STATEMENT OF DR. JOHN J. FEARNSIDES, DEPUTY UNDER SECRETARY, DEPARTMENT OF TRANSPORTATION, BEFORE THE SENATE COMMERCE, SCIENCE AND TRANSPORTATION COMMITTEE, CONCERNING AIR-CARGO DEREGULATION, APRIL 5, 1979

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before this Committee and to review the status and outlook of the air-cargo industry. I am happy to observe that a great deal of progress has been made in this industry.

In 1976, there was a series of hearings concerning air cargo, and the picture was dismal. At best the industry was stagnating, and at worst it was declining at a fairly rapid rate. There were only two certificated all-cargo carriers operating domestic services, and both of them had experienced financial difficulties. In the period of 1970 to 1976, the all-cargo industry did not show a profit in any of these years, as the attached chart shows.

During that same period, Western, Continental, Delta, and Eastern terminated all-cargo service. In addition, American and United reduced prime-time (overnight) air freight service and discontinued freighter operations to a number of cities. Thus, while roughly 50 U.S. cities received domestic all-cargo service in the late 1960's, that figure had been cut almost in half by 1977. There was a movement away from common carrier service and more and more shippers sought contract (charter) carriage or turned to other modes.

What was the problem? Certainly there was a need for air freight. As our economy has grown and as markets have grown from a regional to nationwide focus there is an ever increasing need for premium transportation service in terms of speed. Particular industries, such as the fashion, pharmaceuticals, electronics, and aerospace industries, where the value of the product is substantial and where speed is of the essence, rely very heavily upon air freight.

But the then-current regulatory system was frustrating the growth of this vital segment of the transportation industry. The air cargo carriers were in many ways treated like passenger carriers, and were limited in the number of points they could serve. An airline passenger may only travel between a limited number of points at one time, but a shipper may have dozens and hundreds of destinations. He wants a carrier who can transport his goods to all his intended destinations, and the regulatory system was not allowing carriers to expand.

Rates were also kept low. In fact, CAB Law Judge Present, in his decision in the Domestic Air Freight Rate Investigation (DAFRI) in 1975 found that, on the average, freight rates were roughly 40 percent below industry average freighter costs. Below-cost rates may seem a bargain to consumers, but such rates deny the carriers the incentives to provide good service and the ability to raise capital needed to build the industry. And that was exactly what was happening: a declining and stagnant industry. One bright spot was Federal Express who was able to operate under the small aircraft exemption from the then-current regulatory system and to grow enormously.

In 1977, the air cargo deregulation bill was passed, and the industry was substantially freed of price and entry controls. Since that time the industry has started on the road to revitalization. Freighter capacity, measured in available ton-miles rose 21 percent in 1978 (see attachment), and service has been expanded. In 1978 traffic moved in all cargo aircraft exceeded the prior year's level by about 27 percent. The following are examples of this movement:

- Flying Tiger inaugurated scheduled all-cargo operations at nine new cities. 1/

1/ Anchorage, Alaska; Charlotte, North Carolina; Atlanta, Georgia; Houston, Dallas, and Fort Worth, Texas; San Juan, Puerto Rico; Cincinnati, Ohio; and St. Louis, Missouri.

In addition, Flying Tiger utilized its section 418 authority (the new authority provided by the air-cargo deregulation act) to mount an expansive substitute trucking operation 2/ to provide numerous smaller communities that do not yet generate sufficient traffic for a DC-8 freighter operation with the benefits of overnight domestic all-cargo air service.

- Airlift International, an all-cargo carrier, introduced DC-8 freighter service linking the Pacific Northwest with Chicago and New York. This innovation is part of the carrier's program of expansion into areas found to be lacking in direct all-cargo lift.
- Evergreen, a supplemental air carrier, utilized its 418 authority to establish scheduled all-cargo service along both coasts: from Seattle to Portland, San Francisco and Los Angeles; and from Atlanta to New York and Boston. This represents an important competitive development as the previously existing service had been regarded as generally inferior by the shipping public.
- Seaboard World Airlines, an all-cargo operator serving the major U.S-North Atlantic markets from its JFK headquarters, initiated domestic scheduled service (primarily for United Parcel Service), from New York City to Chicago, Los Angeles, and San Francisco. Prior to deregulation, Seaboard had been denied domestic access to New York City.

2/ The airline has contracted with a number of ICC certificated motor carriers to provide exclusive-use, over-the-road service scheduled so as to arrive at the nearest airport served by Flying Tiger in time to make the cutoff for that carrier's overnight freighter service.

- Pan American has expanded its domestic all-cargo service offerings by carrying local traffic over U.S. transcontinental sectors of its international flights. These new domestic "fill-up" services, formerly precluded by the Board, link New York City and Miami via Chicago or Houston with the West Coast (Los Angeles or San Francisco).
- United Airlines, in part as a competitive response to other carriers' moves, increased its freighter aircraft departures by 20 percent (thus improving its equipment utilization). Those cities benefitting from increased all-cargo capacity include Hartford, Cleveland, Detroit, Newark, New York City, Chicago, San Francisco, and Los Angeles.
- TWA discontinued all freighter service, citing the high cost of operating the 707 aircraft in all-cargo configuration. As an example of the successful interplay of the free market forces of supply and demand, Flying Tiger subsequently obtained permission from the CAB to lease a DC-6 cargo plane to "fill a void created when TWA terminated its freight service between St. Louis and Chicago."
- Federal Express began operating large capacity (B-727) aircraft over routes where it had formerly flown as many as four of its Falcons virtually in formation to meet capacity demands. Federal had previously operated under the small aircraft exemption from regulation and had been reluctant to apply for a Part 401 certificate. Though the 401 certificate would have allowed Federal to utilize the larger aircraft, it would have involved a costly application and certification process and would have brought Federal under the regulatory control of the CAB.

Since the passage of the Act, there have been some rate increases, but these should be viewed in the context of several factors. First, as indicated before, prior to deregulation many rates were set below-cost, and it is only natural -- and I might add desirable -- that rates rise at least to cover costs and adequate return.

Second, some rates may have been significantly raised, but this may be a temporary development due to the timing of the important entry provision of the air cargo deregulation act. In essence, that act immediately deregulated rates, but restricted entry to those carriers which had provided all-cargo air service during the prior year and it was not until a full year later that entry was opened to others. The Board has not yet acted on the new pending all-cargo applications. Even after entry is granted, there may be initial difficulty in expanding service because of limited aircraft availability. In essence, we are still in the short-run.

I think this bill teaches us very clearly that regulatory change is a complex problem. You have to have a firm grasp of the totality before you can move any one piece. With entry now opening and with new capacity in the pipeline, we should see a number of desirable adjustments in this area.

Third, even though rates have gone up, they are more or less in line with prior experience. Most carriers took general freight rate increases in 1978 and 1979 of about 10 percent each, and this is fairly consistent with the experience in the three years prior to deregulation as the attached chart indicates. In addition, there have also been some price decreases as the following examples indicate:

- Recent pricing actions of carriers entering new markets have reflected competitive forces. For example, Pan Am used its section 418 certificate to enter several new domestic markets with rates from 9 percent to 33 percent below competition -- the amount of the discount increasing with shipment size.
- Numerous combination carriers (including United, Continental, and Delta) have substantially reduced prime-time rates on wide-body belly containers by eliminating time-of-tender restrictions formerly required by the CAB. Thus, depending on the density of the containerized commodity, shippers enjoy discounts up to 30 percent as they are now charged one low flat rate for each container type in all wide-body markets. United offers shippers additional savings (up to 10 percent) for multiple container tenders.
- Pan American recently introduced the lowest domestic air-cargo air freight container rates now available in the industry. These off-peak directional rates, subject to a time-of-tender restriction, offer shippers discounts up to 54 percent depending on the container type, market, and density of the commodity involved. Pan Am intends to offer similar discounts on lower deck air freight containers when it introduces additional domestic transcontinental combination service later this year.
- Flying Tiger has maintained all its daylight container rates at pre-deregulation levels. Tiger also introduced lower "excess" charges on its prime-time container rates which, depending on the density of the commodity, offers shippers discounts of up to 15 percent on the total container charge.
- American Airlines reduced bulk rates on selected daylight flights from the West Coast by 40 percent (with service on a space-available basis).

- The industry has witnessed tremendous innovation in the small package sector. Numerous carriers have cut their rates sharply in an attempt to erode the dominant market share held by Federal Express. Emory Air Freight has cut its express package rates by up to 10%.

Fourth, the proponents of air cargo deregulation were not promising across the board rate cuts following deregulation. The air cargo industry had been starved, and the shipper of air cargo in general had a product where the transportation cost was a relatively minor part and where time and service was of the essence. The desire and the promise was for more and better air services, and although it is too early to make a final total judgment, the early developments have been positive. Service is expanding to new points, and volume is up very significantly. As we see new entry and as new capacity is developed, we should see even more growth.

What does the air-cargo experience mean for other industries? Each industry is different. You cannot take the outcome of the air-cargo experience and simply apply it directly to other industries. In air-cargo, the basic effect so far has been growth triggered by improved and expanded service. In the case of air passenger transportation, it was tremendous growth stimulated to a large extent by lower fares.

As we move into other areas with change, we may see different results. In the railroad area, reform will produce greater efficiency. In the trucking area we do not have a regulatory system that has suppressed rates, and there is good evidence to believe that change will bring lower rates. But although the results will be different in each case, in all cases regulatory reform will mean that the system will be more responsive to the public need.

This concludes my written statement, and I will be happy to answer any of your questions.