A HISTORICAL ANALYSIS OF THE

REGULATION OF U.S. AIRLINES

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CHAPTER I

INTRODUCTION

Nature of the Problem

Both the airline industry and general public are concerned with the outcome of the Airline Deregulation Act (ADA) of 1978 (U.S. Government Printing Office, 1978). Numerous articles have been written linking the significant changes in airline service since the inception of the ADA.

Regulation Prior to 1978

The government has played an active role throughout the history of the airline industry. The history prior to deregulation can be divided into five distinct eras. Each of these periods has provided a historical insight into the effect of regulation on air travel.

The first major legislation, the Air Mail Act (U.S. Government Printing Office, 1925), encouraged commercial aviation by transferring the movement of mail from the Army to private carriers. Congress continued to encourage aviation through the Air Commerce Act (U.S. Government Printing Office, 1926), providing funds for ground facilities, along with airway and navigational aides. Abuses of the Air Mail Act led to the McNary-Waters Act (U.S. Government Printing Office, 1930), which required awarding air mail

contracts based on competitive bids. Direct and indirect subsidies were provided to the airlines, and the Interstate Commerce Commission was then authorized to govern passenger fares.

The Civil Aeronautics Act of 1938 (U.S. Government Printing Office, 1938) was, arguably, the most important piece of legislation prior to deregulation. This act established the Civil Aeronautics Authority (CAA), a single economic regulatory body, which helped promote and develop the air transportation system. This Act grandfathered operating rights to all airlines already in existence and contained three major elements: control of entry and competition, control of earning and fares, and control of safety (Van Scyoc, 1987).

In 1940, the Civil Aeronautics Board (CAB) was established to take over the responsibilities of the CAA. The Board was given authority over economic activities, such as commercial airline routing and pricing practices (Kwon, 1991).

The CAB's focus changed during World War II. Profits were high during this period, which piqued the CAB's interest in airline fares. Prior emphasis on competition shifted to reflect the public's concern for the industry's fare structure. This factor culminated in the introduction of the coach fare (Caves, 1962). These new fares resulted in yet another shift in profit margins within the industry.

A Congressional investigation netted the passage of the General Passenger Fare Investigation (GPFI), which created a fair rate of return policy. The Domestic Passenger Fare Investigation, initiated in 1970, compensated for the shortcomings of the GPFI and instituted a formula for determining fares.

The regulatory period, 1938 to 1978, saw increasing government regulation of the airline industry. Price and route structure was carefully controlled by the CAB, primarily for the protection of the major airlines in the industry.

The Airline Deregulation Act of 1978

By 1973, the CAB's regulations had begun to come under attack. Both the Postal Service and the Department of Transportation started to question the policies of the CAB (Meyer, Oster, Morgan, Berman & Strassman, 1981). Additionally, the CAB was being questioned by the Federal Trade Commission and other regulating industries for allegedly over-protecting the industry from competition. The issues raised forced a 1974 Senate subcommittee hearing on the CAB's practices. While the subcommittee investigated these charges, the Board still continued protecting the trunks. Price floors were initiated for supplemental airlines, and industry-wide fare increases were allowed.

In 1975, President Ford proposed legislation to limit the CAB's control over the airline industry. This decision supported the 1974 Senate subcommittee's findings. During 1975 and 1976, numerous bills were introduced to the House and Senate for CAB regulatory reform, but all failed. The CAB, however, began offering more flexibility for setting fares. Discount fares were once again approved for the industry, including Texas International's "Peanuts" fare, which decreased fares for "off peak" demand, and American's "Super Saver" fare.

In June, 1977, Alfred Kahn was appointed as the new Chairman of the CAB. As a supporter of airline deregulation, Kahn argued for and directed the CAB to reduce its control over the airlines. The Kahn-dominated commission thus began to deregulate the airline industry by allowing airlines more freedom, both in pricing and entry.

Airline deregulation became a reality on October 28, 1978, when President Carter signed the Airline Deregulation Act into law. The ADA was designed to allow deregulation to take place gradually. Two of the issues addressed in the ADA were fare levels and route structure. In non-monopoly markets, fares could increase up to 5% or decrease by 50% without the Board's approval. The Standard Industry Fare Level (SIFL), within which fares could vary, was to be reviewed twice a year by the CAB. On January 1, 1983, the fare structure of the airlines was to be completely deregulated. Another issue in the ADA was the control of route entry into the airline industry. The CAB had required two previous stipulations for route entry: the new service was "required by the public convenience and necessity" and the applicant was "fit, willing, and able" to perform the service (O'Connor, 1985, p. 27). New applications for route entry were decided on the basis of the "public convenience and necessity" requirement. The CAB was extremely restrictive with new route entries. The ADA removed the word "required"; accordingly, requirements for a new applicant were less stringent between 1978 and January 1, 1982. Under this more lenient wording, the burden of proof shifted from the airline proposing the route change to the airline opposing it.

The ADA also initiated the "automatic market entry" program. This entry program allowed any airline to choose a pair of cities (origin and destination) to add to its existing route structure. Each airline was allowed to add one city pair for each of the transition years of 1979, 1980, and 1981. The CAB emphasized application approval so that airlines would receive the new routes quickly.

On January 1, 1982, the "public convenience and necessity" requirement for new routes was removed. The ruling was changed so that the airline must only show "fitness" in order to receive a new operator's certificate to the industry or to accommodate new routes.

The ADA also changed the exit control procedures. Before the ADA, exit authority was highly regulated, but deregulation eased these exit requirements. Route abandonments were now the airline's decision; previously, the only method for route exit from the industry was either by merger or by acquisition. The CAB had approved or disapproved mergers pursuant to the guideline of how much impact it would have on competition. Only routes designated as "essential" continued to be regulated.

The final action of the ADA was to dismantle the CAB; the Board ceased to exist on December 31, 1984. The functions of the CAB were then incorporated into the Department of Transportation. The passage of the ADA marked the first time any U.S. industry became totally deregulated.

Statement of the Problem

Since the passage of the ADA, both the airlines and general public have voiced their concern over its effect on the airline

industry. These concerns have manifested themselves in the form of judicial hearings, studies, and publicly voiced questions from citizen groups. In order to validate these concerns, an investigation of the regulatory period is necessary. It is also necessary to investigate the Act itself to determine if the issues leading up to the ADA were in fact addressed.

Purpose of the Study

The purpose of the study will be to examine the factors that precipitated the passage of the ADA and describe the issues that deregulation attempted to address. Since no previous study covers these issues succinctly and comprehensively, there will be three basic aspects to the study: (a) to investigate regulation prior to 1978; (b) to examine the conclusions of studies conducted referencing this era, and; (c) to describe the issues addressed by the passage of the ADA.

Limitations of the Study

This study will examine the factors that led to the Airline Deregulation Act of 1978 and the issues addressed by its passage. For the purposes of this paper, the investigation will only include U.S.-based carriers in existence before the passage of the legislation. The study will include airlines that are no longer in operation, if they were flying prior to deregulation. This examination will include only U.S.-based carriers; no foreign-based carriers will be included in the investigation.

Assumptions

For the purposes of this paper, the following assumptions will be made:

(1) the information gathered from government documents is a true and accurate reflection of the legislation passed; and

(2) the factors examined and conclusions drawn from experimental and analytical studies and referenced documents are an accurate account of the events cited.

Definitions

For the purposes of this paper, the following definitions will be utilized:

(1) Air Mail Act will refer to the 1925 Congressional legislation that encouraged commercial aviation by transferring the movement of mail from the Army to private carriers.

(2) Air Taxi will refer to carriers operating equipment lighter than 12,500 pounds; they were unregulated and did not provide any scheduled service.

(3) ALF will refer to Average Load Factor, which is the overall percentage of seats filled with passengers.

(4) ATA will refer to the Air Transport Association, formed in 1936 to act as a service group to advance the common interests of the airline industry.

(5) CAA will refer to the Civil Aeronautics Authority, established in 1938 as a single economic regulatory body.

(6) CAB will refer to the Civil Aeronautics Board, established in 1940 to take over the duties of the CAA.

(7) Commuter will refer to a sub-group of the Air Taxis, those commuters that did provide scheduled service.

(8) DPFI will refer to the Domestic Passenger Fare Investigation of 1970, which addressed the shortcomings of the GPFI and established a formula for determining fares.

(9) FAA will refer to the Federal Aviation Administration, part of the Department of Transportation, established in 1958 to be responsible for the safety regulation of the airline industry.

(10) GPFI will refer to General Passenger Fare Investigation of 1956, in which the CAB approved a set 10.25 % rate of return (profit).

(11) Kelly Act will refer to the Air Mail Act of 1925.

(12) Local-Service Carriers will refer to carriers who operate over routes between smaller cities, and between smaller cities and larger cities.

(13) McNary-Watres Act will refer to the Air Mail Act amended in 1930.

(14) Supplemental will refer to carriers originally known as "irregular" or "nonscheduled."

(15) Trunk (or trunkline) will refer to those airlines initially licensed by the CAB in 1938.

CHAPTER II

HISTORY OF AIRLINE REGULATION

Regulation Prior to 1978

Throughout its history, air transportation has been significantly influenced by government. While airplanes were first used by the Army for air mail delivery prior to 1920, air movement of passengers did not commence until the early 1930s. The history of air transportation is relatively young; in spite of its youth, however, the industry's history has been shaped by past government regulation and present deregulation.

The history of the airline industry prior to deregulation can be divided into five periods: its inception through 1938; 1938 through World War II; Post-World War II; 1956-1970, and; 1970-1978. This chapter will provide a review of these historical eras and examine studies relative to these five periods in airline regulation history.

Regulation Prior to 1938

The history of the airline industry prior to deregulation can be divided into five periods. The first era dates from the beginning of air transportation and ends in 1938 when the first regulatory act

was passed. In 1916, Congress made $50,000 available for airmail service out of its "steamboat or other powerboat service" appropriation. World War I interrupted further development; however, before the war ended in 1918, Congress appropriated $100,000 for the establishment of an experimental airmail route, in addition to funds already earmarked for the purchase, operation, and maintenance of airplanes (Kane & Vose, 1975). Scheduled air service began on May 15, 1918, when, utilizing World War I surplus planes, the Army began moving mail from New York to Philadelphia, then on to Washington, D. C. (Taneja, 1987a). On August 12, 1918, The U.S. Aerial Mail Service, as it was called, came under the control of the Post Office.

The first regular year-round air passenger route, from Los Angeles to San Diego, did not begin until 1925. Early attempts at passenger air transportation were rarely successful, as the new aircraft -- in terms of safety, speed, and range -- could barely compete with ground transportation. The only successful early air passenger service was among various islands and the U.S. mainland; the early aircraft competed with boat transportation. But as transcontinental airmail service was introduced, the real advantages of the air mode were demonstrated. By 1925, the Post Office had built an airway structure for these new transcontinental routes and developed a system of night lighting and landing fields at locations from New York to San Francisco. In 1918, a sum of $13,604 was appropriated for the Post Office Air Mail service, and by 1926 it grew to $2,885,000 (Locklin, 1972; Davies, 1972; Meyer, Oster, Morgan, Berman, & Strassman, 1981). By 1924, the government

provided continuous day and nighttime transcontinental airmail service (Lieb, 1978).

Commercial air transportation in the U.S. began with a subsidized airmail service operated by the United States Post Office and a number of small passenger companies. During this time, numerous attempts were made to legislate and regulate the aviation industry. The Air Mail Act (U.S. Government Printing Office, 1925), also known as the Kelly Act, was not only the first major piece of U.S. civil aeronautics legislation, it also encouraged commercial aviation by transferring the movement of mail from the Army to private carriers. Congress drafted this legislation to simultaneously encourage air development and avoid a "subsidy" battle with the highway and railroad industries. The Kelly Act formed the basis for the subsequent development of the U.S. domestic airline passenger system (Thayer, 1965; Van Scyoc, 1987; Kucinski, 1990).

Under the Kelly Act, private airlines were awarded airmail contracts by the Postmaster General. Though competitive bids were not required under this law, the Postmaster General did use them, and the Kelly Act stated that compensation was to be "at such rate not to exceed four-fifths of the revenues derived from such first-class mail" (U.S. Government Printing Office, 1925, p. 805). Airline compensation was tied to the number of pieces of mail carried, not to airline operating costs. This source of compensation resulted in an arbitrary system in which the Post Office and the carriers counted letters to determine the subsidy.

The Kelly Act was amended in 1926, changing the basis for airline compensation to $3.00 per pound for the first 1,000 miles and

$0.30 per pound for each additional 100 miles or fraction thereof. Therefore, pending Post Office approval, this change allowed carrier compensation to actually exceed revenues. The resulting effect was that postal revenues, carrier compensation, and carrier costs became independent of one another. Bidding for the airmail routes was restricted to companies deemed by the Postmaster General to be properly equipped and experienced, giving the Post Office tight control over all the airlines (Meyer et al., 1981).

In February, 1927, the Postmaster General lessened the base postage rate by discontinuing zone rates and adopting a standard ten cent rate per 1/2 ounce. Together with the world-wide publicity of Lindbergh's solo transatlantic flight, this rate change led to nearly a 60% (by weight) increase of airmail carried.

One year later, Congressman Kelly again amended his Act. Under this amendment, route certificates, which were limited to 4 years under the Act and a 2-year duration in practice, were extended to a 10-year maximum limit. The Postmaster General was also allowed to cut rates down to five cents per 1/2 ounce letter. Congressman Kelly's intention was to reduce the poundage rate used for calculating airline compensation by using the potential of increased volume. However, the postage rate was reduced without any poundage rate concessions by the airlines, thereby defeating this part of the amendment; consequently, the volume of airmail nearly doubled, along with airline revenues. Cost of airline operation, however, remained relatively unchanged, as there was ample spare airline capacity, even after the doubling of the volume.

The poundage system of payments to the airlines invited massive abuse. "Airlines, or their agents, would simply mail some packages back and forth because postage was much less than the airline compensation. Other anxieties arose over the haphazard nature of airline route coverage and the hospitality of passenger service" (Meyer et al., 1981, p.15). President Hoover and his Postmaster General, William Brown, became alarmed at these events, leading to the last amendment to the Kelly Act, the enactment of the McNary-Watres Act (U.S. Government Printing Office, 1930). David's (1934) description of the three major provisions of the Watres Act is as follows:

1. The poundage system of airline compensation could be changed to a space payment system, set at $1.25 per mile maximum, to be paid regardless of the amount of airmail carried.

2. The 10-year route certificates were retained and these certificates could be awarded by the Postmaster General after renegotiation.

3. The Postmaster General could extend routes or consolidate them "when in his judgments the public interest will be promoted thereby," in effect to ease the problem of unnecessary short routes (p. 81).

The McNary-Watres Act required companies to submit competitive bids for routes, and bids were restricted to companies that had run an air transportation operation with a fixed daily schedule over a distance of not less than 250 miles and for a period of not less than 6 months prior to the advertisement for the bids. As

a safety precaution, Postmaster Brown insisted on night flying experience.

This Act also provided incentives for the airlines to fly longer routes (as compensation previously had been the same for flying 300 miles as 1,000 miles). But these restrictions made entry into the industry more difficult. Postmaster General Brown tried to expand the U.S. domestic system, while avoiding competition on awarded routes; he used his power as route awarder to streamline and stabilize the industry. By 1932, 90% of the $19.4 million paid to airmail contractors had been awarded to only three companies (Biederman, 1982). Given the tremendous growth of the U.S. airline system during these early years, it is highly probable that without the Postmaster General's controlling policies, many additional airlines would have entered the industry. Supplemental payments increased to approximately $15 million per annum by 1933, clearly helping the growth rate of the airlines. The Act also changed the method of compensation from a "poundage" system to a "space" system. Airlines were paid for moving mail based on the allotted space for the mail, regardless of the amount of mail actually carried. This policy encouraged the airlines to solicit passenger traffic for increased revenues. This increased passenger traffic also developed the need for more modern aircraft (David, 1934).

Irregularities in the Postmaster's actions put the airlines on the 1933 agenda of the Special Committee on Investigation of the Air Mail and Ocean Mail Contracts. When the results of this investigation were announced in February, 1934, President Roosevelt canceled the Air Mail Contracts and nullified the Kelly Act. The President then

ordered the U.S. Army Air Corps to assume responsibility for carrying the airmail. However, the Army provided poor service; they were ill-equipped and untrained for the task, and there was much publicity about loss of twelve pilot lives and $5 million in equipment damage (Aeronautic Chamber of Commerce of American, 1937). After four months of disastrous Army service, President Roosevelt ordered that competitive bids be submitted for temporary mail contracts to last until Congress could enact new legislation (Button, 1991).

The awarding of routes from these new bids was a major event in the development of the U.S. domestic airline system, for it was this overall structure that persisted until deregulation. On the shorter routes, some new companies entered the industry, but the longer routes were kept by the four major carriers (American, Eastern, TWA, and United), mainly because only they had the equipment and training to fly these routes (Meyer et al., 1981). Subsequently, the Air Mail Act of 1934 (Black-McKeller Act) was passed.

The Air Mail Acts (U.S. Government Printing Office, 1934) transferred the authority for setting payments for air mail from the Postmaster General to the Interstate Commerce Commission (ICC); however, the Postmaster General continued to exercise influence on the development of the airline industry. The frequency of scheduled flights, the number of intermediate stops, and the time of departures continued to be prescribed by the Postmaster General; by virtue of air mail subsidies and its regulatory controls, the Post Office Department still molded the early structure of the airline industry (Van Scyoc, 1987).

The Air Mail Act promoted air transportation by means other than air mail contracts. The Air Commerce Act (U.S. Government Printing Office, 1926) relieved private airlines of the financial burden of providing their own ground facilities, fostering the development of airway and navigational aids. Since airlines were subsidized by distance and not by the quantity of mail, the McNary-Watres Act encouraged airlines to carry passengers for additional revenues; passengers were cross-subsidized by the mail contracts, promoting the more rapid development of passenger service.

Subsidies to the airline industry have been important throughout its history. Airline subsidies grew tremendously from 1939 to 1978. In addition to these direct subsidies, there were indirect subsidies to the airlines for such items as the availability of weather service and the development and maintenance of airways infrastructure (Lieb, 1978).

Through the Air Mail Act of 1934, the ICC was authorized to govern passenger fares and award mail contracts on a competitive basis, providing the first regulation of airfare. Subsequently, the Act created the Federal Aviation Commission, which studied the air industry and recommended to Congress in January, 1935, the establishment of a separate regulatory agency.

The Report of the Federal Aviation Commission highlighted the following recommendations:

1. The Commission recommended a comprehensive system of regulation of air carriers.

2. The Commission recommended against giving the Interstate Commerce Commission jurisdiction over air carriers and favored the

creation of a separate commission to exercise the given regulatory powers.

3. The Commission recognized that air transport could not exist, at its stage of development, without some form of direct government aid.

4. The Commission favored a competitive organization for the airline industry, believing that the high quality of American air transport was due in large part to the competitive spirit that had existed throughout its development.

5. However, the Commission believed that the competition should be a carefully controlled competition.

6. The Commission recommended that payments for the carrying of mail should be kept separate from the direct financial aid given to the airlines (Locklin, 1972).

The airline industry was also in favor of a separate regulatory body. Before 1938, the industry was simultaneously governed by three different bodies (Post Office, ICC, and Department of Commerce, which regulated safety). The airline companies, along with the trade association, Air Transportation Association (ATA), agreed that it would be easier and less confusing to have only one governmental agency responsible for airline regulation. The Air Transport Association, acting as a service group to the airline industry, outlined three goals: (1) to advance the common interests of the certificated airline industry, (2) to develop better services for the public, and (3) to share in national defense. Member airlines financially supported the Association, and they used the talents of the airline industry to tackle a wide range of common interests, from standardization of

new aircraft to the cutting of red tape for international travel. They had a common motive: to maintain the best system of air transportation for the airline, the national economy, and the general public (Kane & Vose, 1975).

The depression forced financial difficulties on the airline industry. Some industry experts also believed that competition caused additional financial burden. Some carriers were making extremely low bids (below cost), in order to obtain air mail contracts, thus causing financial problems for the whole community.

A regulatory bill was drafted by the airlines and the ATA, working in conjunction with the three different governmental agencies. Watson (1979) asserted that "the Act of 1938 was passed because of the airline Companies; they shaped the legislation and the lobbied it through to passage. . .No wonder then that the scheduled airlines are so fond of the Civil Aeronautics Act--it is their set of rules" (p. 67).

The government agreed with the airlines and the ATA that competition in the industry was destructive. The government's heavy investment in the airline industry was threatened by unrestricted competition. The passage of the Civil Aeronautics Act of 1938 drew support from the government and the airlines, thereby beginning the second period in the industry's history.

1938 through World War II

During the 1930s, air transportation regulation was largely influenced by the Great Depression. The Depression had hit the

American economic system so hard that the concept of open competition came under attack. Most of the economic regulation in the 1930s was in response to the prevalent "excessive" or "cut-throat" competition. Such competition eroded the American work philosophy and resulted in wide-scale bankruptcies, costly products, and disorganized services (Meyer et al., 1981; Wheatcroft, 1964).

In the late 1930s and early 1940s, flying was an expensive and high-risk venture in which only a few companies (and passengers) engaged. The fragile conditions of the developing national air transportation system needed some government protection and regulation (Kwon, 1991). Because of the subsidies present in the highly competitive industry, regulation was demanded. In this environment, bidding for new routes and services could be approved at prices far below cost, allowing for future expansion and using the subsidies to compensate for the cost/price difference. This action occurred frequently among the airlines in the 1930s, and in order to minimize subsidy payments, the government decided to squelch this costly competition (Panzar, 1980). In response to this intervention, Congress passed the Civil Aeronautics Act (U.S. Government Printing Office, 1938), which established the Civil Aeronautics Authority, a single economic regulatory body whose purpose was to help promote, develop, and financially stabilize the air transportation system (Reynolds-Feighan, 1992).

Until the ADA of 1978, the Civil Aeronautics Act of 1938 formed the legal basis for the Civil Aeronautics Authority's policies. The Act of 1938 addressed two fundamental issues: air safety and economic regulation. It separated safety issues by creating an Air Safety

Board (U.S. Government Printing Office, 1938) independent from the Air Carrier Economic Regulation (U.S. Government Printing Office, 1938) aspect of the bill. The mandate to the Authority was to consider "the public interest, and in accordance with the public convenience and necessity" formed the following objectives:

a) the encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of national defense;

b) the regulation of air transportation in such a manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in such transportation, and to improve the relations between and coordinate transportation by air carriers;

c) the promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;

d) competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

e) the regulation of air commerce in such a manner as to best promote its development and safety; and

f) the encouragement and development of civil aeronautics (U.S. Government Printing Office, 1938).

The CAA consists of five members appointed for a maximum of a six-year term. Of the five board members, no more than three can be from the same political party. Members are appointed by the President (with Senate approval) and "shall have no pecuniary interest in or own any stock in or bonds of any civil aeronautics enterprise" (U.S. Government Printing Office, 1938, p. 981). An Administrator is appointed by the President for executive and operational functions (Richmond, 1961).

The Board exercises its power independently; its decisions are not subject to review by any agency, except for the approval of the President in decisions granting or affecting certificates for overseas and foreign air transportation and foreign air carrier permits.

In general, the Board performs two major functions:

1. economic regulation of domestic and international United States air carrier operations and of the operations of foreign air carriers to and from the United States; and

2. guidance in the establishment and development of international air transportation (Kane & Vose, 1975).

One of the first acts of the CAA was the issuance of "grandfather" rights, whereby airlines existing on May 14, 1938, were granted permanent certificates for all of their current route authorities (Meyer & Oster, 1984, p. 5). No proof of "public convenience and necessity" was needed for these airlines, but if they wanted to expand to other markets, they were required to show the CAA (later the CAB) that they were fit, willing and able to serve, and filled a public need (Morrison & Winston, 1986; Finsinger, 1983). They were also required to show that expanding to new routes would

not place a financial burden on existing airlines serving those routes (O'Connor, 1982).

These "grandfathered" certificates provided the basis for regulation in the airline structure. There were sixteen airlines in existence in 1938 (See Appendix A). No new carriers were allowed to enter this group during the 40 years of regulation, even though demand grew rapidly and entry applicants were abundant. Fares were required to be published and observed; any change in fares had to be approved by the CAB in a lengthy process, and all fares needed to be "just and reasonable." Fares could not be discriminatory, and there was no long and short-haul provision in the Act, as there was in the railroad industry. CAB control over the industry was considerable.

The report by the Federal Aviation Commission in 1935 (the major influence on the Act of 1938) provided the following recommendation: "It should be the general policy to promote competition in the interest of improved service and technological development, while avoiding uneconomical paralleling of routes and duplication of facilities." The same report cautioned: "On the other hand, too much competition can be as bad as too little. To allow half a dozen airlines to eke out a hand-to-mouth existence where there is enough traffic to support one really first-class service and one alone would be a piece of folly" (Pulsifer, 1976, p.61). The 1938 Act reformed and institutionalized the method of promoting air transportation by means of direct federal subsidies.

Another early act of the new CAA instituted further development of the national airport system and included a budget of

$125 million for these developments. In June, 1940, the CAA was reorganized into the Civil Aeronautics Board (CAB). The Air Safety Board was abolished, but its functions were infused into the CAB. The role of the Administrator and related airport and airway development activities were transferred to the Department of Commerce (Solberg, 1979).

The Post-World War II Period

The World War II era saw the inception of the third major period in airline history. The beginning of World War II drew the airlines and military into close contact with one another. Military demands for aircraft reduced the number of commercial airline aircraft to less than half, but wartime activity resulted in high demand for remaining services. Airline productivity and efficiency improved considerably, and load factors of 80% to 90% were normal at this time (Davies, 1972). By July, 1942, the airlines had removed all promotional discounts.

Pricing.

Profits of the airlines were extremely high during this period, prompting the CAB to become more interested in airline fares. Until this time, the CAB paid little attention to fares, instead concentrating on the gradual reduction of the number of monopoly routes enjoyed by the "grandfathered" airlines. However, these wartime conditions led to extremely high profit levels, and the CAB ordered the eleven largest domestic trunk carriers to reduce fares by 10% or show cause why the reduction was not possible. After six airlines filed decreases

of less than 10%, the CAB chose to drop the investigation. As Caves (1962) noted, "Under war and depression conditions, the role of price in performing a rationing function diverges from its role in returning a normal yield to factors of production" (p. 143).

Due to the high profit levels at the end of World War II, the CAB reduced both airmail compensation and passenger fares, despite the protests of smaller carriers who feared (correctly) that a fall in load factors would occur during the postwar period (Hudson, 1972). Furthermore, a plentiful supply of aircraft and pilots released from military duty further aggravated the declining profits.

Another major development in the airline industry at this time was the introduction of coach fares. Prior to 1948, the airlines offered only one-class service, although special fares were sometimes given for certain occasions or to specific groups (Locklin, 1972). The reduced (or Coach) fare idea for regular carriers was influenced by the low fares and less expensive accommodations offered by the irregular air carriers (Jones & Davis, 1950). The CAB was reluctant to allow these coach fares because of excess capacity and the resulting low profits. Historically, the CAB had maintained the financial health of the industry by concentrating on overall airline profit levels, not on setting fares. It believed that these low fares would only create an additional financial burden to the industry. The end of the war brought a huge decrease in load factors and increased competition from the large irregulars (non-scheduled charter airlines). In 1948, Capital Airlines proposed a coach fare at a time when the CAB was concurrently granting a series of fare increases to offset falling airline profits. The coach fares were approved but contained a

considerable number of use restrictions. During the Korean Conflict, the Board expanded the coach fare, pricing it not to exceed 75% of the first class fares. Though the Board granted a series of fare increases through the declining load factor years following World War II, it encouraged experimentation with promotional fares and fares aimed at off-peak travel. Eventually, the discounts which had been abandoned during World War II returned ("Odds look," 1977). Its increasing popularity induced the CAB to extend the use of coach fares during the Korean Conflict.

Feeder airlines.

Under considerable political pressure, the CAB announced on March 22, 1943, that it would study the possibility of local service or "feeder" airlines. Feeder airline routes would be of short distance and low density (Finsinger, 1983). The CAB feared that feeder routes (short-haul low-density segments connecting smaller communities in outlying areas with larger airports) would face stiff competition from rail, bus, and automobile transportation. Furthermore, these small communities (normally a population under 50,000) were not expected to generate adequate daily passenger traffic to support profitable operation. After an investigation which generated little economic need for feeder service but confirmed the political support behind them, the CAB decided to try experimental feeder routes. Two safeguards, however, were incorporated into these experimental feeder routes: (1) such authorizations were limited in time (three years in most cases), and (2) these operations were confined to those that did not require unacceptable levels of subsidy (Meyer & Oster, 1984; Molloy, 1985).

Until this time, no airline entry had been granted if it would compete with any part of the established trunk system. The first issue with which this investigation dealt was whether these feeder services, for which there were many applicants, should be awarded to the trunks or to new airline companies. After debating the service needs and unique cost structures of these new feeders, the awards were made to new carriers. This decision, in part, was based on the fact that the trunks were already subsidized and that a successful feeder experiment using trunks would have caused these subsidies (at $14 million in 1942) to rise to potentially unacceptable levels (Eads, 1972).

Deciding the location of the new feeder routes was not easy. The CAB considered the probability of financial success and local need, but population and length of feeder link was probably the greatest influence in reaching a decision. Using population density as a major criterion often resulted in feeder airline routes that were in competition with good ground transportation. The CAB eventually controlled the local service route awards by issuance of "temporary" certificates having a three-year limit. However, dropping a city after regular air service had been provided was not an easy matter, regardless of the economics of the situation (Eads, 1972). Moreover, the CAB implemented the feeder service airlines nationally before any review had been made of their decision-making process.

The CAB strongly avoided competition between the new feeder routes and the existing trunks by usually requiring the feeder airlines to stop at intermediate points between two cities served by a trunk in order to avoid direct competition. In areas where the

feeder airlines were allowed more direct competition with the trunks, some local carriers became a considerable threat to the trunk airline market.

The "Local, Feeder, and Pick-Up Air Service" investigation (Civil Aeronautics Board, 1943) report was pessimistic about proposals for a local service network. In this study, the feeder airlines assumed flight of a twin-engine aircraft of 10 seats or fewer with a pilot and co-pilot only, the co-pilot collecting tickets and stowing baggage. The study also assumed an average load of two passengers, ultimately requiring an airmail/subsidy rate of 25 cents per mile.

The costs of local service operations were considerably more than this subsidy. The major reason for these costs was the use of the DC-3 aircraft, a 21-seat aircraft, rather than the originally planned smaller 10-seat aircraft. This larger aircraft provided an image similar to that of the trunks, but it also increased operating costs. The larger aircraft also necessitated some cabin crews and in-flight service, further increasing costs.

The CAB's response to these higher costs was to increase the subsidy. The other local service airlines quickly learned that the additional operating costs would not be a problem (Eads, 1972). Direct subsidy payments ran approximately $20 million annually in the mid-1950s, peaking at $63 million in 1963 (Caves & Roberts, 1975). When it was time to re-certify the local service airlines, all those equipped with DC-3s were renewed, despite the much higher than expected subsidy levels. In 1955, Congress issued permanent operating certificates to those local service airlines.

The CAB, however, forced substantial restrictions on the routes and operating freedom of the local service airlines. Even so, during the 1950s, the local service airlines became the major recipient of subsidy money. In order to reduce the amount of subsidy given to the local service airlines, the CAB instituted a policy to strengthen their routes. This policy addressed four areas: (1) liberalization of route restrictions placed on the local service airlines; (2) transfer of weaker trunkline points to the local service airlines; (3) a "use it or lose it" policy which ensured each location enplaned at least 5 passengers per day or risk losing its service, and; (4) addition of new routes, often to points that had been without airline service (Meyer & Oster, 1984, p. 15).

The route strategies adopted by the CAB did not diminish the rise of the subsidies paid to the local service airlines. In fact, the transfer of weak points from the trunks and the addition of new and more marginal routes weakened the local service airlines and led to an increased need for subsidies. Moreover, there was considerable incentive under the subsidy system for the local service airlines to improve their fleets, thereby increasing their subsidies (Eads, 1972). In 1952, Pioneer replaced its DC-3 fleet with Martin 202s; its action was followed by a similar move by Southwest. The Martin, with 36 seats, was considerably more expensive to operate than the DC-3s. The CAB, in response, refused to allow an increase in subsidy and Pioneer (though not Southwest) was forced to reaquire the DC-3 aircraft. (In 1955 Pioneer merged with Continental Air Lines, a trunk and its chief competitor).

Supplemental airlines.

When the 1938 Civil Aeronautics Act was passed, airlines offering only nonscheduled service from a fixed base were not clearly included. In October, 1938, such fixed-base nonscheduled operations were given an exemption and allowed to continue. After World War II, many ex-military pilots bought surplus military aircraft and started nonscheduled service. This action caused great concern to the CAB.

A 1944 investigation yielded recommendations that the CAB permit these supplemental carriers to fly up to 10 frequencies per month between points other than the principal place of business (the fixed base). The CAB rejected these recommendations; instead the CAB attempted to define more precisely the meaning of "regularly" as it applied to these operations. If passengers were reasonably sure that trips will be operated on a set schedule, and the only question is whether space could be obtained on such flights, then the operation qualifies as a regularly scheduled air carrier (Rattner, 1976). This clarification was issued in a CAB directive that required the nonscheduled carriers to operate only limited irregular flights.

However, the new nonscheduled airlines were operating more "regular" flights and competing directly with the certified carriers for traffic. On May 5, 1947, the CAB required that all nonscheduled carriers be categorized either as large carriers (operating more than 10,000 pounds gross take-off weight or three or more aircraft with an aggregate weight of more than 25,000 pounds gross take-off weight) or small carriers, and that large carriers be required to take

out letters of registration. By August 6, 1948, the CAB closed the "large irregular" class with 109 registrations in effect (Meyer, 1981).

On May 20, 1949, the CAB revoked its blanket exemption for the large irregulars and required each carrier to apply for an individual certificate. In November, 1949, the CAB required ticketing for all passengers on the large irregular carriers, and it prohibited the combining of operations with other irregulars to produce the effect of providing an overall regular service (Van Scyoc, 1987).

The CAB further limited the large irregulars' schedules to 3 flights in one direction between 13 pairs of cities and 8 flights per 4 weeks in the same direction between any other cities. The large irregulars continued to have problems with flight cancellations and poor equipment maintenance; thus when fifteen irregulars applied for certificates for regular coach service along with their applications for individual "large irregular" status, all fifteen were denied on the grounds that such service would result in excessive and destructive competition with the existing carriers (Holsendolph, 1977a).

The debate continued over the role of irregulars, and after the Large Irregular Air Carrier Investigation of 1951, the CAB concluded that irregulars did provide a valuable service. In particular, charter operations, military support, and low-fare flights were singled out as benefits provided by the large irregulars not supplied by the certificated carriers. The large irregulars were reclassified as Supplemental Carriers, and the CAB specifically encouraged their development.

After the Korean Conflict, the airlines once again saw declining loads and resulting poor returns. In 1952, the carriers asked the

Board's approval for a $1 per ticket fare increase and removal of round-trip discounts. The fare increase was granted, but the round-trip discount remained. These requests resulted in a CAB order calling for a general investigation of the levels and structure of passenger fares. Until that time, no such investigation had ever been made. Earnings improved significantly in late 1952 and in 1953, and the airlines feared that an investigation would result in lower fares. After sustained arguments from the carriers, the Board was convinced to cancel the investigation; however, in 1956, under extreme Congressional pressure, the CAB did institute the General Passenger Fare Investigation (GPFI).

1956 - 1970

The late 1950s evidenced a major investment program for the new jet aircraft and facilities. Passenger revenues in 1957 exceeded $1.3 billion, and traffic increased fourfold, from 6 billion passenger miles in 1948 to 25 billion in 1957. The airlines planned to spend $2.8 billion over the next five years for aircraft and facility acquisitions (Cherington, 1958b). The Government Guaranty of Equipment Loans Act (U.S. Government Printing Office, 1957) authorized the CAB to guarantee loans to local service carriers enabling them to update their equipment, while the Airways Modernization Act (U.S. Government Printing Office, 1957) provided funds for further development and modernization of navigational systems and traffic control facilities (Carroll, 1975).

The GPFI coincided with the arrival of the jet age and a period of low earnings from the recession of the late 1950s (Straszheim, 1969). Moreover, the airlines had enjoyed many years of high profit rates, and the trunk carriers were largely without subsidy support. The Board therefore focused on the fare level rather than its structure, while acknowledging inquires from Congress, which had been critical of the Board's inactivity on the matter (Redford, 1965; OECD, 1988).

The GPFI hearings lasted until 1958. During this time, many carriers filed for higher rates, citing the higher costs of jet aircraft. The CAB policy of the early 1950s was to set fares so that they did not fall below "the level necessary to provide a fare return over a reasonably extended period which includes the good years as well as the bad" (Caves, 1962, pp. 283-284).

The CAB used this philosophy to respond to the airlines' demands of 1956 and early 1957, stating that the costs of jet equipment and routes were of a temporary nature. However, bad economic times and Presidential pressure convinced the CAB to grant a temporary increase of 4% plus $1 per ticket, despite the high profits earned over the past years. The carriers then requested to eliminate the round-trip discounts and free stopovers and to have the family fare discount cut from one-half to one-third. These requests were granted by the CAB (Caves, 1962).

The GPFI hearings finally concluded in August of 1958; however, the Board's opinion was not issued until November 25, 1960, nearly five years after the investigation started. The rate of return for the large trunk airlines was set at 10.5%, 12.0% for the smaller trunks. The period over which this average was to be achieved was left

flexible (indefinite) because no "mechanical device" or mathematical formula was acceptable for determining the correct time period and short-term considerations were not to be ignored. The Board also stated that the "unreliability of the forecasts and the lack of data in the record reflecting jet operations" made it impossible to determine an overall appropriate level of fares (Meyer et al., 1981, p. 22, McShan, 1986). Therefore, the GPFI failed to produce a standard for setting levels, which was a major impetus for initiating the investigation. Many other issues were also left open by the Board, including the use of standard load factors and standard costs (Taneja, 1987b). The CAB did conclude, however, that general fare increases did not solve the financial problems of the weak carriers (Redford, 1965).

The Federal Aviation Act (U.S. Government Printing Office, 1958) created the Federal Aviation Agency (FAA) to replace the Civil Aeronautics Administration and assume its functions. The new FAA would assume two major areas from the old CAA. First, they were given full responsibility and authority for the advancement and enforcement of all safety regulations. Second, they assumed full responsibility for management of the national airspace system, including enforcement of air traffic rules and development and operation of air-navigation facilities. The Civil Aeronautics Board, however, continued its jurisdiction over the investigation of air accidents. In 1966, the Department of Transportation Act (U.S. Government Printing Office, 1966) transferred both the air safety powers of the FAA and the accident investigation powers of the CAB

to the National Safety Board of the newly created Department of Transportation.

Under the Federal Aviation Act of 1958, the CAB continued as the regulatory agency, with no change in policy; there was no intent to change the statute relating to economic regulation or to change the policies of the Board in administering it. Additionally, the Civil Aeronautics Board became an independent agency, not attached to the Department of Commerce as it had been since 1940 (Locklin, 1972; Rochester, 1976; Burkhardt, 1967).

By 1959, all the trunk carriers were operating without subsidy (Northeast Airlines returned to subsidized status for a short time in 1963). The CAB had negated subsidy needs for the trunks by awarding promising routes to the weaker trunk lines. (Appendix B shows the subsidies awarded to the certificated airlines from 1943 through 1978) When the trunks were receiving subsidies, the amounts were essentially an internal balancing question for the CAB; good financial health of companies could be affected almost as well through subsidy or fare levels or route extensions, all other things being equal. To promote the industry, the CAB concentrated on route expansion, while maintaining subsidies at acceptable levels. The postwar profits enjoyed by the large trunks removed the need for subsidies and left fare levels as the major economic control over trunk activities.

<u>1970 - 1978</u>

The late 1960s saw increasing competition among the carriers. Although the prices and routes were fixed, frequency of flights and

capacity levels were not. The airlines flew with high frequency and low loads. In 1970, the CAB conducted hearings into the falling airline profits of the late 1960s. Members of Congress requested to attend, but the CAB rejected their request. The Congressmen carried their action to court; in response to this action, the CAB commenced the Domestic Passenger Fare Investigation (DPFI) on January 19, 1970.

The DPFI was the Board's first analysis of its fare policies (Bailey, Graham, & Kaplan, 1985). During the GPFI, the CAB had agreed only on a reasonable rate of return and had stipulated that fares should be brought into closer alignment with costs; no load factor controls had been established. However, during the 1960s, the average load factor (ALF) for the trunks had fallen from 59.3% to 50.0% . The DPFI therefor set out to make up for the shortcomings of the GPFI and develop a formula for determining fares (Meyer et al., 1981; Kasper, 1988).

DPFI issues were broken into two areas, fare levels and fare structures. In considering fare levels, the CAB agreed with an earlier study conducted by the Department of Transportation which showed that higher fares caused airlines to offer higher capacity and consequently reduce the ALF. The high-fare/low-ALF phenomenon led the CAB to set standards for seating configurations on different aircraft types. Fares were to be tied to an ALF of 55% for trunks and 44% for local service. Fare levels were also to be tied to a 12% rate of return.

During the GPFI period, the airlines competed by offering more frequent service, thereby driving up costs and decreasing the

airline's rate of return. This cost could at least nominally be passed on to the consumer, as fares were set to reflect cost and provide a certain rate of return (Fruhan, 1972). Now with fares presupposing a certain load factor, there would presumably be a more predictable relationship between fares and revenues.

Fares were structured to reflect the cost of service. Prior to the DPFI, airline fares tended to be linearly applied. However, the average costs of aircraft operation decreased per passenger mile and thus long-haul operations were more profitable, subsidizing the less profitable short hauls. The DPFI changed this structure by increasing the "distance taper" in the rates, thus raising short-haul fares and lowering long-haul fares (Wyckoff & Maister, 1977, p. 1i). The CAB's rate calculations are shown in Appendix C. One other proposed fare structure change came in response to an American Airlines request of a "zone of reasonableness" for fares. They wanted the CAB to set a standard fare, above or below which the airlines would be allowed to adjust 10%. This adjustment would allow for changes in market condition and competition. The CAB rejected the zone of reasonableness, maintaining that all airlines would simply set their fares at the maximum of the zone.

The final issue with which the DPFI dealt was discount pricing. In the past, discount pricing was seen as promoting the airline industry, thus helping the industry with the problem of excess capacity. On the issue of pricing, the CAB found that all youth, family, and other discount fares were discriminatory and therefore illegal, and such fares were required to be eliminated within 18 months. This action was contrary to previous CAB action when such

discounts had been actively encouraged for promotional reasons. Discount fares were allowed only if the CAB did not judge them to be discriminatory, however, the CAB felt that these discount fares were so; therefore the youth, family, and "Discover America" discounts became illegal after one and one-half years (Taneja, 1987b).

In 1970, faced by large financial losses, United Airlines, TWA, and American met to discuss the possibility of increasing each carrier's load factors. This plan was to be accomplished by a mutual agreement to restrict the frequency of flights on long distance routes. The initial capacity agreement met with fierce protests from other carriers, and the CAB disapproved it on November 6, 1970. The CAB did, however, encourage the airlines to find ways of reducing the overcapacity they were generating.

Eventually, TWA, United, and American came to a CAB-approved understanding, agreeing to limit capacity in four transcontinental markets for one year. The CAB opposed the capacity limitations in principle, but allowed it as a temporary measure for helping the financial situation of the carriers.

The capacity limitation agreements proved very effective for the three trunk carriers; however, their request for extension of the agreement met with strong opposition from smaller carriers. The smaller carriers felt this agreement was aimed at decreasing their share in the market. After losing a civil case filed by the Department of Justice, the CAB rescinded the capacity agreement on July 21, 1975 (Taneja, 1981).

The publicity from constant media attention which had been raised through the DPFI period, and the inception of capacity agreements, provided a basis for concern about the CAB's policies.

Toward deregulation: 1973 - 1978.

The 1970s saw growing public sympathies toward deregulation (Doganis, 1985; Caves & Roberts, 1975). The trend toward greater regulatory control of the industry peaked as a result of the DPFI. The loss of discount pricing, the increase of rigidity and standardization in pricing formulas, and the institution of route moratoriums and capacity limitation agreements severely limited the carriers' ability to control their profitability. Even those carriers most strongly opposed to deregulation were not content with the current situation and wanted an easing of these restrictions (Morgan, 1981).

The publicity which surrounded the capacity limitation agreements had attracted the attention of the Department of Justice. In October, 1974, Lewis A. Engman, Chairman of the Federal Trade Commission, voiced his concerns over the CAB's protection of the industry from competition and efficiency (Metz, 1974). Concurrently, Senator Edward Kennedy, Chairman of the Senate Judiciary Subcommittee on Administrative Practice and Procedure, decided to begin preliminary investigations for oversight hearings on the CAB which were to take place in February, 1975 (the Kennedy Hearings). The purpose of these hearings was to investigate the fairness and effectiveness of CAB practices and procedures.

The CAB, however, was unconcerned with these events. As a protective measure for the trunk airlines, they proposed rate floor

standards for the supplemental carriers in October, 1974 . The next month, the CAB followed with a general 4% fare increase. This increase, combined with two other fare increases approved by the Board, resulted in an average ticket price increase of 20% between December 1973 and December 1974 (Egan, 1974).

In January, 1975, under mounting Congressional pressure, the Board organized an internal task force to explore the issue of regulatory reform. The task force investigated current regulation policy and recommended less regulation of the industry (Civil Aeronautics Board, 1975).

The CAB's task force recommendations were preempted by President Ford's announcement of February 1975, which stated that legislation would be proposed to "remove most of the Federal Government's control over determining the price of airline tickets and in designating which companies may enter the airline business and what routes they may fly" (Lindsey, 1975, p. 37). President Ford continued by stating that "the rigidly controlled regulatory structure now serves to stifle competition, increase cost to travelers, makes the industry less efficient than it could be and denies large segments of the American public access to lower cost air transportation," and further predicted that his proposal would have a "direct and beneficial impact" on the American consumer (Congressional Quarterly Weekly Reports, 1975, p. 2176).

President Ford's statement drew heavy industry criticism and CAB opposition. (The President's announcement was also supported by the findings of the Kennedy hearings). Numerous reform proponents supported the administration's position on the

"inequitable, inefficient, and uneconomical" impact of the Board's regulatory policies (Burnham, 1975). Numerous economic studies were cited indicating that fares were 40-100% higher than necessary and that carriers had been forced to fly with excessive frequency and to buy unnecessary aircraft to compete (Committee on the Judiciary, 1975a). The Kennedy hearings were well chronicled; this publicity brought attention to the problem of CAB regulation, the resulting inefficiency, and the higher consumer costs.

The unregulated intra-state markets of California and Texas received considerable attention during the Kennedy Hearings, as they provided the only empirical evidence on the likely impact of deregulation. These markets had fares that were 50% to 70% of the CAB-regulated fares for approximately the same distances and kinds of routes. The Kennedy report concluded that fares in unregulated markets were lower due to the higher load factors and seating densities achieved in the intrastate markets (Committee on the Judiciary, 1975b).

The airline industry was not enthusiastic about the possibility of deregulation. Airline officials testified at the Kennedy Hearings in support of continued CAB regulation, stating that the deregulation would be disastrous to the industry. They testified that deregulation would lead to less competition because the smaller, weaker carriers would be forced out of the business. Without CAB protection of route authority, the powerful carriers would invade the markets of the weaker carriers and charge lower fares, driving the weaker carriers out. Subsequently, fares would ultimately increase, as the number of carriers would diminish and the quality and dependability of service

would decrease. The airline industry felt that the deregulation movement was a product of "incorrect economies" (Committee on the Judiciary, 1975c).

The Robson Chairmanship: 1975-1977.

As pressure mounted from Congress and consumer groups for increased competition in the industry, President Ford appointed John Robson as Chairman of the CAB in March, 1975. Robson replaced Robert Timm, who had been a strong advocate of regulation and an enthusiastic supporter of the capacity limitation agreements.

The CAB's new staff report on regulatory reform advocated an end to the tight regulation controls of fares, rates, and entry by the CAB. The industry still feared deregulation, gaining support from former CAB Chairman Secor Browne, who warned that the industry was on the brink of financial disaster ("Ex-C.A.B.," 1975). Simultaneously, the capacity limitation agreements between American, TWA, and United were once again voided by the CAB in July, 1975, due to a Department of Justice suit against the CAB that had found the agreements to be illegal.

In September, 1975, a new competitive nonstop route authority was granted for the first time since the 1970 initiation of the route moratorium. The Board concluded that certain markets could support and benefit from limited competition. Additionally, the Board relaxed charter flight regulations allowing for the sale of charter packages with a single destination (the previous rule had required three stops). This ruling represented a major change in CAB attitude toward the certificated airlines and was a reversal in policy

to the previous year's proposal for instituting rate floors for supplemental carriers.

In October, 1975, the Ford Administration proposed legislation on regulatory reform. The Aviation Act of 1975 (U.S. Government Printing Office, 1975) was aimed at stimulating price competition, eliminating entry barriers to new markets, and altering the basic function and purpose of the CAB (See Appendix D). Once again the industry was skeptical, and even CAB Chairman Robson emphasized his belief in the need for a gradual transition toward regulatory reform, stating his doubts that the Aviation Act would pass Congress (Meyer, 1981).

The CAB policy in the 1960s was to deny petitions for new nonstop service in a market where existing service was satisfactory; in November, 1975, the Board reversed this policy and granted carriers new route authority. The CAB granted this authority because it felt the market could bear additional service when the incumbent carrier failed to demonstrate any significant adverse effects would result from increased competition, and it was believed that the incoming carriers could operate at a profit.

In April, 1976, the Senate Aviation Subcommittee convened hearings on regulatory reform (U.S. Government Printing Office, 1976b). At this time, CAB Chairman Robson delivered his own plan for deregulation, indefinitely delaying the total deregulation of the airlines. Robson acknowledged that regulation might have been responsible for unnecessary hikes in air fares but also emphasized that a shift to a deregulated system could cause major disruptions in

the industry, including possible financial failures among carriers (Committee on Commerce, 1976).

In response to Senate concerns, the Board took steps to relax fare standards and reinstituted discount fares (Meyer & Oster, 1987). In July, 1976, the Board allowed lower fares for regulated interstate carriers so they could be more competitive with the unregulated intrastate carriers in California and Texas. Later in the year, the Board removed the 20% discount limit in the mainland United States to Puerto Rico/Virgin Island market, giving carriers the ability to set new prices.

While many airline officials created the regulatory environment, the subcommittee ultimately announced that it would propose legislation to reduce CAB controls. The Federal Aviation Act Amendments of 1976 was introduced in September, and was aimed at fostering greater competition between carriers by allowing more flexibility in fare adjustment (U.S. Government Printing Office, 1976a).

During 1976, the CAB continued to grant new competitive route authority and make some additional moves toward greater liberalization of its policies. It also continued its policy of granting competitive authority in markets where service was sufficient but whose loads would allow more carriers. In November, for the first time, competitive service in the New York-Richmond (trunk) market was awarded to a local service airline. These changes occurred simultaneously with the relaxing of air charter rules.

As debate over deregulation intensified, a General Accounting Office report released in February, 1977, stated that CAB regulation

of air fares had cost American passengers nearly $2 billion annually in excess fares between 1969 and 1974 (Holsendolph, 1977a). The GAO report urged Congress and the CAB to encourage price competition and allow the entry of new carriers into the industry. Quickly after this report was published, President Carter announced his plan to endorse legislation that would modify industry regulation.

In March, legislation was introduced to substantially deregulate the airline industry. The new legislation allowed carriers to reduce fares by 35% and increase fares by 10% without CAB permission. This bill enabled the airlines to drop routes with a 90-day notice, while giving the CAB power to extend service for an additional 90 days. The legislation also provided Federal subsidies to promote air service in small communities and set a time limit for the CAB to process applications for new service ("Odds look," 1977).

Although President Carter and the majority of Congress backed the major provisions of the proposed legislation, the airline industry and Chairman Robson still balked at this approach. Then, in April, President Carter announced his intention to veto any CAB decision to deny low-fare applications unless the CAB could successfully demonstrate the wisdom of their actions. A month later, economist Alfred Kahn was named to succeed Robson as CAB chairman.

During his last month in office, Chairman Robson continued to relax CAB policies. Most notably, new discount pricing was approved, including the "Peanuts" fare proposed by Texas International and American's "SuperSaver" fares. The Peanuts fare gave 50 % discounts on flights determined as "off-peak" by the carrier, while

the SuperSaver allowed scheduled carriers to better compete with charter fares (Button, 1991).

The Kahn Era: 1977-1978.

By the time Chairman Alfred Kahn took office in June of 1977, United, Airwest, and Continental had indicated their support of deregulation (Holsendolph, 1977b). Even former Chairman Robson, in addition to many consumer groups, now publicly supported deregulation, stating that the existing regulatory system was not conducive to the financial health of the industry.

Before he took office, Chairman Kahn was a known supporter of deregulation. Under his reign, the CAB continued its liberalizing trend approving more discount fares among the trunks and charter operators.

The heated debate over deregulation began to lessen as the products of lower fares and liberalized route entry became apparent. Despite prediction of a period of lower profits during this time, industry profits were increasing, as fares decreased and load factors and demand picked up.

In April, 1978, the CAB initiated a proposal to allow airlines to reduce fares up to 50% without Board approval (Civil Aeronautics Board, 1978). The proposal eliminated the requirement that first-class fares be set at 50% over coach fares; the carriers immediately reduced their first-class fares to 130% of coach, and eventually to 120% of coach fares.

The CAB also simultaneously announced plans to give carriers greater freedom for route exit and entry. The CAB adopted a "show cause" order, whereby people objecting to a new route entrant were

required to provide written arguments and defend why the new carrier should not be granted entry. Eventually, the Board eased entry barriers with the multiple permissive entry policy, whereby all applicants were awarded authority on the route, provided they could demonstrate financial fitness.

By June, 1978, business was booming in the airline industry and carriers were forced to add seating capacity by whatever means possible. The first six months of 1978 showed a 16% increase in revenue passenger miles, profits up 16.3%, and load factors 20% higher than the previous year (Meyer et al., 1981).

On April 19, 1978, the United States Senate voted 83-0 in favor of legislation (U.S. Congress, 1978c) which granted greater freedom for the airlines to compete. More specifically, the bill allowed entry by new carriers without CAB approval, entry and exit rule relaxation, guaranteed subsidies to small communities to maintain essential air service, and new pricing freedom to carriers on competitive routes.

On September 21, 1978, the House voted 363-8 on legislation (U.S. Congress, 1978b) similar to the Senate-approved bill, that additionally called for the abolition of the CAB within 5 years.

After minimal discussions, a compromise bill was passed in both houses. The compromise legislation allowed airlines to reduce fares by as much as 50% without CAB approval and to assume a number of new routes each year without approval. The CAB was directed to promote airline competition, even as its authority to supervise airline pricing and route decisions was curtailed. The remaining powers of the Board, to regulate carrier service routes, were scheduled to terminate on December 31, 1981; rate regulation

would cease on January 1, 1983, and by January 1, 1985, the CAB's residual responsibilities were to be transferred to other agencies, and the Board abolished (Brown, 1987).

On October 24, 1978, President Carter signed the Airline Deregulation Act (U.S. Government Printing Office, 1978) into law. For the first time in U.S. history, a regulated industry was now totally deregulated.

Studies of Airline Regulation

To understand fully the impact of airline deregulation on market performance, a knowledge of research during the regulatory period is needed. The theoretical and empirical work on airline regulation will be reviewed, and the literature dealing with airline regulation will provide models to predict and test industry behavior after regulation.

Gill and Bates (1949) studied the effects of regulation during the industry's youth. They studied the effects of competition under the CAA in terms of quality of service provided, prices charged for such service, and the self-sufficiency of the industry.

Their findings supported the conclusion that competitive air transportation regulated by the Civil Aeronautics Act of 1938 was in the public's best interest. Such regulated competition was one of the most important factors influencing the constant growth and development of the industry.

Airlines competed by offering different types of flight equipment, passenger services, and flexible scheduling. However, they found multiple-carrier competition (where more than two carriers are authorized to serve major markets) to be adverse to the public interests.

Cherington (1958a) was another early investigator of the airline industry's pricing policy; he studied how decisions were made by airline management under the regulatory control of the CAB. He maintained that the industry competed by offering more services; these services were defined as modern aircraft equipment, ground services (baggage and reservation systems), scheduling, inflight amenities, and marketing. However, the airlines would compete primarily by offering more flights and larger aircraft. Therefore, the average load factor would be adversely affected, due to the airlines' increased capacity. This important comparison of flight frequency to load factor continued to be advanced and tested by other researchers.

Meyer, Peck, Zwick, & Stenason (1959) also questioned if the regulatory environment had outlived its usefulness. They arrived at three overlapping conclusions: (1) all transportation activities were becoming increasingly competitive, due to technological changes; (2) competition made government regulation extremely cumbersome and outdated, and; (3) regulatory insistence on highly uneconomical cross-subsidies was not justified since they endangered the survival of otherwise economical routes.

Caves (1962) also studied the effects of regulation on competition. He found that the CAB, by allowing entry into markets,

reduced overall concentration among the trunks. The largest carriers were operating in these markets, and the new entry eroded the trunks' market share.

Caves also studied price and income elasticity demands. Price elasticity greatly affected a carrier's decisions on cooperating with other firms in the industry. If the demand price was found to be inelastic, then all the carriers benefited by cooperating, since they could raise profits. Caves also concluded that price elasticity should decline as the flight distance increased, resulting in more cooperation among the carriers on longer trips.

Caves concluded that price elasticity was higher for business customers and lower for tourist class; therefore carriers would benefit more by moderate growth than by cooperation and slower growth. He also studied airline costs, suggesting that economies-of-scale were not a factor for the major carriers, concluding there was no cost advantage to being a large firm in the industry.

Jordan's (1970) study compared the regulated trunk airline industry in California to the unregulated intrastate airlines' performance also operating in California. Studying the data gathered from 1946 to 1965, he found the CAB was extremely effective in controlling pricing and market entry, often protecting the trunklines by allowing mergers and transfer of assets to keep them financially sound. However, unregulated prices were as much as 47% lower in the California markets. Like Caves, Jordan found that economies-of-scale were realized only with small output levels. Since the industry operated on the principle of constant returns to scale, airlines would

be under constant threat of new carriers if price or profits were excessively high in an unregulated market.

Since route entry was controlled, the carriers competed by offering a higher quality of service; the price and service combination was usually higher than most consumers wanted. He further stated that consumers were required to purchase higher quality service, even though they wanted lower quality service at a lower price. Therefore, Jordan concluded that regulation was not in the consumer's best interest.

Keeler (1972) maintained that Caves' conclusions regarding the effects of CAB regulation were ambiguous. Caves simultaneously stated that deregulation would bring about no improvement in market performance, while also stating that deregulation of high-density routes was desirable. While Jordan's conclusions were not ambiguous, Keeler declared inaccuracies existed in Jordan's study, due to his analysis of cost structure. The Northeast Corridor cost structure for airlines might be completely different from the unregulated cost structures of the California airlines. If the cost structure was higher in the Northeast Corridor, then Jordan's estimate of regulation inefficiencies would be over-estimated and therefore invalid. Additionally, Jordan did not include any long-haul costs in his study, only speculating what these fares might be.

The purpose of Keeler's study was "to estimate hypothetical unregulated fares on the 30 highest-density trunk airline routes in the United States"(p. 400). To estimate unregulated fares, cost functions would first need to be estimated and verified using

interstate airline data. His estimate of the total cost function included two categories, direct cost and indirect cost.

Direct cost included expenses for aircraft capital investment, crew salaries, fuel and aircraft cost and maintenance. Indirect costs included expenses for ground services (cabin service, fuel), ticket sales and reservations, and administrative costs. To compute costs, Keeler used three aircraft types (DC-9s for short-, B-727s for medium-, and DC-8s for long-haul routes), an average load factor of 50% (the normal load for the Pacific Southwest, which operated only in unregulated California markets) and a 12% return on investment with no depreciation.

Keeler predicted airline fares for two intrastate (unregulated) California markets from his cost estimates; his predicted fares were similar to actual fares, thereby confirming his cost model. He then calculated fares for the thirty trunk markets and then determined the percentage of markup for regulated fares. He found markups of 20% to 95% in 1968, and markups of 45% to 84% in 1972, with less correlation between markup and distance.

Douglas and Miller (1974) studied the impact of regulation on economic efficiency for the trunklines. They looked at two aspects of economic performance: technical efficiency and allocative efficiency. Technical efficiency requires that a firm appropriately select and combine inputs to produce a given output at its lowest total cost. Allocative efficiency measures whether the product offered reflects the consumer's desires. To evaluate technical efficiency, Douglas and Miller reviewed the cost of producing scheduled passenger air service.

Airline costs can be divided into three groups: capacity costs, traffic costs, and overhead costs. Capacity costs are those costs associated with generating capacity on an airline and include such things as aircraft operating costs and aircraft ownership costs. Capacity is measured in available-seat-miles and account for approximately 75% of total costs. Capacity cost does not vary with the volume of passengers.

Factors affecting capacity cost are new aircraft technology, aircraft size and crew costs, flight distance, and the total aircraft flight time. Aircraft technology has changed greatly, especially since the introduction of jet service in the 1960s. As aircraft technology has progressed, capacity cost per seat has declined. The researchers also found economies-of-scale to be associated with aircraft size and flight distance, but not by the size of the individual airline. As aircraft size increases, capacity costs are spread over more seats, creating economies-of-scale.

Traffic costs are those costs that vary directly with the volume of passengers and include baggage handling and the costs of processing passengers at the terminal. These traffic costs combine for approximately 20% of total cost. The remaining cost then is overhead cost, which is a relatively small part of total cost.

Patterns of demand during the day, week, month, and year, and the ensuing pricing problems were studied; it was determined that peak pricing is not employed. In the peak periods, the opportunity costs to the airline are higher and thus price should reflect these additional costs. Douglas and Miller reported that demand was both income elastic and price elastic.

The CAB indirectly regulates service by dictating the rate of return and fares. The CAB will designate fares to produce a given rate of return. Airline operations under regulation will operate at the breakeven load factor. If the load factor rises above this level, profits will rise and firms will schedule more capacity (flights) until load factor declines to the breakeven level. This excess causes carriers to accept price structures and compete primarily on capacity.

Under regulation, there are few incentives for the airlines to keep costs down. Typically, the industry passes on higher operating costs to the consumer rather than becoming more cost efficient. Although the industry will charge higher fares, in the long run, they will operate at zero economic profits.

One major problem is that the CAB does not consider marginal cost when setting price. The CAB sets fares below marginal cost on short-haul markets. To offset the these losses, the CAB allows the long-haul markets to price above their marginal cost.

Douglas & Miller conclude by stating that the overall level of airline fares is inefficient and leads to a price-quality combination much higher than most consumers want. The principle source of this economic inefficiency results from regulatory-imposed restraints on airline competition.

CHAPTER III

THE AIRLINE DEREGULATION ACT OF 1978

An Overview of Congressional Arguments For and Against Airline Deregulation

The Airline Deregulation Act of 1978 (ADA) increased the airline industry's freedom from government control over its economic activities. In enacting this legislation, Congress hoped to ensure a more competitive environment for American air carriers; however, the measure did not pass without controversy. The numerous Congressional debates and hearings that led up to the Act's passage produced a variety of opinions on whether the airlines, their passengers, and the American economy would indeed benefit by deregulation (Lynch, 1984; Kwon, 1991).

Alfred E. Kahn, chairman of the Civil Aeronautics Board, was a highly visible proponent for the passage of the ADA, speaking out enthusiastically for free competition. Testifying before Congress, he portrayed the CAB as "a firm advocate of loosening the tight grip of Government on the aviation industry and moving it in the direction of restoring it to the control of a more competitive market . . ." (Committee on Budget, 1977, p. 8). Believing less government intervention was better for the public, Kahn based his advocacy of competition upon the general principle of free enterprise, asserting

that ". . . growing markets, expanding markets under the pressure of competition - have been beneficial to all parts of the economy" (Committee on Public Works and Transportation, 1978, p. 132).

Kahn drew on his economics and public administration background in order to address the objections raised against deregulation; his study and experience in economic matters convinced him that the public interest was best served by competition, not regulation. He asserted that competition served the public interest because it "is the only persistently effective mechanism available to us for holding costs and prices in check, and for stimulating cost, price, and service innovations" (Committee on Public Works and Transportation, 1978, p. 71).

Kahn divided his proposal for competition into two sections: substantive and procedural. The substantive section centered exclusively on the "automatic entry provision" as an essential program to encourage free competition. This system allowed each individual carrier to move into a limited number of markets on the basis of its own judgment; due to the ease of entry, new carriers would create price and service competition. In his procedural section, Kahn expressed the desire to move quickly in the competitive direction (Kwon, 1991). Even though it was expected that the development of new routes and fares might be more difficult and complicated, he wanted to establish unrestricted competition in the airline industry, asserting:

> We (the CAB) intend to proceed in a phased and orderly fashion to move from the present program . . . to the new program. That is why we have requested a seven-year

> transition. . . . at the end of the seven-year period, each of the carriers will have an opportunity to complete the transition to full-fledged trunkline status (Committee on Public Works and Transportation, 1978, p. 111).

The CAB chairman was a strong believer in free competition, pointing out the eventual benefits for the companies, their employees, stockholders, and creditors. He believed with fewer regulations organizing the market, the airlines would face the challenge of achieving productivity and profits based on effective management and efficient innovations. Kahn asserted that the achievement of these goals by airline executives would ensure the ongoing growth of private business in the industry and concluded that low fares, derived from more competition, would create a higher demand for air travel (Kwon, 1991).

However, most of the established big airlines did not favor deregulation. They argued that the changes and the pressure of increased competition would result in unfavorable consequences. American Airlines' chairman and president, Albert V. Casey, asserted that no further competition was required because of the high level already established. He maintained that the effect of additional competition would increase neither revenues nor profits and believed that the severe competition faced through deregulation would not guarantee profits. Casey further stated that the effects of deregulation would lead to financial instability and perhaps even chaos, adding that:

> Once you take the dangerous step of putting the new regulatory concepts into play, there will be little

> opportunity to turn back. . . . There will be service complaints, cries for Federal subsidies, appeals for job protection measures, and searches for new ways to control rising fares" (Committee on Public Works and Transportation, 1977, p. 1187).

Others shared the view that the deregulation bill might contain serious, hidden flaws. Some members of Congress and the industry believed that excessive competition might lessen service to more marginal markets and small communities, enlarge industry concentration, force reduced opportunity for new entrants, harm smaller carriers and the weak members of large trunk lines, and induce fare increases on less-populated routes (Committee on Commerce, Science, and Transportation, 1978).

As the ADA was being drafted, Congress realized the Act could either free the industry from stifling regulation or destroy it. The Congress sought to address these concerns in the Act so the bill would foster a beneficial environment for the industry and consumers alike.

The Airline Deregulation Act of 1978

Overview of the Airline Deregulation Act of 1978

The Airline Deregulation Act of 1978 (U.S. Government Printing Office, 1978) amended the Federal Aviation Act of 1958 (U.S. Government Printing Office, 1958), providing legislation toward the public interest, convenience, and necessity and away from the

protection of the industry. As this transition took place, its creators aimed to ensure that safety would remain the top priority in air transportation, assigning this responsibility to the Secretary of Transportation. Safety implications of new services and a full evaluation thereof were required prior to the authorization of new air transportation services. Rigid safety procedures were established to ensure no degradation of established airline safety records. The Act recognized the clear intent, encouragement, and dedication of the U.S. Congress to continue the highest degree of safety in air transportation and air commerce while maintaining the safety vigilance that had evolved within the airline industry and had come to be expected by the traveling public.

After ensuring safe travel, the Act concentrated on maintaining adequate, efficient, and low-cost service to the traveling public. This focus was to be accomplished by maximum use of competitive market forces to provide a balanced national air transportation system, with efficient carriers who could earn profits. The Act prevented unfair, predatory, or anti-competitive practices by allowing the market to prevent monopolies, unreasonable price increases, or reduced services in air transportation.

The Act encouraged entry into air transportation markets by new carriers and enticed established carriers to enter additional markets. It also provided for the continued strengthening of small carriers to assure a more effective, competitive airline industry. The Act sought the encouragement, development, and maintenance of an air transportation system, relying on actual and potential competition. This reliance would provide efficiency, innovation, and

low price, and it would allow public input to help determine the variety, quality, and price of air transportation services (U.S. Government Printing Office, 1978).

Loss of service to small communities was of great concern; therefore the Act provided for the maintenance of a comprehensive and convenient system of continuous scheduled airline service for these communities and other isolated areas, with direct Federal assistance where appropriate. At major urban areas, the Act sought use of secondary or satellite airports to allow more carriers access to the larger cities. This added service was encouraged where consistent with regional airport plans and when such encouragement was endorsed by appropriate State entities. These agencies encouraged services by air carriers whose sole responsibility was to provide service exclusively at the secondary and satellite airports.

Finally, the Act developed and maintained a sound regulatory environment responsive to the needs of the public. Decisions were to be reached promptly, in order to facilitate adaptation of the air transportation system to the present and future needs of the United States, the Postal Service, and the national defense (U.S. Government Printing Office, 1978).

Safety Study

Congress insisted that implementation of the Airline Deregulation Act result in no diminution of the high standard of safety in air transportation attained in the United States at the time of its enactment. The Secretary of Transportation was instructed to prepare and submit a report to Congress and the Board, not later

than January 31, 1980, and each January 31 thereafter. This report would be a comprehensive annual analysis of the extent to which the implementation of the ADA had affected, during the preceding calendar year, or will affect, in the succeeding calendar year, the level of air safety.

The Act dictates that each report contain a detailed analysis:

(1) All relevant data on air transportation accidents and incidents occurring during the previous year will be included.

(2) All relevant data on violations of safety regulations issued by the Secretary of Transportation occurring during the previous year will be outlined.

(3) The effects of changes on current levels of air safety or proposals for changes in airline operating practices and procedures will be discussed.

(4) The adequacy of current air safety regulations will be evaluated, emphasizing changes in airline operating practices and procedures which occurred during the previous year.

Based on this report, the Secretary of Transportation is instructed to take those steps necessary to ensure the highest standard of safety in air transportation. The Secretary shall continually modify safety regulations, as necessary, to prevent any potential conflict of safety interest (U.S. Government Printing Office, 1978).

The CAB is given the authority to oversee commuter operations. The Board must determine that a commuter air carrier is fit, willing,

and able to perform such service, and the aircraft used and all operations will conform to the safety standards established by the Administrator. Not later than the 180th day after the Act takes effect, the Administrator will establish safety standards for commuter aircraft and their operations. Such safety standards will become effective within 18 months. Furthermore, the Administrator will ensure that the level of safety provided to persons traveling on commuter air carriers is, to the maximum feasible extent, equivalent to the level of safety provided to persons traveling on major air carriers.

Route Applications

When any carrier files a route application, the Board is given 90 days to: (a) set such application for a public hearing; (b) begin to make a determination on the application under the simplified procedures established by the Board, or; (c) dismiss the application. Any person may file a letter of opposition to or support of the issuance of the route application. Any order of dismissal without setting the application for hearing, or beginning to make a determination with respect to such application under the simplified procedures, will be deemed a final order, subject to judicial review.

If the Board determines that an application should be set for a public hearing, an initial or recommended decision will be issued not later than 150 days after the date of such determination by the Board. The Board must make its final decision within 90 days of the issuance of the initial or recommended decision. If the Board does not act within the 90-day period, the initial or recommended

decision becomes the final decision of the Board and is subject to judicial review; the Board's final order will be issued under the simplified procedures within 180 days (U.S. Government Printing Office, 1978).

The Act simplified the process of issuing new route certificates. It directs the Board to issue a certificate if it finds that the applicant is fit, willing and able to perform the transportation properly and can conform to the provisions of the ADA. The applicant must abide by the rules, regulations, and requirements of the Board, and such transportation must be deemed consistent with the public convenient and necessity. These requirements apply to all applicants in all situations.

In the case of an application for a certificate to engage in temporary air transportation, the Board may issue a certificate authorizing the application for limited periods as is consistent with the aforementioned requirements of public convenience and necessity. In the case of an application for a certificate to engage in charter air transportation, the Board may issue a certificate to any applicant not licensed as an air carrier on January 1, 1977.

Unused authority (routes certificated but not used) was defined in the Act, and the Board was directed to release these routes to other carriers. Any air carrier authorized to provide round-trip service nonstop between any 2 points in the continental U.S. must provide a minimum of 5 round trips per week for at least 13 weeks during any 26-week period. If the air carrier fails to provide such service as published in flight schedules (a minimum of five round trips per week) and is the only air carrier providing this scheduled

service, then the Board must issue a certificate to the first applicant who, within 30 days after the last day of the 26-week period, submits an application for that route. If two or more carriers provide the nonstop service, the Board will issue a certificate to the first applicant who, within 30 days, submits an application. Seasonal routes, those that operate only during specified times of the year, are likewise treated (U.S. Government Printing Office, 1978).

The Act requires the Board to issue a final order granting the certificate within 60 days of the date of the application, unless it is found that the issuance of a certificate is inconsistent with the requirement of public convenience and necessity. Prior to issuing such final order, the Board is directed to give adequate notice and opportunity for interested persons to file appropriate written evidence and argument, but the Board does not need to hold oral evidentiary hearings. For any application covering an unused authority, it is presumed that any transportation covered by an application for a certificate is consistent with the public convenience and necessity.

Whenever the Board issues a new permanent certificate, the air carrier receiving such certificate must commence the new service within 45 days. If the air carrier fails to commence service within the allowed 45-day period, the Board will revoke the new certificate. Whenever the Board issues a temporary certificate, the air carrier receiving this certificate must commence service within 15 days after the beginning of the requested season, otherwise the certificate will be revoked.

When a carrier fails to provide service to a given point, the Board will issue only one new certificate to cover that route. At that time, the Board will suspend the authority of the first air carrier to provide that service (U.S. Government Printing Office, 1978).

Automatic entry into new markets became allowed under the ADA. Between January 1 and 12 of each of the calendar years 1979, 1980, and 1981, any carrier that had operated during the preceding calendar year may apply to the Board for a certificate to engage in a new, nonstop service. This new service can be between any one pair of points in interstate air transportation, in addition to any pair of points already authorized. A carrier may apply for new, nonstop service between any two points; however, each carrier can protect one market pair from new entry by other carriers. Within 60 days of this application, the Board must issue a certificate to the applicant for the nonstop service specified in the application. This issuance is automatic, unless the applicant does not fulfill the requirements of being fit, willing, and able.

Not later than the 120th day of calendar years 1979, 1980, and 1981, any air carrier which submitted an application to the Board and: (a) did not receive a certificate to provide service between the pair of points set forth in the application, or; (b) received a certificate to provide service between the pair of points, but was not the only air carrier to receive one, may reapply to the Board. The carrier may submit a request for a certificate to engage in nonstop service between any one pair of points (other than the cities specified in the first application), in addition to those authorized by an existing certificate. However, no air carrier may apply to engage in nonstop

service between such pair of points if another air carrier has filed written notice to the Board with respect to the same pair of points. Not later than the 60th day after the date on which the Board receives an application, the Board shall issue a certificate to the applicant for such nonstop service (U.S. Government Printing Office, 1978).

Any air carrier which is authorized to engage in nonstop service between any pair of points in interstate air transportation on the first business day of calendar year 1979, 1980, or 1981 can preclude any other air carrier from obtaining authority to engage in nonstop service between such pair of points. At this time, the carrier may file written notice to the Board naming these points. Upon receipt of written notice, the Board makes this notice available to the public.

To prevent a sudden disruption in service, the ADA states that no air carrier can terminate or suspend all air transportation its providing to a point, or reduce the air transportation below which the Board has determined to be essential air transportation. If the air carrier adversely changes its service to a point, it must give the Board, any community affected, and any appropriate State agencies in the community at least 90 days' notice of its intent to terminate, suspend, or reduce such air transportation.

Likewise, air carriers may not change any rate, fare, or charge, or any classification, rule, regulation, or practice affecting the same, until 30 days after notice of the proposed change has been filed, posted, and published. However, if the effect of any proposed tariff change would be to institute a fare that is outside of the applicable range of fares specified in the Act, the proposed change can not be

implemented, except after 60 days' notice (U.S. Government Printing Office, 1978).

The ADA also addresses the issue of compensation for the transportation of mail. It determines that the rate paid must be sufficient to ensure the performance of such service. Compensation shall reflect the carrier's capability to provide honest, economical, and efficient service and to maintain the same level of quality as previously provided. The mail compensation must also allow the carrier to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense. Compensation rates paid to any carriers shall be based on its subsidy need, calculated with respect to service performed.

Mergers and mutual aid agreements were addressed by the ADA to ensure competition in service and pricing remained at the center of deregulation. If any air carrier wishes to consolidate, merge with, purchase, lease, or acquire another carrier, it must first notify the Board. After a hearing, if the Board finds that the transaction will be consistent with the public interest, it will approve the transaction. However, the Board will not approve this transaction if it results in a monopoly or a substantial lessening of competition in that region. The Board may approve a transaction that produces a monopoly or reduces competition, if it finds that the anti-competitive effects of the proposed transaction are outweighed by the public interest. This approval will occur if the applicant shows that consumer needs may not be satisfied by any available alternative.

Mutual aid agreements, which provide for payments from other air carriers during reduced levels of service due to a labor strike, are no longer approved. Furthermore, no air carrier is allowed to enter into any new mutual aid agreement, unless the air carrier files a copy of such agreement with the Board and the Board approves it. The Board is directed not to approve any mutual aid agreement, unless specifically stated that the benefits are not payable for more than two months and benefits may not be for losses incurred during the first month of a labor strike. Moreover, any carrier participating in an agreement must submit the debated issues to binding arbitration under the Railway Labor Act (U.S. Government Printing Office, 1978).

Service to small communities is guaranteed by the ADA. The ADA defines "essential air transportation" as scheduled air transportation to points designated by the Board that satisfies the needs of the communities involved. This transportation must ensure access to the nation's air system at rates, fares, and charges which are not unjust, unreasonable, discriminatory, preferential, or prejudicial. The transportation must be at least two daily round trips, five days per week, or the level of service provided by air carriers to that point for calendar year 1977, whichever is less. The essential air transportation section is in effect for ten years from the date of passage of the Act.

The term "eligible point" means any point in the United States which (a) a carrier is providing service to, or (b) has lost air carrier service between July 1, 1968, and the date of passage of the Act. The Board will establish objective criteria for designating points as

eligible and may also specify any point in the state of Alaska or Hawaii as eligible. When considering eligible points, the Board shall consider: (a) the level of traffic generated by the point; (b) its future traffic generating potential; (c) the cost to the Federal Government of providing essential air transportation; (d) any alternate means of transportation available to residents of the communities of interest, and; (e) the views of any interested community and the State agencies in which such community is located.

After January 1, 1982, the Board may designate any point an eligible point, but only if this designation will not increase the total number of points above that receiving a subsidy on July 1, 1968. The designation of any point as eligible may be withdrawn, if the point no longer meets the criteria (U.S. Government Printing Office, 1978).

An air carrier that holds a certificate, whether or not receiving compensation for service to that eligible point, may not terminate, suspend, or reduce air transportation established by the Board. If a carrier desires to decrease service to an eligible point, it must give the Board, the appropriate State agencies, and the communities affected at least 90 days' notice prior to such termination, suspension, or reduction.

If the Board determines that compensation is required to provide essential air transportation, then it will announce the eligible points and establish the amount of compensation to be paid for providing such essential air transportation. In selecting an applicant to provide essential air transportation, the Board will consider the desirability of developing an integrated linear system of air

transportation and the experience of the applicant in providing scheduled air service.

After the eligible routes are awarded, the Board makes payments of compensation at times and in a manner determined to be appropriate. The Board continues to compensate any air carrier to provide essential air transportation to any eligible point, but only for as long as the Board deems necessary (U.S. Government Printing Office, 1978).

If an air carrier notifies the Board of its intention to suspend, terminate, or reduce service to any eligible point below the level of essential air transportation, the Board will seek new air carriers for that point. If no new carriers are found, the Board will require the original carrier to continue such service to such point for an additional 30-day period, or until another carrier can be found, whichever first occurs. The Board will continue this system as necessary to ensure air transportation to such eligible point. In this situation, the air carrier would continue to receive compensation (if previously compensated, or begin receiving compensation, if appropriate) until the Board finds another air carrier to provide essential air transportation to that point.

Finally, the Board will periodically review the determination of what is essential air transportation to what eligible point. The Board may, based upon such review and consultations with any interested community and any appropriate State agencies, make appropriate adjustments as to what is essential air transportation to such point.

Rates

On July 1, 1977 the "standard industry fare level" (SIFL) set the fare level for each interstate pair of points and each class of service. The ADA dictates that the Board at least semi-annually adjust each SIFL, increasing or decreasing it by the percentage change in the actual operating cost per available seat-mile.

The Board no longer has authority to find any fare unjust or unreasonable, except in unusual circumstances. Fare changes will not be subject to review if the fare increase is not more than 5% above or 50% below the SIFL for the same class of service. If the proposed fare change is above the 5% limit, then the rate will usually be disallowed on the basis that it was unduly preferential, unduly prejudicial, or unjustly discriminatory. Any fare request below the 50% limit will normally not be granted, as deemed predatory by the ADA (U.S. Government Printing Office, 1978).

In determining whether any fare request is unjust or unreasonable on the basis that it is too high, the Board will consider reasonably estimated or foreseeable future costs and revenues during which the requested fare may be in effect. By July 1, 1979, the Board must issue regulations modifying the rules governing those classes of service in existence on July 1, 1977. These regulations also apply to classes providing lower fare levels during off-peak periods. The Board will also allow any carrier to establish additional classes of service shown to be consistent with the public interest. If a complaint is filed alleging that a fare is discriminatory or predatory, then the Board will act on the complaint within 90 days.

In determining rates, fares, and charges, the Board considers the need for adequate and efficient transportation at the lowest cost, consistent with the furnishing of such service. It should also determine the effect of a variety of price and service options in response to particular competitive market conditions, such as peak and off-peak pricing.

Sunset Provisions

The Airline Deregulation Act included provisions for the termination and transfer of the authority of the CAB. On December 31, 1981, the CAB ended its authority to issue certificates, approve service terminations, reductions, and suspensions (except essential air transportation). The sections governing tariff changes and rates were terminated on January 1, 1983 (U.S. Government Printing Office, 1978).

The ADA also decided to transfer authority of areas that continued to function. The first area transferred was mergers, which went to the Department of Transportation on January 1, 1983. In January, 1985, authority to provide compensation for air transportation to small communities was transferred to the Department of Transportation. Simultaneously, authority for the determination of rates for the carriage of mails in air transportation was given to the Postal Service.

As a final procedure, the Board was directed to submit to Congress by January, 1984, a comprehensive review of the Board's implementation of the provisions of the Act. The report was to cover accomplishments during the initial period of the Act's existence,

along with a comprehensive review of each of the Board's programs. The comprehensive review would include a detailed comparison of the degree of completion of the programs within the Act as well as a comparison of the degree of pricing competition within the industry. The report was to discuss the extent of unused authority and provide a comparison of the extent of air transportation service provided to small communities, together with facts detailing the comparative subsidy costs. Finally, the report was to assess the impact of these changes on the national air transportation system and give the Board's opinion as to whether these changes have improved or harmed this nation's domestic air transportation system. This assessment was to include a detailed opinion from the Board as to whether the public interest required continuation of the Board and its functions beyond January 1, 1985.

Summary

The Airline Deregulation Act of 1978 was designed first to relax, and then to terminate, direct economic control of the domestic airline industry. This change was to ensure a gradual deregulation of the airline industry. The CAB was scheduled for termination in 1985, following a gradual transition period in which its regulatory functions were either terminated or transferred to other government agencies.

During this transition period, the Civil Aeronautics Board was directed to ". . . stress competition and to encourage low fare service and new entry into the industry" (U.S. Congress, 1978a, p. 3740). Its

authority to regulate airline market entry, exit, and fares was diminished, and procedures to expedite Board decisions were established.

The established restrictions on entry of new airlines into scheduled passenger service and controls over established carrier entry into new routes were greatly reduced. Though still required to obtain a certificate, a carrier must only prove that it was "fit, willing, and able" to provide the service; it no longer had to show that it was "required by the public convenience and necessity." The Board was also now required to allow charter operators to provide scheduled passenger service. New route authority, an accelerated certification process, less stringent fitness standards, and a shift in the burden of proof to opponents of new entry greatly increased the ability of all air carriers to set their own destiny (Brown, 1987).

Relaxed entry requirements were enhanced with unused authority and automatic entry programs that allowed carriers to enter new routes without CAB interference. Under the unused authority provisions, carriers were allowed to provide nonstop flights on routes where other carriers were certified but not providing nonstop service. The automatic entry program required the CAB to grant carriers at least one new route during the 1979, 1980, and 1981 calendar years.

Carriers were also granted more freedom to exit markets, requiring them only to give advance notice and allowing them to bypass lengthy evidentiary hearings before terminating service. The only restriction placed on exit from a market was the requirement that "essential air transportation" be maintained at selected cities.

This restriction included all cities receiving scheduled passenger service before passage of the Act. The essential air transportation program was included to prevent abrupt termination of service on less profitable routes to smaller communities. The Board was directed to define the requirements for essential service to small communities. This service was guaranteed for ten years and funded by a new subsidy program. If a replacement carrier could not be found, the Board would deny a carrier's request to exit that market. The Board was authorized to subsidize the original carrier for any losses on that route, thereby guaranteeing essential air service to the communities (Brown, 1987).

Pricing freedom was a major goal of the Act. Even though an upper and lower limit on pricing flexibility was set, the airlines had a major input in determining fares for their markets. The Board determined, and periodically revised, a standard industry fare level (SIFL). Rate adjustments not greater than 5% above of 50% below the SIFL were automatically granted, unless they were found to be predatory.

The Board's authority to provide antitrust exemption was amended. Under the old law, Board approval was required for all inter-carrier agreements regarding mergers and mutual aid agreements. In the past, Board approval exempted carriers from prosecution under the antitrust laws. Inter-carrier agreements still required Board approval, but the Act limited Board discretion by directing it to apply the pro-competitive thrust of antitrust statutes in immunity decisions. Also, the Board was prohibited from approving an agreement which substantially reduced or eliminated

competition, unless the carrier could prove a serious transportation need or an important public benefit. Finally, the Board could not approve any agreement that limited capacity or fixed rates, fares, or charges (Brown, 1987).

During the transition period, the major components of the old regulatory framework were terminated. Regulation of carrier routes stopped on December 31, 1981. On January 1, 1983, all regulation of fares and mergers ended. Finally, the CAB presented a detailed opinion to Congress as to whether the Board and its functions should be continued beyond January, 1985.

After its termination on January 1, 1985, the CAB's responsibilities were transferred to other governmental agencies. The Department of Transportation assumed responsibility for essential air transportation. The Justice Department assumed control of the antitrust authority, and the Postal Service oversaw responsibilities regarding mail transport.

The Airline Deregulation Act was designed to increase the airline industry's freedom from government control over its economic activities. By passing this legislation, Congress hoped to ensure a more competitive environment for American air carriers. Some members of Congress and the industry believed that excessive competition from deregulation might be disastrous. They feared loss of service to small communities, fare increases on less-populated routes, and a decrease in safety for airline travelers.

The ADA addressed these concerns. Safety, its first priority, was not to be compromised at any level. The Act relaxed restrictions on route entry and pricing, and guaranteed service to small

communities for at least ten years. Moreover, the ADA allowed charter and supplemental carriers the chance to acquire major routes and expand their operations. The Act's gradualism approach was included to ensure the industry time to prepare for total deregulation.

CHAPTER IV

SUMMARY AND RECOMMENDATIONS

Summary

The purpose of the study was to investigate the history of U.S. airline regulation. There were three basic aspects of this study. Specifically, it sought to: (a) investigate regulation prior to 1978, (b) examine conclusions of studies conducted referencing this era, and; (c) describe the issues addressed by the passage of the ADA.

A review of the literature revealed that the government has played an active role throughout the history of the airline industry. The history prior to deregulation provides insight into the effect of regulation on air travel.

The first major legislation, the Air Mail Act (U.S. Government Printing Office, 1925), encouraged commercial aviation by transferring the movement of mail from the Army to private carriers. Congress continued to encourage aviation through the Air Commerce Act (U.S. Government Printing Office, 1926), providing funds for ground facilities, along with airway and navigational aides. Abuses of the Air Mail Act led to awarding air mail contracts based on competitive bids. Direct and indirect subsidies were provided to the airlines, and the Interstate Commerce Commission was then authorized to govern passenger fares.

In January, 1935, the Federal Aviation Commission recommended to Congress the establishment of a separate regulatory agency. The airlines and the Air Transport Association were also in favor of one governing agency to oversee the airline industry. The government agreed that their heavy investment in the airline industry was threatened by unrestricted competition; accordingly, they enacted the Civil Aeronautics Act of 1938.

The Civil Aeronautics Act of 1938 (U.S. Government Printing Office, 1938) was the most important piece of legislation prior to deregulation. This Act established the Civil Aeronautics Authority, a five-member board, to guide the airline industry. Their goal was to regulate, promote, and develop the air transportation system. They oversaw three major elements: control of entry and competition, control of earning and fares, and control of safety (Van Scyoc, 1987). This Act established the regulatory framework that would rule the airline industry until 1978.

In 1940, the Civil Aeronautics Board (CAB) was established to take over the responsibilities of the CAA. The Board was given authority over economic activities, such as commercial airline routing and pricing practices (Kwon, 1991).

The CAB's focus changed during World War II. Since profits were extremely high, public pressure shifted the focus from competition to the industry's fare structure. This emphasis culminated in the introduction of the coach fare (Caves, 1962). The CAB also instituted feeder airlines for service to small communities. Concurrently, supplemental (nonscheduled) airlines were allowed to

operate, offering charter operations, military support, and low-fare flights.

After the Korean Conflict, earnings improved significantly, drawing attention to very high profits. A Congressional investigation resulted in the passage of the General Passenger Fare Investigation (GPFI), which created a fair rate of return policy.

The Federal Aviation Act (U.S. Government Printing Office, 1958) created the Federal Aviation Agency (FAA) to replace the Civil Aeronautics Administration and assume its functions. The new FAA assumed two major areas: (1) they were given full responsibility and authority for the advancement and enforcement of civil aeronautics, including all safety regulations, and; (2) they assumed full responsibility for management of the national airspace system. This responsibility included enforcement of air traffic rules, and development and operation of air-navigation facilities. The Civil Aeronautics Board, however, continued its jurisdiction over the investigation of air accidents.

The late 1960s saw increasing competition among the airlines. Although prices were fixed, frequency of flights and capacity levels were not. The airlines flew with high frequency and low load factors. This situation prompted the CAB to initiate the Domestic Passenger Fare Investigation (DPFI), providing the Board's first analysis of its fare policies (Bailey, Graham & Kaplan, 1985). The DPFI enhanced the policies of the GPFI and instituted a formula using load factors for determining fares.

The 1970s saw growing public sympathy toward deregulation (Doganis, 1985; Caves & Roberts, 1975). In February, 1975, the

Senate Judiciary Subcommittee on Administrative Practice and Procedure began investigations into the fairness and effectiveness of CAB practices and procedures. Later that year, the Ford Administration proposed the Aviation Act of 1975 (U.S. Government Printing Office, 1975), which was aimed at stimulating price competition, eliminating entry barriers to new markets, and altering the basic function and purpose of the CAB.

In June, 1977, Alfred E. Kahn was appointed chairman of the Civil Aeronautics Board. A highly visible proponent of deregulation, he was an aggressive spokesman for free competition.

Kahn continued his support for deregulation and offered plans for its inception. He proposed a gradual phasing out of the regulatory environment, in order to ensure an orderly transition from regulation to deregulation. His plan envisioned freedom from route and pricing restrictions which the CAB had controlled for 40 years.

Others feared that the deregulation bill might contain serious, hidden flaws, believing that excessive competition might diminish service to small communities, harm smaller carriers, and induce fare increases on less-populated routes (Committee on Commerce, Science, & Transportation, 1978).

As the Act was drafted, Congress realized that these concerns were justified. They sought to address these concerns in the Act, in order for the bill to create a beneficial environment for the industry and consumers alike.

The Airline Deregulation Act of 1978 (ADA) increased the airline industry's freedom from government control. In enacting this

legislation, Congress hoped to ensure a more competitive environment for American air carriers, while ensuring a safe, low-cost fare for the American consumer.

The ADA was designed first to relax, and then to terminate, direct economic control by the CAB. The CAB was scheduled for termination in 1985, following a gradual transition period in which its regulatory functions were either terminated or transferred to other government agencies.

During this transition period, the Civil Aeronautics Board was directed to rely on competitive market forces to further the industry. Its authority to regulate airline market entry, exit, and fares was diminished, and procedures to expedite Board decisions were established. Relaxed entry requirements were enhanced with unused authority and automatic entry programs that allowed carriers to enter new routes without CAB interference.

Carriers were also granted more freedom to exit markets, requiring them only to give advance notice and allowing them to bypass lengthy evidentiary hearings before terminating service. The only restriction placed on exit from a market was the requirement that "essential air transportation" be maintained at selected cities. The essential air service program was added to prevent abrupt termination of service on less profitable routes to smaller communities.

Pricing freedom was a major goal of the Act. Although an upper and lower limit on pricing flexibility was set, the airlines had a great deal of input in determining fares for their markets.

During the transition period, the major components of the old regulatory framework were terminated. Regulation of carrier routes ended on December 31, 1981. On January 1, 1983, all regulation of fares and mergers would terminate. Finally, the CAB was required to present a detailed opinion to Congress by January, 1984, as to whether the Board should continue beyond January, 1985.

After its termination on January 1, 1985, the CAB's responsibilities were transferred to other governmental agencies. The Department of Transportation assumed responsibility for essential air transportation. The Justice Department assumed control of the antitrust authority and the Postal Service oversaw responsibilities regarding mail transport.

Recommendations

Research conducted for this study provides recommendations for further study in this area:

1. Safety was a prime consideration of the Airline Deregulation Act. Prior to the passage of the ADA, the major airlines maintained an excellent safety record. Further research should be done to identify any significant changes in the safety standard of U.S. airlines since passage of the ADA.
2. Consumer cost was a major factor which induced the ADA. The Act sought to ensure lower prices with satisfactory service for the American consumer. A study should be done to (a) compare consumer cost (in dollars)

between the date of the Act's passage and the present, and (b) compare the frequency of flights/average load factors/airline earnings between the date of the Act's passage and the present.

3. Essential Air Transportation was designed to ensure service to small- and medium-sized communities. The service, however, was only guaranteed for ten years after passage of the ADA. Future studies should be done to determine the effects on the these communities after expiration of the ten-year requirement.

4. The limitations of this study dealt specifically with U.S.-based airlines. Future studies could be designed to examine the economic effects of foreign-based airlines entering the U.S. domestic system.

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APPENDIXES

Appendix A

EXISTING AIRLINES IN 1938

Appendix A
Existing Airlines in 1938

CARRIER	DATE MERGED
American	
Braniff	
Capital Airline	1961 - Merged with United
Chicago & Southern	1956 - Merged with Delta
Colonial Airline	1956 - Acquired by Eastern
Continental	
Delta	
Eastern	
Inland Airline	1952 - Merged with Western
Mid Continent	1952 - Merged with Braniff
National	1980 - Merged with Pan Am
Northeast	1971 - Merged with Delta
Northwest	
Trans World	
United	
Western	1987 - Merged with Delta

Appendix B

AIRLINE SUBSIDIES

Appendix B
Airline Subsidies 1943-1978
(In thousands of dollars)

YEAR	LOCAL SERVICE	TRUNKLINE[a]	TOTAL[b]
1943	-------	4,969	7,599
1944	-------	2,007	3,568
1945	-------	2,305	6,897
1946	1,081	4,082	21,048
1947	3,674	9,056	43,452
1948	9,411	21,574	65,004
1949	12,396	26,188	74,323
1950	14,848	26,749	81,938
1951	17,319	16,510	64,918
1952	18,990	6,607	63,122
1953	21,852	3,527	67,736
1954	24,299	3,822	58,401
1955	22,358	2,773	39,739
1956	24,122	1,790	43,189
1957	28,444	1,572	48,613
1958	32,703	2,283	52,540
1959	36,450	1,201	50,016
1960	51,498	0	65,576
1961	56,300	0	71,856
1962	64,835	0	80,010
1963	67,700	0	82,910
1964	65,511	2,566	82,590
1965	61,453	3,475	77,534
1966	58,562	3,089	70,545
1967	54,966	2,477	63,949
1968	47,982	1,343	55,219
1969	40,513	0	46,723
1970	34,830	0	39,726
1971	55,940	0	60,439
1972	62,160	0	66,554
1973	60,206	0	64,571
1974	68,988	0	73,333
1975	63,581	0	65,348
1976	71,343	0	74,656
1977	79,787	0	81,134
1978	73,999	0	75,893

a/ Trunkline subsidies for 1964-1968 reflect payments to Northeast Airlines serving the New England area.

b/ Total subsidies include trunkline, local, intra-state, helicopter and international operations.

Sources: Civil Aeronautics Board, Subsidy for U.S. Certificated Air Carriers, 1943-1978.

Appendix C

DOMESTIC-PASSENGER-COACH FARE STRUCTURE

APPENDIX C

Domestic-Passenger-Coach Fare Structure

Terminal Charge	Line-haul Charge (cents per mile)	Mileage
$12.56	7.06	0-500
	5.39	501-1500
	5.18	1501 and over

Source: Civil Aeronautics Board, Domestic Passenger Fare Investigation, Phase 9, 18 March 1974, p. 181.

Appendix D

MAJOR PROVISIONS OF THE AVIATION ACT OF 1975

Major Provisions of the Aviation Act of 1975

1. Policy Changes

(a) the Declaration of Policy, enacted in 1938, is revised to stress the desirability of competition rather than protection of established carriers

(b) directs the Board to encourage the entry of new firms into air transportation.

2. Pricing Flexibility

(a) allows increased airline pricing flexibility over a three year period

(b) during the first year airlines may lower prices as much as 40 percent; and by the third year, fare decreases will be allowed unless they are below the direct cost of service

(c) fares may be increased up to 10 percent per year.

3. Entry

(a) all existing restrictions to route entry will be eliminated within the next five years

(b) allows each carrier to increase route mileage by about five percent per year

(c) after January 1, 1978, a carrier may sell, transfer or lease any portion of its operating authority to any air carrier found by the CAB to be fit, willing, and able to provide air service

(d) supplemental airlines may immediately apply for authority to provide scheduled service between cities not receiving such service from certificated carriers

(e) reduces the strict limitations on charter services and allows commuter airlines to increase the size of aircraft they operate from 30 to 35 seats.

4. Abandonment of Service

(a) carriers will be permitted to exit upon 90 days notice if alternative schedules air service is provided by another carrier

(b) if alternate scheduled air service is not provided, carriers will be permitted to exit whenever, taking subsidies into account, they could not cover fully allocated costs for one year

(c) he Board can require continued service if the community or another industry were willing to defray the carrier's losses.

5. Subsidies

(a) no change at this time

(b) Secretary of transportation will study the current system and report to Congress within one year.

6. Mergers

(a) the Act brings airline merger standards in line with normal antitrust laws

(b) the Board could not approve a merger which would tend to create a monopoly or substantially lessen competition, unless unusual circumstances existed.

7. Anticompetitive Agreements

the Act prohibits the Board from approving agreements that in any way control levels of capacity, equipment or schedules, or which relate to pooling or apportioning of earnings or of fixing of rates.

8. Procedural Changes

(a) the Act requires the Board to hear and decide cases speedily

(b) will end the practice of dismissing applications on procedural grounds; thereby allowing applicants to appeal decisions to the courts.

2

VITA

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