

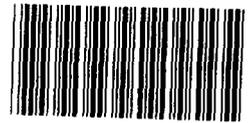
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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON AVIATION
HOUSE COMMITTEE ON PUBLIC WORKS
AND TRANSPORTATION
ON
THE CHANGING AIRLINE INDUSTRY



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Mr. Chairman and Members of the Subcommittee:

We welcome the opportunity to discuss our draft report entitled "The Changing Airline Industry: A Status Report Through 1982." The report will be issued in the near future.

The airline industry is changing, responding to greater freedoms provided by the Airline Deregulation Act of 1978. Our current report is the fourth in a series of reports on airline industry operations, and is 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.

In 1982, air fares fell below 1981 levels, while airline costs rose slightly. In addition, air traffic, weekly departures, available seats, and load factors all turned upward. The

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airline industry suffered losses last year, as return on investment fell to a 7-year low. Certificated and commuter airlines lowered their overall accident rate in 1982, but fatalities were up over the prior year's level.

FIVE YEARS OF EXPERIENCE WITH DEREGULATION

The airline industry, which is sensitive to general economic conditions, was adversely affected in 1982 by a third consecutive year of recession. In the first 2 years after deregulation, 1978 and 1979, economic indicators were rising and 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. In the next two years, 1980 and 1981, the airline industry was buffeted by the combined effects of recessions, rapidly rising fuel costs, and the air traffic controllers strike, all of which led to an erosion of the first two years' gains. In 1982 the economy was in a third year of recession and airlines profitability continued to decline. Information reported by the airlines for the first 3 months of calendar year 1983 shows air traffic is increasing but airline profitability is still declining.

TRAFFIC TRENDS

Since deregulation began, airline traffic in terms of revenue passenger miles and total passengers increased substantially. In the first 2 years of deregulation, 1978 and 1979, the number of passengers increased by an average of about 30 million per year; the next 2 years saw passenger decreases of

18.5 million in 1980 and 7.6 million in 1981; during 1982 passengers increased by 12.4 million. The average annual increase in passengers since deregulation was 9.3 million, while the annual increase in the five years before deregulation was 11.5 million. 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 1972-77, which was before deregulation, air fares per passenger-mile rose by 33 percent. During the same period, airline costs rose by 72 percent.

In the 5-year period after deregulation began, average fares per passenger-mile increased by 46 percent, while airline costs rose by 87 percent. In 1982, air fares fell 6 percent below prior year levels while airline costs rose 2 percent.

RETURN ON INVESTMENT

The domestic airline industry's rate of return on investment fell to a 7-year low in 1982. By contrast, the industry had a decade-high rate of return on investment in 1978 and an above-average return in 1979. In 1982 one of the industry's major airlines, Braniff and two other smaller airlines declared bankruptcy. Table 2 provides more detail.

PRODUCTIVITY

Improved airline productivity and favorable economic conditions were two major factors that contributed to airline profitability in 1978 and 1979. The Nation's recession and inflation

adversely affected the industry's profitability in the next 2 years and led to lower airline productivity, as evidenced by lower load factors and higher airline costs. In 1982, despite a third year of recession, airline productivity improved. Part of the gains, however, resulted from price discounting which although increasing passengers and load factors, did not improve the airlines' profitability.

LOAD FACTORS

During 1982 airlines were able to increase the percentage of available seats sold. As chart 2 indicates, the 1982 load factor of 58.5 percent, while still above the average load factor of 55 percent for the 4 years before deregulation, fell below the load factors experienced in 1978 and 1979. A traffic boom in 1978 and 1979 allowed airlines to increase their load factors to 61 and 63 percent, respectively. In 1980 and 1981, available seat-miles increased, while revenue passenger-miles declined, dropping the load factor to 58 and 57.5 percent, respectively. With airlines making increasing use of discount fares, load factors rose slightly in 1982.

AIR SERVICE PATTERNS

Since deregulation, weekly departures and available seats have increased at all but the smallest communities. The growth in air service is marked by sharp gains from 1977 through 1979, broad-based declines from 1979 through 1981, and renewed gains in 1982. Additional detail is provided in table 3.

SMALL COMMUNITY SERVICE

Communities of all sizes benefited from the renewed gains during 1982. Since deregulation, however, only the smallest communities have suffered declines in departures and available seats. Significant gains in service at these communities initially occurred between 1977 and 1979, and were followed by severe declines in service during 1980 and 1981 and renewed gains in 1982.

STATEWIDE SERVICE

Changes in air service patterns have not affected all geographic areas equally. Twenty-seven States had increases in weekly departures and available seats between 1977 and 1982. The remaining 21 of the contiguous 48 States and the District of Columbia had a decrease in departures and/or available seats.

SERVICE TERMINATIONS

During the 10 years before the act was passed, 137 communities lost all certificated air service--service provided by airlines holding Civil Aeronautics Board certificates of public convenience and necessity. As of December 1982, CAB was subsidizing air service to three of these communities and 14 others were receiving unsubsidized air service. The Airline Deregulation Act guaranteed essential air transportation for 10 years to small communities that were receiving air service on the date of the act from a certificated carrier. We recently issued a report on this program ("More Flexible Eligibility Criteria Could Enhance The Small Communities Essential Air Service Subsidy Program," GAO/RCED 83-97, May 18, 1983). In that

report, we suggested that Congress consider changes to the program to allow CAB, which administers the program, to help some communities develop markets using higher subsidies or discontinue subsidies to communities unlikely to support air service. CAB has determined the essential air service requirements and has ensured continued air service to 555 small communities that were covered by this provision. Of the 203 small communities that were receiving service on the date of the act from noncertificated carriers, and were, therefore, not eligible for essential air service protection, 102 communities or 50 percent lost all air service since deregulation.

DEREGULATION AND AIR SAFETY

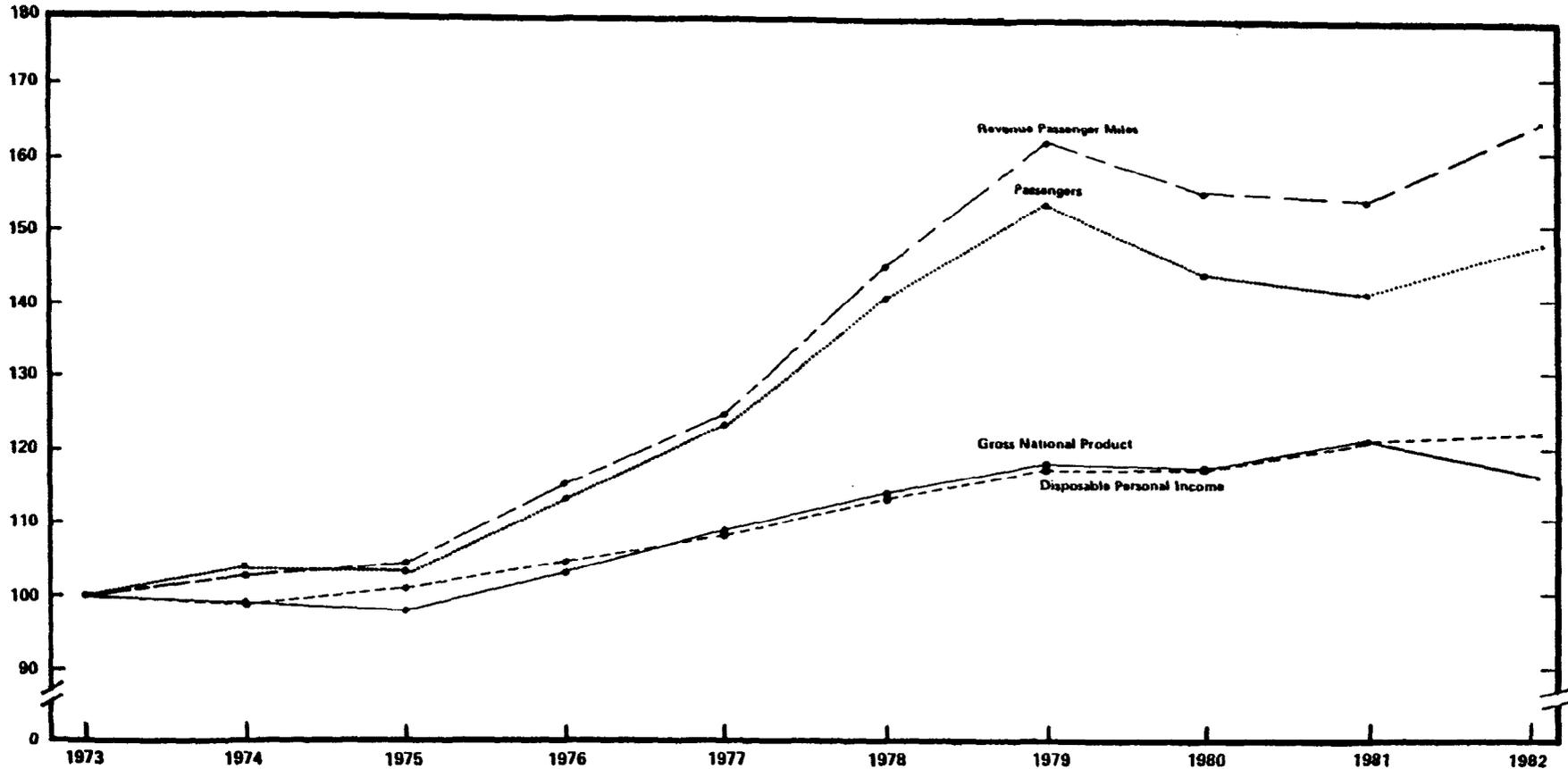
According to studies by the Secretary of Transportation, there was no evidence that deregulation had adversely affected air safety in 1979, 1980, or 1981. The fourth report, which will cover 1982, has not yet been issued as of May 17, 1983, but air traffic safety statistics for 1982 indicated that certificated airlines lowered their overall accident rate. However, two major fatal accidents--a January 1982 Air Florida crash in Washington, D.C., claiming 78 fatalities, and a July 1982 Pan Am crash in Kenner, Louisiana, claiming 153 fatalities--raised the 1982 fatality rate significantly above that of 1981. Commuter airlines cut their fatal accident rate and fatality rate by about one-half in 1982 compared with 1981. There have been no major fatal accidents to date in 1983.

Mr. Chairman, this concludes my statement. We will be pleased to respond to your questions.

Chart 1

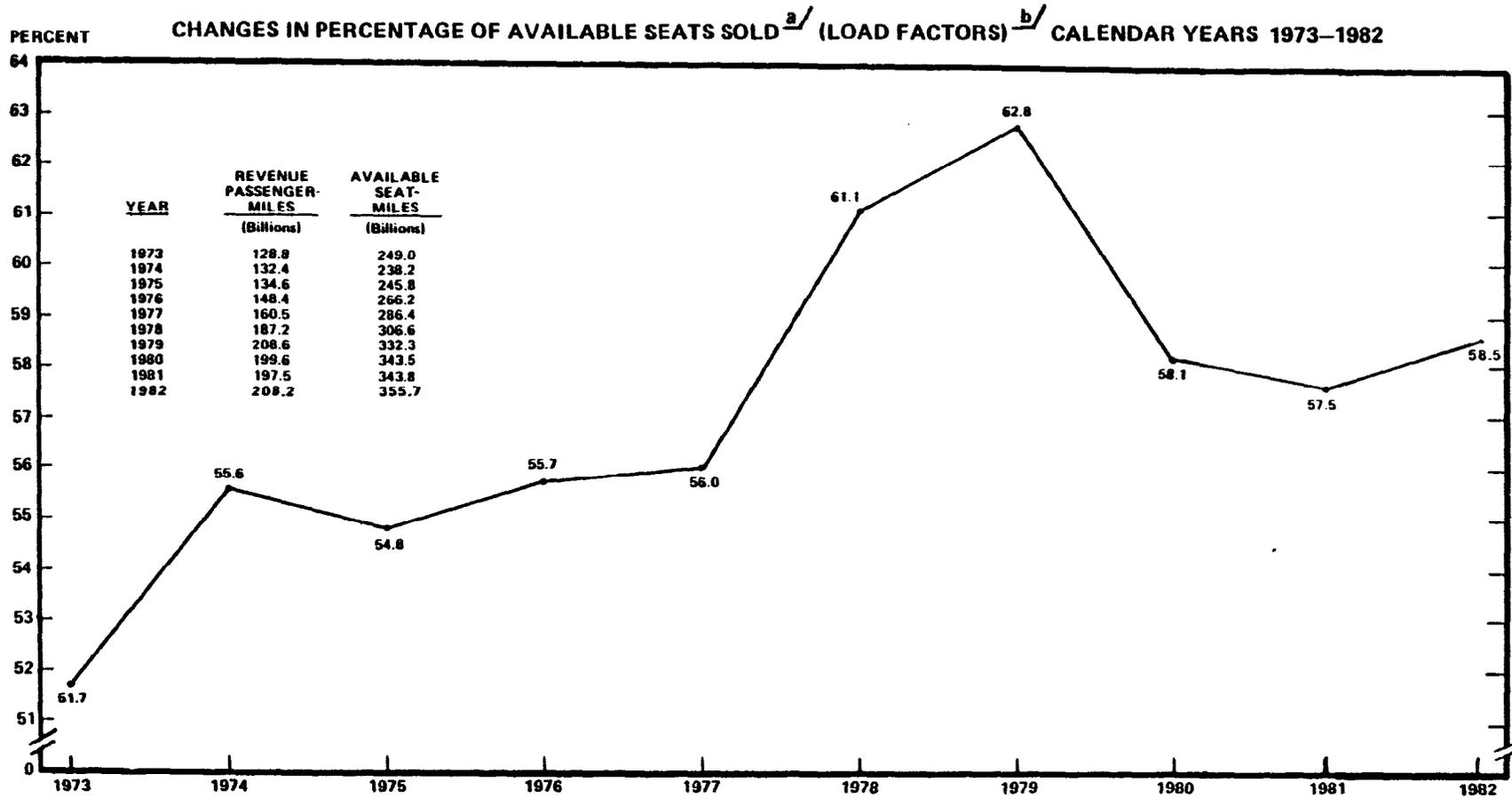
INDEX
(1973 = 100)

CHANGES IN TRAFFIC ^{a/} AND ECONOMIC INDICATORS CALENDAR YEARS 1973- 1982



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

Chart 2



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

	<u>Before deregulation</u> <u>(1972-77)</u>		<u>After deregulation</u> <u>(1978-82)</u>	
	<u>Total</u> <u>increase</u>	<u>Average annual</u> <u>compounded increase</u>	<u>Total</u> <u>increase</u>	<u>Average annual</u> <u>compounded increase</u>
	(percent)			
Air fares	33.3	5.9	46.4	7.9
Airline costs index (note a)	72.2	11.5	87.4	13.4
Consumer Price Index	44.9	7.7	59.2	9.7

a/Based on a CAB index of costs to the airline—fuel, personnel, goods and services purchased, and landing fees, but not capital charges such as depreciation, amortization, and interest. This index compares prices paid by the airlines in a given period to prices paid in 1978.

Table 2

Rate of Return on Investment (note a)
Domestic Operations

<u>Year</u>	<u>Percent of return on investment</u>
1982	3.3
1981	b/ 4.3
1980	c/ 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
1978-82 average	6.6
1972-77 average	7.0
1972-82 average	6.9

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/Excludes Pan American World Airways' extraordinary gain of \$249.4 million on the sale of Intercontinental Hotel in 1981. If the extraordinary gain is included, the 1981 return on investment is 6 percent. The 1972-82 average is 7.2 percent if both the 1980 and 1981 extraordinary gains are included.

c/Excludes Pan American World Airways' 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.

Table 3

**Summary of Weekly Aircraft Departures and
Available Seats by Hub Category**

	Hub market				Total
	Large	Medium	Small	Nonhub	
Number of communities	23	35	62	518	638
Number of departures per week (in thousands)					
October 1, 1977	58.6	21.7	12.8	27.4	120.6
October 1, 1978	61.9	23.4	13.7	29.6	128.6
October 1, 1979	66.8	25.3	14.5	31.2	137.8
October 1, 1980	63.4	22.8	13.3	27.8	127.3
October 1, 1981	61.5	22.8	12.4	25.9	122.7
October 1, 1982	65.8	26.7	14.5	26.9	133.8
Percentage change					
1977-82	12.2	22.9	12.7	-2.0	11.0
1977-79	13.9	16.6	13.0	13.9	14.3
1978-82	6.2	14.1	5.8	-9.1	4.1
1979-82	1.5	5.4	-2.2	-13.9	-2.9
1980-81	-2.9	0.1	-7.1	-7.0	-3.7
1981-82	6.9	16.8	16.8	3.9	9.1
Number of available seats per week (in millions)					
October 1, 1977	6.6	2.2	1.1	1.1	11.0
October 1, 1978	7.0	2.3	1.2	1.1	11.6
October 1, 1979	7.6	2.3	1.2	1.1	12.1
October 1, 1980	7.1	2.1	1.1	1.0	11.3
October 1, 1981	7.0	2.1	1.0	.8	11.0
October 1, 1982	7.7	2.5	1.1	.9	12.3
Percentage change					
1977-82	16.4	15.3	2.9	-16.8	11.6
1977-79	13.9	8.5	4.4	5.5	10.6
1978-82	10.2	9.3	-2.7	-18.8	6.0
1979-82	2.2	6.3	-1.5	-17.2	.9
1980-81	-1.4	2.1	-8.3	-13.6	-2.5
1981-82	9.8	17.8	13.8	7.7	11.6

Note: Totals may not add due to rounding.