

STATEMENT OF
PATRICK V. MURPHY
DEPUTY ASSISTANT SECRETARY FOR AVIATION
AND INTERNATIONAL AFFAIRS
DEPARTMENT OF TRANSPORTATION
BEFORE THE
SUBCOMMITTEE ON AVIATION
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
OCTOBER 28, 1997

THANK YOU MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. I
APPRECIATE THE OPPORTUNITY TO DISCUSS DOMESTIC AIRLINE
COMPETITION AND SERVICE ISSUES.

AT THE OUTSET, LET ME STATE WHAT WE HAVE SAID THIS YEAR IN
TESTIMONY IN BOTH HOUSES; NAMELY, THAT THE DEPARTMENT
CONTINUES TO VIEW DOMESTIC AIRLINE DEREGULATION AS A SUCCESS
THAT HAS BROUGHT MORE COMPETITION, LOWER FARES AND BETTER
SERVICE TO THE VAST MAJORITY OF OUR CITIZENS, HAS MADE OUR
AIRLINES THE MOST EFFICIENT AND INNOVATIVE IN THE WORLD, HAS
SERVED AS THE MODEL FOR THE AVIATION LIBERALIZATION THAT IS
RAPIDLY SPREADING WORLD WIDE, AND HAS SEEN SAFETY INCREASE
AND NOISE LEVELS DECLINE.

NEVERTHELESS, NOT ALL CITIES AND REGIONS OF THE COUNTRY HAVE
SHARED EQUALLY IN THE FULL BENEFITS OF DEREGULATION, AND THE

DEPARTMENT IS SENSITIVE TO ITS OBLIGATION TO ADDRESS IMPEDIMENTS TO COMPETITION AND SERVICE WHERE WE CAN IDENTIFY THEM.

THE KEY COMPETITIVE PROBLEM WE IDENTIFIED IN OUR MULTI-VOLUME STUDY OF DOMESTIC AIRLINE COMPETITION IN 1990--HIGH FARES AT HUB CITIES DOMINATED BY ONE CARRIER--REMAINS WITH US TODAY. FOR SEVERAL YEARS WE WERE ENCOURAGED THAT A MARKET RESPONSE TO THIS PROBLEM IN THE FORM OF NEW COMPETITION FROM LOW-FARE POINT-TO-POINT CARRIERS WAS PROVIDING THE NECESSARY COMPETITIVE DISCIPLINE TO EVENTUALLY SOLVE THIS PROBLEM. SINCE THE BEGINNING OF 1993 THERE HAD BEEN A STEADY STREAM OF NEW ENTRANTS, MANY OF WHICH WERE USING THE LOW-FARE APPROACH PIONEERED BY SOUTHWEST AIRLINES. IN AN APRIL, 1996 STUDY WE ESTIMATED THAT ALMOST 40% OF DOMESTIC PASSENGERS TRAVELED IN MARKETS WITH LOW FARE COMPETITION, SAVING CONSUMERS AN ESTIMATED \$6.3 BILLION ANNUALLY IN AIRLINE FARES.

HOWEVER, BEGINNING IN MAY OF 1996 WHEN ONE OF THE MOST SUCCESSFUL NEW ENTRANT AIRLINES, VALUJET, HAD A TRAGIC CRASH, THE EXPANSION OF COMPETITION FROM NEW ENTRANTS HAS SLOWED TO ALMOST A HALT. ONLY ONE LOW-FARE NEW ENTRANT HAS STARTED

OPERATIONS OVER THE PAST 16 MONTHS AND NO NEW APPLICATIONS HAVE BEEN FILED IN 1997. OF GREAT CONCERN TO US OVER THIS 16-MONTH PERIOD HAS BEEN AN INCREASING NUMBER OF ALLEGATIONS OF ANTICOMPETITIVE PRACTICES AIMED AT NEW COMPETITION, PARTICULARLY AT MAJOR NETWORK HUBS. IN ADDITION TO POSSIBLE ANTICOMPETITIVE BEHAVIOR, THE DEPARTMENT BELIEVES THAT FARES HIGHER THAN APPROPRIATE CAN ALSO BE ATTRIBUTED TO AIRPORT ACCESS RESTRICTIONS SUCH AS SLOT CONTROLS, AND MARKETING BARRIERS SUCH AS COMPUTER RESERVATION SYSTEMS THAT FAVOR NETWORK CARRIERS.

WE ALSO RECOGNIZE THAT SMALL AND MEDIUM SIZED COMMUNITY ISSUES ARE A CONCERN TO MEMBERS OF CONGRESS. NOT UNEXPECTEDLY, MANY SMALLER COMMUNITIES HAVE BENEFITED UNDER DEREGULATION AND HAVE SEEN THEIR SERVICE INCREASE. BUT, OTHERS HAVE EXPERIENCED DECLINES IN THE QUALITY OR QUANTITY OF SERVICE. IN MOST INSTANCES THE DEGREE OF CHANGE HAS CORRESPONDED TO THE DISPARITY BETWEEN SERVICE AND DEMAND AT THE TIME OF DEREGULATION: COMMUNITIES WITH HIGH SERVICE LEVELS BUT LOW PASSENGER COUNTS HAVE EXPERIENCED THE LARGEST LOSSES IN SERVICE WHILE OTHERS HAVE FARED QUITE WELL. IT IS DIFFICULT TO ATTRIBUTE SERVICE CHANGES AFTER DEREGULATION TO

ANY ONE SINGLE FACTOR --FARES, CARRIER REPLACEMENTS, POPULATION SHIFTS, OVERALL ECONOMY, ETC.--BECAUSE SO MANY ELEMENTS HAVE CHANGED SIMULTANEOUSLY. IN GENERAL SERVICE AT SMALL COMMUNITIES SHIFTED FROM INFREQUENT, MULTI-STOP SERVICE WITH JET AND LARGE TURBOPROP AIRCRAFT TO MORE FREQUENT AND TYPICALLY NONSTOP SERVICE WITH SMALLER COMMUTER AIRCRAFT.

THE DEPARTMENT HAS BEEN AT WORK OVER THE PAST YEAR IN DEALING WITH SMALL COMMUNITY ISSUES AS WELL AS COMPETITION PROBLEMS. LAST WEEK WE REPORTED TO CONGRESS ON OUR PROGRESS IN ADDRESSING COMPETITIVE ISSUES OVER THE PAST YEAR. THE REPORT SPELLED OUT FOUR AREAS OF ACTIVITY.

THE FIRST INVOLVES ACCESS TO SLOTS AT THE FOUR HIGH DENSITY AIRPORTS IN NEW YORK, CHICAGO AND WASHINGTON. IN 1994, CONGRESS GAVE US THE POWER TO GRANT EXEMPTIONS TO THE SLOT RULE. IN RESPONSE TO A GAO RECOMMENDATION THAT DOT BE MORE PROACTIVE IN GRANTING SLOT EXEMPTIONS, THE DEPARTMENT ANNOUNCED ITS INTENTIONS EARLY THIS YEAR TO BE MORE ACTIVE AND TAKE COMPETITION INTO ACCOUNT WHEN DECIDING ON EXEMPTION REQUESTS FROM NEW ENTRANTS. AS OF TODAY, WE HAVE

RECEIVED 6 REQUESTS FOR 109 SLOT EXEMPTIONS AT CHICAGO O'HARE AND 7 REQUESTS FOR 55 SLOTS AT NEW YORK'S LAGUARDIA AIRPORT. AFTER CAREFULLY CONSIDERING THE BENEFITS AND COSTS OF ADDING SERVICE, LAST FRIDAY WE RULED ON THE FIRST 8 REQUESTS AND GRANTED 10 SLOT EXEMPTIONS TO TWO NEW ENTRANTS AT O'HARE AND 21 SLOT EXEMPTIONS TO THREE NEW ENTRANTS AT LAGUARDIA. WE WILL ADDRESS THE NEWER SLOT REQUESTS IN THE FUTURE. I MUST EMPHASIZE THAT THE NUMBER OF NEW OPERATIONS WE CAN AUTHORIZE THROUGH EXEMPTIONS IS LIMITED.

IN ADDITION TO EXEMPTIONS FROM THE SLOT RULE, THE DEPARTMENT HAS BEGUN A PROCESS OF EVALUATING HOW EFFECTIVELY SLOTS ARE CURRENTLY BEING USED AT EACH OF THE FOUR SLOTTED AIRPORT. THERE IS REASON TO BELIEVE THAT AIR CARRIER SLOTS ARE NOT ALWAYS BEING PUT TO THEIR HIGHEST AND BEST USE. THE NEW YORK PORT AUTHORITY HAS TESTIFIED THAT SLOTS AT LAGUARDIA ARE NOT BEING EFFECTIVELY USED AND AS A CONSEQUENCE SOME OF THEIR FACILITIES ARE UNDERUTILIZED. AS WE UNDERGO THIS INVESTIGATION, WE WILL KEEP IN MIND THE GAO RECOMMENDATION TO REALLOCATE SLOTS TO IMPROVE COMPETITION, AS WELL AS THE INTEREST IN REALLOCATION EXPRESSED IN DRAFT LEGISLATION BY YOU MR. CHAIRMAN AND BY OTHER MEMBERS OF CONGRESS.

A SECOND AREA OF PROCOMPETITIVE ACTIVITY HAS BEEN RULEMAKINGS INVOLVING COMPUTER RESERVATION SYSTEMS. WE HAVE PROPOSED FOUR NEW RULES FOR COMPUTER RESERVATION SYSTEM OWNERS. ONE RULE INVOLVED ONLINE PREFERENCE GIVEN BY THE CRS OWNERS TO OPERATIONS INVOLVING CONNECTIONS BETWEEN MAJOR CARRIERS AND THEIR CODE-SHARE PARTNERS. THE PROPOSED RULE WOULD REQUIRE EACH SYSTEM TO OFFER A DISPLAY WITHOUT AN ONLINE PREFERENCE.

A SECOND RULE INVOLVES THE USE OF ELAPSED TIME IN CALCULATING HOW TO DISPLAY A PARTICULAR AIRLINE'S SERVICE ON A COMPUTER SCREEN. SEVERAL SMALLER CARRIERS HAD COMPLAINED THEIR FLIGHTS WERE BEING GIVEN UNFAIR TREATMENT. THE PROPOSED RULE WOULD PROHIBIT COMPUTER SYSTEMS THAT NEITHER USED ELAPSED TIME AS A SIGNIFICANT FACTOR NOR GAVE SINGLE PLANE FLIGHTS PREFERENCE OVER CONNECTIONS.

A THIRD PROPOSED RULE WOULD REQUIRE EACH SYSTEM TO USE DISPLAY CRITERIA WHICH ARE RATIONALLY RELATED TO CONSUMER PREFERENCE, ON THE THEORY THAT SUCH A REQUIREMENT WOULD

KEEP SYSTEMS FROM OFFERING UNJUSTIFIABLE COMPUTER SCREEN DISPLAYS.

FINALLY, WE PROPOSED A RULE THAT WOULD PROHIBIT A "PARITY CLAUSE" THAT FORCES EACH AIRLINE TO BUY AS HIGH A LEVEL OF SERVICE FROM A SYSTEM AS IT DOES FROM ANY OTHER SYSTEM. SEVERAL SMALL AIRLINES HAD COMPLAINED ABOUT THIS PRACTICE.

FINAL RULES ADDRESSING THESE FOUR AREAS HAVE BEEN PREPARED AND WILL BE ISSUED SOON. WE HAVE ALSO RECENTLY BEGUN A COMPLETE EXAMINATION OF ALL THE EXISTING RULES REGULATING COMPUTER RESERVATION SYSTEMS. WE PUBLISHED AN ADVANCED NOTICE OF PROPOSED RULEMAKING LAST MONTH ASKING FOR COMMENTS ON WHETHER AND HOW COMPUTER RULES SHOULD BE CHANGED. GIVEN THE SUBSTANTIAL IMPACT OF COMPUTER RESERVATION SYSTEMS ON COMPETITION, WE PLAN TO MAKE COMPLETION OF THIS RE-EXAMINATION A HIGH PRIORITY.

WITH RESPECT TO ANTICOMPETITIVE PRACTICES, WE HAVE HEARD MANY COMPLAINTS THAT LARGE AIRLINES ARE TRYING TO DRIVE OUT NEW COMPETITORS BY MATCHING OR UNDERCUTTING MUCH LOWER FARES OF LOW-COST AIRLINES AND BY SELLING FAR MORE SEATS AT

THESE LOW FARES THAN ARE BEING OFFERED BY THE NEW ENTRANTS. WE HAVE SEEN DOZENS OF EXAMPLES IN ROUTINELY REPORTED DATA OF FARE MATCHING AND EXPANSION OF LOW FARE CAPACITY BY MAJOR AIRLINES ON A LARGE SCALE. IN THOSE INSTANCES WHERE LOW-FARE COMPETITION HAS LEFT A MARKET, AVERAGE FARES GENERALLY INCREASE ABOVE THOSE CHARGED PRIOR TO NEW ENTRY AND LOW FARE BARGAINS VIRTUALLY DISAPPEAR.

BOTH DOT AND THE DEPARTMENT OF JUSTICE HAVE STATUTORY AUTHORITY TO ADDRESS THIS BEHAVIOR. JUSTICE ENFORCES THE SHERMAN ACT UNDER WHICH PREDATORY PRACTICES REPRESENT AN ATTEMPT TO MONOPOLIZE. DOT HAS THE AUTHORITY TO PROHIBIT BUSINESS PRACTICES AS UNFAIR METHODS OF COMPETITION. DOT'S AUTHORITY IS BROADER THAN THE JUSTICE DEPARTMENT'S SINCE DOT MAY PROHIBIT CONDUCT THAT DOES NOT VIOLATE THE ANTITRUST LAWS AS LONG AS THE CONDUCT IS SIMILAR TO CONDUCT THAT THE ANTITRUST LAWS DO PROHIBIT. WE HAVE BEEN WORKING CLOSELY WITH THE DEPARTMENT OF JUSTICE IN DEVELOPING AN ANALYSIS OF WHAT CONSTITUTES PREDATORY CONDUCT IN AIR TRANSPORTATION UNDER BOTH OUR STATUTES.

AS THE RESULT OF DETAILED INVESTIGATIONS OVER THE PAST YEAR, THE DEPARTMENT BELIEVES IT NOW HAS THE UNDERSTANDING NECESSARY TO DEVELOP CLEAR POLICY GUIDANCE FOR THE INDUSTRY, AND TO PURSUE INDIVIDUAL ENFORCEMENT ACTION WHEN THAT GUIDANCE IS NOT FOLLOWED. WE ARE IN THE PROCESS OF DEVELOPING POLICY GUIDELINES WHICH SHOULD BE DISSEMINATED IN THE FUTURE.

FINALLY, ON THE COMPETITION FRONT, WE HAVE UNDERTAKEN CONSUMER INFORMATION ACTIVITIES INCLUDING THE PUBLICATION OF A QUARTERLY REPORT ON AVERAGE AIRLINE FARES PAID IN THE TOP 1000 CITY-PAIR MARKETS. AN IMPORTANT PURPOSE OF THE REPORTS IS TO PROVIDE CIVIC LEADERS AND AIRPORT MANAGERS WHO ARE TRYING TO GAUGE THE EFFECT OF COMPETITION WITH INFORMATION ABOUT HOW AVERAGE FARES AT THEIR CITIES COMPARE WITH FARES FOR OTHER MARKETS AND CITIES. CITIES CAN USE THIS INFORMATION AS AN AID IN SEEKING OUT NEW COMPETITORS AND AIRLINES CAN USE IT TO SEE WHERE THE OPPORTUNITIES FOR ADDED COMPETITION ARE THE GREATEST. WE HAVE ALSO PUBLISHED IN THE FEDERAL REGISTER A REQUEST FOR COMMENT ON A CONSUMER UNION PETITION FOR A RULE THAT WOULD REQUIRE CARRIERS TO DISCLOSE THE MOST RECENT AVERAGE FARES AND LOWEST FARES CHARGED BY THE CARRIER FOR THE ROUTE AND CLASS OF SERVICE.

WITH REGARD TO SMALL COMMUNITY ACTIVITIES, CONGRESS AND THE ADMINISTRATION HAVE WORKED TOGETHER TO RESTORE THE EFFECTIVENESS AND EFFICIENCY OF THE ESSENTIAL AIR SERVICES PROGRAM WHICH HAD BEEN SUBJECT TO A BUDGET ROLLERCOASTER IN YEARS PAST. BEGINNING IN FISCAL YEAR 1998, THE PROGRAM IS FUNDED AT A \$50 MILLION LEVEL PROVIDED FOR BY THE RURAL AIR SERVICE SURVIVAL ACT. WE ARE USING THESE FUNDS TO RESTORE THE STATUTORY ESSENTIAL AIR SERVICE REQUIREMENTS ESTABLISHED IN 1987. WE FIND THAT RESTORATION OF SERVICE IS IMPERATIVE FOR COMMUNITIES TO REGAIN TRAFFIC AND PROMOTE GROWTH. WE HAVE NEARLY COMPLETED THE PROCESS OF UPGRADING SERVICE LEVELS BACK TO WHERE THEY WERE PRIOR TO THE FY 1996 CUTS. EQUALLY IMPORTANT IS THE FACT THAT CONGRESS REMOVED THE SCHEDULED SUNSET DATE OF SEPTEMBER 30, 1998. WE ARE ALREADY SEEING RENEWED INTEREST FROM AIR CARRIERS TO PARTICIPATE IN THE PROGRAM.

THE DEPARTMENT HAS ALSO BEEN ACTIVE IN USING SLOT EXEMPTION AUTHORITY FOR THE BENEFIT OF SMALL RURAL COMMUNITIES. IN 1994 THE DEPARTMENT GRANTED 28 EXEMPTIONS TO A COMMUTER CARRIER TO SERVE SEVEN SMALL COMMUNITIES IN THE MIDWEST TO O'HARE.

EARLIER THIS YEAR THE DEPARTMENT GRANTED AN ADDITIONAL 20 EXEMPTIONS FOR A CARRIER TO SERVE FIVE MORE SMALL COMMUNITIES TO O'HARE.

IN ADDITION TO THE ACTIONS DOT HAS BEEN TAKING, OTHER IDEAS TO ASSIST DOMESTIC COMPETITION AND SMALL AND MEDIUM SIZED COMMUNITY AIR SERVICE HAVE BEEN SUGGESTED.

WITH REGARD TO DOMESTIC COMPETITION, A NUMBER OF PROPOSALS HAVE SURFACED INCLUDING: COMPLETE ELIMINATION OF THE HIGH DENSITY RULE, CHANGES TO THE PERIMETER RULE AT WASHINGTON NATIONAL AIRPORT AND ELIMINATION OF THE WRIGHT AMENDMENT WHICH LIMITS OPERATIONS OUT OF DALLAS LOVE FIELD. THESE DECADES' OLD RESTRICTIONS HAVE BEEN EITHER LEGISLATED OR RECOGNIZED BY CONGRESS. THEY HAVE TO SOME EXTENT EVOLVED BEYOND THEIR ORIGINAL INTENT TO CONTROL AIRCRAFT OPERATIONS. ENVIRONMENTAL AND REGIONAL DEVELOPMENT CONCERNS EMERGE EACH TIME CHANGES TO THESE RESTRICTIONS ARE CONTEMPLATED. WE ARE OF THE VIEW THAT IT IS UP TO CONGRESS AND LOCAL AUTHORITIES TO DECIDE WHETHER TO MODIFY THESE LONG-STANDING ARRANGEMENTS. WE TAKE THIS VIEW WHILE AT THE SAME TIME RECOGNIZING THAT AIRLINE DEREGULATION IS PREMISED ON THE

CONCEPT OF OPEN COMPETITION AND THE ELIMINATION OF ECONOMIC RESTRICTIONS ON THE AIRLINE INDUSTRY. SEVERAL STUDIES DONE OUTSIDE DOT HAVE DEMONSTRATED THAT SLOT RESTRICTIONS LEAD TO HIGHER FARES AND LESS COMPETITION.

WITH REGARD TO AIR SERVICE AT SMALLER CITIES, WE HAVE DISCUSSED WITH CONGRESSIONAL STAFFS THE CONCEPT OF LEGISLATIVE PROPOSALS THAT WOULD SET UP DEMONSTRATION PROJECTS TO PROVIDE UPGRADED SERVICE, WITH SOME FEDERAL SUPPORT IN THE FORM OF LOANS, LOAN GUARANTEES, GRANTS AND DIRECT SUBSIDIES. THE DEPARTMENT HAS HAD EXPERIENCE IN A NUMBER OF AREAS WITH DEMONSTRATION PROJECTS. WE FIND THEY CAN BE MOST USEFUL WHEN CONDUCTED ON A LIMITED AND SELECTIVE BASIS.

IN THIS CONTEXT, THE NEW GENERATION OF 50-SEAT REGIONAL JETS WILL SIGNIFICANTLY CHANGE THE AIR SERVICE LANDSCAPE, ESPECIALLY AT SMALL- AND MEDIUM-SIZED COMMUNITIES. BUT, IT IS TOO EARLY TO TELL WHAT THE SMALLEST MARKET SIZE WILL BE THAT WILL ATTRACT THESE AIRCRAFT. HOWEVER, ASSUMING THAT CARRIERS WOULD TYPICALLY NOT ENTER A MARKET WITH FEWER THAN THREE ROUND TRIPS A DAY, AND ASSUMING A BREAKEVEN LOAD FACTOR OF 50 PERCENT, MARKETS AS SMALL AS 75 PASSENGERS A DAY IN EACH

DIRECTION MAY BE ABLE TO ATTRACT AND MAINTAIN 50-SEAT JETS.
MARKETS OF THIS SIZE MAY BE GOOD CANDIDATES FOR
DEMONSTRATION PROJECTS.

THANK YOU MR. CHAIRMAN FOR PROVIDING US AN OPPORTUNITY TO
TESTIFY. WE ARE PREPARED TO PROVIDE OUR FORMAL VIEWS ON ANY
DRAFT LEGISLATION YOU MAY WISH US TO REVIEW.