STATEMENT OF SECRETARY OF TRANSPORTATION
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BEFORE THE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION

CONCERNING COMPETITION IN THE AIRLINE INDUSTRY
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Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before you to discuss recent developments in the airline industry.

The airline industry is going through a very difficult period, and no one should try and gloss that over. Eastern Airlines has ceased operations; Continental and Pan American are currently operating under the protection of the bankruptcy courts; and the U.S. airline industry as a whole has just experienced an annual loss estimated to be $2 billion for 1990--the greatest one-year loss in its history. Most of this loss occurred in the last quarter of 1990 and has led to a flurry of proposed transactions among airlines.

The Department has worked diligently over the last two years to understand the changing nature of the airline industry and to set in place a framework for policy action. One of my first acts as Secretary was to begin the most comprehensive study of the airline industry ever conducted. It was completed just about a year ago and clearly demonstrated that airline deregulation has resulted in substantial benefits for travelers.

The National Transportation Policy, also completed last year, provided the Department with the policy framework to move forward on aviation reauthorization.

Last year's reauthorization legislation is the most significant aviation legislation since airline deregulation. One of the most pro-competitive features of the reauthorization can be directly credited to this Committee and you, Mr. Chairman, and that is the new statutory power provided local airport authorities to initiate Passenger Facility Charges to finance airport expansion. The Department was an early and ardent proponent of that significant pro-competitive authority. PFC's will allow the industry to expand significantly in the future. Anticipated PFC revenue streams can support more than a billion a year in new bonding. Many airports are eager to begin participating in this program, and we have today published a notice of proposed rulemaking which will allow a PFC rule to be in place to meet the July 1, 1991 deadline.

This landmark legislation also maintained significant airport grant levels, approaching $2 billion annually, which can translate directly into capacity enhancement and more competition at our largest hubs. These levels had my personal support.

The Department, the Congress, and the industry, working together, also established a comprehensive policy to deal with the

environmental problem of aircraft noise. The Act's noise provisions will provide relief for two-thirds of all affected Americans by the end of the decade. This policy puts the United States ahead of all nations in addressing aircraft noise, and will also result in a much more fuel efficient U.S. fleet.

So I believe we have accomplished a great deal over the last two years to provide a sound long-term environment for a competitive and healthy airline industry. Later, I will summarize more recent steps I have taken or plan to take which will aid the carriers in dealing successfully with current economic circumstances and help them to emerge from this difficult period as vigorous competitors.

The airline industry's recent troubles should not be read as an indictment of deregulation. As you know, the Department's study of airline deregulation documented in great detail the enormous benefits deregulation has provided for American travelers, and our ongoing analysis of the industry gives us confidence that these benefits will continue. Other credible studies, such as those conducted by the Brookings Institution, have confirmed our results.

To summarize briefly what our study and ongoing analysis have concluded: First, airline travel is much less expensive. Real airline fares in the United States have declined by an average of 28 percent since 1981. Second, because air travel is now accessible to millions of low- and middle-income Americans, the

number of people who travel on scheduled airlines in the United States has increased by 65 percent since deregulation. Last month almost 92 percent of air travelers flew on discount fares. Third, passengers enjoy a wider choice among airlines, and more frequent service. Three times as many passengers now travel in truly competitive markets--those served by three or more airlines--than did in 1978. Thanks to the development of competing nationwide hub and spoke networks, almost all passengers have a choice of carrier and routing in making domestic trips. For example, in the year ended June 30, 1990, 94% of all passenger trips were in markets where at least one competing airline carried five percent or more of the passengers, a far higher percentage than in pre hub-and-spoke days. The airline traveler has not been the only beneficiary; the number of airline jobs has grown by 75 percent too. Finally, economic deregulation has not diminished the safety oversight of the Federal Aviation Administration. As the National Transportation Safety Board confirmed a few weeks ago, accident and fatality rates have declined steadily since the 1960's. And 1990 was one of the safest years ever.

The current industry restructuring we are seeing is a continuation of the process that got underway in the late 1980's. It is in some ways the inevitable result of market forces unleashed by the Airline Deregulation Act of 1978. The reason so much seems to be happening today is that several factors have recently combined to accelerate the process.

First, the recent slowdown in the U.S. economy has reduced the demand for air travel. This sluggish growth has come at a time when airlines have added new planes and new services. This has contributed significantly to current carrier losses.

Second, the cost of jet fuel increased dramatically following Iraq's invasion of Kuwait in early August. Jet fuel is a major component of airline operating costs, second only to labor costs. Each one cent increase in the cost of a gallon of jet fuel imposes an extra $164 million in operating cost on the industry. Also, Kuwait was a significant factor in the supply of aviation jet fuel. I am gratified to see that prices have dropped dramatically from their November peak in the $1.40 range to the present levels in the low 70 cent range.

Third, airlines were given greater latitude under the free market principles of deregulation. Some airlines never quite adjusted to the rigors of the marketplace and suffered accordingly. Others took on massive and excessive debt, and have found it difficult to service that debt in a slow economy. To some degree airline management and the investment community are themselves responsible for the industry's current situation.

Fourth, most airlines have not been able to bring their labor costs under control. For example, the average salary for one carrier's pilots and copilots was $114,000 in 1989, not counting fringe benefits. The average salary for its maintenance workers

was $51,000. Pilots and copilots industry-wide made five times what the average American worker earns. The average airline worker--including reservation agents, ticket clerks, janitors, and baggage handlers--makes approximately twice the national average wage.

These wages are not the product of a strictly free market. When pilots at one major airline average nearly twice what their colleagues earn at another airline, one might question whether something is seriously out of balance in the airline labor market.

Today's market is still distorted by vestiges of the era of regulation which allowed airlines to pass on uneconomically high costs. The industry still operates under outdated legislation from the 1930's--the Railway Labor Act--which, among other things, contains never-ending procedures to resolve disputes and allows for secondary boycotts.

I believe these distortions have created an unhealthy environment for the consumer. In contrast to other industries, airline managers and their employees appear to be oblivious to the long range consequence for the industry caused by an imbalance in power between labor and management. In the end, of course, the <u>consumer loses</u>. Either consumers must pay for high industry salaries through higher fares, or airlines will continue to hemorrhage financially.

Of one thing we are confident: consolidation is no grounds for panic. There may be fewer airlines in the 1990's than there were at the end of the 1980's. But even if this happens, we have every reason to believe that robust competition will continue. Under the system of competing nationwide hub and spoke networks which has developed under deregulation, existing carriers can serve most major markets in the nation on a one-stop basis. As a consequence competition should continue to thrive. Further, vigorous antitrust enforcement can be expected to prevent anticompetitive airline mergers.

The recent financial difficulties of the industry have produced almost desperate marketing strategies by some carriers and some incredible air fare bargains. But we know that unrealistically low prices are a bad bargain in the long run. Airlines must cover their costs or eventually go out of business. We should expect that as the industry consolidates further, which is likely, some of the lowest fares will disappear. When some of these bargains disappear, consumers should understand that the increase should not be blamed on deregulation. Had it not been for deregulation, fares would have been higher than they are now and service options lower. But, fares must cover airline costs in the long run and will still be lower then they would have been but for deregulation.

As the industry continues to restructure, the Department will take aggressive steps to sustain and enhance airline competition. Let

me give you an overview of steps the Department intends to take to enhance competition in the airline industry, both domestically and in international markets.

Number one, the Department has announced a new policy which will significantly relax previous restrictions on foreign investment in U.S. airlines. This new approach is an acknowledgement of the changing nature of the airline industry, as the integration of domestic and international operations is moving the industry toward one of truly global airline companies. We believe it is important that our airlines be given greater access to foreign capital to enhance their competitiveness both domestically and internationally and allow them to participate in this globalization process.

At the same time, we don't believe it is necessary to change the current legislative limits on foreign ownership and control contained in Section 101(16) of the Federal Aviation Act. This section requires that the president and at least two-thirds of the board of directors and other managing officers of an air carrier be U.S. citizens and that at least 75 percent of the voting stock in the company be owned or controlled by U.S. citizens. Historically, the Department, and the Civil Aeronautics Board before it, have interpreted the statute to require that a carrier, in fact, be under the actual control of U.S. citizens. This has not changed. We have, however, reexamined and refined our application of the "control" test to ensure that it's fully

consistent with today's realities. Our new policy will allow greater ownership of equity--up to 49 percent--while keeping foreign ownership of voting stock to the 25 percent statutory limit. We have also decided not to view debt as a foreign control issue, unless the loan agreement provides special rights to the foreign debt holder that imply control. We will also allow foreign membership on airline boards to reflect voting stock ownership--as long as it satisfies the statutory ceiling, and as long as representatives of foreign airlines do not take part in decisions affecting competition.

As I said, I am not persuaded that changes to the statutory limits are warranted at this time. There are legitimate arguments for maintaining the statutory citizenship requirements. There is a need for quick access to civilian airlift capacity in times of national emergency, as Operations Desert Shield and Desert Storm have shown. Also, in international aviation, landing rights are parceled out through narrowly drawn bilateral agreements. The U.S. has been the leader in opening up international markets to competition. If we are to maintain the leverage we need to open more foreign markets to U.S. carriers, we have to maintain oversight of the extent to which foreign carriers enjoy access to our market through investments.

Number two, in our exercise of our authority over international route awards and transfers, we intend to place even greater emphasis on safeguarding the competitiveness of U.S. carriers.

The availability of international routes is generally limited to rights negotiated in bilateral treaties and the Department must select among carriers to serve these limited entry markets. We intend to seek ways to streamline what is today a time-consuming, expensive and inefficient process of selecting carriers. We are also seeing a lively "secondary market" for international routes where carriers that have obtained international authority are seeking to sell established routes to other carriers. I believe the market can be an effective means of allocating international route authority, as long as the transactions are consistent with competition and the economic health of the U.S. airline industry. For example, Pan Am's sale of its Pacific routes to United in 1985, and Eastern's sale of its Latin American routes to American last year have produced a net dividend for the public. While we do not have any intension of "rubber-stamping" every transaction we review, we will be exploring ways to make our review of these transactions more efficient. Where there are no impediments to competition or where a transaction promises to enhance competition, our disposition is likely to be favorable.

Number three, we intend to take a close look at the policy of granting antitrust exemptions which permit airlines, both U.S. and foreign, to enter into agreements that fix the price of travel to and from the United States. There is a proceeding on this issue pending before the Department.

Number four, we are committed to removing barriers to entry in the airline industry. As I noted earlier, last year's aviation reauthorization legislation was critical to meeting this goal. It will enhance aviation capacity by allowing localities to raise money for expanding their airport facilities or building new ones. As called for by the legislation, we will soon propose a rule that will address the ability of new entrants to gain access to the four slot-controlled airports in the country. A proposed rule addressing ways to eliminate certain anti-competitive practices involving computer reservation systems should also issue soon.

Number five, we will explore the concept of allowing foreign carriers to compete in the U.S. market and U.S. carriers to compete in foreign markets. The U.S. and Canadian governments are due to begin negotiations in a couple of months toward the establishment of a truly open aviation regime between our two countries. During the course of those negotiations it has been agreed that the question of internal market access--called cabotage--would be addressed. This will be an important test of the cabotage proposition.

Number six, we put a policy in place last year to extend the benefits of domestic deregulation to international travel. One example is our cities program whereby underserved cities can receive air service to countries that have liberal aviation agreements with the United States, even if the bilateral agreement does not expressly call for this service. The Department just

two weeks ago approved a KLM request to provide the only nonstop service to the continent of Europe from Minneapolis.

As the airline industry continues to restructure to meet the new realities of the changing global marketplace, the Department is committed to doing all it can to assure that the enormous benefits of deregulation are maintained in domestic markets and expanded to international markets. Airlines for their part must continue to look beyond our borders, whether by flying internationally themselves or by entering into agreements with foreign carriers. As for airline labor, it must look at the realities of the industry, and determine whether greater wage demands are in its own best interests. It is essential that airlines keep their costs under control. Failure to do so will ensure that no one wins: not employees, whose jobs will be placed at risk; not airlines, who may be forced out of business; and certainly not consumers, who will ultimately foot the bill through higher fares.

As the sad experience of Eastern Airlines demonstrates, there are no winners when labor and management do not work together.

We at the Department are optimistic that industry will weather the current storm and remain vigorously competitive. We will use the tools at our disposal to insure that that happens. I look forward to working with the Congress to achieve this goal.

Mr. Chairman, this completes my statement, and I would be pleased to respond to any questions you or members of the Committee may have.