

August 2015

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Recommended Citation

Heymsfeld, David A. (1976) "Deregulation of Air Transportation Under the Aviation Act of 1975," *Akron Law Review*: Vol. 9 : Iss. 4 , Article 5.

Available at: <http://ideaexchange.uakron.edu/akronlawreview/vol9/iss4/5>

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DEREGULATION OF AIR TRANSPORTATION UNDER THE AVIATION ACT OF 1975

DAVID A. HEYMSFELD*

INTRODUCTION

THE QUESTION of whether less regulation by the Civil Aeronautics Board (CAB) would lead to more efficient air service is as old as the CAB itself. For the first 35 years of the Board's existence, the issue was considered in occasional books and scholarly articles by academics.¹ Then, almost overnight, "deregulation" became an issue of national interest.² In the past year deregulation of air transportation has been exhaustively examined and debated in a number of forums: in hearings by a Senate Committee,³ in studies by government officials and private consultants,⁴ in conferences sponsored by research organizations,⁵ in speeches by industry executives,⁶ and in numerous articles and editorials in newspapers and magazines.⁷ In October, 1975, the Ford Administration sent Congress the Aviation Act of 1975, a bill which would substantially lessen CAB control over air carrier fare levels and entry and exit from markets.⁸

The objective of this article is to analyze where we are after more than a year of intensive analysis and debate, with particular focus on the issues raised by the Aviation Act of 1975. What are the main contentions of the supporters and opponents of deregulation? What is the main evidence supporting these contentions? Are there areas in which further study appears desirable?

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¹ See, e.g., R. CAVES, AIR TRANSPORTATION AND ITS REGULATORS (1962); W. JORDAN, AIRLINE REGULATION IN AMERICA (1970); Levine, *Is Regulation Necessary? California Air Transportation and National Regulatory Policy*, 74 YALE L.J. 1416 (1965).

² See generally 40 Fed. Reg. 28747-83 (1975), for a summary of the positions which have been taken on both sides of the regulation debate.

³ See *Hearings on S.2551 Before the Subcomm. on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. (1975).

⁴ See CIVIL AERONAUTICS BOARD, REGULATORY REFORM (1975) [hereinafter cited as Special Study]; A PROPOSED MEANS OF EVALUATING THE CONSEQUENCES OF CHANGED APPROACHES TO ECONOMIC REGULATION OF THE DOMESTIC COMMERCIAL AIR TRANSPORTATION SYSTEM, CAB Docket No. 28048 (1975).

⁵ Among the conferences which have been held on these issues were those sponsored in September, 1975, by MITRE and the American Enterprise Institute.

⁶ See, e.g., note 16, *infra*.

⁷ See, e.g., *No Cheers for Decontrol*, TIME, Oct. 20, 1975, at 82; *Airlines—The Stormy Skies: Deregulating the Industry*, DUN'S REVIEW, Sept. 1975, at 48-51.

⁸ H.R. 10261, 94th Cong., 1st Sess. (1975); S.2251, 94th Cong., 1st Sess. (1975).

I will consider three main areas: the effect of deregulation on the price of services, the effect on the quality of services, and the effect on industry stability. Several disclaimers are needed. My analysis will of necessity be broad-brush, since I am seeking to cover in a few pages a subject which a CAB task force recently discussed intelligently for over 400 pages. Additionally, the questions posed in this paper should not be construed as indicating final positions on any issues. My hope is that the questions will provoke further thought and analysis, and a sharpening of the issues.

EFFECT OF LESS REGULATION ON FARES

The supporters of less regulation (deregulators) believe that loosening of regulatory constraints on entry and pricing would result in lower fares. They believe that under a less restrictive regulatory scheme there would be entry by new carriers, some of which could operate more efficiently than existing industry members. It is also believed that the threat of entry itself would force existing carriers to improve their efficiency. Existing or new carriers might also offer lower fares by operating with a greater percentage of seats filled, by providing service with older equipment, or providing service with fewer amenities.⁹

The opponents of less regulation (proregulators) appear to agree that changes of the nature proposed in the Aviation Act of 1975 would lead to some price cutting. However, they argue that these cuts would be limited to a few dense markets and that the less dense markets would lose their service or find it reduced in quality. Even in the dense markets the proregulators do not believe that price cuts would stick. In these markets they

⁹ Cf. Russell, *The CAB and the Consumer*, 40 J. AIR L. & COM. 51, at 56-57 (1974), where the author, who advocates more stringent regulation by CAB, states:

Competition in the airline industry, nominally a "public utility" industry with restricted entry (because of route certification requirements) and Board-controlled rates and charges is intense, but largely expresses itself at the level of predominantly subjective factors such as, for example, which carrier has the "best" meal service. Any poll of passengers using competitive carriers would produce protagonists for all competitors, but the basic results of the poll would bear relationship not to the quality of the food service, but more likely to the relative use of competing carriers who spend approximately the same amounts for food service and, in many cases, use the same caterers. In other words, passengers would indicate a preference for the carrier they use, not for the food service itself. The same observation would be true with respect to many other aspects of customer preference such as promptness of response, courtesy and efficiency in handling reservations, ticketing procedures and baggage check in, the provision of inflight amenities, schedule dependability, and the return of baggage at destination. Carriers also compete through advertising, seeking through diverse approaches to lure customers to their basically similar services. But advertising creates no basic consumer advantage nor any consumer harm. There is, however, one aspect of airline competition which has directly affected consumer interests, and that is competitive scheduling. (footnotes omitted)

foresee excessive competition, desperate price cutting, and ultimately the survival of a few large carriers which would raise fares to monopoly levels.

To some extent, the proregulators are arguing that the benefits of reduced prices would be outweighed by other adverse effects of deregulation such as loss of service or loss of stability. These problems will be discussed later. To the extent the proregulators are directly questioning that there would be any significant price reductions, they are questioning the possibility of higher load factor or lower cost operations. They are also contending that under a system of freer competition a few large carriers would have insurmountable competitive advantages which would enable them to eliminate prospective price cutters from the market.

I believe that there is a need for elaboration of these contentions. Certainly there is evidence in the other direction. The record of Pacific Southwest Airlines (PSA) in California and charter carriers in the transatlantic suggest the possibility of higher load factor and/or lower cost operations. The recent success of the air carrier industry, in reducing costs and increasing productivity raises the question of whether these carriers had previously given sufficient priority to cost efficiency.¹⁰ The recent increases in industry cost efficiency have been encouraged by the industry's financial distress. This raises the question of whether increased competition is needed as a spur to productivity in less troubled times. Similarly, the recent cooperation of airline employees in limiting wage demands raises the question of whether labor costs would be lower in a less protected industry.¹¹

There is also evidence suggesting that larger carriers do not have an insurmountable competitive advantage. Witness the success of PSA and the smaller trunks, such as Delta and Continental, in competing with the largest trunks. The report of the CAB Task Force on Regulatory Reform concluded, on the basis of existing data and studies, that:

There are no structural traits inherent in domestic air transportation which indicate superior performance by large-size firms nor are there traits which would significantly inhibit the entry of new firms into the industry.¹²

¹⁰ Between 1969 and 1974, the industry reduced employment from 270,000 to 263,000, while increasing revenue ton miles from 17.6 billion to 20.8 billion.

¹¹ The pilots of Eastern Airlines agreed to a "pay freeze." Eastern stated that overall savings to the airline for 1976-77 as a result of the agreement, would total approximately \$75 million. See WALL STREET JOURNAL, Oct. 27, 1975, at 4, col. 12.

¹² See Special Study, *supra* note 4, at 271.
Published by IdeaExchange@UAKron, 1976

Although the proregulators apparently disagree with these conclusions, I have not seen much detailed analysis in support of their position. There is a need for elaboration of the considerations which lead the proregulators to a different result.

EFFECT OF LESS REGULATION ON QUALITY OF SERVICE

There are two methods in which air carriers can reduce the quality of service: first they can eliminate all service to a city, and secondly, they can take steps short of abandonment, such as reducing the number of markets in which a city receives service, downgrading service by increasing the number of stops, and reducing the frequency of service.

The first option, total abandonment of service to a city, does not appear to be a major problem under the Aviation Act of 1975. Virtually all the certified cities at which large aircraft service would be unprofitable are presently served by local service carriers, which receive subsidy for their unprofitable service. The Act of 1975 does not basically change the standards by which the CAB will decide whether to require continuation of subsidized service.¹³

Would the Act of 1975 lead to a reduction in the quality of service at a city? A preliminary question is whether under present circumstances the quality of service is determined by existing law and CAB policies. In general the answer appears to be "no." Under the present law the Board is prohibited from regulating air carrier schedules¹⁴ unless they are so deficient that they do not provide "adequate" service to a city.¹⁵ The Board has rarely exercised its "adequacy" powers. Nor do the certificates issued by the Board control the quality of service. The certificates leave the carriers with considerable flexibility as to the markets they will serve and whether they will serve them with non-stop, one-stop, or multi-stop service.

If the law does not presently control quality of service, why would the Act of 1975 result in a down-grading of service? The answer of the proregulators is that under present law carriers do not take full advantage

¹³ Under Section 401 of the Federal Aviation Act of 1958, the CAB can permit temporary suspension of service at a city or the deletion of a city from a certificate, if it is found to be in the best interests of public. However, the CAB has generally been willing to permit the suspension of service only where it can be shown that replacement service of an adequate nature would be provided by a commuter carrier.

Section 8 of the Aviation Act of 1975, would require the CAB to allow abandonment if replacement service is available or if federal, state, or local government is unwilling to subsidize the losses from that service. Thus, in the absence of replacement service, the CAB would decide, as it does under the existing law, whether service at a community should continue to be subsidized.

¹⁴ Federal Aviation Act §401(e) (1958).

¹⁵ Federal Aviation Act §404(a) (1958).

of their powers to curtail unprofitable services. The proregulators believe that carriers presently choose to provide a substantial amount of unprofitable service because they are motivated by a public service obligation to provide some unprofitable service in return for the more lucrative routes they have been awarded. The proregulators further believe that if legislation such as the Aviation Act was adopted, carriers would be subject to so much competitive pressure that they would be unable to continue to fulfill their service obligations.¹⁶

The Air Transport Association has submitted a study concluding that 37 percent of trunk line, non-stop routes are unprofitable and candidates for abandonment.¹⁷ The deregulators have criticized this study on numerous grounds, and argue that the study understates the profitability of the markets studied.¹⁸ However, the deregulators have not submitted any in depth study setting forth their conclusions on how quality of service would be affected by deregulation. A study of this nature would be most helpful and welcome.

On the other side of the issue, the deregulators appear to concede that under deregulation there would be some downgrading of service, such as more crowded flights and fewer passenger amenities. More detail on this point would be helpful.

EFFECT OF LESS REGULATION ON STABILITY

As I have indicated, the proregulators believe that the loosening of restrictions on entry would lead to economic chaos. They believe that an excessive number of carriers would seek to enter dense markets, creating excessive capacity. There would then be desperate fare cutting, leading ultimately to carrier failure and abandonment of markets.¹⁹

¹⁶ Robert Oppenlander, Senior Vice-President of Delta Airlines, in a speech delivered to the Transportation Club of the Harvard Business School, Boston, Massachusetts, on March 19, 1975, criticized the advocates of deregulation and strongly asserted:

These advocates seem to overlook that fact that freedom of entry carries with it the necessary alternative of freedom of exit. The obligation to serve which has long protected the traveling and shipping public would no longer be there. The effect of this "freedom" will be immediate and dramatic. Those carriers which now operate in marginal and non-compensatory markets will quickly drop them. Air service will be lost to many thousands of secondary markets. *Cited in AVIATION WEEK*, April, 1975, at 7.

¹⁷ The Air Transport Association submitted the study entitled: *ATA, CONSEQUENCES OF DEREGULATION OF THE SCHEDULED AIR TRANSPORT INDUSTRY*, to the Senate Judiciary Subcommittee on Administrative Practice and Procedure in April, 1975.

¹⁸ See Special Study, *supra* note 4, App. 4.

¹⁹ See, e.g., the remarks of Monte Lazarus before the Center for Transportation Studies, Massachusetts Institute of Technology, at 9 (May 16, 1975). "Some critics visualize a host of carriers freely entering and exiting markets, thereby providing the necessary spur of competition which would keep the system alive and fares low. These carriers — maybe hundreds as some suggest — would create economic chaos and, ultimately, higher fares because of excessive capacity."

The question I would pose to the proregulators is whether they believe that air transportation is different in these respects from other businesses? In other words is there something unique in air transportation that encourages new carriers to enter a market when its capacity would exceed demand? Are air carriers more likely than other businesses to offer services at unduly low prices.

A related question is whether the experience of commuter carriers casts doubt upon some aspects of the "economic chaos" theory. The CAB special study²⁰ concluded that the commuter experience indicated that service was stable at cities which originated 25 or more passengers a day. At these points there were no gaps in service, although the identity of the carrier providing service might change. The report recognized that under deregulation "inefficient carriers would go out of business and be replaced by other firms." The report further concluded that there was "no reason to believe that under mature unregulated conditions, business failure due to inefficiency would be commonplace."²¹

Another question is whether the Aviation Act of 1975 furnishes significant protection against economic chaos. The Act makes it much easier for existing carriers to expand their operations than for new carriers to enter markets already served by the existing carriers. New carriers seeking to provide additional competitive services would still have to demonstrate to the CAB that the service was required by the public convenience and necessity, although the criteria to be used in interpreting the statutory provision would be changed in a "pro-entry" direction. The Aviation Act also provides that new entry will be phased in over a period of several years, and it also gives the Board power to prohibit prices which are below direct costs.

Another contention of the proregulators is that if there is regulatory reform, investors and creditors would lose interest in air transportation. This raises the question of why proregulators believe that investors and creditors would be less interested in an air transportation industry which operates under free competition than they are in investing in any other industry which operates under free competition. One hypothesis which should be explored is whether there would be increased investiture interest in air transportation under deregulation, since CAB regulation is believed by some to have presented the carriers from realizing a reasonable return on investment.

²⁰ See Special Study, *supra* note 4, at 179.

²¹ See Special Study, *supra* note 4, at 180.

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In conclusion I again emphasize that congressional consideration of regulatory reform is still at a relatively early state. As the legislative process goes forward I hope that both sides will continue to advance the debate with the same high interest and enthusiasm which they have shown in the past.

