

STATEMENT OF BROCK ADAMS, SECRETARY, UNITED STATES DEPARTMENT OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE ON AVIATION OF THE HOUSE PUBLIC WORKS COMMITTEE, CONCERNING H.R. 8813 AND AVIATION REGULATORY REFORM, OCTOBER 11, 1977.

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here to discuss with you the critical issue of aviation regulatory reform.

In my judgment, the case for reform is compelling. We have gone through a meteor shower of debates and deliberations, hearings in the Congress and commentary in the media and the trade press. Nothing I have read has shaken my belief one iota that change is needed and the time is now.

When I say reform I mean real reform, not reform that merely "tinkers" with the mechanism. Not token reform that merely places a few time limits on the CAB or lets one carrier in and then closes the door. Meaningful reform must include: pricing flexibility with a definite zone in which carriers can make their own decisions on fares; entry reform based on a new policy declaration, reversing the burden of proof in entry cases, and reasonable automatic entry; and a small community reform that changes our present program from a subsidy for carriers into a subsidy for service to small communities.

I think H.R. 8813 is a good bill. I have some suggestions for changes but I would first like to make a few comments as to why reform is necessary.

The kind of regulatory system we have now may have been necessary once, but it just doesn't make sense today. Things have changed drastically

in the last 40 years. The DC-3 is still a serviceable aircraft but it's not the way most of us fly anymore. Airline travel has changed from a novelty for the few to a necessity for the many. We have a modern airport and airway system. The airline industry has become a highly competitive business, but we haven't changed the basic economic regulatory system. We still operate on the highly suspect principle that a board of regulators in Washington is better qualified to judge service needs and to make the decisions most basic to the industry -- where an airline can fly and how much it can charge.

Most importantly, fares could be lower. We can take pride in the fact that air fares have not increased as fast as other items in our economy, but this is as it should be. Few industries have experienced the tremendous technological progress that has occurred in a relatively short time in the aviation industry. Great advances in productivity and volume normally produce lower consumer prices. It was the cost savings that came with the jets that brought tail-wind profits for the companies and better bargains for air travelers and shippers. It was not the regulatory system.

The bottom line is that fares could still be lower. Only 10 to 15 percent of our population can use the airlines. Airlines produce a "high-class" service in more ways than one. I hope the message has gotten around town that this Administration and that this Secretary, in particular, are committed to lower fares. We recently had some discussions in this Administration about the appropriate fares in the North Atlantic. I take particular pride in the decision of the President to reverse a determination of the CAB that would have denied lower fares to our consumers. We can also have lower fares in the domestic market.

I know there's a difference between what occurs on the West Coast and on the East Coast, but all that good weather and Western hospitality can't be the only reasons why the Texas and California carriers can charge prices that many times are half what the CAB carriers charge for comparable service. Those intrastate carriers are simply putting more seats and passengers on their planes and experimenting with the radical thought that the way you attract more people to your business is by lowering the price, not raising it.

Mr. Chairman, you know this Department has participated in the field hearing held by this Subcommittee. They have been excellent hearings and I think it's important to get out of Washington once in a while and see what the rest of the nation is thinking. I was at Midway Airport a few weeks ago. I believe the type of low-cost, medium-haul service being proposed for Chicago is a forerunner of things to come nationwide. For years, people have been trying to get the carriers to use Midway Airport to relieve some of the congestion at O'Hare and to help revitalize that part of Chicago. Besides carrier support, the Midway case has had strong civic participation. The Board recently announced it was going to expedite the case and hoped to reach an initial decision within a year's time. But that announcement came seven or eight months after the case was filed. Why should it take almost two years to decide that case? I don't think it's the fault of the people at the Board. The problem is the process. We must adopt an automatic entry provision to avoid a two-year proceeding every time we have to decide an entry application.

As for the arguments against reform, they really haven't changed much in the last few years, and even after they're disproved they seem to creep back. Let me spend a little time on the alleged threat to small communities.

Opponents of regulatory reform claim that reform would result in a loss of service to smaller communities. That is simply not correct. Let's look at the facts:

- 0 Over the past twenty years, half of the small towns served by certificated carriers have lost that service. This year, for example, certificated carriers have entered replacement agreements with commuters and ceased service at such points as Galesburg, Illinois; Temple, Texas; and Cedar City, Utah. There are now fewer than 400 points in the 48 States served by regulated airlines. Carriers serve small communities not because they have to but because they want to, for feeder purposes or other traffic and route-related reasons.
- 0 Because the Board cannot control equipment selection or scheduling, many towns which do retain service receive inferior service. Some, such as Manistee, Michigan, and Havre, Montana, receive only one flight a day. Many other towns receive only two flights a day.
- 0 Local service carriers, who started thirty years ago to provide small community service, are maturing into large carriers and outgrowing those markets. More than 85 percent of their revenue passenger miles are now accounted for by jet aircraft. These planes have 75 seats or more, and are far larger than most small town markets should have. Our subsidy system is costing us about \$70 million a year. This

service could be provided for less than half or even a quarter of that price.

0 The real answer for small community service is with the commuter air carriers who are, ironically, exempt from Federal regulation and not eligible for subsidy. While our certificated carriers continue to reduce small town service, commuters have been growing by leaps and bounds. From 1969 through 1976, the number of passengers grew at an annual rate of more than nine percent and cargo at a rate of more than 30 percent. And speaking of cargo, Federal Express, operating as a commuter, now has greater domestic cargo revenues than Flying Tiger and has an application on file at the Board to serve 315 points.

What is in the aviation regulatory legislation for small and medium sized communities? I think they have a great deal to gain from such legislation.

0 First, there is a guarantee of service. The legislation in both Houses would guarantee continued air service for every point now certificated for at least 10 years. This would immediately halt the long-standing erosion of service. Would this cost a lot of money? No, I think it is clear from the growth of unsubsidized commuter carriers that a great deal of service can be provided to small towns using commuter aircraft at far less cost than the present subsidy. Almost every time infrequently scheduled jet service is replaced by better scheduled and smaller equipment, there are benefits to the passengers as well as savings in cost.

- 0 Many communities feel they need air service but have none and find the Federal Government unresponsive. Both the Senate and House bills require the CAB to set standards for applications from communities seeking eligibility for a commuter subsidy. While the level of subsidy available for new service has not been established, it is clear that a relatively small amount of money, if efficiently used, will support service at a large number of additional points. It is worth noting that very few towns have been added to the nation's certificated system since 1960.
- 0 Finally, the legislation would be beneficial to commuter air carriers by making them eligible for Federal subsidy for the first time and by allowing them to use bigger planes. Both bills, for the first time, allow the CAB to provide essential service to small towns by making subsidies available to commuters.

Small communities have much to gain from the enactment of reform legislation. On the other hand, they have much to lose if this legislation is not enacted. I intend to do what I can in the weeks ahead to see that the small community service issue is judged on its merits. I ask you to share in this effort to clear the air.

Let me now talk briefly about the major provisions of H.R. 8813. In general, I think this bill provides an excellent framework for progress towards the objectives of increased flexibility and improved small community service. I do have some suggestions, however, about the pricing and entry provisions.

With respect to pricing, the bill provides a free zone in which carriers can make pricing decisions without Board interference. For

increases, carriers could increase their fares 10 percent each year. For decreases, carriers could decrease their fares 25 percent the first year. Thereafter, they could lower their fares to any level without Board interference as long as the resulting fare was no more than 50 percent lower than the fare in existence on the date of enactment or 110 percent of the direct costs of the service, whichever is less.

I believe a zone is exactly the way we should proceed, but I am worried about the limits of this zone. The upward limit of the zone probably should not be more than 5 percent. In addition, the upward free zone should not apply to monopoly markets. I do not believe that the system that will be produced by this bill or the Senate bill will provide enough entry to protect against abuses of a 10 percent upward ceiling.

With respect to the downward part of the zone, after the first two years, what you have in essence is a floor of 110 percent of direct costs. The Senate bill after long deliberation rejected the idea of a direct-cost floor. Direct cost is a difficult concept to work with and the preferable course would be to use a specific percentage. We should not pass a "reform" bill which might result in lengthy Board proceedings and court cases to determine direct costs.

Percentages are somewhat arbitrary. I think, however, that the 25 percent figure or perhaps a zone of a little more depth is appropriate. A great deal depends upon how much entry we have. My recommendation is that we decide upon a downward percentage and then use this percentage rather than a direct cost floor. If carriers want to go below this zone, they could then apply to the Board, and the Board could review the proposal.

I believe, however, that the Board should only be able to reject a decrease if the opponent could prove that the fare was predatory. The burden of proof should be on the opponent to make this showing.

With respect to entry, this bill is quite good. The bill would change the policy declaration to emphasize competition. The changes in the domestic policy statement are good, but I believe the new foreign policy declaration should not be included in the bill since it might produce a more restrictive system than at present.

You have also recognized that we need more than hortatory sentences that can be interpreted by different people in different ways. This bill wisely includes provisions that do not depend upon the interpretation of a particular Board.

It has a strong dormant authority provision that requires unused authority to be awarded to any person regardless of whether the applicant is an existing carrier -- an approach which I favor -- on a fit, willing and able basis. I feel that we should have a strong dormant authority provision and not allow carriers to hoard their authority while keeping<sup>5x</sup> a willing applicant out of a market. 9r

Further, the bill has a discretionary entry provision that would<sup>07</sup> allow carriers to choose one new route a year without mileage limitations.<sup>71</sup> I am very pleased with various aspects of the House version of discretionary<sup>70</sup> entry. It applies to a broad range of carriers, and not just the existing<sup>30</sup> CAB scheduled carriers. It is a relatively simple provision. The provision<sup>7</sup> also allows the Board to increase the number of routes a carrier can choose to a number greater than one. This flexibility is a particularly desirable feature of the bill.



However, the minimum one route a year floor is perhaps too low. I believe that as time goes on, after a few years, we should allow the carriers to choose at least two routes a year and that this gradual increase should be provided in the statute. As a final point, I do not think it is necessary to end this provision after 5 years. Although I believe in phasing, I am confident that automatic entry should be a permanent fixture of our regulatory system. If we make the program an experiment, I am afraid that we will add an element of uncertainty that may make it very difficult for intelligent planning by the carriers.

In addition to making commuters eligible for subsidy, which would be a real breakthrough, I am also pleased that this bill would raise the commuter exemption to 55 seats or an 18,000-pound limit. I think these are the appropriate limits for commuters. I note that this bill would extend the loan guarantee program and make commuters eligible for this program. We are in the process of analyzing this program, and we hope to get back to you shortly with our views on this program.

I started these comments by noting that after much debate and examination, the central question about aviation reform is not what, but when. There are now whole segments of the industry in support of the proposal -- small carriers like Flying Tiger, Frontier, Hughes Airwest and the intrastate carriers -- and such large carriers as United and Pan Am. I recently sent all the Governors a letter explaining the need for reform and the response has been gratifying. A broad coalition of outside groups has been formed.

Mr. Chairman and Members of the Subcommittee, I believe we are now close to success, and I am willing to work with you in any useful way in the next few months to produce a bill that will truly reform the air carrier industry.

This concludes my prepared remarks. I would be happy to answer your questions.