

3
1

U.S. DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20590

STATEMENT OF CHARLES D. BAKER, ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE ON AVIATION OF THE SENATE COMMITTEE ON COMMERCE REGARDING S. 2423, ON TUESDAY, OCTOBER 19, 1971.

Mr. Chairman, members of the Committee:

The Department of Transportation welcomes this opportunity to testify in support of increased regulatory power for the Civil Aeronautics Board over international air rates and fares. As you know, the need for such increased CAB authority was recognized by President Nixon last year, when he approved a Statement of International Air Transportation Policy in June, 1970. Developments since then have only served to underscore the need for greater U.S. authority in this area.

The bill which you have introduced, S. 2423, would indeed give the CAB added authority. And in our judgment, increased regulatory authority is needed to implement our stated objective:

"The U.S. should work for the broadest range of potentially profitable services designed to appeal to the broadest consumer market and based on the lowest cost of operating an efficient air transport system." Statement of International Air Transportation Policy, July 22, 1970, at p. 9.

However, we believe S. 2423 would give the Board more new authority than can now be justified. In summary, we favor the following additional authority of the CAB:

- (1) The CAB should have the power to suspend and reject the international rates and fares of U.S. and foreign scheduled

and charter air carriers. This would not include the power to fix or set such rates.

(2) The grounds for the exercise of this authority should be such as to prevent the use of excessively high or low fares, or those which are unjustly discriminatory, and which would have a substantial adverse effect on commerce.

(3) When the CAB proposes to suspend or reject a rate, the President should have the power to approve, disapprove, or stay the Board's proposed action.

The Department's concern about our international air fare situation is no new or occasional thing. Secretary Volpe has for some time been involved in trying to promote a fare structure designed to move all members of the traveling public at the lowest possible cost-related fares. A review of this Department's previous activity in this area, beginning with the Secretary's speech at the Paris Air Show in 1969 and concluding with the Department's recent comments to the CAB on the various student/youth fare proposals, is submitted for the record. Through all these Department actions run certain common themes which are relevant today:

(1) The inordinately complex and outdated international fare structure does not adequately reflect the economies of jet equipment. Under the present structure, for example, the amount many travelers pay is determined by length of stay, type of ground accommodations purchased, and ability to associate with a group.

(2) We have urged the development of a cost-related fare structure, where fares would reflect a "taper" principle. For example, fares per mile would decline with distance, and there would be a specific charge for passengers making costly stopovers.

(3) The carriers have provided insufficient justification for the continual increase of normal economy fares. Evidence suggests that some of the carriers' present financial difficulties are caused by a substantial shift of their higher yield normal fare passengers to very low promotional fares. And those passengers that do pay the higher fares may in some cases be subsidizing the discount passengers. We favor a reduction in the dollar spread between the two classes of fares, and appropriate limitations on the use of promotional fares, i.e., to fill excess seats in off-peak periods.

(4) We are opposed to fares which favor a special segment of the public, such as student/youth fares, because they may be unjustly discriminatory.

(5) Despite having found fault with various IATA rate proposals, we generally have not advocated that the CAB disapprove them. One major reason has been the inability of the CAB to deal effectively with the consequences of such a disapproval: disapproval would result in an open rate situation

where the IATA carriers would either file the same fares anyway (as has been long true in the Pacific) or the carriers would engage in rate competition, possibly leading to the use of predatory, discriminatory, or non-compensatory rates.

So much for the past. Let me now address the issue at hand. The failure of the IATA carriers to agree at Montreal has led to the possibility of an open-rate situation over the North Atlantic. The competitive pressures that have led to this are clear: the introduction of larger equipment by the scheduled carriers has depressed load factors and intensified their competition among themselves; and the competition between charter carriers and scheduled carriers continues to intensify.

Given these competitive pressures, and with an open-rate situation facing us next February 1, we are concerned that scheduled and charter fares may be cut to the point that yields for both types of service could be unduly depressed. Rates may be offered that unjustly favor certain groups -- such as the young, or the aged. Rates may be offered that are predatory -- intended not only to compete, but to eliminate competitors -- and which may be subsidized -- perhaps through higher fares charged to certain segments of the traveling public. We see all these possibilities, and we know that the CAB's present authority to deal rapidly and effectively with such developments is simply inadequate. The Board cannot suspend an

international rate pending hearing and investigation and the Board cannot reject an international rate on the ground that it is unduly low or excessively high.

Our concern about the rates to be offered in an open-rate situation over the North Atlantic is supported by our analysis of the rates which the carriers have already expressed a willingness to use: one fare package which was almost adopted at Montreal, and one filed by the German airline Lufthansa after IATA failed to reach agreement.

The Lufthansa package is a simplified fare package containing eight basic fares, five of which are substantially below current comparable fares. Lufthansa proposes reductions in the normal economy fares of between 15% and 25%; reductions in the excursion fares of between 24% and 45% and reductions in the group inclusive tour fare of 35%. The Lufthansa proposal continues the first class fare at the existing level, and offers youth fares with a slight increase in the peak season.

The Montreal fare proposal, on the other hand, is a more complicated package than either the Lufthansa proposal or the one that exists at the present time. Montreal contains seventeen basic fares with additional surcharges added for travel during certain periods. The Montreal proposal contemplates modest reductions in the existing group inclusive tour fares and affinity/incentive fares, and the introduction

of three new fares: a winter group inclusive tour fare; and an advanced purchase fare (or APEX, as it is called) for the off-peak and peak seasons.

What then would be the financial effect of each of these two fare packages on the scheduled carriers? Two U.S. flag carriers, Pan Am and TWA, have indicated to the Department that the Montreal fare proposal would bring an improvement in net revenues over the existing fares, with modest increases in traffic, but that the Lufthansa fare proposal would bring in substantially less net revenues than existing fares produce, with substantial increases in traffic. They estimate that probably one half of the increase in scheduled traffic under the Lufthansa package would be diverted from charter services. No foreign carrier has given us any similar revenue analysis. Our own analysis confirms the statement of U.S. carriers that the Lufthansa proposal would yield insufficient revenues to match existing levels, while Montreal would result in some revenue improvement.

Of course, we find no fault as such with a decreased level of revenue for the carriers, flowing from lower rates for the travelers. We favor "air services available on the lowest economic basis to the widest possible market." (International Air Transportation Policy Statement, p. 9) But given the financial posture of some international air carriers today, a predicted drop in revenue certainly raises the question as to whether the rates are compensatory or prudent for the long term viability of the international air structure. We have no certain answers here, because we have

not been able to acquire the relevant cost data. But, to take Pan Am as an example, we estimate that the use by Pan Am of the Lufthansa package could result in \$26 to \$38 million less revenue in a 12-month period than Pan Am's current fares are producing. Since Pan Am posted over a \$45 million operating loss for their Atlantic Division for the 12 months ending June 30, 1971, the non-compensatory nature of the Lufthansa package -- as far as Pan Am is concerned -- is certainly suggested.

Let me turn to other aspects of these fare packages which warrant attention.

It appears that both the Montreal and Lufthansa fare proposals are designed to attract a substantial volume of charter traffic to scheduled service. Certainly, competition for this bulk passenger market is wholly appropriate. But it can be expected that the charter operators (at least those which are not subsidiaries of scheduled carriers) will make comparable reductions in their charter rates (or ask for more extensive charter authority) in order not to lose their volume of traffic. In fact, Atlantis, a German charter carrier holding authority from the U.S. Government, has already announced that it intends to make comparable reductions in its North Atlantic charter rates in order to match Lufthansa's proposals -- the number I recall was \$135. As such a situation develops, all charter operators would soon match the lower rates offered by Atlantis and then it would be the turn of the scheduled operators and so on. Let me say again: competition is desirable. But we are concerned that it

could depress scheduled and charter rates to the point where the viability of certain carriers, and indeed the quality of air service in general, may be at issue.

Let me also mention the question of cross-subsidy between groups of passengers: some high yield traffic moving on scheduled services covering the cost of low yield traffic also moving on scheduled services or charter services. For example, in the Montreal proposal, the basic advanced purchase fare is only 42.9% of the normal economy fare and, under the Lufthansa proposal, the 14-45 day excursion is 50% less than the normal economy fare. I offer for the record an analysis of selected economy fares and discount fares which shows these disparities. It is hard to believe that the cost savings of handling either the APEX passenger, or the 14-45 day excursion passenger, is of the magnitude of 50% of the costs of handling the normal economy passenger.

We have heard IATA carriers argue that their seat factors are low, and these types of low so-called promotional fares will bring in additional revenues and fill seats that would otherwise go empty. While the fares would no doubt have that effect, we suggest that a sounder policy would reduce excess scheduled capacity and at the same time relate fares more closely to costs.

In the light of the foregoing considerations, let me again address the proposed legislation, S. 2423.

We believe the Board should be given additional authority to regulate international air rates for the carriage of passengers and cargo between the United States and foreign points, whether such rates are charged for scheduled or charter air service, and whether they are charged by U.S. or foreign air carriers. We differ with S. 2423, however, in the amount of authority to be given to the Board. First, we believe that the Board's authority should be limited to the suspension and rejection of such international air rates, and that it should not include the power to prescribe or fix such rates. The powers contained in S. 2423 are an extension of the CAB's domestic rate authority which we consider to be too wide ranging for use on the international side, and not necessary. We have two principal reasons for this position.

(1) We are aware of no demonstrated need for Board authority to fix international air rates; the powers we do favor seem to us adequate authority to deal with past, present and foreseeable situations. For example, the Board would be able to act in a timely and effective fashion in an open-rate situation by suspending or rejecting proposed fares that fail to meet the prescribed criteria, or by retaliating against the disapproval by foreign countries of fares proposed by U.S. airlines. Thus the Board should no longer feel constrained to reject an IATA rate agreement for fear that a "chaotic" and uncontrollable rate war is the only alternative.

(2) Under the view we understand the Department of State has of the clauses in certain existing air bilateral agreements, giving the Board the power

to fix international air rates (in addition to the power to suspend and reject) would be counterproductive in that it would have the effect of limiting the power to suspend or reject a foreign air carrier's rate where there is a disagreement with a foreign nation.

Second, we believe the grounds for the exercise of Board authority to suspend or reject international air rates should be narrower than those in S. 2423. The Board should be able to act, on economic grounds and on petition or its own motion, only where a rate is excessively high or low, or unjustly discriminatory and would have a substantial adverse effect on commerce. We have not yet developed the precise statutory language to express the standards to be used by the Board in exercising the limited power over international rates that we recommend. We are presently studying various statutory analogies, including section 18(b)(5) of the Shipping Act of 1916 which incorporates the "too high-too low" concept. We will shortly submit to you our recommended statutory language. Regardless of the language used, it should permit the Board to act where a rate is found to be non-compensatory.

Section 6 of S. 2423, amending section 1002(g)(2) of the Federal Aviation Act, would also allow the Board to act in retaliation to the Act of a foreign government. We can envisage the utility of such authority, but we defer to the Department of State as to the propriety of it.

With respect to the outside time limit for the suspension of international rates, we think there are two significant variables that should be

taken into account. The first is the length of time needed to conduct a Board investigation of air rates, and the second is the length of time needed to engage in and complete consultations with foreign governments about challenged air rates. We would think that 180 days is clearly ample for either purpose, but because it amounts to a six month delay in the institution of a proposed rate with the resulting disruptions of marketing effort of an airline, we would hope that the Board and the State Department would in most cases complete their work in far less time.

S. 2423 provides for limited Executive notice. The Department favors giving the President the power to review a proposed Board suspension or rejection of a rate, so that the President could choose to approve, disapprove or stay the Board action, or do nothing and allow the Board action to take place. We believe that a period of 10 days is required and is appropriate for the President to exercise the powers we recommend. Executive review was recommended in the Statement of International Air Transportation Policy approved by the President, although the CAB at that time noted that it had for years favored only Executive notice. We consider Executive review to be a necessity in view of the President's responsibilities respecting national security and foreign relations.

Mr. Chairman, that concludes my prepared statement. Thank you very much.

A REVIEW OF THE DEPARTMENT OF TRANSPORTATION'S PREVIOUS
ACTIVITY REGARDING INTERNATIONAL AIR FARES

1. Secretary Volpe's Speech of June 5, 1969 - Paris Air Show

His speech gave credit to the IATA carriers for bringing about a substantial fare decrease in November 1969 in certain types of fares across the Atlantic (the so-called Caracas fares). After pointing out that U.S. supplemental charter carriers were largely responsible for the significant bulk inclusive tour fare reduction, he stated that these reductions were partially offset by an increase in normal fares (effective in May) which affected at that time over 60 percent of all transatlantic passengers. The Secretary said that there was no economic justification whatsoever for increasing normal fares at a time when the IATA carriers were introducing the lowest fares applicable on scheduled flights in the history of transatlantic service, and at a time when the wide-bodied jet made it possible to operate at lower unit costs.

The main thrust of the Secretary's speech was directed at the complex fare structure which was geared to the piston era and precluded the carriers from passing on to the public the cost benefits which have resulted from jet equipment capable of flying passengers over longer stages at reduced unit costs per mile. The concept of fares increasing in cost per mile beyond London, as well as free stopovers, was considered by the Secretary to be contrary to good economic principles.

2. Statement of Position of DOT on the Caracas Agreement,
Docket 20781, filed on October 14, 1969

The Department's filing criticized the complexity of the existing fare structure which was becoming even more complicated with three new fare packages being offered. We argued that fares should be based on through rates per mile, decreasing with distance and noted that the California proportional fares (introduced to compete with charter services) were a step toward this objective. We said that fares should reflect costs, and that passengers should pay more for more services rendered. If a passenger chooses to travel by a circuitous route, he should pay for it, including reasonable stopover charges.

If the present fare structure were simplified and the various fares offered more closely reflected carrier costs, normal economy fares could be reduced resulting in acceptable load factors during peak periods, and promotional fares could be used in a manner for which they were originally designed -- to fill excess seats in off-peak periods.

On the issue of contract bulk inclusive tour fares (CBIT) we took no position on whether revenues to be derived therefrom would, in fact, add to the carriers' profits after giving consideration to all costs that should be associated with such fares and to self-diversion from higher priced fares. We took the position that the bulk fares should not be disapproved because they would divert to IATA carriers traffic now carried by supplementals. We stated that the new fares would generate a large amount of new traffic and there

should be great reluctance to find unlawful the bulk fares -- the lowest transatlantic fares ever offered by scheduled carriers. Consequently, so long as a fare adopted by IATA carriers is reasonable when measured against the applicable costs, the fare should not be found unlawful simply because that fare would divert traffic from competing supplemental carriers. An exception might be made to this standard if the supplementals were threatened as a result of a new low fare. But the evidence in this proceeding did not support a finding that the existence of supplemental carriers would be imperiled by the bulk fares. Rather, the record supported that these carriers would continue to enjoy good growth rates in traffic.

3. Meeting with the CAB Staff on August 5, 1970 Prior to the Honolulu IATA World Traffic Conference to be Held in September 1970

We met with the CAB staff on this subject to present our views on a U.S. Government position. In sum these views were:

1. The IATA fare structure should preferably reflect a "taper" principle, i.e., fare per mile decreasing with distance.
2. There should be a specific charge for passengers making stop-overs.
3. While transatlantic passenger traffic thus far in 1970 is growing at a rate well above average, carrier yield is decreasing. This is principally due to diversion of normal economy fare passengers (the fare level which should account for most of all scheduled traffic) to the lower promotional fares introduced last November.

There is no basis for further increasing normal fares which were previously increased in May 1969 when the round trip discount was eliminated.

4. The present promotional fares are too low and should be increased.
5. The family plan and youth fare proposals would encourage further diversion from normal fare traffic, and may also be unjustly discriminatory.
6. In the Pacific, economy fares are higher than justified and should reflect more closely the fare level now in effect in the North Atlantic.
7. There should be year-round excursion fares in the Pacific with reductions comparable to what we are advocating in the Atlantic, and a specific charge for stopovers.

The Board's publicly released letter of September 2, 1971 which was sent to the U.S. carriers just prior to the Honolulu Conference incorporated most of our views. For example, the CAB letter (1) supported our efforts to rationalize the relationship of fare to distance, and to limit free circuitous stopover privileges; (2) favored a rise in the level of the discount fares; (3) opposed family and youth fares as leading to uneconomic results; and (4) supported a promotional fare structure in the Pacific similar to that in the North Atlantic.

4. Letter of December 9, 1970 from DOT to CAB Staff

We wrote to the CAB staff at this time because it seemed that the IATA carriers were reaching an agreement on a publicly released series of fares and expressed the following observations:

1. The proposed increases in normal fares are ill-advised, and not supported by economic facts. They increased the dollar spread between normal and promotional fares which we oppose.
2. The record shows that the carriers' present financial difficulties are caused in large part by a shift of their higher yield normal fare passengers to the very low Caracas/Alitalia promotional fares. For example, Pan Am's 1970 normal economy traffic was 24% less than it was in 1968. This shift has helped depress their yield to marginal levels at a time when passenger traffic is increasing at a rate well above average, and seat factors are climbing. Pan Am's proportion of discount fare passengers to total has increased from 42% in 1968 to 63% in 1970. Consequently, more of the burden of capacity costs is being placed on a declining number of normal fare passengers.
3. The Department supported the proposed increase in promotional fares. In fact, it favored the slightly higher promotional fares originally sought by Pan Am and TWA. However, the IATA agreement that was reached continued to reflect their concern with charter competition.

4. The IATA carriers had made some favorable progress towards fare simplification by (a) eliminating the CBIT and affinity fares for groups of 15 and 25, and (b) establishing a two season fare level by eliminating the shoulder season.
 5. No progress was achieved, however, in creating a fare taper or tightening the fare structure by limiting circuitous and costly stopovers.
5. Assistant Secretary Baker's Letter of January 11, 1971 to Chairman Browne Regarding IATA Resolutions on the North/Central Pacific Routes, Docket 22628

The letter pointed out the difficulties engendered by the failure of the Federal Aviation Act to provide for CAB authority to regulate individual carriers' international rates and fares. The IATA carriers had made no demonstration that the fares under consideration met the criterion that the structure and level of air fares should reflect the costs of providing the service.

We pointed out the following deficiencies:

1. The existing fare taper across the Pacific has been all but eliminated.
2. The fare resolutions provided for no charge for costly stopovers.
3. The proposed increase in normal economy fares provided for in the resolutions were inconsistent with the President's Policy Statement that normal fares on North/Central Pacific routes "remain well above justifiable levels".

Notwithstanding these deficiencies we did not advocate that the Board disapprove the resolutions proposed, since we were not persuaded at that time that such disapproval would produce any meaningfully different result. Disapproval would result in an open rate situation after February 1, 1971, and each of the IATA carriers involved might very well file (as they have done previously) much the same fares as are provided for in the resolutions, and the Board is without statutory authority to do anything about it.

The Department pointed out that the President had advocated that "the effectiveness of the Board in its dealings both with IATA and governments should be enhanced by vesting it with authority to regulate rates and fares between the U.S. and foreign points, subject to Executive review." We concluded that the legislation sought by the President obviously is what is required.

6. DOT Comments of January 21, 1971, on the North Atlantic Fare Proposals to be Effective April 1, 1971, Docket 22628

With some reluctance, the Department recommended approval of the proposed fare resolutions because the likely results of Board disapproval raised even more serious problems.

Many problems were raised by the fare proposals, such as the failure to produce a fare taper and to eliminate free stopover privileges, as well as increasing normal fares and further expanding the dollar spread between normal and promotional fares. Nevertheless, we considered it essential to increase yields in view of the financial health of the U.S. transatlantic carriers, and the proposed increases

in promotional fares were expected to increase yield by 5 to 8 percent. We emphasized that it would be preferable if the CAB could require the increased yield to be predicated on a fare structure having a closer relationship to carrier costs. Again we noted that the Board unfortunately lacks the necessary regulatory tools to do effectively. The only avenue open to the CAB should it find the fare proposals not to be in the public interest would be to disapprove the resolutions. In view of the large number of carriers serving the North Atlantic markets over many different routes, we believe that Board disapproval could result in a hectic open rate situation in which yields might be reduced even further. We wanted to avoid that result since the financial ill-health of carriers resulting from unduly depressed fares is clearly not in the public interest.

We also pointed out that the justifications presented by the carriers in support of the resolutions were sorely inadequate. They did not provide sufficiently detailed traffic projections, cost projections or capacity projections. We stressed that in the future far more of a justification should be required in order to assure interested parties a real opportunity to comment meaningfully.

7. Letter of June 25, 1971 from Assistant Secretary Baker to Chairman Browne Regarding Student/Youth Fares

In this letter, the Department said that it would file a statement with the CAB recommending that the Board take the speediest course possible to have the presently effective individually filed student/youth fares discontinued, unless it can be demonstrated that they are not unjustly discriminatory. If the fares are not unjustly

discriminatory, then we proposed that they be made available to all travelers.

DOT favors all members of the traveling public (not just a special segment) receiving the benefit of the lowest possible cost-related fares. We look with disfavor on policies which discriminate against any major segment of the public since noncompensatory and below real marginal cost pricing must be paid by someone else.

The IATA carriers have now created a chaotic open-rate situation in an area of strong competition between scheduled and charter services which could result in fare-cutting to the point that yields for both types of services could be unduly depressed. While the Board lacks the authority to suspend these tariffs, and is limited to determining, after hearing, whether the filings are unjustly discriminatory, these unilateral carrier actions once again point out the necessity for the Board to be empowered to regulate international fares.

In this filing we also said it would be desirable for U.S. carriers to seek liberalization of IATA Resolution 045 (dealing with charter services) so as to make it consistent with the CAB's more liberal charter rules adopted on January 29, 1971. This would improve the ability of scheduled carriers to compete in the bulk market and would be in accord with the President's Policy Statement calling for uniformity of charter regulations for all classes of carriers, scheduled and supplemental.

Comparison of Fare Per Mile for Selected
Economy Fares

City Pair: New York - Frankfurt

Non-stop Mileage (CAB): 3856 miles

<u>Package/Fare Class:</u>	<u>Round Trip Fare</u>	<u>Fare Per Mile</u>	<u>% Of Normal Economy</u>
<u>Honolulu</u>			
Normal Economy			
Basic	\$536	6.95¢	
Peak	636	8.25	
29-45 day excursion			
Basic	312	4.05	58.3%
Peak	372	4.82	58.4
<u>Montreal</u>			
Normal Economy			
Basic	Same as Honolulu		
Peak	" "	" "	" "
APEX (22-45)			
Basic	230	2.98	42.9
Peak	290	3.76	45.6
<u>Lufthansa</u>			
Normal Economy			
Basic	420	5.45	
Peak	540	7.00	
14-45 day excursion			
Basic	210	2.72	49.9
Peak	270	3.50	50.0

