Remarks prepared for delivery by Deputy Secretary of Transportation
Alan A. Butchman To the Aerospace Industries Assn., Williamsburg, Virginia,
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I'm delighted to be here and take a part in your annual conference. I bring you greetings from Secretary Adams and his regrets that he cannot be here with you.

In his year-end statement last December, your president predicted that 1978 would be a pivotal year for the aerospace industry, because many of the issues that have been developing would come to a point of decision during the year.

Mr. Harr was absolutely correct, and since a number of those issues involve Department of Transportation programs or responsibilities, I want to use this time to address those issues that jointly concern us.

I have divided them, in my own thinking, along domestic and international policy lines.

DOMESTIC AVIATION ISSUES

1. Regulatory Reform
(a) Legislative Status

Turning first to the items of domestic policy, the most burning issue is regulatory reform. After long debate and many legislative twists and turns, one reform bill has been passed by the Senate and a companion bill cleared the House Public Works Committee last week.

President Carter urged regulatory reform of the airline industry in one of the first statements he made after taking office. The Department has long supported a more liberal policy of economic regulation, including automatic entry and flexible pricing provisions. We believe that while present CAB fare policies have given the industry greater rate freedom, we also believe that without new entry -- or the threat of entry -- we are not likely to see price competition or innovation for any length of time.

The Senate bill, approved last month by an overwhelming 83 to 9 vote, provides both entry and price competition. As President Carter noted in commenting on the Senate vote: "This bill guarantees that the trend toward lower fares, already begun by many carriers in anticipation of this amendment, will continue -- benefiting more passengers and putting an end to one form of government regulation of business."

The House bill is more restrictive. It would allow any already certificated airline to add one new domestic route in the first year, and would permit fare increases of up to five percent and decreases of as much as 50 percent without prior CAB approval. Yet the House bill would put the CAB out of business by 1983, and therefore comes closer to "deregulating" the industry than the Senate bill which is essentially a regulatory "reform" measure.

In any case, it is gratifying that in little more than a year the pendulum of legislative opinion has swung in favor of regulatory change. Each of the bills achieves some of the goals we feel essential, and Secretary Adams and I are confident that an acceptable compromise will be worked out in conference and that final legislation will be on the President's desk before the close of this session.

(b) Carrier/Manufacturer Relationships

I would note, before leaving this discussion of regulatory reform, that I am aware of the questions that have been raised concerning the effects fare competition might have on historic air carrier/aircraft manufacturer relationships. Elizabeth Bailey of the CAB explored this subject at a recent National Science Foundation seminar, and I have studied her thesis with interest.

As I'm sure you know, Ms. Bailey is suggesting that the development of new aircraft may be more difficult under a competitive -- that is, unregulated -- system, since she presumes that no group of carriers would have enough market share to place the large orders needed to launch new aircraft design efforts.

I understand the logic, but I do not believe that effect will be the result of deregulation. For one thing, Ms. Bailey has based much of her argument on the economics and events of the 1950's and '60's. It is true that airlines may once have bought new equipment for "prestige" purposes -- to keep up with the Jones' airline, so to speak -- but that was in the days when fuel costs were negligible and trunk losses were made good by Federal subsidies. No airline today would buy an operationally inefficient aircraft, even if a manufacturer were foolish enough to market one.

Secondly, Ms. Bailey wonders if any small group of carriers will take on the large-scale risk involved in the advance payments that accompany a new aircraft order, when the market -- as she suggests -- may be divided among 100 to 200 carriers.

I believe we need more competition in the airline business, because -- for one reason -- that business has grown tremendously in 50 years. I do not foresee a field of 100 to 200 carriers above the commuter airline category -- in the foreseeable future. There is nothing in either of the bills now in Congress to suggest that degree of market entry.

In fact, Fred Kahn, Chairman of the CAB, disputes the argument that deregulation would cause chaos in the market by inducing excessive competition. "Companies are not likely to rush headlong into markets already adequately served, impelled by some drive for self-destruction," he says. As he points out, the competition for route authorizations has always been intense because government franchises carried with them certain exclusive rights to the territory and, therefore, afforded a high degree of economic protection. In a free entry situation, route certificates would have no value.

The issue, nevertheless, is an interesting one, and merits further study. But I believe the sum total of regulatory reform's significance for the aircraft industry will be a plus, not a minus, in that price competition will stimulate traffic -- as discount fares already are doing -- leading to increased airline profits and a greater demand for new aircraft. The changing nature of the market, including the growth of commuter carriers and the expanding role of the regional airlines, will almost certainly sharpen the demand for a family of aircraft of various sizes and performance capabilities. But the aerospace industry has already anticipated that need and is moving to meet it.

2. Noise Reduction

Let me move on now to the second major domestic issue concerning us -- noise reduction. Again, this should be a decision year.

Noise is a constraint to aviation growth that must be reckoned with, and for all that we have done -- and are doing -- to suppress it, divert it, or otherwise contain it at the airport, the real pay-off is in reducing aircraft noise at its source.

The industry, I'm pleased to say, has done a pretty good job. The newest wide-bodies are perceptibly quieter and the next generation of jets -- I'm assured -- will bring even greater improvements. The question before us is: how do we get those planes off the drawing boards and into the air?

A series of noise rules proposed and adopted over the last 10 years has lowered the allowable noise threshold to a point where all jet aircraft in the domestic fleet must meet fairly stringent noise limitations by 1985. About 75 percent of the current fleet cannot meet that 1985 standard.

The problem, as I'm sure everyone here knows, is money. The airlines would like to begin acquiring new generation aircraft, not only because many of their present planes are noisy but also because they are getting older and costlier to operate.

The public would welcome new planes, because they are quieter more fuel efficient and -- in many cases -- more comfortable.

You, the aircraft manufacturers want to build and sell the new-technology planes, both here and abroad.

The world market for new air carrier aircraft has been variously estimated at $50 billion to $80 billion. You know the figures better than I. Whatever the actual dollar size of the market, it is appreciably more than the airlines have invested previously in new equipment over their entire history.

To assist this situation, the Administration went on record last year in favor of a "noise bill" that would authorize a two percent ticket tax and waybill surcharge to help finance the retrofit of noisy aircraft or their replacement.

At present, this proposal -- like regulatory reform -- has taken two forms, one in the House and another in the Senate. Neither bill matches precisely what the Administration favors, but both provide a supplemental funding mechanism that would satisfy many of our goals. Both emphasize the advantages of replacement over retrofit.

The Senate bill, introduced by Senators Cannon and Pearson, proposes a $20 billion loan guarantee program, to be secured -- in part -- by aviation trust fund reserves. We believe that the loan guarantee approach is an insufficient mechanism to provide the financial resources needed by the carriers to bring about a massive replacement program which would have numerous national benefits. In any event, we are committed to an assistance program and we will continue to work with Senate and House leaders to develop a bill that will produce meaningful noise relief.

INTERNATIONAL AVIATION ISSUES
1. International Aviation Policy

Our approach to international aviation agreements is the same as that which governs our domestic aviation policy. We believe that free market forces are more effective than laws or regulations in providing convenient, efficient, affordable air transportation.

The key words are free market forces. When international airline managements are allowed to price their product according to competitive market forces, some interesting things happen: fares come down -- traffic increases -- load factors go up and profits improve. In sum, capacity problems are best solved by competition, not regulation.

If there are any doubts that the process can work, look at the North Atlantic, where U.S. carriers went from a negative 1.1 percent return in 1970 to a positive 12.8 percent return on investment in 1977. Or consider what has happened in the U.S. domestic market since the widespread adoption of "supersaver," "chicken feed" and other discount fares. Compare those fares with the much higher costs of scheduled air transportation in Europe, where capacity limitations are in effect. In a relatively free market, demand catches up with capacity.

I note, too, that the European Travel Commission is predicting that this will be the biggest year in history for American travel to Europe. Our people will be travelling to the continent in record numbers. At the same time, 20 million Europeans will be visiting the United States. One of the great contributors to this travel surge is the bargain air fair and these new low fairs have come about partly because of the persistence of Freddy Laker and partly because of our own insistence on price competition.

In this insistence on competition, we have, in all our international aviation negotiations, favored a liberal rather than a rigid legal framework, preferred private enterprise to government subsidies and shunned capacity regulation. We do not believe that market capacity should be divided equally, according to some arbitrary standard. We hold, rather, that each country's airlines should have an equal opportunity to compete for business.

The competitive system we seek in these international air agreements will serve these specific objectives:

1. Encourage innovative pricing and fare flexibility to meet the needs of different consumers;

2. Liberalize charter rules;

3. Reduce or remove capacity restrictions;

4. Eliminate discriminatory or unfair competitive practices;

5. Permit multiple U.S. airlines in international air markets; and

6. Encourage greater access to international markets by permitting more non-stop service points and improve the integration of domestic and international airline services.

In these respects, our international aviation policy is also consistent with the President's trade and tariffs policy. As you know, the U.S. Delegation at the General Agreement on Tariff and Trade (GATT) negotiations has recommended the elimination of all tariff barriers to aircraft trade; has requested the elimination of offset production requirements or licensing agreements; and requested that governments not intervene in airline equipment decisions. In other words, we believe in technology competition as well as price competition -- and we take that position because of our unqualified confidence in the superiority of the American aerospace industry.

2. Bilateral Agreements

In negotiating the bilateral agreement with the British last year -- the agreement that has become known as "Bermuda Two" -- our objective was to achieve an understanding that would maintain a competitive system. The British, on the other hand, wanted to move toward the more restrictive government-controlled agreements common elsewhere in the world.

There are some who contend that Bermuda Two was not a good agreement -- that it did not represent a "victory" for the United States. But, as Secretary Adams has said, we went to the negotiating table to write a treaty, not dictate one; to arrive at an agreement, not fight the Battle of Britain. The deliberations were long and arduous -- we never expected less -- and in the end we reached an acceptable compromise, fair to all concerned.

Bermuda Two is more than an exchange of route and landing rights. It sets the rules under which the airlines of the two nations will compete in providing international air services.

Before Bermuda Two was concluded, we had embarked on a six-months long negotiation of the bilateral agreement between the United States and the Netherlands. Frankly, in defining a new model agreement, we look to our pact with the Netherlands -- not Britain -- to set a new liberal pattern for bilaterals with other U.S. aviation partners. We both agreed that fares and rates should be based primarily on commercial considerations, and that intervention by governments should be limited to: (1) prevention of predatory or discriminatory practices, (2) protection of consumers from the abuse of monopoly power, and (3) protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support.

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In other negotiations, we have completed a new civil agreement with Romania, we are engaged in talks with Poland and France, and we will begin discussions later this month with West Germany. Our earlier talks with Japan have recessed until Fall.

The end products of these bilaterals -- and of our whole policy of competition -- are, as I noted, more travelers -- more passengers and more promising load factors that mean higher profits and all this, needless to say, means increased demand for new aircraft. We are, in our international aviation policy, serving not only our airlines but also the best interest of our important aircraft industry.

3. International Aircraft Competition

While we are urging more competition in our domestic air transportation system and advocating a greater reliance on competition internationally, we are finding competition thrust upon us in another area -- that of aircraft sales.

Eastern's recent $778 million order for 23 European A-300 Airbus aircraft marked the first time in more than 15 years that a foreign-built airplane has been selected by a major U.S. airline. Largely on the strength of that purchase, a European consortium is now promoting the smaller B-10 version of the A-300 and two new transports -- the 130-seat JET-1 and the 160-seat JET-2 -- in the world airline market.

I realize this is a matter of concern to your industry, as it is to a government keenly interested in the positive impact U.S. aerospace sales have on our balance of trade, but the emergence of a strong foreign competitor may not be all bad. For example:

-- About 30 percent of the A-300 is American-made. Yet over the life of the aircraft, that value increases to approximately 50 percent, because many of the spares are U.S. built.

-- The drop in exports of commercial transports last year, from $2.5 billion to $1.8 billion, was offset by the increase in sales to U.S. carriers. Traditionally, foreign sales have followed domestic purchases by several years.

-- Singapore Airlines is buying $900 million in new equipment from Boeing.

-- The major airframe manufacturers expect to deliver 270 aircraft worth $4.7 billion this year, an increase of 89 planes and nearly $2 billion. The industry has a $10 billion backlog and new orders this year may reach 300.

4. Financing

In the financing area, which I know has also been a matter of concern, some foreign manufacturers have made extraordinary financing arrangements. However, the U.S. is not without its own resources in that kind of competition.

The Export-Import Bank has been a major instrument of marketing and financing for U.S. aircraft producers. In the past 10 years the Bank has supported aircraft sales with a total export value of $15 billion. In response to the foreign challenge to lower interest, longer term financing, the Export-Import Bank will probably be doubling its lending resources, from $20 billion to $40 billion, extending repayment schedules from 10 years to 12 years, and is prepared to offer fully competitive financing packages wherever U.S. manufacturers face head-to-head competition with foreign companies. That these new approaches are effective is evident in Singapore Airlines' announcement that it intends to seek 30 or 40 percent of its financing from the Ex-Im Bank.

CONCLUSION

I am pleased to have had this time with you. The major question that concerns you -- the maintenance of U.S. leadership in transport aircraft -- cannot be answered unequivocally by me this morning, or by anyone else at this Conference. But I have tried to set before you a tableau of Federal faith in your industry, Federal support for your economic and financing needs, and Federal confidence in American aerospace competence. I assure you, we will work to the utmost to help you retain the leadership your skills have earned and the world reputation your products have achieved. I do not expect you, or us, to fail.

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