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UNITED STATES GENERAL ACCOUNTING OFFICE

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FOR RELEASE OR DELIVERY
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JULY 9, 1981

STATEMENT OF
HENRY ESCHWEGE, DIRECTOR
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON AVIATION
HOUSE COMMITTEE ON PUBLIC WORKS
AND TRANSPORTATION



115778

ON

[THE CHANGING AIRLINE INDUSTRY]

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

WE WELCOME THE OPPORTUNITY TO DISCUSS THE REPORT WE ISSUED TO YOU ON JUNE 1, 1981, ENTITLED "THE CHANGING AIRLINE INDUSTRY: A STATUS REPORT THROUGH 1980" (CED 81-103). WE ALSO WILL PROVIDE SOME OBSERVATIONS ON THE SUNSET OF CAB.

THE AIRLINE INDUSTRY IS CHANGING, RESPONDING TO GREATER FREEDOM PROVIDED BY THE AIRLINE DEREGULATION ACT OF 1978. IT IS, HOWEVER, TOO EARLY TO JUDGE THE ULTIMATE SUCCESS OR FAILURE OF DEREGULATION BECAUSE IT IS A GRADUAL PROCESS WHICH UNDER CURRENT LAW WILL NOT BE COMPLETED UNTIL 1985. OUR COMPARISONS OF AIR SERVICE ALSO REFLECT CHANGES THAT HAVE BEEN CAUSED BY CIRCUMSTANCES OTHER THAN AIRLINE DEREGULATION, SUCH AS THOSE ATTRIBUTABLE TO CHANGING ECONOMIC CONDITIONS.

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OUR REPORT WAS INTENDED TO TAKE A SNAPSHOT OF THE AIRLINE INDUSTRY BEFORE AND AFTER THE ACT'S PASSAGE. IT COMPARES TRAFFIC TRENDS; FARES; PROFITS; PRODUCTIVITY; SERVICE PATTERNS, PARTICULARLY AT SMALL COMMUNITIES; AND AIR SAFETY BEFORE AND AFTER DEREGULATION. THIRD YEAR OF EXPERIENCE WITH DEREGULATION DIFFERS FROM FIRST TWO

THE AIRLINE INDUSTRY'S EXPERIENCE IN THE THIRD YEAR OF DEREGULATION--1980--DIFFERED FROM ITS EXPERIENCE IN THE FIRST TWO. IN 1978 AND 1979--THE FIRST 2 YEARS AFTER DEREGULATION--THE AIRLINE INDUSTRY EXPERIENCED MODERATE AIRFARE INCREASES, SUBSTANTIAL AIR PASSENGER TRAVEL GROWTH AND BROAD BASED GAINS IN DEPARTURES, AVAILABLE SEATS, AND FLIGHT FREQUENCIES COMPARED WITH THE YEARS BEFORE DEREGULATION. OUR LATEST STATUS REPORT, WHICH INCLUDES 1980 DATA, TELLS A SHARPLY DIFFERENT STORY. THE AIRLINE INDUSTRY, WHICH IS SENSITIVE TO GENERAL ECONOMIC CONDITIONS, WAS BUFFETED IN 1980 BY THE COMBINED EFFECTS OF A RECESSION AND RAPIDLY RISING FUEL COSTS. THESE FACTORS HAD A SUBSTANTIAL IMPACT ON 1980 INDUSTRY EXPERIENCE. GAINS MADE UNDER THE MORE FAVORABLE ECONOMIC CONDITIONS EXISTING IN 1978 AND 1979 WERE SUBSTANTIALLY ERODED BY 1980 DEVELOPMENTS.

TRAFFIC TRENDS

SINCE DEREGULATION BEGAN THE AIRLINE TRAFFIC INCREASES POSTED IN 1978 AND 1979 HAVE BEEN PARTLY OFFSET BY 1980 DECLINES IN BOTH REVENUE PASSENGER-MILES AND THE NUMBER OF PASSENGERS. DESPITE THE 1980 DECLINES, THE AVERAGE ANNUAL INCREASE IN BOTH INDICES SINCE DEREGULATION SUBSTANTIALLY EXCEEDED GAINS BEFORE DEREGULATION. CHART 1, AT THE END OF THIS STATEMENT, ILLUSTRATES THIS.

FARES AND COSTS

DURING THE PAST 11 YEARS, AIR FARES AND AIRLINE COSTS HAVE RISEN SIGNIFICANTLY, AS SHOWN IN TABLE 1. IN THE PERIOD 1970-77, WHICH WAS BEFORE DEREGULATION, AIR FARES PER PASSENGER-MILE ROSE BY 42 PERCENT. DURING THE SAME PERIOD AIRLINE COSTS ALMOST DOUBLED.

IN THE 3-YEAR PERIOD AFTER DEREGULATION BEGAN, AVERAGE FARES PER PASSENGER-MILE INCREASED BY 37 PERCENT; MOST OF THE INCREASE OCCURRED IN 1980 WHEN FARES ROSE 29 PERCENT OVER 1979. AIRLINE COSTS ROSE BY 60 PERCENT IN THE 3-YEAR PERIOD. FOR 1980 ALONE COSTS ROSE 23 PERCENT ABOVE THE PRIOR YEAR.

RETURN ON INVESTMENT

RETURN ON INVESTMENT IN 1980 WAS INFLUENCED BY A \$294 MILLION EXTRAORDINARY GAIN ON THE SALE OF THE PAN AM BUILDING BY PAN AMERICAN WORLD AIRWAYS. WITH THIS GAIN INCLUDED, THE INDUSTRY'S RATE OF RETURN WAS 7.8 PERCENT. WITH THE EXTRA-ORDINARY GAIN EXCLUDED, THE 1980 RETURN ON INVESTMENT WAS 5.6 PERCENT, THE LOWEST RATE OF RETURN SINCE DEREGULATION BEGAN AND THE LOWEST IN THE PAST 5 YEARS. IN CONTRAST, THE INDUSTRY POSTED A 7.1 PERCENT RETURN ON INVESTMENT IN 1979 AND A 12.9 PERCENT RETURN IN 1978. TABLE 2 PROVIDES MORE DETAIL.

PRODUCTIVITY

AIRLINE PRODUCTIVITY IMPROVED THROUGH 1979, AS EVIDENCED BY HIGHER LOAD FACTORS AND LOWER AIRLINE COSTS PER REVENUE TON-MILE ADJUSTED TO 1976 DOLLARS. IMPROVED PRODUCTIVITY HAD CONTRIBUTED TO INCREASED AIRLINE PROFITABILITY WITHOUT FARES RISING AT THE SAME RATE AS COSTS. FAVORABLE ECONOMIC CONDITIONS

MAY HAVE ALSO BEEN A CONTRIBUTING FACTOR. IN 1980 A BUSINESS RECESSION AND INFLATION AFFECTED THE AIRLINE INDUSTRY; TRAFFIC DECLINED FROM 1979 LEVELS; AND LOAD FACTORS FELL SHARPLY, SEVERELY ERODING THE AIRLINE PRODUCTIVITY GAINS OF THE PAST SEVERAL YEARS.

LOAD FACTORS

ALONG WITH THE TRAFFIC BOOM WHICH OCCURRED IN 1978 AND 1979, AIRLINES WERE ABLE TO SIGNIFICANTLY INCREASE THE PERCENTAGE OF AVAILABLE SEATS SOLD. LOAD FACTORS AVERAGED ABOUT 55 PERCENT FOR THE 4 YEARS BEFORE DEREGULATION, COMPARED TO ABOUT 61 AND 63 PERCENT FOR 1978 AND 1979, RESPECTIVELY. AS SHOWN IN CHART 2 IN 1980 AVAILABLE SEAT-MILES ROSE WHILE REVENUE PASSENGER-MILES DECLINED, DROPPING THE LOAD FACTOR TO 58 PERCENT.

SYSTEMWIDE SERVICE PATTERNS

WEEKLY DEPARTURES HAVE INCREASED AT ALL DOMESTIC COMMUNITY SIZES SINCE DEREGULATION, ALTHOUGH AVAILABLE SEATS INCREASED AT ONLY THE LARGEST COMMUNITIES. THE GROWTH IN AIR SERVICE, HOWEVER, MASKS TWO DISTINCT PERIODS--1977-79 MARKED BY SHARP GAINS, AND 1979-80 MARKED BY BROAD-BASED DECLINES. THESE DECLINES REDUCED EARLIER GAINS, AND IN SOME INSTANCES, REVERSED WHAT HAD BEEN GAINS TO LOSSES. ADDITIONAL DETAIL IS PROVIDED IN TABLE 3.

SMALL COMMUNITY SERVICE

SMALL COMMUNITY AIR SERVICE EXPERIENCED A SLIGHT INCREASE IN WEEKLY DEPARTURES SINCE DEREGULATION, BUT STRONG GAINS IN 1978 AND 1979 WERE ERODED BY 1980 DECLINES. SERVICE BETWEEN SMALL COMMUNITIES HAS DECLINED MARKEDLY BETWEEN OCTOBER 1977

AND OCTOBER 1980, WHILE SERVICE BETWEEN LARGE AND SMALL COMMUNITIES HAS ONLY DECLINED SLIGHTLY.

STATEWIDE SERVICE

EVEN THOUGH AIR SERVICE HAS INCREASED NATIONWIDE, NOT ALL AREAS HAVE BENEFITED EQUALLY. BASED ON AIR SERVICE LISTED IN THE "OFFICIAL AIRLINE GUIDE" FOR THE 48 CONTIGUOUS STATES AND THE DISTRICT OF COLUMBIA, 19 STATES RECEIVED INCREASES IN DEPARTURES AND AVAILABLE SEATS BETWEEN OCTOBER 1, 1977, AND OCTOBER 1, 1980. THE REMAINING 29 STATES AND THE DISTRICT OF COLUMBIA HAD A DECREASE IN EITHER DEPARTURES OR AVAILABLE SEATS. FOR THE SHORTER PERIOD BETWEEN OCTOBER 1, 1977, AND OCTOBER 1, 1979, 35 STATES AND THE DISTRICT OF COLUMBIA RECEIVED INCREASES IN DEPARTURES AND AVAILABLE SEATS WHILE THE REMAINING 13 HAD A DECREASE IN EITHER DEPARTURES OR AVAILABLE SEATS. ONLY ONE STATE, MARYLAND, HAD AN INCREASE IN DEPARTURES AND AVAILABLE SEATS BETWEEN 1979 AND 1980.

SERVICE TERMINATIONS

DURING THE 10 YEARS BEFORE THE DEREGULATION ACT WAS PASSED, 137 COMMUNITIES LOST ALL OF THEIR CERTIFICATED AIR SERVICE-- SERVICE PROVIDED BY AIRLINES HOLDING BOARD CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY. AFTER DEREGULATION, ONLY TWO COMMUNITIES LOST ALL CERTIFICATED SERVICE, AND THAT WAS ONLY TEMPORARILY AND WITH THE COMMUNITIES' CONSENT.

THROUGH DECEMBER 1980, 287 COMMUNITIES, WHILE NOT LOSING ALL AIR SERVICE, HAVE BEEN AFFECTED BY SOME AIRLINE SERVICE TERMINATIONS SINCE DEREGULATION, BUT ALMOST HALF CONTINUE TO RECEIVE AIR SERVICE BY ONE OR MORE CERTIFICATED AIRLINES. THE

REMAINING COMMUNITIES WERE RECEIVING SERVICE BY COMMUTERS OR THE ONLY CERTIFICATED AIRLINE WAS REQUIRED BY CAB TO CONTINUE SERVICE UNTIL REPLACEMENT SERVICE COULD BE ARRANGED.

DEREGULATION AND AIR SAFETY

STATISTICS SHOW THAT WHILE THE NUMBER OF CERTIFICATED CARRIERS AND FLIGHT HOURS INCREASED IN 1980 OVER 1978 AND 1979, THE NUMBER OF ACCIDENTS DECLINED SHARPLY TO HALF THE ACCIDENT RATE PER 100,000 FLIGHT HOURS RECORDED IN 1978 AND 1979. THE 1980 FATAL ACCIDENT RATE AND FATALITY RATE ALSO FELL SHARPLY FROM THE 1978 AND 1979 RATES. COMMUTER AIR CARRIERS EXPERIENCED A LARGE INCREASE IN FLIGHT HOURS AND A DECLINE IN BOTH THE ACCIDENT AND FATAL ACCIDENT RATE FROM THE 1978 AND 1979 RATES.

CAB SUNSET

LET ME BRIEFLY DISCUSS OUR EARLIER REPORT TO THE CHAIRMAN, CIVIL AERONAUTICS BOARD, ENTITLED "THE CIVIL AERONAUTICS BOARD SHOULD EXPAND ITS SUNSET PLANNING" (JANUARY 4, 1980, CED 80-45). WE CONCLUDED THAT AS THE AIRLINE DEREGULATION ACT'S SUNSET PROVISIONS BECAME EFFECTIVE SOME IMPORTANT BOARD FUNCTIONS WOULD CEASE AND SOME CONSUMER PROTECTIONS WOULD BE LOST UNLESS LEGISLATIVE PROVISIONS WERE MADE FOR TRANSFERRING THESE FUNCTIONS TO OTHER AGENCIES.

WE RECOMMENDED THAT THE BOARD:

--REVIEW ALL STATUTES IT ADMINISTERS TO DETERMINE THOSE NOT ADDRESSED IN THE AIRLINE DEREGULATION ACT AND SUBMIT TO THE CONGRESS ITS LEGISLATIVE PROPOSAL FOR TRANSFERRING THESE RESPONSIBILITIES ALONG WITH THE IMPLEMENTING REGULATIONS: AND

--REVIEW EXISTING TARIFF PROVISIONS TO IDENTIFY THOSE WHICH SHOULD BE CONTINUED, INCORPORATE THEM IN BOARD REGULATIONS, AND CONSIDER PROPOSING THAT RESPONSIBILITY FOR ENFORCING THESE REGULATIONS BE TRANSFERRED TO OTHER AGENCIES.

IN LINE WITH OUR RECOMMENDATIONS, THE CAB, ON MAY 7, 1981, SUBMITTED A LEGISLATIVE PROPOSAL TO THE CONGRESS PROVIDING FOR THE TRANSFER OF SOME AND ENDING OTHER STATUTORY FUNCTIONS NOT SPECIFICALLY ADDRESSED BY THE AIRLINE DEREGULATION ACT.

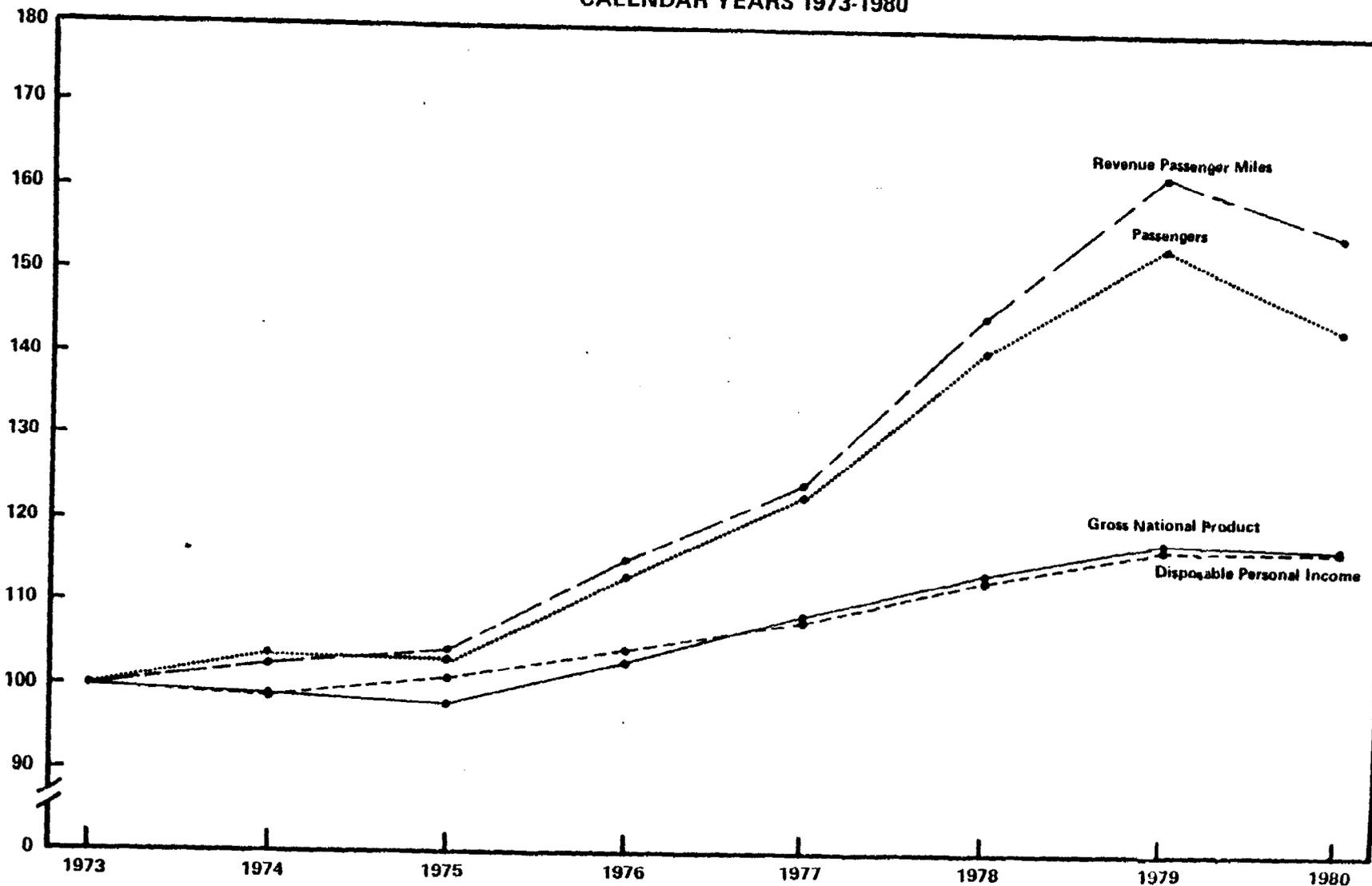
CAB HAS BEEN REVIEWING EXISTING TARIFF PROVISIONS. IN MARCH 1980 CAB ADVISED THE CONGRESS THAT IT HAD IDENTIFIED SOME MAJOR TARIFF RULES TO BE CODIFIED IN THE REGULATIONS OR DELETED. IN MATERIAL SUBMITTED TO THE CONGRESS WITH THE MAY 7, 1981, LEGISLATIVE PROPOSAL ADDITIONAL FUNCTIONS WERE IDENTIFIED WHICH WOULD REQUIRE LEGISLATIVE DECISIONS REGARDING TRANSFER OR TERMINATION. BEFORE IT GOES OUT OF BUSINESS THE BOARD PLANS TO REVIEW ALL ITS REGULATIONS AND DECIDE WHETHER TO CONTINUE, CHANGE, OR REPEAL THEM. AT SUNSET, HOWEVER, THOSE NOT DEALT WITH BY CAB WILL BE TRANSFERRED TO THE DEPARTMENT OF TRANSPORTATION. THIS STRATEGY WAS ADOPTED BECAUSE IT ALLOWS FOR THE CONTINUATION OF THESE PROGRAMS AND FUNCTIONS THROUGH AND BEYOND THE SUNSET PERIOD.

MR. CHAIRMAN THIS CONCLUDES MY STATEMENT. WE WILL BE PLEASED TO RESPOND TO YOUR QUESTIONS.

Chart 1

CHANGES IN TRAFFIC^{a/} AND ECONOMIC INDICATORS
CALENDAR YEARS 1973-1980

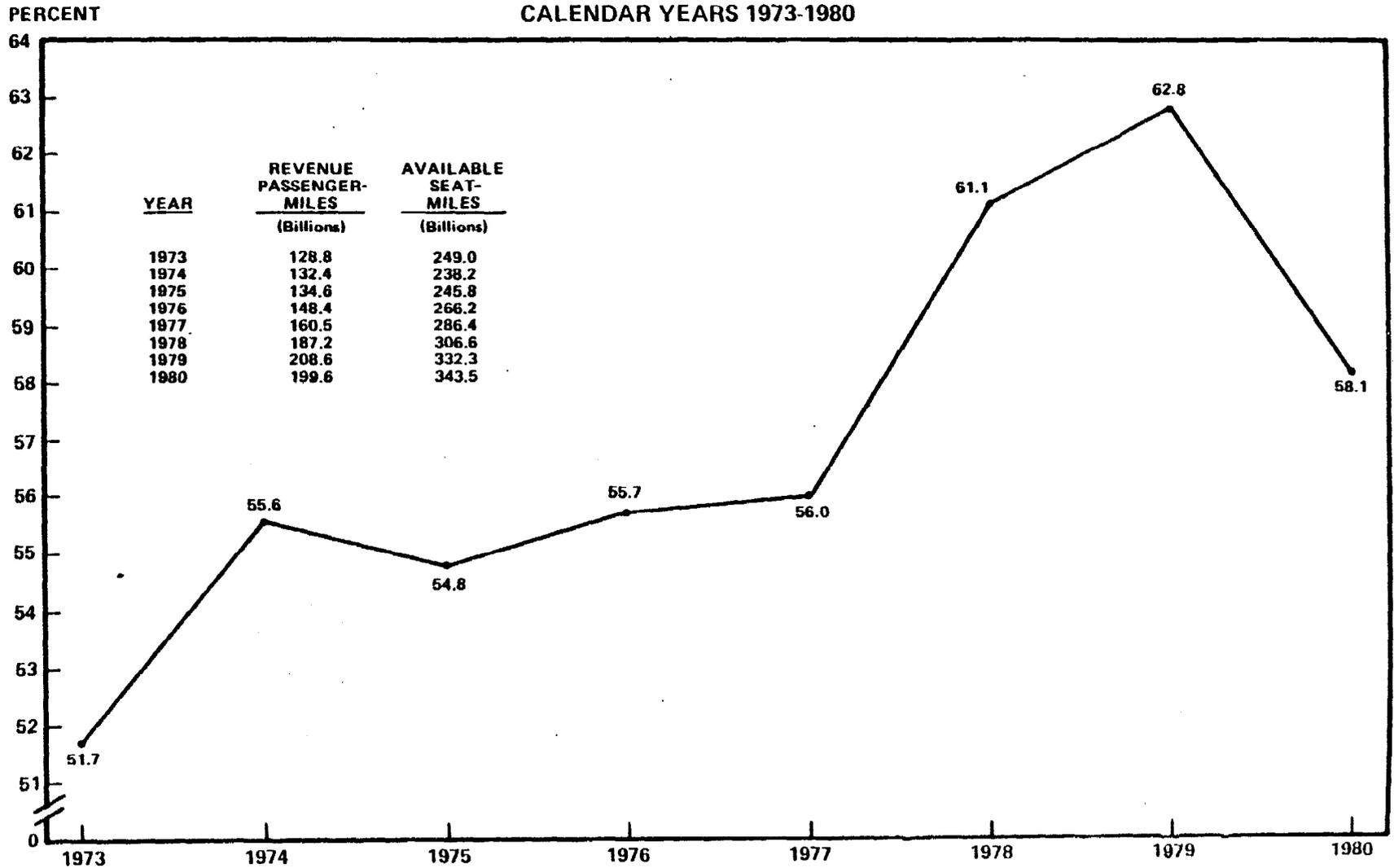
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(1973 = 100)



^{a/} Covers domestic scheduled certified carriers, former intrastate carriers, and commuters.

Chart 2

CHANGES IN PERCENTAGE OF AVAILABLE SEATS SOLD^{a/} (LOAD FACTORS)^{b/}
CALENDAR YEARS 1973-1980



^{a/} Covers domestic scheduled certificated carriers and former intrastate carriers. Data was not available for domestic commuters.

^{b/} Revenue passenger miles divided by available seat miles.

Table 1

Changes in Consumer and Airline Costs

	Before deregulation (1970-77)		After deregulation (1978-80)	
	<u>Total increase</u>	<u>Average annual compounded increase</u>	<u>Total increase</u>	<u>Average Annual compounded increase</u>
----- (percent) -----				
Air fares	42.4	5.2	36.9	11.0
Airline costs index (note a)	95.7	10.1	59.6	16.9
Consumer price index	56.1	6.6	36.1	10.8

a/Based on an index of costs to the airlines--fuel, personnel, goods and services purchased, landing fees, rentals, and depreciation. This index compares prices paid by airlines in a given period to prices paid in the fourth quarter of 1976 for purchase of fourth quarter 1976 quantities.

Table 2

Rate of Return on Investment (note a)

Domestic Operations

<u>Year</u>	<u>Percent of return on investment</u>
1980	b/ 5.6
1979	7.1
1978	12.9
1977	9.7
1976	7.9
1975	3.2
1974	9.0
1973	6.3
1972	6.1
1971	4.3
1970	2.0
1970-77 average	6.1
1970-80 average	6.7

a/Based on CAB definition of airline rate of return. Basically, the figure represents net income and interest expense divided by the sum of airline debt and equity.

b/Pan American World Airways had an extraordinary gain of \$294 million on the sale of the Pan Am Building in 1980. If the extraordinary gain is included, the 1980 return on investment is 7.8 percent and the 1970-80 average is 6.9-percent.

Table 3

Summary of Aircraft Departures and Available
Seats by Hub Category

	Market type				<u>Total</u>
	<u>Large hubs</u>	<u>Medium hubs</u>	<u>Small hubs</u>	<u>Non- hubs</u>	
Number of communities	24	36	71	528	659
Departures per week:					
Oct. 1, 1977	59,877	21,315	13,686	25,720	120,598
Oct. 1, 1979	68,415	24,529	15,524	29,375	137,843
Oct. 1, 1980	64,613	22,363	14,403	25,951	127,330
Percentage change:					
1977-80	7.9	4.9	5.2	.9	5.6
1977-79	14.3	15.1	13.4	14.2	14.3
1979-80	-5.6	-8.8	-7.2	-11.7	-7.6
Available seats per week:					
Oct. 1, 1977	6,760,367	2,120,114	1,157,428	940,433	10,978,342
Oct. 1, 1979	7,716,650	2,265,432	1,215,709	938,955	12,136,746
Oct. 1, 1980	7,249,534	2,036,635	1,137,123	837,112	11,260,404
Percentage change:					
1977-80	7.2	-3.9	-1.8	-11.0	2.6
1977-79	14.1	6.9	5.0	- 0.2	10.6
1979-80	-6.1	-10.1	-6.5	-10.8	-7.2