirable channels. Such a regime, of course, could
not possibly work within a framework of need rate subsidy for
particular carriers.

CONCLUSION

In the preceding discussion, an attempt has been made to point out
(1) that the national program of airline support through the mail
payment is now and has been since its beginning inadequately oriented
in terms of national need; (2) that the present legislation has resulted
in an unfortunate division of ultimate responsibility for the profitable
operation of the airlines at any given level of Government support;
(3) that the assumption of this responsibility by the Board demands
the assumption of complete power over airline operations; and (4)
that the present scheme of protective regulation is essentially in con-
tradiction with maximum efficiency and maximum competitive stim-
ulus in the airline field. It has also been brought out that problems of
economic regulation are closely related to the support program: for
example, a cost-plus support program justifies and demands complete
managerial control by the Board; short of this, this type of support
program may be used as a basis for an argument in favor of protection
of the commercial revenues of supported carriers in order to reduce
the direct cost to the Government.47

The keystone of a rational program of economic control is therefore
the development of a support plan based on an adequate definition of
national need, in terms of which the best method of administering
Government aid and the appropriate type of economic control may
be determined. The direct importance of such a plan—in order to
assure so far as possible that the national need will be met—is
obvious. It is therefore recommended that Congress undertake as soon
as possible to define the air transport needs of the United States from
the point of view of the national defense, the postal service, and what-
ever other aspects of national interest may be considered relevant; that
it develop a program of support (if support is found to be necessary)
devised so as to meet these needs in the most efficient manner; and
that it then investigate thoroughly and without prejudice the problem
of economic control of air transport.

47 It is, of course, not at all certain that the assumption of complete man-
agerial control by the Government would put an end to protective restrictions. In
this connection, one may recall the exceedingly drastic restrictions which have
been placed on competing forms of transportation in countries where Government-
owned railways have suffered decreases in revenues as a result of outside com-
petition.