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ESSENTIAL AIR SERVICE

Changes in Passenger Traffic, Subsidy Levels, and Air Carrier Costs

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Mr. Chairman and Members of the Subcommittee

Over two decades have passed since the Congress phased out the federal government's control over airfares and service. Concerned that air service to some small communities would suffer in a deregulated environment, the Congress established the Essential Air Service (EAS) program as part of the Airline Deregulation Act of 1978 and made special provisions for providing this service in Alaska. The objective of the EAS program, administered by the Department of Transportation (DOT), is to ensure that small communities that had received scheduled passenger air service before deregulation continued to have access to the nation's air transportation system. DOT does this by awarding subsidies to carriers willing to provide service to communities that would not otherwise receive it. Recently, we issued a report on changes in the subsidy levels and costs for the EAS program in 1999 compared with 1995.[1] Our testimony today, which is based on information developed for that report, focuses on three major topics: (1) changes in the number of communities and passengers receiving subsidized service, (2) changes in the level of subsidies provided, and (3) reasons why the subsidy levels changed.

In summary, we found the following:

- Between 1995 and 1999, the overall number of communities receiving EAS-subsidized service decreased by 6, from 95 to 89. In addition, the number of passengers served by the EAS program declined by 4 percent, from 617,000 to 590,000.

- Despite the decrease in number of communities and passengers served, the overall level of funding for EAS subsidies increased by 47 percent, from $31.4 to $46.3 million in constant dollars. For communities within the continental United States, Hawaii, and Puerto Rico, the average subsidy per passenger increased by 47 percent, from about $56 to $82. For communities in Alaska, the average subsidy per passenger increased by 23 percent, from about $25 to $30.

[1] *Essential Air Service: Changes in Subsidy Levels, Air Carrier Costs, and Passenger Traffic* (GAO/RCED-00-34, Apr. 14, 2000)

- Overall, the level of EAS subsidies increased because increases in air carriers' operating costs were not offset by a corresponding rise in passenger revenues. The operating costs of air carriers increased as they complied with the Federal Aviation Administration's (FAA) Commuter Safety Initiative, adapted to unique circumstances associated with particular markets, such as airport fees, and/or upgraded aging aircraft. Although operating costs increased, the demand for subsidized air service declined slightly, thus limiting the potential for additional revenues. In addition, some EAS carriers had difficulty competing for passengers because of the availability of low-fare jet air service at nearby airports.

Background

According to the Airline Deregulation Act of 1978, communities eligible to receive subsidized service are those that could receive scheduled air service on October 24, 1978.[2] To receive subsidized service, communities located in the 48 continental states must also meet criteria imposed annually by the Congress beginning in fiscal year 1994. These criteria prohibit DOT from subsidizing service to communities that are located fewer than 70 highway miles from the nearest medium- or large-hub airport or require a subsidy per passenger in excess of $200. The law makes exceptions to the subsidy limit per passenger for communities located more than 210 miles from the nearest medium- or large-hub community airport.[3]

EAS subsidies are provided to air carriers that provide service to communities that they would not otherwise serve without the subsidies. DOT examines the financial records of each airline and sets these subsidies to cover the difference between a carrier's projected revenues and expenses and provide a minimum amount of profit. The law specifies that communities requiring subsidized service, except those in Alaska, are entitled to a minimum of 12 round-trip

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[2]Communities did not have to be actively receiving air service in 1978 to be eligible for EAS, but they did have to be listed on an air carrier certificate. These certificates, issued under 49 USC 41102, authorized an air carrier to provide scheduled service along particular routes between named communities. For additional information on the establishment of the EAS program, see *More Flexible Eligibility Criteria Could Enhance the Small Communities Essential Air Service Subsidy Program* (GAO/RCED-83-97, May 18, 1983).

[3]By FAA's definition, air traffic hubs are not airports but communities requiring aviation services on scheduled carriers. FAA designates an air traffic hub as small, medium, or large depending on the number of passengers it handles. A small hub community has at least 0.05 percent, but less than 0.25 percent, of the total annual passenger enplanements (boardings) in the United States in any given year. A medium hub has at least 0.25 percent and less than 1.0 percent of total U.S. enplanements, and a large hub has 1.0 percent or more of total U.S. enplanements. A nonhub community has less than 0.05 percent of total U.S. enplanements.

flights per week—2 daily round-trip flights 6 days per week, with not more than one intermediate stop on each flight to a hub airport. In Alaska, communities are entitled to the number of flights provided in 1976 or two daily round-trips per week, whichever is greater, unless the affected communities agree otherwise.

Most EAS communities are served by commuter air carriers in turboprop aircraft with fewer than 30 seats. In 1996, FAA changed the air safety rules for commuter air carriers to match the operational, equipment, and performance safety standards required of large air carriers. Collectively known as the "Commuter Safety Initiative," these rules imposed many new requirements on commuter air carriers that flew aircraft equipped with 10 seats or more. For example, this initiative increased training requirements for pilots and further limited the number of duty hours crewmembers can fly.

To determine the number of communities and passengers served by EAS and the level of subsidies provided, we reviewed and analyzed relevant data for the years 1995 and 1999. We adjusted subsidies awarded to communities for inflation. We chose 1995 as the basis of comparison because it was the most recent year in which the EAS program was unaffected by reduced appropriations and because it preceded the Commuter Safety Initiative, a major change in airline safety standards. We interviewed DOT and airline officials and examined reports that airlines may have filed with the U.S. Securities and Exchange Commission to determine why EAS funding increased. However, since we did not have access to all pertinent airline financial records, we could not determine the exact financial impact that individual factors (e.g., the Commuter Safety Initiative) had on EAS subsidies in 1995 compared with 1999.

Overall Number of Communities and Passengers Receiving EAS-Subsidized Service Decreased

Between 1995 and 1999, the overall number of communities receiving subsidized service decreased by 6, from 95 to 89. Table 1 shows the number of communities that gained and lost their subsidized service in 1995 compared to 1999 in (1) the continental United States, Hawaii, and Puerto Rico and (2) Alaska.

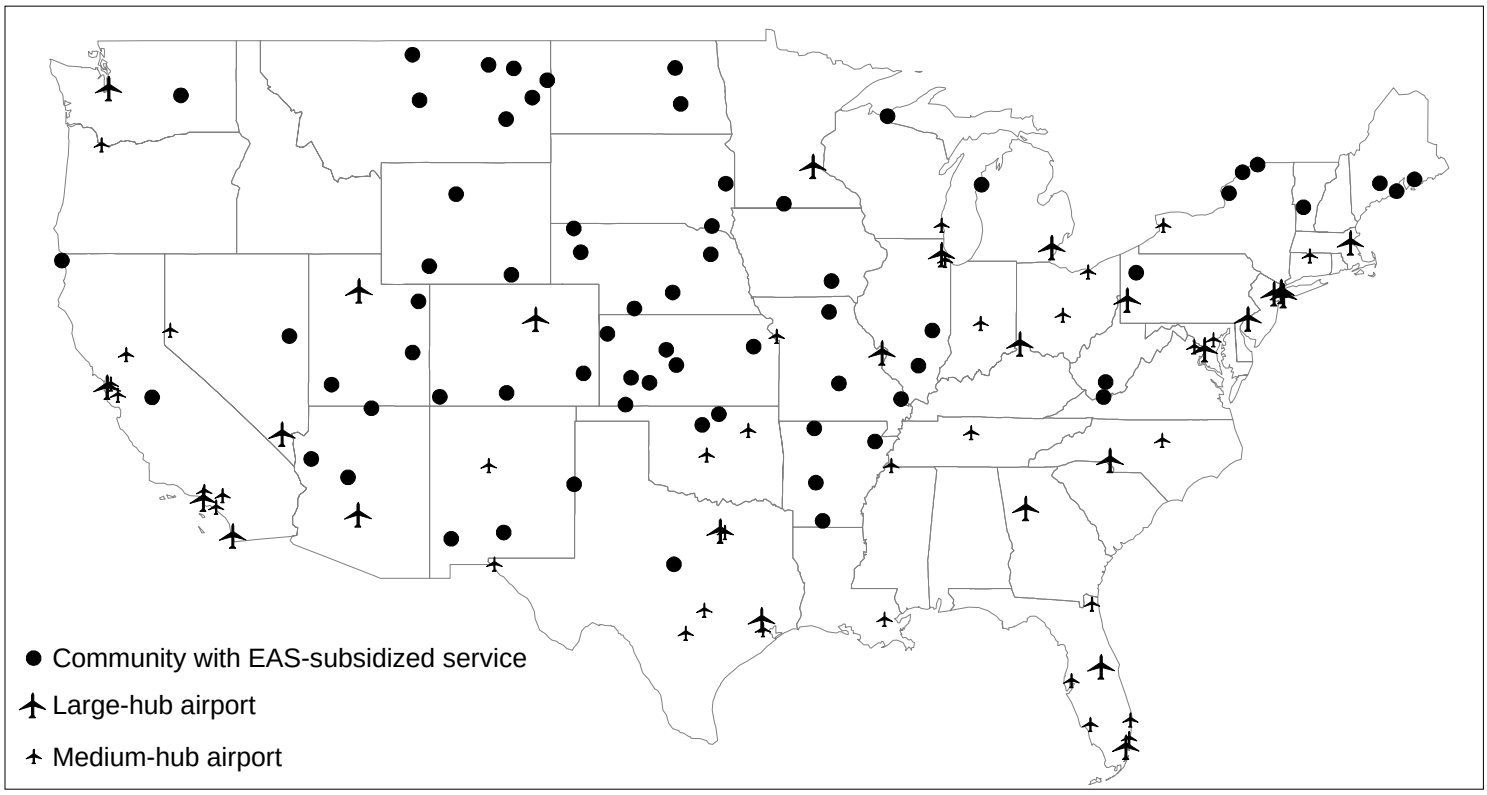
Table 1: Change in Number of Communities That Received EAS-Subsidized Service in 1995 Compared With 1999

Community location	Communities that received subsidized service in 1995	Change in number of communities receiving subsidized service		Communities that received subsidized service in 1999
		Did not receive subsidized service in 1995 but gained it by 1999	Received subsidized service in 1995 but lost it by 1999	
48 continental states, Hawaii, and Puerto Rico[a]	77	6	14	69
Alaska	18	2	0	20
Total	**95**	**8**	**14**	**89**

[a]The one community in Puerto Rico that received service in 1995 did not receive service in 1999.

In 1999, 69 of the 89 communities that received subsidized service were located in the 48 continental states and Hawaii, and 20 were located in Alaska. Of the communities located in the continental United States, 31 were located more than 210 miles from the nearest medium- or large-hub community airport. Figure 1 shows the locations of the communities in the 48 continental states that received subsidized air service in April 1999 and shows their proximity to medium- and large-hub community airports. Figure 2 shows the locations of the communities in Alaska that received subsidized air service in April 1999.

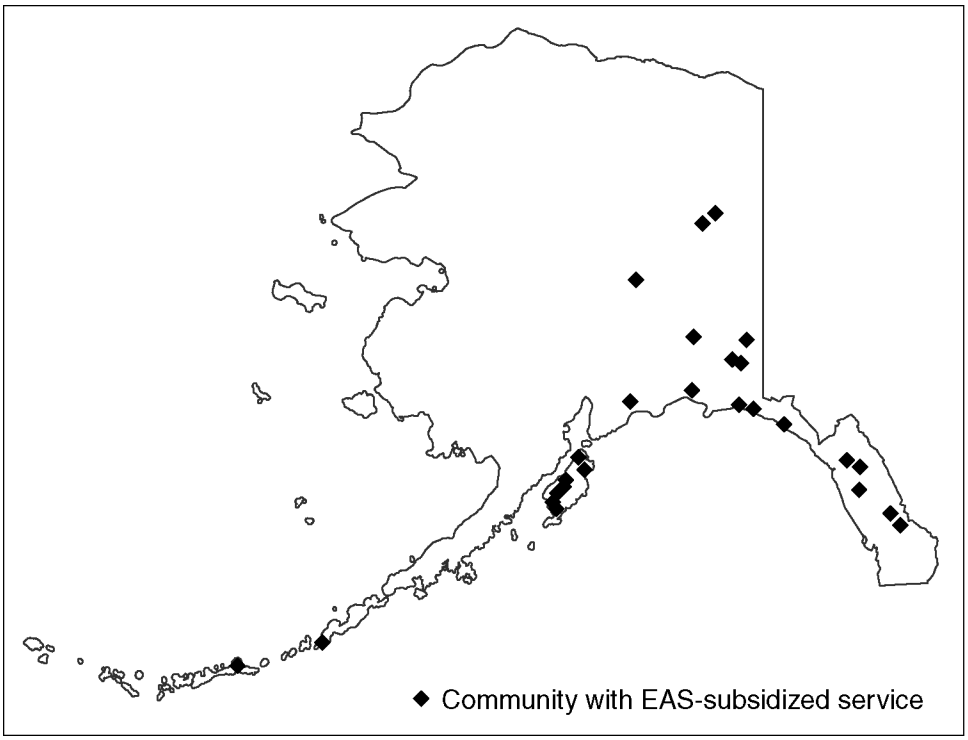
Figure 1: Locations of Communities in the 48 States That Received Subsidized Air Service in 1999



Source: GAO's analysis of DOT's data.

Note: Since only one community in Hawaii received subsidized service in 1999, we did not include a map of this location.

Figure 2: Locations of Communities in Alaska That Received EAS-Subsidized Air Service in 1999



Note: This figure shows the location of the communities in Alaska that received subsidized service in April 1999, including the 8 Kodiak bush communities that received subsidized service in 1999. However, for the purpose of our analysis, we treated the Kodiak bush communities as one because, in calculating a subsidy, DOT treats them as one community.

Source: GAO's analysis of DOT's data.

Between 1995 and 1999, the number of passengers served by EAS declined by 4 percent, from about 617,000 to 590,000. However, the change in number of passengers served varied widely by community. For example, the number of passengers flying to and from Kearney, Nebraska, increased by 138 percent, from about 4,500 to 10,800, while the number of passengers at Kirksville, Missouri, decreased by 41 percent, from about 4,500 to 2,700. In both years, commuter air carriers making EAS flights were doing so with aircraft that were relatively empty. For example, for communities in the continental United States and Hawaii that received subsidized service in both years, in 1995, on average, passengers filled about 19 percent of the available seats, and in 1999, on average, passengers filled about 15 percent of the available seats.

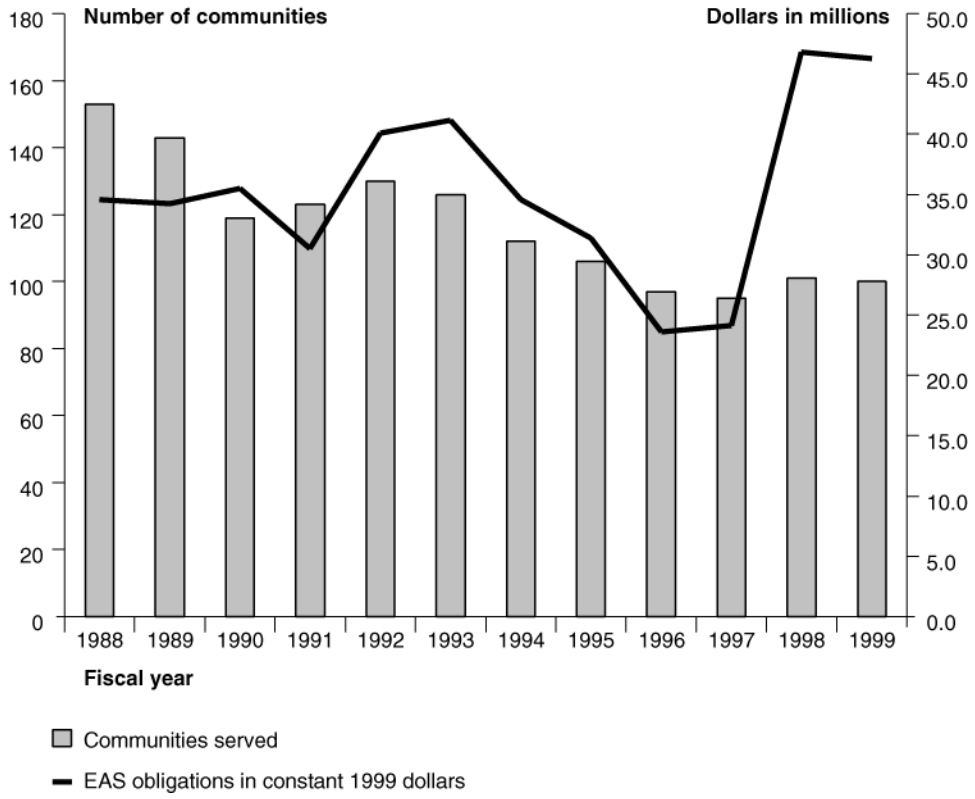
EAS Subsidy Levels Have Increased

Figure 3 contrasts the number of communities receiving EAS-subsidized service with the change in total EAS subsidies (in constant dollars) between 1988 and 1999. As indicated, between these years, the overall number of communities receiving subsidized service generally decreased while total subsidies increased. Between 1993 and 1997, there was a sharp decline in program funding available for EAS and total subsidies decreased accordingly.[4] However, beginning in 1998, total subsidies increased significantly after the program's authorized funding was increased to $50 million.

Between 1995 and 1999, total subsidies for the program increased by 47 percent, from $31.4 to $46.3 million in constant dollars. The increase in total subsidies was more moderate for communities in Alaska than for other locations. Appendix I contains more detailed information on the number of communities served, EAS obligations, and the source of this funding.

[4]During fiscal years 1996 and 1997, when the level of available funding for the EAS program was reduced, DOT was not able to provide each community that qualified for subsidized service the minimum amount of service required by law.

Figure 3: Change in the Number of Communities Receiving EAS-Subsidized Service and Change in Total EAS Subsidies (Obligations), 1988-99



Note: For the purpose of our analysis, we treated the Kodiak (Alaska) bush communities as one because, in calculating a subsidy, DOT treats them as one community. For the purpose of this figure, however, to show the historical change in the number of communities receiving subsidized service, we treated the Kodiak bush communities as individual communities. Thus, the number of communities shown includes the 12 Kodiak bush communities that received subsidized service in 1995 and the 8 that received such service in 1999.

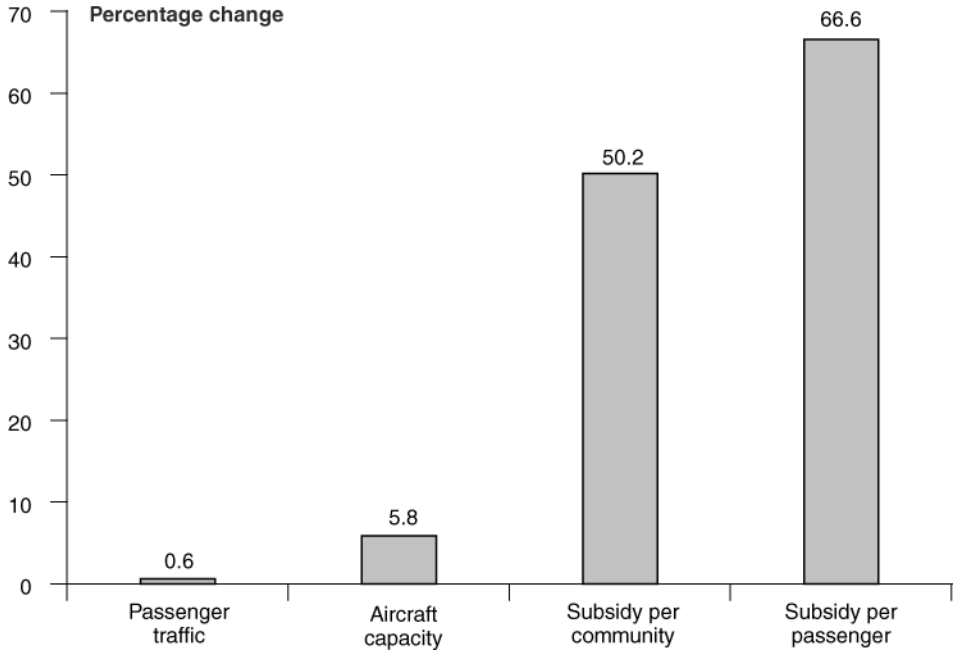
Source: GAO's analysis of DOT's data.

Overall, between 1995 and 1999, for service to communities in the continental United States, Hawaii, and Puerto Rico, EAS subsidies increased by 41 percent, from about $30 million to $43 million. During this same period, the total number of EAS passengers at these communities declined slightly, by about 4 percent, from about 537,000 to 516,000. As a result, the average subsidy per passenger increased by 47 percent, from $56 to $82 per passenger.

To obtain a better understanding of how the costs and the level of service changed between 1995 and 1999 in the continental United States, Hawaii, and Puerto Rico, we examined changes in subsidies, aircraft capacity, and passenger levels in the 63 communities that received subsidized service in both 1995 and 1999. These communities represented 91 percent of all communities

that received subsidized service in the continental United States in 1999. For these communities, the median change in the average subsidy per community was an increase of about $223,000 and the median percentage change in subsidy per community was an increase of 50.2 percent.[5] The median change in average subsidy per passenger was an increase of $49 and the median percentage change in subsidy per passenger was an increase of 66.6 percent. Figure 4 summarizes the median percentage changes in passenger traffic, aircraft capacity, subsidy per community, and subsidy per passenger.

Figure 4: Median Percentage Changes in Passenger Traffic, Aircraft Capacity, Subsidy per Community, and Subsidy per Passenger for Communities That Received EAS-Subsidized Service in Both 1995 and 1999



Source: GAO's analysis of DOT's data.

Although the median change is a useful way of summarizing changes that took place for these 63 communities, the extent of these changes varied widely by community. Total increases in the subsidy per community ranged from about $331, an increase of less than 1 percent, for service to Cape Girardeau, Missouri, to about $949,000, an increase of about 264 percent, for service to McCook, Nebraska. Changes in the subsidy per passenger also varied. For instance, for

[5]The median is the statistical point at which half of the communities' change is greater and the other half of communities' change is less. The median may not equal the arithmetic average (mean).

Rutland, Vermont, the subsidy per passenger increased by 4 percent, from $72 to $75, as compared to that for Clovis, New Mexico which increased by 294 percent, from $37 to $146.

For communities in Alaska, increases in the total subsidy level and average subsidies per passenger were less than in other U.S. locations. Between 1995 and 1999, total EAS subsidies for Alaska rose by 12 percent, from $2.0 million to $2.2 million, compared to the 41-percent total increase for the other states. During this same period, the total number of communities in Alaska receiving subsidized service increased from 18 to 20, and the total number of passengers decreased from about 80,000 to 73,000, or by 9 percent. As a result, the average subsidy per passenger increased by 23 percent, from about $25 to $30. In 1999, funding for Alaskan communities represented about 5 percent of total EAS funding, and Alaskan passengers represented about 12 percent of all passengers.

Increased Safety Requirements and Other Factors Contributed to an Increase in EAS Subsidy Levels

Overall, EAS subsidy levels increased between 1995 and 1999 because the costs of serving EAS communities increased without an offsetting increase in passenger revenues. Carriers' costs increased as they complied with FAA's Commuter Safety Initiative, adapted to unique circumstances associated with particular markets, such as airport fees, and/or upgraded their aging fleets. Despite the increase in operating costs, the number of passengers using these services was essentially the same, and carriers did not benefit from an increase in revenues.

Information we reviewed from the four airlines that served 80 percent of the passengers flying on EAS-subsidized service in 1999 revealed that complying with FAA's Commuter Safety Initiative was one reason that their operating costs increased. For example, officials from Mesa Airlines and Colgan Airlines emphasized that the initiative's new training and personnel requirements were costly. Mesa officials noted that because pilots who formerly required 4 hours of cockpit training now require 30 hours, the company had to hire additional pilots to ensure that it could fully staff its operations. Colgan officials said that training costs increased by an additional $27,000 per month, in part due to having to hire full-time trainers. Great Lakes Aviation reported that commuter rule compliance drove up wages for its mechanics between 30

and 35 percent. According to Great Lakes' 1996 financial report, salaries, wages, and benefits increased about 8 percent from 1995 to 1996, due in part to the Commuter Safety Initiative.

Factors that affected service to specific communities and airlines also affected operating costs and potential revenues. For instance, for 16 communities, the cost of flying passengers to Denver increased significantly because fees at Denver International Airport are much higher than those at Denver's Stapleton International Airport, which closed in February 1995. DOT estimated that the cost of airport fees for flights departing from Denver to Alliance, Chadron, and McCook, Nebraska, increased from $173 per departure to $235 per departure, about 35 percent, between 1996 and 1997. Moreover, the cost of providing service to several communities in Montana increased when Big Sky Airlines upgraded its aging fleet of 15-seat Metro II aircraft with 19-seat Metro IIIs.

The availability of air service at nearby airports, especially from low-fare carriers, also adversely affected the ability of some EAS carriers to compete successfully for local passenger traffic. For example, subsidized service was suspended at Keene, New Hampshire, in part because local residents were driving to Manchester, New Hampshire, which is less than 60 miles away, to take advantage of low fares offered by Southwest Airlines and US Airways' low-fare subsidiary, MetroJet. In addition, changes in the local economy have reduced the ability of some air carriers to generate passenger revenues in some communities.

Although difficult to quantify, changes and consolidation in the airline industry have undoubtedly affected the cost of providing air service to smaller communities. DOT officials reported that fewer airlines now compete to serve any given route because of dwindling interest in the program among carriers, principally because the major carriers and their code-sharing commuter partners control entire regions around hubs. Between 1995 and 1999, the number of air carriers serving subsidized EAS communities decreased from 17 to 11. In contrast, in 1987, about 51 different carriers served communities receiving subsidized service.

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In summary, the EAS program has generally met its objective of ensuring that communities continue to receive subsidized service where market forces might otherwise have prevented airlines from offering any scheduled commercial service. In 1998, when the Congress increased the program's authorized funding level, DOT used the additional funding to cover the increased costs of providing subsidized service. Should funding become inadequate to fund subsidized service to all communities that require it at current levels, DOT program officials will have to limit its subsidies or look to the Congress for additional funding or legislative guidance that they can use to target program subsidies.

Mr. Chairman, this concludes my prepared statement. We would be glad to respond to any questions that you or any Member of the Committee may have.

Contact and Acknowledgments

For questions regarding this testimony, please contact John H. Anderson, Jr., at (202) 512-2834. Individuals making key contributions to this testimony included Steven Martin and Sonja Bensen.

Appendix I

Number of Communities and Amount of Subsidized Service Provided to EAS Communities Since 1978

Fiscal year	[a]Number of EAS communities	EAS obligations in nominal millions of dollars (total subsidy level)	EAS obligations in 1999 millions of dollars	[b]EAS subsidy per community in 1999 millions of dollars	Source of EAS Funding
1979	[c]11	$1.7	$3.4	$0.31	General Fund of Treasury
1980	24	$9.8	$18.0	$0.75	General Fund of Treasury
1981	57	$15.0	$25.1	$0.44	General Fund of Treasury
1982	88	$26.1	$41.2	$0.47	General Fund of Treasury
1983	119	$42.2	$64.0	$0.54	General Fund of Treasury
1984	146	$35.3	$51.6	$0.35	General Fund of Treasury
1985	148	$34.9	$49.5	$0.33	General Fund of Treasury
1986	138	$24.3	$33.7	$0.24	General Fund of Treasury
1987	135	$26.7	$36.0	$0.27	General Fund of Treasury
1988	153	$28.4	$37.0	$0.24	General Fund of Treasury
1989	143	$25.6	$32.1	$0.22	General Fund of Treasury
1990	119	$33.2	$40.1	$0.34	General Fund of Treasury
1991	123	$26.1	$30.4	$0.25	General Fund of Treasury
1992	130	$37.1	$42.2	$0.32	Aviation Trust Fund[d]
1993	126	$37.1	$41.2	$0.33	Aviation Trust Fund
1994	112	$31.8	$34.6	$0.31	Aviation Trust Fund
1995	106	$29.5	$31.4	$0.30	Aviation Trust Fund
1996	97	$22.6	$23.6	$0.24	Aviation Trust Fund
1997	95	$23.5	$24.2	$0.25	Aviation Trust Fund
1998	101	$46.1	$46.8	$0.46	Authorization--FAA Budget[e]
1999	100	$46.3	$46.3	$0.46	Authorization--FAA Budget

[a]Given that the number of communities receiving a subsidy can fluctuate from month to month, the data provided reflects DOT's estimates for a given point in time during each year. In addition, for the purpose of this table, we treated the 12 Kodiak bush communities that received subsidized service in 1995 and the 8 that received such service in 1999 as individual communities. However, for the purpose of our analysis provided earlier in the report, we treated the Kodiak (Alaska) bush communities as one because, in calculating a subsidy, DOT treats them as one community.

[b]The subsidy per community estimate serves as a rough gauge of how the Essential Air Service (EAS) program's costs have changed over time. Since the number of passengers can vary widely by community, estimates of subsidy per passenger serve as a better way of understanding how program costs have changed over time. However, data on the historical number of EAS passengers is not readily available.

[c]Previous to the establishment of the EAS program in 1978, subsidies for air service were provided under the authority of Section 406 of the Federal Aviation Act of 1958, as amended (49 U.S.C. 1376). Between 1978 and 1983, Section 406 subsidies were phased out as the EAS program was implemented. Unlike the EAS program, Section 406 subsidized air carriers on the basis of their overall financial needs, not the cost of providing service to specific communities. According to DOT, many communities included in this program generated sufficient air traffic to support unsubsidized service. In 1978, Section 406 subsidies amounted to $76 million ($165 million in 1999 dollars) for service to about 400 communities. In 1983, Civil Aeronautics Board (CAB) officials perceived the EAS

program as more efficient than Section 406, because, for example, EAS provided subsidies for service in small prop aircraft. In contrast, under Section 406, air carriers provided service in jets and large prop aircraft.

[d]The Airport and Airway Trust Fund (also know as the Aviation Trust Fund) was established by the Airport and Airway Revenue Act of 1970 (P.L. 91-258) to finance the FAA's investments in the airport and airway system.

[e]In the Rural Air Service Survival Act of 1996, the Congress instructed that the EAS program was to be funded from fees assessed on international aircraft flying over but not landing in the United States. However, since foreign airlines successfully challenged the legality of FAA's collecting those fees, EAS funding was taken directly from FAA's appropriations pursuant to the statute.

Source: GAO's analysis of Civil Aeronautic Board's and DOT's data

Related GAO Products

Essential Air Service: Changes in Subsidy Levels, Air Carrier Costs, and Passenger Traffic (GAO/RCED-00-34, Apr. 14, 2000)

Airline Deregulation: Changes in Airfares, Service Quality, and Barriers to Entry (GAO/RCED-99-92, Mar. 4, 1999).

Airline Deregulation: Addressing the Air Service Problems of Some Communities (GAO/T-RCED-97-187, June 25, 1997).

Domestic Aviation: Changes in Airfares, Service, and Safety Since Airline Deregulation (GAO/T-RCED-96-126, Apr. 25, 1996).

Airline Deregulation: Changes in Airfares, Service, and Safety at Small, Medium-Sized, and Large Communities (GAO/RCED-96-79, Apr. 19, 1996).

Airport Competition: Essential Air Service Slots at O'Hare International Airport (GAO/RCED-94-118FS, Mar. 4, 1994).

Airline Deregulation: Trends in Airfares at Airports in Small and Medium-Sized Communities (GAO/RCED-91-13, Nov. 8, 1990).

More Flexible Eligibility Criteria Could Enhance the Small Communities Essential Air Service Subsidy Program (GAO/RCED-83-97, May 18, 1983).

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