

STATEMENT OF JEFFREY N. SHANE
ASSISTANT SECRETARY OF TRANSPORTATION
FOR POLICY AND INTERNATIONAL AFFAIRS
BEFORE THE
AVIATION SUBCOMMITTEE OF THE SENATE COMMITTEE
ON COMMERCE, SCIENCE, AND TRANSPORTATION
CONCERNING U.S. AVIATION POLICY
JUNE 10, 1992

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM PLEASED TO HAVE THIS OPPORTUNITY TO APPEAR BEFORE YOU TO COMMENT ON THE PROVISIONS OF S. 2312 AND THE STATE OF COMPETITION IN THE AIRLINE INDUSTRY.

THE AIRLINE INDUSTRY IS FACING CHALLENGES UNLIKE ANYTHING WE HAVE WITNESSED SINCE THE EARLY DAYS OF DEREGULATION. THE INDUSTRY'S RECENT HISTORY IS CHARACTERIZED BY A LOT OF BAD NEWS: THE INDUSTRY'S LOSS OF SIX BILLION DOLLARS DURING 1990 AND 1991; THE FAILURE OF THREE LARGE AIRLINES LAST YEAR; AND THE CONTINUING BANKRUPTCY STATUS OF THREE MORE MAJOR AIRLINES. NOT SURPRISINGLY, SOME FEAR THAT INDUSTRY CONSOLIDATION WILL CONTINUE TO THE POINT THAT EFFECTIVE COMPETITION WILL BE LOST.

BUT A LOT OF GOOD NEWS HAS ESSENTIALLY GONE UNNOTICED. EVEN WITH FEWER AIRLINES THAN WE HAD A FEW YEARS AGO, THE LEVEL OF COMPETITION HAS NOT DECLINED AND AIR FARES CONTINUE TO BE A BARGAIN. EVEN BEFORE THE WIDELY PUBLICIZED FARE WARS THAT BEGAN IN APRIL, INFLATION

ADJUSTED DOMESTIC AIR FARES HAD CONTINUED THEIR LONG-TERM DOWNWARD TREND AND FOR THE YEAR ENDING DECEMBER 31, 1991, WERE AT THEIR LOWEST LEVEL EVER. BUT MOST IMPORTANTLY, WE ARE NOW SEEING CLEAR EVIDENCE OF NEW COMPETITIVE PRESSURES THAT WILL ASSURE THE CONTINUED COMPETITIVENESS OF THE INDUSTRY INTO THE FUTURE. WHILE I UNDERSTAND YOUR CONCERNS, I BELIEVE INFORMATION I WILL DISCUSS TODAY WILL ILLUSTRATE WHY THE DEPARTMENT STRONGLY OPPOSES S.2312 AND WHY REGULATORY, NOT LEGISLATIVE, ACTION IS MOST APPROPRIATE FOR THE ISSUES FACING THE AIRLINES AND THEIR CUSTOMERS.

WE HAVE BEEN TELLING YOU THAT THE DOMESTIC AIRLINE SYSTEM REMAINS VERY COMPETITIVE, AND I AM GOING TO REPEAT THAT MESSAGE TODAY USING UP-TO-DATE INFORMATION TO DEMONSTRATE THE POINT. I WILL ALSO BRIEFLY TALK ABOUT THE INDUSTRY'S FINANCIAL CONDITION, AND, AS YOU HAVE REQUESTED, I WILL OFFER MY VIEWS ON THE PROVISIONS OF S. 2312. BUT MY FOCUS TODAY WILL BE PRIMARILY ON THE FUTURE OF COMPETITION IN DOMESTIC AVIATION.

THERE IS GOOD REASON TO BELIEVE THAT THE U.S. AIRLINE INDUSTRY IS NOT GOING TO HAVE ITS PRICES SET AT NON-COMPETITIVE LEVELS. MOREOVER, THE EVIDENCE SUGGESTS THAT THE "BIG THREE" AIRLINES MAY FIND IT DIFFICULT TO INCREASE THEIR RELATIVE POSITIONS IN THE FACE OF PRESSURE

BY GROWING, SMALLER AIRLINES, PARTICULARLY LOW-COST AIRLINES. THE LARGE AIRLINES WILL HAVE TO REDUCE COSTS IF THEY ARE TO CONTINUE TO GROW AND PROSPER IN THE DOMESTIC MARKET. THE END RESULT WILL BE CONTINUED GOOD SERVICE FOR THE TRAVELING PUBLIC AT HIGHLY COMPETITIVE PRICES.

THE ONGOING DEBATE ABOUT THE COMPETITIVENESS OF THE AIRLINE INDUSTRY HAS CHANGED DIRECTION A COUPLE OF TIMES IN RECENT YEARS AND I BELIEVE THAT THE DEBATE IS ABOUT TO TAKE STILL ANOTHER FUNDAMENTAL TURN -- ONCE AGAIN A POSITIVE ONE.

IN THE MID-1980'S, AT A TIME WHEN A LARGE NUMBER OF AIRLINES CEASED TO OPERATE AS SEPARATE ENTITIES, INCLUDING MOST AIRLINES THAT CAME INTO BEING AS A RESULT OF DEREGULATION, CONCERNS AROSE ABOUT THE COMPETITIVENESS OF THE INDUSTRY. THESE CONCERNS LED FORMER SECRETARY SKINNER TO CREATE A TASK FORCE TO CONDUCT A COMPREHENSIVE ASSESSMENT OF THE STATE OF AIRLINE COMPETITION. THAT STUDY, CONCLUDED IN EARLY 1990, SHOWED UNEQUIVOCALLY THAT THE INDUSTRY HAD NOT ONLY REMAINED COMPETITIVE, BUT HAD ACTUALLY BECOME MORE COMPETITIVE DURING THE VERY TIME THAT THE NUMBER OF CARRIERS HAD DECLINED THROUGH MERGER OR FAILURE. THIS INCREASED COMPETITIVENESS IS A DIRECT CONSEQUENCE OF THE TREND TOWARD COMPETING HUB-AND-SPOKE

NETWORKS MADE POSSIBLE BY DEREGULATION. THIS STRUCTURAL CHANGE VIRTUALLY GUARANTEES ACTIVE COMPETITION EVEN WITH FEWER AIRLINES. THE NATIONAL ACADEMY OF SCIENCES AND THE BROOKINGS INSTITUTION HAVE ALSO THOROUGHLY STUDIED THE COMPETITIVENESS OF THE AIRLINE INDUSTRY AND REACHED CONCLUSIONS VIRTUALLY IDENTICAL TO OUR OWN.

I BELIEVE THAT FEW WOULD DISPUTE THAT THE AIRLINE INDUSTRY IS, IN FACT, VERY COMPETITIVE TODAY. BUT THE DEBATE HAS NOW SHIFTED TO WHETHER THE INDUSTRY WILL REMAIN COMPETITIVE. THIS CONCERN HINGES ON THE ASSUMPTION THAT THE BIG THREE AIRLINES HAVE SUCH A COMPETITIVE ADVANTAGE THAT THEY HAVE THE ABILITY TO CONTINUE TO WEED OUT RIVALS. IN FACT, AS THE DEREGULATION PROCESS CONTINUES TO EVOLVE, IT IS BEGINNING TO BECOME CLEAR THAT THE BIG THREE AIRLINES ARE NOT IN A POSITION TO DICTATE THE FUTURE OF THE DOMESTIC AIR TRANSPORTATION SYSTEM.

FIRST, WE SHOULD REMEMBER THAT IN SPITE OF ALL THE CONSOLIDATION THAT HAS OCCURRED, WE STILL HAVE NINE PASSENGER AIRLINES (REVENUES OVER \$1 BILLION ANNUALLY). THIS IS IMPORTANT BECAUSE THE KEY TO INCREASING COMPETITIVENESS IN RECENT YEARS HAS BEEN THE EXPANSION OF THE AIRLINES' NETWORKS. WE KNOW THAT THE HUB-AND-SPOKE DOMINATED MARKET STRUCTURE STRONGLY ENCOURAGES GEOGRAPHIC

EXPANSION; EACH NEW SPOKE THAT IS ADDED TO A HUB MULTIPLIES THE NUMBER OF MARKETS THAT AIRLINE SERVES. THE REMAINING NINE MAJOR CARRIERS, THEREFORE, WILL CONTINUE THEIR EFFORTS TO EXPAND, AND EACH OF THEM, PARTICULARLY AIRLINES OTHER THAN THE BIG THREE, HAVE ROOM TO EXPAND EXTENSIVELY IN DOMESTIC MARKETS. IN TANDEM, THESE ELEMENTS -- A SIGNIFICANT NUMBER OF AIRLINES WITH ROOM TO EXPAND AND A BUILT-IN INCENTIVE TO DO SO -- WILL PROVIDE FOR INTENSE COMPETITION FROM WITHIN. WHILE ONE OR MORE AIRLINES MAY FAIL, WE CAN REASONABLY EXPECT MOST OF THESE AIRLINES TO SUCCEED, GIVING US ONE REASON TO CONCLUDE THAT THE INDUSTRY WILL REMAIN COMPETITIVE.

A SECOND SOURCE OF FUTURE COMPETITION IS THE GROWTH OF LOW COST POINT-TO-POINT SERVICE. THE LARGER AIRLINES ALL HAVE A VERY SIGNIFICANT COST DISADVANTAGE COMPARED WITH SOME SMALLER AIRLINES, AND THEY SIMPLY CANNOT EFFECTIVELY COMPETE IN THE LONG TERM WITH AIRLINES THAT HAVE OPERATING COSTS THAT ARE 25 PERCENT OR MORE BELOW THEIR OWN. SOUTHWEST AIRLINES IS THE PRIME EXAMPLE OF THIS POWERFUL NEW COMPETITIVE FORCE. UNTIL VERY RECENTLY SOUTHWEST WAS ESSENTIALLY A DALLAS LOVE FIELD NICHE CARRIER. IT IS NOW BY FAR THE FASTEST GROWING DOMESTIC AIRLINE AND IS ALSO THE LOWEST COST AIRLINE BY A WIDE MARGIN EXCEPT FOR AMERICA WEST, WHOSE COSTS ARE COMPARABLE. WHEREVER SOUTHWEST OPERATES IT CHARGES SUCH

LOW FARES THAT OTHER CARRIERS, INCLUDING THE BIG THREE, MUST FOLLOW SUIT. WHEREVER THEY COMPETE, SOUTHWEST -- NOT ONE OR MORE OF THE BIG THREE AIRLINES -- REGULARLY SETS THE PRICE. TODAY, SOUTHWEST SETS THE PRICE IN MARKETS THAT ACCOUNT FOR OVER 20 PERCENT OF DOMESTIC PASSENGER TRIPS. IT CURRENTLY SERVES CALIFORNIA, THE SOUTHWEST REGION OF THE COUNTRY, AND IS NOW EXPANDING IN THE MIDWEST. THIS IS A VERY IMPORTANT SHIFT IN THE COMPETITIVE BALANCE IN DOMESTIC AIR SERVICE. ONE OUT OF EVERY FIVE DOMESTIC PASSENGERS PAYS A PRICE THAT IS WELL BELOW WHAT ANY OTHER AIRLINE WOULD OTHERWISE CHARGE AS A CONSEQUENCE OF THE COMPETITIVE PRESENCE OF THIS SINGLE, LOW COST AIRLINE.

I AM NOT SUGGESTING TO YOU THAT THE SURVIVAL OF THE LARGER AIRLINES IS THREATENED BY SOUTHWEST, OR THAT SOUTHWEST AIRLINES ALONE WILL PROVIDE ALL THE COMPETITIVE DISCIPLINE THE INDUSTRY NEEDS IN THE FUTURE. BUT I AM SUGGESTING THAT AS A CONSEQUENCE OF LOW COST POINT-TO-POINT SERVICE THE BIG THREE AIRLINES ARE NOT IN A POSITION TO DOMINATE DOMESTIC MARKETS. RATHER, THEY MUST FIND A REMEDY TO THEIR SERIOUS DISADVANTAGE IN OPERATING COSTS. THIS IS A MAJOR ISSUE FOR THE LARGE AIRLINES TO DEAL WITH, AND I BELIEVE IS LEADING US INTO STILL ANOTHER PHASE OF THE AIRLINE DEREGULATION PROCESS.

IN ADDITION TO LOW COST CARRIERS LIKE SOUTHWEST AND AMERICA WEST, A NUMBER OF SMALLER CARRIERS ARE QUIETLY DEVELOPING THEIR OPERATING SYSTEMS. FOR EXAMPLE, ALASKA AIRLINES IS RAPIDLY GROWING, PRIMARILY BY EXPANDING ITS SERVICE IN THE CONTIGUOUS 48 STATES, AND WILL SOON BE LARGE ENOUGH TO BE CLASSIFIED AS THE TENTH MAJOR AIRLINE. EVEN SMALLER SUCCESSFUL AIRLINES SUCH AS MIDWEST EXPRESS ARE GRADUALLY, BUT CONSISTENTLY, BUILDING A COMPETITIVE PRESENCE. IN RELATIVE TERMS, MIDWEST EXPRESS IS STILL A VERY SMALL AIRLINE, BUT ITS SERVICE HAS RAPIDLY EXPANDED OVER THE PAST THREE TO FOUR YEARS. ALASKA AIRLINES, MIDWEST EXPRESS AND SOUTHWEST ALL DISPEL THE IDEA THAT ONLY THE BIG AIRLINES CAN EARN PROFITS. THESE THREE AIRLINES HAVE BEEN AMONG THE MOST PROFITABLE FOR SEVERAL YEARS NOW.

ANOTHER COMPONENT OF COMPETITION IN THE FUTURE WHICH CANNOT BE DISMISSED IS NEW ENTRY. TODAY, THE NOTION OF NEW ENTRY IS ALMOST AUTOMATICALLY REJECTED OUT OF HAND BY MANY INDUSTRY OBSERVERS. WE ARE ALL FULLY AWARE OF THE LACK OF SIGNIFICANT NEW ENTRY INTO THE DOMESTIC AIRLINE SYSTEM IN RECENT YEARS, AND THIS IS OFTEN REGARDED AS A FAILURE OF DEREGULATION. I BELIEVE, HOWEVER, THAT THIS IS MORE A TESTAMENT TO THE VERY HIGH DEGREE OF COMPETITIVENESS IN THE DEREGULATED AIRLINE INDUSTRY. NOW THAT WE HAVE A BETTER UNDERSTANDING OF JUST HOW INTENSELY

COMPETITIVE THE AIRLINE INDUSTRY HAS BECOME, IT IS NOT APPARENT WHY ANYONE WOULD REALISTICALLY EXPECT A LARGE NUMBER OF NEW CARRIERS TO APPEAR.

HOWEVER, NEW ENTRY IS NOT DEAD. I CAN TELL YOU THAT WE AT THE DEPARTMENT SEE APPLICATIONS FOR NEW ENTRY INTO THIS BUSINESS ON AN ALMOST WEEKLY BASIS. NEW FIRMS ARE REGULARLY SUBMITTING PLANS TO START NEW, SMALL AIRLINES. MANY NEVER START UP, BUT OTHERS DO. SOME ARE COMMUTER CARRIERS, SOME ARE CHARTER AIRLINES, SOME ARE CARGO AIRLINES, AND SOME ARE SMALL, SCHEDULED PASSENGER AIRLINES. BASED ON OUR EXPERIENCE OVER THE PAST FEW YEARS AND THIS YEAR, I BELIEVE THIS CONSTANT FLOW OF NEW ENTRY WILL CONTINUE. THESE NEW CARRIERS ARE CONSTANTLY SEEKING NICHE WHERE THE CURRENT INDUSTRY STRUCTURE CAN BE EXPLOITED. WE SEE THAT HAPPENING TODAY BY EXISTING CARRIERS, AND ONCE THE RESTRUCTURING PROCESS RUNS ITS COURSE, IF INDEED THAT EVER HAPPENS, THEN THE PACE OF NEW ENTRY WILL ALMOST CERTAINLY PICK UP. FROM TIME TO TIME SOME OF THESE NEW AIRLINES WILL FIND A NICHE THAT THEY CAN USE AS A SPRINGBOARD TO ESTABLISHING MEANINGFUL COMPETITIVE PRESENCES.

THE ESTABLISHED AIRLINES SEE THESE GROWING SOURCES OF COMPETITION AND ARE NOT ACTING AS THEY WOULD IF THE INDUSTRY WERE HEADED TOWARD OLIGOPOLY. THE TRADE PRESS

IS RIFE WITH AIRLINE ANNOUNCEMENTS OF LONG RANGE COST CUTTING CAMPAIGNS, NOT JUST BY THE FINANCIALLY STRUGGLING CARRIERS, BUT BY ALL AIRLINES INCLUDING THE BIG THREE. THESE EFFORTS AT COST REDUCTION ARE INDICATIVE OF THE REALITY THE DOMESTIC INDUSTRY FACES -- VIGOROUS COMPETITION FAR INTO THE FUTURE. THESE COST REDUCTION EFFORTS SIGNAL RECOGNITION OF NEW COMPETITIVE PRESSURES. BUT, THEY ALSO REPRESENT AN ACKNOWLEDGMENT BY THE AIRLINES THAT FARES MUST BE KEPT LOW IF THE DEMAND FOR DOMESTIC AIR TRAVEL IS TO CONTINUE TO GROW. THEY MUST KEEP AIR TRAVEL COMPETITIVE WITH SURFACE TRAVEL AND SUBSTITUTES FOR AIR TRAVEL SUCH AS TELECONFERENCING. I BELIEVE THAT THE AIRLINES WILL FIND WAYS TO KEEP THEIR COSTS DOWN, KEEP TRAFFIC GROWING, AND RETURN TO PROFITABILITY.

AS I PROMISED AT THE OUTSET, I WILL PRESENT A FEW STATISTICS FOR 1991 THAT SHOW THE INDUSTRY INDEED REMAINS VERY COMPETITIVE. FIRST, THE NUMBER OF MARKETS CONTINUED TO INCREASE IN 1991 DESPITE THE EFFECTS OF THE RECESSION AND THE DEMISE OF EASTERN AIRLINES AT THE BEGINNING OF 1991. THERE ARE NOW OVER 20,000 MARKETS, UP BY 2600 SINCE 1988, BY WHICH TIME THE FIRST ROUND OF INDUSTRY CONSOLIDATION HAD RUN ITS COURSE, AND UP BY 9,400 MARKETS OVER 1984, BEFORE THE PROCESS OF CONSOLIDATION HAD STARTED. THIS SHOWS THAT THE RELENTLESS COMPETITIVE

DYNAMICS OF HUB-AND-SPOKE NETWORKS CONTINUE TO LINK MORE AND MORE SMALL CITIES INTO THE MAINSTREAM OF AIR TRAVEL.

SECOND, INTENSE COMPETITION IS MOVING INTO EVEN SMALLER MARKETS. HUBBING VIRTUALLY DICTATES THAT AIRLINES COMPETE FOR EVEN VERY SMALL VOLUMES OF TRAFFIC. DURING 1991, THE AVERAGE DENSITY OF MARKETS WITH THE MOST INTENSE COMPETITION -- FIVE OR MORE COMPETITORS -- WAS LESS THAN 100 PASSENGERS A DAY. THIS AVERAGE SIZE IS HALF WHAT IT WAS IN 1988. TRAFFIC VOLUMES THAT SMALL COULD NOT HAVE SUPPORTED A SATISFACTORY PATTERN OF OPERATION FOR EVEN A SINGLE AIRLINE IN THE POINT-TO-POINT SYSTEMS OF SERVICE THAT WERE OPERATED BEFORE DEREGULATION. IN 1979, THERE WERE ONLY THREE MARKETS WITH FIVE OR MORE COMPETITORS; TODAY THERE ARE 120. MOREOVER, IN 1979 THE AVERAGE DAILY VOLUME IN FIVE-CARRIER MARKETS WAS 10 TIMES GREATER THAN TODAY, OR ALMOST 1,000 DAILY PASSENGERS.

THIRD, THE NUMBER OF MARKETS IN 1991 WITH THREE OR MORE COMPETITORS CONTINUES TO BE HIGHER THAN IN 1988, AND IS MORE THAN TWO AND A HALF TIMES THE NUMBER IN 1984. TRAFFIC IN THESE MARKETS, MEASURED BY REVENUE PASSENGER MILES, IS 40 PERCENT HIGHER THAN IN 1984, AND ONLY FOUR PERCENT BELOW 1988 DESPITE THE EFFECTS OF THE RECESSION. THE PERCENTAGE OF TOTAL TRAFFIC IN THESE MARKETS HAS

CONSISTENTLY BEEN ABOUT 50 PERCENT OF TOTAL TRAFFIC, ALTHOUGH LITERALLY THOUSANDS OF VERY SMALL MARKETS HAVE BEEN DEVELOPED SINCE 1984 AND EVEN SINCE 1988, AS I HAVE DESCRIBED.

FOURTH, AN AREA OF CONCERN THAT WE HAD IDENTIFIED IN OUR COMPETITION STUDY IS FARE PREMIUMS IN SHORT-HAUL MARKETS AT CONNECTING HUB COMPLEXES THAT ARE DOMINATED BY A SINGLE CARRIER. OUR STUDY WAS BASED ON 1988 DATA, AND WE HAVE NOW UPDATED OUR HUB PREMIUM CALCULATIONS USING DATA THROUGH 1991. THE NEW DATA SHOW VIRTUALLY NO CHANGE IN THE FARE PREMIUM, AT ABOUT 19 PERCENT. NOR HAS THERE BEEN ANY CHANGE IN THE PROPORTION OF TOTAL PASSENGERS THAT ARE AFFECTED, ABOUT FIVE PERCENT. THIS IS CONSIDERED VERY GOOD NEWS BECAUSE OF CONCERN THAT AS HUBBING PRACTICES MATURED, HUBBING CARRIERS MIGHT BE ABLE TO TIGHTEN THEIR GRIP ON THE RESPECTIVE CONNECTING HUBS AND EXTRACT EVEN GREATER PREMIUMS FROM ADDITIONAL PASSENGERS. THAT'S NOT HAPPENING.

THESE COMPARISONS ALL SHOW THAT COMPETITION REMAINS AS INTENSE AS EVER, NOTWITHSTANDING THE CONSOLIDATION THAT HAS OCCURRED SINCE THE MID-1980'S.

TURNING TO FINANCIAL PERFORMANCE, IT HAS INDEED BEEN A BLEAK PERIOD FOR THE AIRLINE INDUSTRY DURING THE PAST TWO

YEARS. BUT WHILE THE INDUSTRY HAS A LONG WAY TO GO TO RETURN TO AN ACCEPTABLE LEVEL OF PROFITABILITY, WE ARE CONFIDENT THAT IT WILL SUCCEED.

OF GREAT IMPORTANCE IN MY OPINION IS THE FACT THAT THE LOSSES HAVE NOT RESULTED FROM A FUNDAMENTAL FAILURE ATTRIBUTABLE TO INDUSTRY STRUCTURE, BUT ARE THE RESULT OF A SET OF CIRCUMSTANCES, THE MOST TELLING OF WHICH HAVE BEEN BEYOND THE INDUSTRY'S CONTROL. YOU KNOW, OF COURSE, THAT I AM REFERRING TO THE PERSIAN GULF WAR AND THE ECONOMIC DOWNTURN. EITHER EVENT ALONE WOULD HAVE HIT INDUSTRY EARNINGS HARD. THE AIRLINES ARE A VERY CYCLICAL INDUSTRY AND ONE OF THE MOST SENSITIVE INDUSTRIES TO FLUCTUATIONS IN THE BUSINESS CYCLE. AND THE WAR HAD A STAGGERING EFFECT ON BOTH COSTS AND PASSENGER DEMAND IN INTERNATIONAL OPERATIONS. BUT IN TANDEM, THESE EVENTS WERE MUCH MORE DIFFICULT TO DEAL WITH. THE WAR LED TO ENORMOUS LOSSES THAT SEVERELY DEPLETED FINANCIAL RESERVES AND THE ABILITY OF ALL AIRLINES TO DEAL WITH THE ECONOMIC DOWNTURN. THE FACT THAT THE INDUSTRY HAS MANAGED TO COPE WITH THESE CIRCUMSTANCES AS WELL AS IT HAS IS AN INDICATION OF ITS OVERALL RESILIENCE.

THE MORE RECENT DISAPPOINTING PERFORMANCE OF THE INDUSTRY TO SOME EXTENT REFLECTS THE WEAK ECONOMY, BUT IT HAS ALSO BEEN STRONGLY INFLUENCED BY THE GLOBALIZATION PROCESS.

SEVERAL AIRLINES ARE GREATLY EXPANDING THEIR INTERNATIONAL OPERATIONS THROUGH ENTRY ON NEW ROUTES AND ACQUISITIONS OF ROUTES AND OTHER ASSETS OF FAILED CARRIERS AND CARRIERS THAT ELECTED TO WITHDRAW FROM CERTAIN INTERNATIONAL MARKETS. THIS IS A VERY EXPENSIVE PROCESS, INVOLVING ENORMOUS STARTUP COSTS AND OPERATING LOSSES, AS NEWLY ACQUIRED ROUTES ARE DEVELOPED AND MARKETED. THIS PROCESS CLEARLY HAS HAD A DOWNWARD INFLUENCE ON PROFITS THAT WILL NOT BE REPEATED BEYOND THE NEAR TERM. ALSO IMPORTANT, FROM THE STANDPOINT OF INDUSTRY CONSOLIDATION, THESE COSTS ARE GENERALLY BEING BORNE BY THE LARGEST, STRONGEST AIRLINES AND NOT THOSE IN WEAKENED FINANCIAL CONDITION. IN FACT, I AM ENCOURAGED THAT ALL THREE AIRLINES NOW IN BANKRUPTCY SHOW CONSIDERABLE IMPROVEMENT IN THE FIRST QUARTER COMPARED WITH THE PREVIOUS QUARTER, AND TWO OF THESE CARRIERS ARE VIRTUALLY AT OPERATING BREAKEVEN.

INDUSTRY EARNINGS BEYOND THE FIRST QUARTER OF 1992 ARE VERY UNCERTAIN. THE ECONOMY HAS SHOWN SIGNS OF RECOVERY, WHICH SHOULD BOOST TRAFFIC AND REVENUES, AND, ULTIMATELY, PROFITABILITY. BUT THE UNCERTAINTY STEMS FROM VERY BROAD-BASED REVISIONS TO AIRLINE PRICING THAT OCCURRED IN EARLY APRIL WHEN AMERICAN AIRLINES INTRODUCED A SIMPLIFIED FARE STRUCTURE.

WHETHER AMERICAN'S NEW FARE STRUCTURE WILL PRODUCE MORE REVENUE FOR THE INDUSTRY IS MORE DIFFICULT TO EVALUATE. AMERICAN HAS INDICATED THAT IT DID NOT BELIEVE THAT AVERAGE FARES WOULD CHANGE VERY MUCH BUT MORE PEOPLE WOULD FLY. BUSINESS TRAVEL IN PARTICULAR WOULD BE STIMULATED AS THESE TRAVELERS COULD MAKE FLEXIBLE ARRANGEMENTS AT MORE REASONABLE PRICES. AMERICAN'S ASSESSMENT WAS NOT SHARED BY ALL. INDUSTRY ANALYSTS GENERALLY HELD THE VIEW THAT AMERICAN'S NEW FARES WOULD CAUSE AVERAGE FARES AND REVENUE TO DROP.

THE ONLY RESULTS WE HAVE TO DATE SHOW THAT FOR APRIL DOMESTIC YIELDS WERE 8.5 PERCENT HIGHER THAN LAST APRIL, OFFSETTING A 5.3 PERCENT DECLINE IN TRAFFIC TO PRODUCE A 2.8 PERCENT INCREASE IN REVENUE. THE APRIL YIELDS WERE ALSO SLIGHTLY HIGHER THAN MARCH YIELDS. THIS LIMITED EVIDENCE MAY SUGGEST THAT THE NEW FARE STRUCTURE ATTRACTED ADDITIONAL BUSINESS TRAVEL. AND ACTUALLY INCREASED AVERAGE FARES.

HOWEVER, THIS NEWS IS NOW STALE BECAUSE OF A SERIES OF FARE WARS STARTING IN LATE APRIL AND CONTINUING INTO LATE MAY, WHEN AMERICAN CUT ITS LOWEST DISCOUNT FARES IN HALF. BUT WHILE THESE LOWER FARES WILL ALMOST CERTAINLY CAUSE YIELDS TO DECLINE, WE CANNOT BE SURE HOW MUCH REVENUE WILL BE LOST BECAUSE NO ONE KNOWS WHAT PROPORTION OF

THEIR CAPACITY PARTICULAR AIRLINES WILL COMMIT TO THE LOWER FARES. ALL INDICATIONS ARE THAT WHATEVER CAPACITY THE AIRLINES HAVE DECIDED TO OFFER AT THESE LOW FARES WAS QUICKLY SOLD OUT. WHATEVER THE ULTIMATE IMPACT, FOR NOW, THE AIRLINES QUICKLY PULLED IN ADDITIONAL REVENUE FOR TRAVEL THAT WILL BE OCCURRING OVER THE COURSE OF THE SUMMER.

TURNING TO S. 2312, LET ME FIRST ADDRESS THE COMPUTER RESERVATIONS SYSTEMS ISSUES.

AIRLINE COMPUTER RESERVATION SYSTEMS (CRSS) ARE AN INDISPENSABLE MEANS BY WHICH TRAVEL AGENTS MAKE BOOKINGS AND RECEIVE INFORMATION ON SCHEDULES, FARES, AND SEAT AVAILABILITY. IN 1984, THE CIVIL AERONAUTICS BOARD (CAB), SUPPORTED BY THE DEPARTMENT OF JUSTICE, FOUND THAT CERTAIN AIRLINES WERE USING THEIR CONTROL OVER CRSS TO HANDICAP AIRLINE RIVALS. THE CAB ADOPTED RULES THAT HAVE BEEN IN EFFECT AND ENFORCED BY THE DEPARTMENT OF TRANSPORTATION, WITH ONLY SLIGHT MODIFICATIONS, EVER SINCE.

ALTHOUGH THE CURRENT RULES HAVE BEEN EFFECTIVE IN DEALING WITH CERTAIN PROBLEMS, THERE HAVE BEEN CALLS FOR MORE REGULATION. CONTROVERSY HAS PERSISTED OVER PRACTICES THAT WERE DELIBERATELY LEFT UNREGULATED AND OTHERS THAT HAVE

COME TO BE SEEN BY SOME PARTIES AS IMPEDIMENTS TO AIRLINE COMPETITION.

THE DEPARTMENT HAS STUDIED THE EVOLUTION OF THE CRS INDUSTRY OVER SEVERAL YEARS, PUBLISHING A MAJOR STUDY IN 1988 AND ANOTHER REPORT IN 1990. ON MARCH 26, 1991, WE ISSUED A NOTICE OF PROPOSED RULEMAKING (NPRM) THAT PROPOSED SEVERAL MODIFICATIONS TO THE PRESENT RULES AND REQUESTED COMMENT ON OTHER PROPOSALS. THE RULES WERE SCHEDULED TO EXPIRE ON DECEMBER 31, 1990, BUT HAVE BEEN EXTENDED UNTIL DECEMBER 11, 1992, TO GIVE US MORE TIME TO COMPLETE OUR RULEMAKING.

MR. CHAIRMAN, GIVEN THE ONGOING NATURE OF THE DEPARTMENT'S RULEMAKING, I'M SURE YOU WILL UNDERSTAND THAT I CANNOT COMMENT IN DETAIL ON THOSE PROVISIONS IN S. 2312 THAT DEAL WITH CRSS. AS A MATTER OF POLICY, HOWEVER, THE DEPARTMENT STRONGLY OPPOSES A LEGISLATIVE "SOLUTION" TO CRS REGULATORY ISSUES. THE CRS INDUSTRY CONTINUES TO EVOLVE, BOTH IN TERMS OF TECHNOLOGY AND MARKET STRUCTURE. THE DEVELOPMENT OF "HOSTLESS" CRSS AND THE IMPROVING COMMUNICATION LINKAGES BETWEEN CRS VENDORS AND PARTICIPATING AIRLINES ARE WORKING TO REDUCE ANY UNFAIR COMPETITIVE ADVANTAGES THAT MAY RESULT SOLELY FROM CRS OWNERSHIP. THE CRS INDUSTRY, MOREOVER, IS BECOMING TRULY GLOBAL, AND U.S. VENDORS ARE ESTABLISHING JOINT

VENTURES AND MARKETING AGREEMENTS WITH FOREIGN AIR CARRIERS. PREMATURE LEGISLATIVE ACTION TO CORRECT CURRENTLY PERCEIVED PROBLEMS COULD RESULT IN ADDITIONAL COSTS AND REDUCED SERVICE FOR SUBSCRIBERS, PARTICIPATING AIRLINES, AND CRS VENDORS WITH FEW, IF ANY, OFFSETTING BENEFITS FOR CONSUMERS.

CALLS FOR ADDITIONAL CRS REGULATION HAVE FOCUSED ON FOUR ISSUES: THE LEVEL OF BOOKING FEES PAID BY PARTICIPATING AIRLINES, BIASED DISPLAYS, CONTRACT PROVISIONS THAT PREVENT SUBSCRIBERS FROM MORE EASILY SWITCHING CRSS, AND THE PERCEIVED ADVANTAGES CRS VENDOR AIRLINES ENJOY OVER OTHER AIRLINES BECAUSE AGENTS BELIEVE IT IS EASIER AND SAFER (I.E., MORE RELIABLE) TO MAKE A BOOKING ON THE VENDOR AIRLINE.

BOOKING FEES

THE PROPOSED LEGISLATION WOULD REQUIRE THAT FEES CHARGED TO PARTICIPATING AIRLINES BE "FAIR AND REASONABLE." DISPUTES WOULD BE SUBMITTED TO THE DECISION OF AN ARBITRATOR. VENDORS WOULD THEN BE PROHIBITED FOR A PERIOD OF ONE YEAR FROM CHARGING FEES GREATER THAN THOSE FOUND "FAIR AND REASONABLE."

THE DEPARTMENT PROPOSES TO CONTINUE PROHIBITING DISCRIMINATORY BOOKING FEES. IN OUR NPRM, HOWEVER, WE DID NOT CALL FOR ADDITIONAL REGULATION OF BOOKING FEES.

WE DID INDICATE THAT WE WERE WILLING TO CONSIDER SUCH A RULE IF IT WERE WORKABLE, WOULD PROVIDE SIGNIFICANT NET BENEFITS TO SOCIETY, AND WOULD RELY ON MARKET FORCES.

QUITE FRANKLY, ARBITRATION IS NOT A WORKABLE SOLUTION TO THE BOOKING FEE PROBLEM; INDEED, ARBITRATION SUFFERS FROM MANY OF THE PROBLEMS OF TRADITIONAL PUBLIC UTILITY REGULATION. MEASURING AND ALLOCATING THE VENDORS' LEGITIMATE COSTS AND DETERMINING A COMPETITIVE RATE OF RETURN ARE DIFFICULT TASKS UNDER THE BEST OF CIRCUMSTANCES, MUCH LESS IN A RISKY AND TECHNOLOGICALLY PROGRESSIVE INDUSTRY. THERE ALSO WOULD BE NO GUARANTEE THAT THE OUTCOMES OF SUCCESSIVE ARBITRATION PROCEEDINGS WOULD BE MUTUALLY CONSISTENT OR THAT THE IMPLICATIONS OF THESE DECISIONS FOR THE CRS INDUSTRY'S LONG-TERM COMPETITIVE VIABILITY WOULD BE CONSIDERED. IN SHORT, ARBITRATION COULD WEAKEN RATHER THAN IMPROVE COMPETITION IN THE CRS INDUSTRY, AND THE DEPARTMENT STRONGLY OPPOSES THIS PROVISION.

DISPLAY BIAS

UNDER S. 2312 CRS VENDORS WOULD BE PROHIBITED FROM OFFERING INTEGRATED DISPLAYS ORDERED BY CARRIER IDENTITY. IN ADDITION, THE BILL WOULD PROHIBIT A VENDOR FROM INDUCING A SUBSCRIBER TO CREATE A BIASED, INTEGRATED DISPLAY. VENDORS WOULD ALSO BE PROHIBITED FROM SUPPLYING

DEPARTMENT FROM CONSIDERING SLOT AVAILABILITY IN SETTING EAS GUARANTEES. IT WOULD ALSO REQUIRE THE DEPARTMENT TO ENSURE SUFFICIENT SLOTS ARE AVAILABLE TO THE CARRIER PROVIDING, OR SELECTED TO PROVIDE, SUCH SERVICE.

(HOWEVER, SLOTS WOULD NOT HAVE TO BE MADE AVAILABLE AT O'HARE IF THE NUMBER OF AVAILABLE EAS SLOTS IS AT LEAST 132.) FINALLY, THIS SECTION WOULD AMEND CURRENT LAW TO CLARIFY THAT AN AIR CARRIER SUSPENDING SERVICE TO AN EAS COMMUNITY COULD NOT KEEP SLOTS ASSOCIATED WITH THE SERVICE UNLESS THEY WERE BEING USED TO PROVIDE BASIC ESSENTIAL SERVICE TO ANOTHER EAS COMMUNITY.

SLOTS AT O'HARE ARE A SCARCE RESOURCE AND SHOULD BE USED IN AN EFFICIENT MANNER TO BENEFIT ALL COMMUNITIES. WHEN SUFFICIENT ACCESS TO THE NATIONAL TRANSPORTATION SYSTEM CAN BE PROVIDED THROUGH OTHER REGIONAL AIRPORTS, ALLOCATING ADDITIONAL SLOTS AT O'HARE TO EAS COMMUNITIES NEAR CHICAGO IS NOT, IN OUR VIEW, A WISE USE OF THESE SCARCE RESOURCES. THE DEPARTMENT IS NOT IN A POSITION TO CREATE NEW COMMUTER SLOTS AND, AS I STATED IN MY COMMENTS ON SECTION 2 OF THE BILL, WE RECENTLY PUBLISHED A FINAL RULE CONCERNING THE OPERATION OF JET AIRCRAFT IN COMMUTER SLOTS AT O'HARE, AND WE PREFER OUR RULEMAKING APPROACH RATHER THAN A MANDATED LEGISLATIVE SOLUTION TO THE SLOT PROBLEM.