

TESTIMONY OF
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U.S. DEPARTMENT OF TRANSPORTATION
BEFORE THE
SUBCOMMITTEE ON THE RURAL ECONOMY AND FAMILY FARM
OF THE
SENATE COMMITTEE ON SMALL BUSINESS
OCTOBER 28, 1987

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, I APPRECIATE HAVING THE OPPORTUNITY TO APPEAR TODAY AS YOU STUDY THE EFFECT OF AIRLINE DEREGULATION ON RURAL COMMUNITIES. THIS CERTAINLY IS A CRITICAL CONSIDERATION IN ANY EVALUATION OF THIS ECONOMIC REGULATORY REFORM. HOWEVER, SINCE THE AVIATION INDUSTRY IS MADE UP OF A COMPLEX SYSTEM OF INTERRELATIONSHIPS, I PROPOSE WE BEGIN WITH A QUICK LOOK AT THE BIG PICTURE.

AS YOU KNOW, AVIATION OPERATIONS WERE DEREGULATED IN 1978 AND THE CHANGES BROUGHT BY THIS POLICY SHAPE TODAY'S MARKET. THE RESULTS? NINE YEARS AGO APPROXIMATELY 39 COMMERCIAL CARRIERS WERE OPERATING. A RECENT COUNT ESTIMATES THAT 131 ARE NOW IN SERVICE. I AM SURE YOU ARE FAMILIAR WITH THE STUDY CONDUCTED BY THE BROOKINGS INSTITUTION WHICH CONCLUDED THAT TODAY AIRLINE TRAVELERS IN THE UNITED STATES ARE ENJOYING \$6 BILLION PER YEAR IN 1977 DOLLARS IN LOWER FARES AND MORE FREQUENT FLIGHTS. SINCE 1978, THE NUMBER OF PASSENGER ENPLANEMENTS HAS GROWN BY OVER 140 MILLION -- A 55 PERCENT INCREASE. FURTHERMORE, AN ARTICLE IN DUN'S BUSINESS MONTHLY NOTES THAT THE ECONOMY HAS PROSPERED DUE TO THE REFORMS OF DEREGULATION. "IN AVIATION ALONE," THE ARTICLE SAYS, "DEREGULATION HAS INCREASED THE NATION'S GROSS NATIONAL

PRODUCT BY \$8 BILLION IN 1977 DOLLARS...THAT EQUALS A PERMANENT 0.4 PERCENT INCREASE IN GNP."

LET'S CONSIDER A FEW OTHER KEY DEVELOPMENTS IN THE INDUSTRY SINCE ENACTMENT OF THE AIRLINE DEREGULATION ACT:

- o SCHEDULED REVENUE PASSENGER MILES INCREASED 61.5 PERCENT, FROM 226 BILLION IN 1978 TO 366 BILLION LAST YEAR; AVAILABLE SEAT MILES INCREASED 64.6 PERCENT, FROM 368 BILLION NINE YEARS AGO TO 606.8 BILLION IN 1986; FREIGHT AND EXPRESS TON MILES ROSE 26 PERCENT, FROM 5.4 BILLION TO 7.3 BILLION.

- o THE INDUSTRY WORK FORCE TOTALED 340,483 IN 1978; THAT NUMBER STOOD AT 449,789 LAST YEAR.

MOST IMPORTANT, MR. CHAIRMAN, COMPETITION HAS BEEN ENLIVENED BY DEREGULATION. IN FACT, INDUSTRY COMPETITION IS MORE DYNAMIC AND DIVERSE IN ITS MANY ELEMENTS TODAY THAN EVER BEFORE. CHANGING OPERATING PRACTICES AND MARKETING STRATEGIES ARE WORKING TO RESHAPE THE STRUCTURE AND BUSINESS PRACTICES OF THE AIRLINE SECTOR RESULTING IN THE GREATER COMPETITION WHICH BENEFITS THE CONSUMER, ALL CONSUMERS...RURAL AND URBAN ALIKE.

THE PRESS OF COMPETITION HAS PROMPTED THE AIRLINES TO ALTER SERVICE PATTERNS TO MEET CONSUMER NEEDS. DELIVERING WHAT THE CONSUMER WANTS--INCLUDING ON-LINE SERVICES--HAS LED TO THE DEVELOPMENT OF BUSINESS AFFILIATIONS BETWEEN MAJOR AND REGIONAL CARRIERS, AND THIS PHENOMENON IS RESHAPING SMALL COMMUNITY AIR SERVICE. TODAY, 45 OF THE 50 LARGEST REGIONAL AIR PASSENGER CARRIERS--WHICH COLLECTIVELY FLY MORE THAN 80 PERCENT OF THOSE CARRIED BY REGIONAL OPERATORS--HAVE ENTERED INTO MARKETING ALLIANCES WITH ONE OR MORE LARGE JET OPERATORS.

ALLIANCES BETWEEN MAJOR AND REGIONAL CARRIERS CAN PROVIDE THE RURAL AREA WITH SUBSTANTIAL BENEFITS, INCLUDING INTEGRATION OF SCHEDULES, COOPERATIVE MARKETING AND PROMOTIONAL ARRANGEMENTS, PARTICIPATION BY THE REGIONALS IN THE MAJORS' FREQUENT FLYER PROGRAMS, AND ADDITIONAL ADMINISTRATIVE AND SUPPORT SERVICES. A NUMBER OF MAJOR CARRIERS EVEN PROVIDE THEIR REGIONAL PARTNERS WITH FINANCIAL ASSISTANCE. AMERICAN AIRLINES, FOR EXAMPLE, HAS A \$100,000,000 AIRCRAFT LEASING PROGRAM FOR REGIONAL CARRIERS AND EXTENDED \$27,000,000, TO AN AMERICAN EAGLE COMMUTER EARLIER THIS YEAR.

AS IS THE CASE IN THE MORE HEAVILY TRAVELED MARKETS, COMPETITION IN THE SMALLER MARKETS IS LIVELY. THOSE REGIONALS AFFILIATED WITH DIFFERENT MAJORS CAN AND DO COMPETE DIRECTLY WITH EACH OTHER IN VARIOUS AREAS; AND REGIONALS OFTEN COMPETE INDIRECTLY WITH ONE ANOTHER BY SERVING ALTERNATIVE HUB AIRPORTS, THUS PROVIDING TRAVELERS WITH MORE PRICE AND SERVICE OPTIONS.

RELATED TO THIS, IN 1978 NOT EVERY STATE HAD REGIONAL/COMMUTER SERVICE; TODAY THERE ARE REGIONAL/COMMUTER AIR CARRIERS OPERATING IN EACH STATE. AS REVEALED IN A RECENT DEPARTMENT OF TRANSPORTATION STUDY ^{1/} MOST STATES HAVE EXPERIENCED AN INCREASE IN THE NUMBER OF REGIONAL/COMMUTER CARRIERS OPERATING WITHIN THEM. IN ADDITION, THE INDUSTRY FLEET HAS GROWN SUBSTANTIALLY SINCE 1978, BOTH IN OVERALL NUMBER AND IN VARIETY OF SIZES AND TYPES OF EQUIPMENT. ALTHOUGH COMMUNITIES HAD BECOME ACCUSTOMED TO SERVICE WITH LARGER AIRCRAFT, THEIR TRAFFIC LEVELS OFTEN DID NOT WARRANT THOSE LEVELS OF AVAILABLE CAPACITY. MANY WERE BEING OVER SUPPLIED. WITH DEREGULATION A MORE RATIONAL MATCHING OF EQUIPMENT WITH MARKET SIZE WAS INEVITABLE. INITIALLY, MANY COMMUNITIES DID NOT RESPOND FAVORABLY WHEN 50 TO 100-SEAT AIRCRAFT OPERATIONS WERE REPLACED WITH 15 TO 50-SEAT OR SMALLER COMMUTER AIR CARRIER SERVICE. BY NOW, HOWEVER, THE EQUIPMENT RESTRUCTURING IS LARGELY COMPLETE AND, WITH FEW EXCEPTIONS, THE AIRCRAFT BEING USED REASONABLY MATCH THE LEVEL OF DEMAND. TODAY, 17-19 SEAT SWEARINGEN METROLINERS, 19-SEAT BEECH 1900'S, 30-36 SEAT SHORTS AND 50-SEAT DASH 7 AIRCRAFT ARE WIDELY USED IN THE INDUSTRY. EQUALLY IMPORTANT, A WIDE VARIETY OF SIZES OF AIRCRAFT IS BEING OPERATED IN EVERY REGION OF THE COUNTRY, ENABLING REGIONAL/COMMUTERS TO MEET ALL LEVELS OF MARKET DEMAND.

1/ Report to Congress on Subsidized Air Service Under the Essential Air Service Program -- Section 419 of the Federal Aviation Act, U.S. Department of Transportation, Washington, D.C., February 1987.

MR. CHAIRMAN, THE GENERAL ECONOMIC IMPACT OF AIRLINE DEREGULATION ON SMALL AND RURAL COMMUNITIES CANNOT BE VIEWED SEPARATE AND APART FROM THE GENERAL ECONOMIC CONDITIONS OF A PARTICULAR AREA. THIS IS ESPECIALLY TRUE WHEN STUDYING THE HEALTH OF AREAS DOMINATED BY AGRICULTURE AND RELATED INDUSTRIES.

AS WE CONSIDER THE SUBJECT BEFORE US TODAY, LET'S KEEP IN MIND THAT WHEN CONGRESS ENACTED THE AIRLINE DEREGULATION ACT, IT ALSO ACTED TO PRESERVE AIR SERVICE TO SMALL COMMUNITIES. THE SOLE PURPOSE OF THE ESSENTIAL AIR SERVICE PROGRAM WAS, AND IS, TO GUARANTEE CONTINUED ACCESS TO THE AIR TRANSPORTATION SYSTEM BY SMALL AND ISOLATED POINTS WHICH HAD BEEN A PART OF THE AIR TRANSPORT NETWORK PRIOR TO DEREGULATION. THIS PROGRAM GUARANTEES THAT SMALL COMMUNITIES WHICH HAD AIRLINE SERVICE BEFORE DEREGULATION WOULD CONTINUE TO BE SERVED BY AN AIR CARRIER FOR TEN YEARS, UNTIL OCTOBER 1988. FOR COMMUNITIES IN THE EAS PROGRAM, NO AIR CARRIER MAY TERMINATE OR REDUCE SERVICE IN A MANNER THAT WILL LOWER THE COMMUNITY'S TOTAL SERVICE BELOW THE GUARANTEED LEVEL WITHOUT FILING NOTICE WITH THE DEPARTMENT OF TRANSPORTATION, AS WELL AS THE APPROPRIATE STATE AGENCIES AND COMMUNITIES INVOLVED. IN THE CONTIGUOUS 48 STATES, 468 POINTS WERE PROTECTED UNDER THE ESSENTIAL AIR SERVICE PROGRAM IN 1978. THE EAS PROGRAM WAS SUCCESSFUL IN STABILIZING SERVICE TO RURAL AND SMALL COMMUNITIES. AS YOU KNOW, WE AT THE DEPARTMENT ARE ADVOCATING THE SUNSET OF THIS PROGRAM AFTER A JOB WELL DONE.

THERE IS NO DENYING THE FACT, MR. CHAIRMAN, THAT MANY OF THOSE COMMUNITIES NOT INCLUDED UNDER THE EAS PROTECTIVE BLANKET LOST

SERVICE. HOWEVER, THE IMPACT OF THESE REDUCTIONS WAS OFTEN CUSHIONED BY THE AVAILABILITY OF SERVICE AT NEARBY AIRPORTS. A RECENT STUDY BY PATRICK V. MURPHY AND WAYNE S. WATKINS ^{2/} CONDUCTED A RANDOM SAMPLING OF VARIOUS POINTS THAT LOST SERVICE AND DISCOVERED THAT ALL ARE WITHIN 21 TO 128 MILES OF AN ALTERNATE AIRPORT.

IT SHOULD ALSO BE NOTED HERE TODAY THAT INDUSTRY COMPETITION SPURRED BY DEREGULATION HAS PROMPTED A DECLINE IN FARES TO MARKETS OF ALL SIZES. (SEE TABLE 1) WHILE THE DECLINE IN REAL FARES HAS BEEN MORE PRONOUNCED IN MAJOR MARKETS, SUCH AS LARGE HUB-TO-LARGE HUB ROUTES--WHERE FARES HAVE DECLINED BY 17 PERCENT ON AVERAGE--EVEN IN THE SMALLEST MARKETS, FARES HAVE DECLINED AN AVERAGE OF SEVEN PERCENT.

IN THE MAJOR MARKETS, LOW-COST CARRIERS INAUGURATED SERVICE AT FARES BELOW NORMAL COACH FARES. THEIR FARES IN TURN FORCED THE HAND OF COMPETING CARRIERS. FURTHER, THE NUMBER AND DEPTH OF DISCOUNT FARES INCREASED GREATLY IN DIRECT PROPORTION TO THE SIZE OF THE MARKET SERVED. CONSEQUENTLY, LARGE MARKETS HAVE A WIDER RANGE OF DISCOUNT FARES THAN DO SMALL MARKETS.

THE MORE MODEST FARE REDUCTIONS IN SMALLER MARKETS ARE NOT SURPRISING. TRADITIONALLY, LOW DENSITY MARKETS HAVE HAD FEWER FARE AND SERVICE OPTIONS AVAILABLE. WITH A SMALLER BASE OF

^{2/} Murphy, Patrick V. and Watkins, Wayne S., "Rural America Benefits from Airline Deregulation, but Less than Urban America," Rural Development Perspective, October 1986, pages 2-7. Both authors were DOT employees when this article was written.

CONSUMERS, IT STANDS TO REASON THAT OPERATING COSTS WOULD BE HIGHER, SERVICE LESS FREQUENT, AND THE FARE STRUCTURE TIGHTER. TODAY'S MARKET SIMPLY REFLECTS ECONOMIC REALITY.

ALSO, SOME OF THE DIFFERENCES IN FARE CHANGES IS DUE TO THE ELIMINATION OF CROSS-SUBSIDY AMONG DIFFERENT CATEGORIES OF PASSENGERS. BEFORE DEREGULATION, CARRIERS TENDED TO OVERPRICE IN HEAVILY TRAVELED LONG-HAUL MARKETS AND UNDERPRICE IN LIGHTLY TRAVELED MARKETS. THIS POLICY WAS THE DIRECT RESULT OF CIVIL AERONAUTICS BOARD FARE FORMULAS DESIGNED TO ENCOURAGE GROWTH IN SHORT-HAUL AND LIGHTLY TRAVELED MARKETS.

WHATEVER THE DISPARITY FOUND BETWEEN FARE STRUCTURES OF LARGE AND SMALL MARKETS, THE DIFFERENCES CAN BE JUSTIFIED BY COST ANALYSES. THE DEPARTMENT OF TRANSPORTATION STUDY REFERRED TO EARLIER ANALYZES THE COST OF PROVIDING SERVICE TO SMALLER MARKETS, AND UPON COMPARING THE COSTS WITH ACTUAL FARES CHARGED IN VARIOUS MARKETS, IT WAS DISCOVERED THAT THE CURRENT PRICING POLICIES OF COMMUTER CARRIERS ARE QUITE REASONABLE. (SEE TABLES 2 AND 3.) FOR EXAMPLE, IN A 125-MILE MARKET WITH 5 ENPLANEMENTS PER DAY, THE ECONOMIC COST PER PASSENGER RANGES FROM A LOW OF \$139.45 FOR AN EIGHT-SEAT AIRCRAFT, TO \$322.47 FOR A 44-SEAT, F-27 AIRCRAFT. THUS, IN ORDER FOR A 125-MILE MARKET WITH FIVE ENPLANEMENTS PER DAY TO SUPPORT AIR SERVICE ON ITS OWN--WITHOUT FEDERAL SUBSIDY-- THE ONE-WAY FARE WOULD HAVE TO BE WELL OVER \$100. COMPARING THIS FIGURE WITH VARIOUS FARES CHARGED IN ESSENTIAL AIR SERVICE MARKETS WE FIND SKY WEST CHARGING \$126 IN THE PAGE-PHOENIX CONNECTION, A

DISTANCE OF 242 AIR MILES WITH 13 ENPLANEMENTS PER DAY. SIMILARLY, IN THE LAMAR-DENVER MARKET, A DISTANCE OF 166 MILES WITH FOUR ENPLANEMENTS PER DAY, AIR MIDWEST IS CHARGING \$119. THESE ARE FAIRLY REPRESENTATIVE OF THE FARE STRUCTURES FOUND IN THE SMALLER MARKETS.

ON A BROADER LEVEL, POTENTIAL COMMUNITY BENEFITS FROM THE AVAILABILITY OF SCHEDULED AIR SERVICE FALL INTO TWO CATEGORIES: INCREASES IN EMPLOYMENT AND EARNINGS WITHIN THE LOCAL AREA THAT RESULT FROM THE AIRLINE'S EXPENDITURES, AND THE MORE ELUSIVE ECONOMIC DEVELOPMENT BENEFITS INDUCED BY THE PRESENCE OF SCHEDULED AIR SERVICE. EMPLOYMENT AND EARNINGS BENEFITS ARE APT TO BE QUITE SMALL IN NON-HUB COMMUNITIES. A DOT STUDY OF THE REGIONAL IMPACT OF ESSENTIAL AIR SERVICE ^{3/} FOUND THAT ECONOMIC DEVELOPMENT BENEFITS, INCLUDING THE OFTEN-CITED CLAIMS OF BENEFITS ACCRUING FROM THE INCREASED ATTRACTIVENESS TO BUSINESSES OF A COMMUNITY RECEIVING SCHEDULED AIR SERVICE, ARE EXTREMELY DIFFICULT TO QUANTIFY. UPON CLOSER EXAMINATION, SUCH DEVELOPMENT BENEFIT CLAIMS APPEAR TO BE MADE FOR AIRPORTS AND GENERAL AVIATION FACILITIES RATHER THAN FOR SCHEDULED AIR SERVICE.

SOME LIMITED EVIDENCE SUGGESTS THAT AIRPORTS AND THE TYPE OF SERVICES THEY PROVIDE MAY WELL BE CONSIDERATIONS FOR THE SITING OF CERTAIN TYPES OF BUSINESS AND INDUSTRIAL FACILITIES, BUT THERE IS NO EVIDENCE THAT THE EXISTENCE OF SCHEDULED SERVICE AT THESE

^{3/} Essential Air Service: Regional Impacts, U.S. Department of Transportation, Research and Special Programs Administration, Transportation System Center, Cambridge, Mass., December 1986.

AIRPORTS HAS COMPARABLE EFFECTS ON LOCATION DECISIONS. EVEN IN CASES WHERE AIRPORTS AND SERVICES ARE SITING CONSIDERATIONS, THE DESIRABILITY OF AN AIRPORT MAY PLACE WELL DOWN ON A LIST OF SELECTION FACTORS, BELOW ITEMS SUCH AS PROXIMITY TO IMPORTANT MARKETS, AVAILABILITY OF RAW MATERIALS, LABOR, UTILITIES, TAX TREATMENT, AMENITIES, AND SITE SUITABILITY.

A 1970 STUDY BY LEONARD F. WHEAT FOUND THAT FOR CITIES IN THE NORTHEAST BELOW 19,000 POPULATION THERE WAS NO EVIDENCE THAT THE PRESENCE OF AIR SERVICE HAD AN IMPACT UPON MANUFACTURING EMPLOYMENT GROWTH. FOR LARGER CITIES, HE CONCLUDED THAT AIR SERVICE PROBABLY PROMOTED GROWTH, BUT FOUND THE BENEFITS TO BE "SEVERELY LIMITED."^{4/}

A 1975 NASA-FUNDED STUDY OF GENERAL AVIATION IMPACTS CONCLUDED THAT UNLESS OTHER FREQUENTLY MENTIONED FACTORS WERE PRESENT, IT WAS UNLIKELY THAT THE LACK OF AVIATION SERVICES WOULD DETER AN OTHERWISE INTERESTED COMPANY.^{5/}

A STUDY OF RESPONSES TO A NEBRASKA SURVEY OF INDUSTRIAL PLANTS FOUND THAT AIR PASSENGER TRANSPORTATION RATED 36TH IN IMPORTANCE OUT OF 43 POSSIBLE FACTORS.^{6/} A 1975 STUDY BY THE MINNESOTA

^{4/} Wheat, Leonard F., The Effect of Airline Service on Manufacturing Growth in Cities Below 40,000 Population, Economic Development Administration, U.S. Department of Commerce, May 1970.

^{5/} Dayani, J., and Sinoff, M., General Aviation and Community Development, NASA Langley Research Center and Old Dominion University, Norfolk, VA, 1975.

^{6/} Whiting, Larry R., Rural Industrialization: Problems and Potentials, Iowa State University Press, Ames, Iowa, 1974.

DEPARTMENT OF AERONAUTICS FOUND AIR SERVICE ACCESSIBILITY IN THE BOTTOM HALF OF LOCATIONAL CONSIDERATIONS LISTED FOR ALL TYPES OF INDUSTRIES AND COMMUNITIES STUDIED.^{7/}

IN SUMMARY, A SURVEY OF THE LITERATURE INDICATES THAT THE VARIOUS BUSINESSES STUDIED TO DETERMINE THE IMPORTANCE OF AVIATION SERVICES APPEARED TO BE PRIMARILY CONCERNED WITH ACCESS TO A GENERAL AVIATION AIRPORT, AND THE PRESENCE OF A FIXED BASE OPERATOR TO SUPPORT PRIVATE BUSINESS AIRCRAFT AND AIR-TAXI SERVICE. THE AVAILABILITY OF SCHEDULED AIR SERVICE WAS NOT HIGHLY RATED NOR, IN MOST CASES, EVEN EXPRESSED AS A FACTOR INFLUENCING BUSINESS LOCATION DECISIONS.

RELATED TO THIS, AIRLINE DEREGULATION SHOULD HAVE LITTLE, IF ANY, IMPACT ON THE COST OF DOING BUSINESS IN A SMALL OR RURAL COMMUNITY. THESE COSTS IN ANY LOCALITY DEPEND HEAVILY ON LOCAL ECONOMIC CONDITIONS. AND, AS NOTED, AIR SERVICE EXERCISES LITTLE INFLUENCE ON SUCH CONDITIONS.

FURTHERMORE, THE AVAILABILITY OF CAPITAL AND THE COST OF THAT CAPITAL ARE GENERAL FUNCTIONS OF NATIONAL ECONOMIC CONDITIONS AND INTEREST RATES AS WELL AS THE CONDITION OF THE LOCAL INDUSTRIAL/ECONOMIC BASE AND THE STATE OF LOCAL AND REGIONAL FINANCIAL INSTITUTIONS.

^{7/} A Study of the Socio-Economic Impact of Aviation on Selected Communities, Minnesota Department of Aeronautics, January 1975.

MR. CHAIRMAN, AIRLINE DEREGULATION HAS DEFINITELY IMPACTED ON SMALL AND RURAL COMMUNITIES. THE IMPACT OF THIS REVOLUTIONARY ECONOMIC REGULATORY REFORM IS MUCH THE SAME AS THAT FELT IN LARGER COMMUNITIES, BUT--AS COULD BE EXPECTED--THE DEGREE OF CHANGE IS LESS PRONOUNCED. FARES HAVE DECLINED BUT THAT DECLINE IS LESS PRONOUNCED THAN CUTS MADE AT LARGE HUBS; SERVICE OPPORTUNITIES ARE AVAILABLE BUT THE VARIETY IS LESS PRONOUNCED THAN THAT FOUND IN LARGER METROPOLITAN AREAS. THIS PATTERN EXTENDS ACROSS THE BOARD WHEN DISCUSSING AIR SERVICE AT SMALL AND RURAL COMMUNITIES BUT, QUITE FRANKLY, I BELIEVE YOU WILL FIND THIS IS REFLECTIVE OF ALL SERVICES PROVIDED IN THESE AREAS. AIR SERVICE IS NOT ANY LESS ACCESSIBLE OR MORE EXPENSIVE THAN OTHER SERVICES; IN FACT, I BELIEVE IT IS A BETTER BUY AND A BETTER SERVICE THAN MOST OTHERS SUPPLIED TO OUR RURAL COMMUNITIES. THE BENEFITS OF AVIATION DEREGULATION ARE BEING FELT IN EVERY CORNER OF THE COUNTRY, SMALL AS WELL AS LARGER CORNERS.

THAT CONCLUDES MY FORMAL STATEMENT.