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CAN AIRLINE DEREGULATION WORK IN INTERNATIONAL AIR TRANSPORTATION?

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Chairman, Civil Aeronautics Board

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CAN AIRLINE DEREGULATION WORK IN INTERNATIONAL AIR TRANSPORTATION?

I AM PLEASED TO BE ABLE TO JOIN YOU TODAY TO TALK ABOUT THE DEVELOPMENT OF A MORE COMPETITIVE INTERNATIONAL AIR TRANSPORT SYSTEM -- A TOPIC THAT HAS GENERATED SUBSTANTIAL DEBATE WORLDWIDE OVER THE LAST SEVERAL YEARS. IN THE COURSE OF THIS INTERNATIONAL DIALOGUE, THE UNITED STATES WHICH HAS ACTIVELY PROMOTED MORE COMPETITION, HAS BEEN ACCUSED NOT ONLY OF A VARIETY OF HEINOUS DIPLOMATIC CRIMES BUT ALSO OF TRYING TO SUBVERT THE CONTINUING DEVELOPMENT OF THE INTERNATIONAL AIR TRANSPORT SYSTEM.

IN MY PRESENTATION I WILL FIRST ADDRESS THE SPECIFIC CHARGES THAT HAVE BEEN MADE AGAINST THE UNITED STATES AND THEN DISCUSS MORE BROADLY THE REASONS WHY THE UNITED STATES FAVORS A MORE COMPETITIVE REGIME.

BACKGROUND

THE INTERNATIONAL CIVIL AVIATION CONFERENCE OF 1944 COMMONLY REFERRED TO AS THE CHICAGO CONFERENCE WAS A SEMINAL EVENT IN THE HISTORY OF INTERNATIONAL AVIATION AND RESULTED IN INTERNATIONAL COOPERATION ON MANY ASPECTS OF CIVIL AIRCRAFT OPERATION. BUT NO MULTILATERAL AGREEMENT COULD BE REACHED ON THE KEY QUESTION OF HOW COMMERCIAL AIRLINES SHOULD BE PERMITTED TO COMPETE. SEVERAL COUNTRIES, INCLUDING THE UNITED STATES, ADVOCATED A VIRTUAL OPEN SKIES REGIME. OTHER IMPORTANT aviation powers like the United Kingdom argued for much more restrictive arrangements. As a result, the exchange of operating rights between nations was left to be resolved through bilateral negotiations. The Bermuda I agreement negotiated by the U.S. and the U.K. in 1946 became the model for all the U.S. aviation agreements over the last 30 years.

In Bermuda I, the United States accepted a much more restrictive arrangement than the one it advocated at Chicago. It agreed to the establishment of specific routes, and acquiesced in intercarrier price fixing through the recently created IATA subject to government review. The British gave up their desire for predetermined capacity. Although Bermuda I left the right to designate a number of carriers in any particular route open, the U.S. Civil Aeronautics Board until quite recently applied its own generally restrictive entry policy and never designated more than two U.S. carriers on any international route.

Over the years, regulatory decisions by most governments on international routes tended to protect the market shares of incumbent carriers and international rates were established by IATA at levels high enough to assure a reasonable return to

VIRTUALLY THE LEAST EFFICIENT CARRIER. BY 1970 INTERNATIONAL AIR TRANSPORTATION OPENLY FUNCTIONED AS A GOVERNMENTALLY SANCTIONED CARTEL. THROUGH MUCH OF THE 1970'S, A NUMBER OF IATA CARRIERS ARGUED THAT THE ORGANIZATION'S PERVASIVE CONTROL OF AIR RATES WAS DETRIMENTAL TO THE INDUSTRY AND THE PUBLIC. INDEED, THE ONLY COMPETITIVE PRESSURE IN THE MARKET AT ALL UNTIL 1977 WAS EXERTED BY A SMALL CADRE OF CHARTER CARRIERS WHICH MANAGED TO OPERATE OUTSIDE THE BILATERAL FRAMEWORK DESPITE THEIR BEING SUBJECT TO NUMEROUS OPERATING RESTRICTIONS BY THE AVIATION AUTHORITIES OF MOST GOVERNMENTS.

RESTRICTED ENTRY AND PRICING POLICIES WHILE DOING NOTHING FOR CONSUMERS GENERALLY, HAVE ALSO FAILED TO PROVIDE SUBSTANTIAL BENEFIT FOR THE INDUSTRY. INDUSTRY PROFITS HAVE BEEN EXTREMELY CYCLICAL AND NEVER VERY HIGH. FOR EXAMPLE, THE EARLY 1970'S WAS A DISASTROUS PERIOD FOR AVIATION. THE REASONS FOR THIS TERRIBLE PERFORMANCE APPEARED TO BE THREEFOLD. FIRST, THE INDUSTRY'S MOVE TO ACQUIRE WIDEBODIED AIRCRAFT BASED ON UNREALISTIC TRAFFIC FORECASTS. THE LACK OF PRICE COMPETITION COMPELLED CARRIERS TO COMPETE ONLY ON SERVICE QUALITY. THIS FORCED ALL MEMBERS OF THE CARTEL TO PURCHASE NEW EQUIPMENT AT ABOUT THE SAME TIME THUS FOSTERING THIS OVERINVESTMENT. SECOND, THE UNEXPECTED AND SHARP RISE IN FUEL COSTS BROUGHT ABOUT BY OPEC NECESSITATED PRICE INCREASES WHICH FURTHER

DEPRESSED TRAFFIC. FINALLY, THE WORST WORLDWIDE RECESSION SINCE THE 1930'S.

MOST COUNTRIES AND AIRLINES DID NOT SEE THE FINANCIAL CRISIS OF THE EARLY 1970'S AS A PRODUCT OF THOSE UNIQUE CIRCUMSTANCES COUPLED WITH THE REGULATORY INDUCED OVERINVESTMENT BUT RATHER BELIEVED IT TO BE THE PRODUCT OF TOO MUCH COMPETITION. UNFORTUNATELY, MANY BILATERAL AGREEMENTS WERE COMING UP FOR RENEWAL IN 1976 AND THERE WAS A CLEAR CONSENSUS AMONG FOREIGN GOVERNMENTS TO SEEK MORE RESTRICTIVE AGREEMENTS WITH THE UNITED STATES, IN THE BELIEF THAT ADDITIONAL CONTROLS WOULD PREVENT ANOTHER FINANCIAL CRISIS DESPITE THE HISTORIC EVIDENCE TO THE CONTRARY.

THE FIRST MAJOR NEGOTIATIONS WERE WITH THE UNITED KINGDOM. THE U.S. NEGOTIATORS WERE UNDER GREAT PRESSURE TO ACCEPT AN AGREEMENT SUBSTANTIALLY MORE RESTRICTIVE THAN BERMUDA I. WITHOUT A CLEAR SET OF CONSUMER ORIENTED GOALS AND AN OVERALL NEGOTIATING STRATEGY, THE U.S. PLAYED A NUMBERS GAME TO DIVIDE UP THE MARKETS BETWEEN ITS FLAG CARRIERS AND THE U.K. FLAG CARRIERS. THE BERMUDA II AGREEMENT WAS A COMPETITIVE DISASTER WHICH AMONG OTHER THINGS IMPOSED RESTRICTIONS ON THE NUMBER OF CARRIERS THE U.S. COULD DESIGNATE IN U.K. MARKETS AND ESTABLISHED A MECHANISM THAT ALLOWED THE BRITISH GOVERNMENT

TO CONTROL INCREASES IN FREQUENCY (AND THUS CAPACITY) ON THE NORTH ATLANTIC.

IT SOON BECAME CLEAR TO THE UNITED STATES GOVERNMENT THAT UNLESS A NEW APPROACH TO NEGOTIATIONS WAS IMPLEMENTED QUICKLY, BERMUDA II WITH ITS NUMEROUS ANTICOMPETITIVE FEATURES WOULD BECOME THE MODEL FOR FUTURE AGREEMENTS.

THE UNITED STATES INTERNATIONAL AIR TRANSPORT POLICY

THE STARTING POINT FOR THE UNITED STATES IN THE SEARCH FOR A NEW POLICY WAS A COMMITMENT TO CREATING A MORE EFFICIENT SYSTEM LEADING TO GREATER SERVICE AND PRICE OPTIONS FOR TRAVELERS AND SHIPPERS -- A RETURN TO THE PRINCIPLES OF EQUAL COMPETITIVE OPPORTUNITIES WHICH WE FIRST PROPOSED AT CHICAGO -- AND THAT BILATERAL AGREEMENTS SHOULD BE DESIGNED TO CREATE A MARKET ENVIRONMENT WHERE COMPETITION CAN FLOURISH. IN DEALING WITH DOMESTIC AIR TRANSPORTATION, THE BOARD, THE CONGRESS AND THE PRESIDENT ALL VIEWED MORE COMPETITION AS THE VEHICLE FOR ACHIEVING THESE GOALS. AS IS APPARENT FROM THE POLICY STATEMENT OF OUR DOMESTIC AIRLINE DEREGULATION ACT OF 1978, WE HAVE GENERALLY RECOGNIZED THAT THE INDUSTRY IS POTENTIALLY HIGHLY COMPETITIVE BECAUSE AIRCRAFT ARE A MOBILE CAPITAL ASSET WHICH

CAN BE READILY MOVED FROM ONE MARKET TO ANOTHER. MOREOVER, WHILE ROUTE NETWORKS AND ECONOMIES OF SCALE MAY BE IMPORTANT FOR SOME KINDS OF SERVICES, THEY ARE NOT CRITICAL IN ESTABLISHING NEW POINT-TO-POINT SERVICE IN A PARTICULAR CITY-PAIR MARKET.

THE PRESIDENT OF THE UNITED STATES FORMALLY ANNOUNCED A PRO-COMPETITIVE POLICY ON AUGUST 21, 1978. THE PRINCIPLES CONTAINED IN THIS STATEMENT WERE SUBSEQUENTLY ADOPTED BY CONGRESS IN THE INTERNATIONAL AIR TRANSPORTATION COMPETITION ACT OF 1979. SINCE 1978, WE HAVE NEGOTIATED MORE OPEN AGREEMENTS WITH THE NETHERLANDS, BELGIUM, LUXEMBOURG, GERMANY, KOREA, SINGAPORE, JAMAICA, JORDAN AND ISRAEL; AND SIGNS ARE GOOD FOR LIBERAL AGREEMENTS WITH SEVERAL OTHER COUNTRIES.

IN CONJUNCTION WITH THE NEGOTIATIONS OF LIBERAL BILATERALS, THE CIVIL AERONAUTICS BOARD INITIATED IN JUNE, 1978 A REVIEW OF OUR POLICY OF SANCTIONING INTERCARRIER RATE SETTING BY IATA. THE BOARD COMPLETED ITS REVIEW IN APRIL, 1980 AND GENERALLY CONTINUED APPROVAL OF THE RATE SETTING MECHANISM FOR AN ADDITIONAL TWO YEARS. OVER THE NEXT TWO YEARS, THE BOARD INTENDS TO CONSIDER FURTHER THE NEED FOR INTERCARRIER AGREEMENTS ON INTERNATIONAL AIR FARES AFFECTING TRAVEL TO AND FROM THE UNITED STATES. THE BOARD'S DECISION PROHIBITS

U. S. CARRIER PARTICIPATION IN THE NORTH ATLANTIC CONFERENCE WHERE THE RATE SETTING MECHANISM HAS NOT FUNCTIONED FOR SEVERAL YEARS BECAUSE OF THE HIGHLY COMPETITIVE NATURE OF THIS MARKET.

THE BOARD'S REVIEW OF THE IATA TARIFF MECHANISM GENERATED MORE CRITICISM THAN ANY OTHER ASPECT OF OUR INTERNATIONAL PROGRAM. YET, OUR ACTIONS SEEMED TO PROMPT SOME OF THE REFORMS THAT SOME MEMBER CARRIERS HAD BEEN ARGUING FOR WITH IATA OVER THE LAST SEVERAL YEARS. TO SOME EXTENT, OUR ACTION CAUSED ATTENTION TO SHIFT TO THE UNITED STATES AND AWAY FROM MANY OF THE REAL ECONOMIC ISSUES THAT FACED THE MEMBER CARRIERS. TODAY, THE U.S. IN CONJUNCTION WITH A NUMBER OF OTHER COUNTRIES IS TRYING TO REFOCUS THE ATTENTION OF GOVERNMENTS AND AIRLINES TO THE REAL AND CRITICAL ISSUES CONFRONTING THE WORLD AVIATION COMMUNITY.

<u>THE SIX MYTHS ABOUT A COMPETITIVE INTERNATIONAL SYSTEM</u>

THE NEW UNITED STATES POLICIES HAVE CAUSED SUBSTANTIAL CONTROVERSY. MANY GOVERNMENTALLY OWNED AIRLINES AND SOME GOVERNMENTS HAVE GONE TO GREAT LENGTHS TO CRITICIZE AND RIDICULE OUR POLICIES. AS I WILL NOW DISCUSS, LITTLE OF WHAT THEY CONTEND CAN WITHSTAND CLOSE SCRUTINY. I HAVE PARAPHRASED THEIR ARGUMENTS INTO SIX MYTHS. EACH OF THESE MYTHS WILL BE ADDRESSED IN SOME DETAIL.

1. THAT THE UNITED STATES IS ATTEMPTING TO FOIST ITS APPROACH ON OTHER NATIONS WHICH MAY HAVE DIFFERENT NATIONAL GOALS AND IS IGNORING BASIC PRINCIPLES OF SOVEREIGNTY AND COMITY;

2. THAT DEREGULATION QUICKLY WILL LEAD TO THE LOSS OF THE REGULAR HIGH-FREQUENCY SERVICE THAT IS REQUIRED BY THE WORLD BUSINESS COMMUNITY;

3. THAT OPEN COMPETITION IS INCONSISTENT WITH SOUND ENERGY POLICY WHICH MAY REQUIRE SEVERE RESTRICTIONS IN LEISURE TRAVEL TO ASSURE MAINTAINING SERVICE FOR BUSINESS TRAVELERS;

4. THAT COMPETITION MAY LOOK GOOD DURING THE BOOM IN THE BUSINESS CYCLE BUT HISTORY HAS SHOWN THAT EXCESSIVE DISCOUNT PRICING DURING GROWTH PERIODS HAS LED TO OVER-CAPACITY AND FINANCIAL DISASTER DURING THE DOWNTURNS;

5. THAT CAREFUL REGULATION AND CAPACITY CONTROL CAN ACHIEVE LOWER FARES THAN CAN OPEN ENTRY AND COMPETITION;

6. THAT IT IS FOOLISH TO TALK ABOUT OPEN SKIES WHEN THE INDUSTRY IS SO DEPENDENT ON EXTERNAL CONSTRAINTS SUCH AS LIMITED AIRPORT CAPACITY, AIR TRAFFIC CONTROL, TOURIST ORGANIZATIONS, ETC.

<u>FIRST MYTH</u>: "THAT THE UNITED STATES IS ATTEMPTING TO FOIST ITS APPROACH ON OTHER NATIONS WHICH MAY HAVE DIFFERENT NATIONAL GOALS AND IS IGNORING BASIC PRINCIPLES OF SOVEREIGNTY AND COMITY."

SINCE NO MULTILATERAL AGREEMENT COULD BE REACHED AT CHICAGO ON THE EXCHANGE OF OPERATING RIGHTS, THE TASK OF ESTABLISHING THESE RELATIONSHIPS THEN, AS IT IS TODAY, WAS LEFT TO BILATERAL NEGOTIATIONS BETWEEN SOVEREIGN GOVERNMENTS. WE ARE MORE THAN A LITTLE CONFUSED BY THE CONTENTION THAT IT IS WRONG -- PRESUMABLY IN SOME MORAL SENSE -- TO NEGOTIATE A LIBERAL BILATERAL WITH BELGIUM OR KOREA WITHOUT ALSO CONSULTING WITH FRANCE OR JAPAN. TO IMPLY THAT TWO COUNTRIES CANNOT <u>FREELY AGREE</u> TO EXCHANGE COMPETITIVE OPPORTUNITIES RATHER THAN RESTRICTIONS WITHOUT SECURING THE APPROVAL OF THIRD COUNTRIES JUST DOES NOT COMPORT WITH BASIC PRINCIPLES OF INTERNATIONAL DIPLOMACY.

WE EMPHASIZE THE EXPRESSION "<u>FREELY AGREE</u>," BECAUSE THERE IS A COMMON MYTH THAT NO GOVERNMENT WOULD ENTER INTO A LIBERAL AGREEMENT IF IT WERE NOT SUBJECT TO, IF NOT OUTRIGHT ECONOMIC THREATS, THEN AT LEAST SUBSTANTIAL INTIMIDATION BY THE U.S. NEGOTIATING TEAM. THIS VIEW IS MORE WISHFUL THINKING THAN A REFLECTION OF REALITY -- THE UNITED STATES HAS NEVER DENOUNCED

AN AGREEMENT AND HAS ALWAYS LIVED UP TO ITS END OF A BILATERAL AGREEMENT.

AT LEAST AS IMPORTANT, THE U.S. HAS NEVER THREATENED TO RETALIATE AGAINST THOSE WHO FIND ITS AVIATION POLICIES DIFFICULT TO ACCEPT BY CHANGING POLICIES IN NONAVIATION AREAS. THOSE COUNTRIES THAT ENTER INTO LIBERAL AGREEMENTS ARE NOT UNDER ANY THREATS OR COMPULSION -- THEY ARE ATTRACTED BY THE EXPANDED OPPORTUNITIES OFFERED TO THEM AND THEY SEE BENEFIT TO THEIR CITIZENS AND THEIR AIRLINES FROM SUCH AGREEMENTS.

MANY COUNTRIES ALSO SEEM TO HAVE THE MISTAKEN IMPRESSION THAT THE UNITED STATES HAS A SINGLE "ALL OR NOTHING" APPROACH TO COMPETITIVE BILATERALS. WE HAVE, HOWEVER, ALWAYS RECOGNIZED THAT AN AGREEMENT THAT MAKES SENSE WITH GERMANY WILL NOT BE DIRECTLY TRANSFERABLE TO LESS INDUSTRIALIZED COUNTRIES LIKE JAMAICA. INDEED, THE PRESIDENT'S 1978 POLICY STATEMENT STATED:

> "OUR POLICY FOR NEGOTIATING CIVIL AIR TRANSPORT AGREEMENTS REFLECTS OUR NATIONAL GOALS IN INTERNATIONAL AIR TRANSPORTATION. THIS POLICY PROVIDES A SET OF GENERAL OBJECTIVES, <u>DESIGNED PARTICULARLY FOR MAJOR INTERNATIONAL AIR MARKETS</u>, ON THE BASIS OF WHICH UNITED STATES NEGOTIATORS CAN DEVELOP SPECIFIC NEGOTIATING STRATEGIES."

It, therefore, is really a myth to say that deregulation is not acceptable internationally. The claim is little more than a ploy intended to obscure the real economic issues.

Second Myth: "That deregulation quickly will lead to the loss of the regular high-frequency service that is required by the world business community."

Those who support a status quo philosophy often oppose change by predicting that world order will end if change is allowed. Between 1974 and 1977, Delta Airlines was an active advocate of this theory in the U.S. domestic deregulation debate. In 1978, in an environment of fare flexibility and multiple entry, Delta had record earnings on record revenues of $2.24 billion. Today, even with the rapid escalation in fuel cost and a domestic recession which has led to a drop in traffic, Delta is expanding into new markets, remains profitable and contends that the Board regulates too much. There is absolutely no evidence at all to support the allegation that scheduled air service that is useful for business travel will disappear. Indeed, since deregulation, a number of carriers have instituted three class service with a fare and service package specifically designed for business travelers sandwiched

BETWEEN FIRST CLASS AND NORMAL ECONOMY CLASS.

FROM THE CONSUMER'S PERSPECTIVE, THE STATUS QUO ARGUMENTS ARE PERHAPS THE MOST COUNTERPRODUCTIVE. PERVADING THESE ARGUMENTS IS THE NOTION THAT THE INTERNATIONAL AIR TRANSPORTATION SYSTEM AS IT STANDS CANNOT BE IMPROVED UPON TO ANY SIGNIFICANT DEGREE, SO NEW SERVICE THAT MIGHT IN THE SLIGHTEST WAY RESTRUCTURE THIS SYSTEM IS BAD FOR TRAVELERS AS WELL AS FOR AIRLINES. THIS APPROACH WOULD HAVE THE WORLD MAINTAIN THE STATUS QUO EVEN AT THE EXPENSE OF PREVENTING NEW SERVICE OFFERINGS THAT CONSUMERS MIGHT PREFER -- INDEED BECAUSE CONSUMERS MIGHT PREFER THEM. THE ADVANTAGE TO CONSUMERS FROM COMPETITION IS DEMONSTRATED OVER THE NORTH ATLANTIC WHERE 45 CARRIERS NOW OFFER ABOUT 130 FARES FROM A VARIETY OF GATEWAYS. QUALITY AND PRICE OPTIONS ARE AVAILABLE TO MEET THE NEEDS OF VIRTUALLY EVERY TRAVELER. WE HOPE THAT THESE BENEFITS WILL SPREAD TO OTHER INTERNATIONAL MARKETS.

OPPONENTS ARGUE THAT HIGH-FREQUENCY HIGH-CONVENIENCE WORLDWIDE SERVICES ARE ONLY POSSIBLE WHEN THERE HAS BEEN INTIMATE DETAILED COOPERATION AND COORDINATION AMONG AIRLINES. THE UNITED STATES HAS NEVER ADVOCATED THE ABOLISHMENT OF INTERLINING OR JOINT TICKETING OR BAGGAGE FACILITATION AGREEMENTS OR ANY OF THE MYRIAD OTHER LEGITIMATE JOINT ENDEAVORS THAT MUST BE UNDERTAKEN TO PRESERVE A FUNCTIONING AIR TRANSPORT SYSTEM. IATA HAS DONE A FINE JOB OF RESOLVING MANY OF THOSE

COMPLICATED PROBLEMS AND THE UNITED STATES HAS NO DESIRE OR INTEREST IN DISRUPTING THESE ACTIVITIES.

BUT THE UNITED STATES DOES QUESTION THE PRESUMPTION THAT CARRIER AGREEMENTS ON PRICE, STRICTLY CONTROLLED CAPACITY AND PROHIBITIONS AGAINST NEW ENTRY IN AIRLINES ARE A UNIFORM AND UNIVERSAL NECESSITY TO PRESERVE A WORKING INTERNATIONAL AIR TRANSPORT SYSTEM. ALL THE EVIDENCE SHOWS THAT THESE RESTRAINTS ARE ONLY NOT REQUIRED BUT ARE UNDESIRABLE. IN A COMPETITIVE MARKET, SUCH AS THE NORTH ATLANTIC, THE COMPETITORS CAN CHOOSE THE TYPE OF SERVICE OR SERVICES THEY WISH TO OFFER AS THEY DO TODAY IN OUR DOMESTIC SYSTEM AND AS IN MOST OTHER INDUSTRIES AND STILL MAKE A PROFIT. WE ARE CONVINCED THAT IN VIRTUALLY ANY MARKET, SERVICE TO THE PUBLIC CAN BE ENHANCED BY EXPANDING COMPETITIVE OPPORTUNITIES.

THE UNITED STATES BELIEVES STRONGLY THAT AIR TRAVEL SHOULD NOT BE THE PREROGATIVE ONLY OF BUSINESS TRAVELERS AND THE VERY RICH. GIVEN TODAY'S AVIATION TECHNOLOGY, THERE IS NO QUESTION THAT A MUCH GREATER RANGE OF SERVICE CAN BE MADE AVAILABLE TO THOSE OF US WHO ARE NOT IN EITHER OF THESE EXCLUSIVE CATEGORIES. IN THE LONG RUN, COMPETITION IS THE SIMPLEST AND MOST EFFICIENT WAY TO INSURE THE PROPER MIX OF SERVICE.

THE MERE SUGGESTION THAT THE CURRENT SYSTEM MUST BE PRESERVED FOR THE BUSINESS TRAVELER BY DENYING SERVICE TO OTHERS WHO WANT IT AND WHO COULD EASILY AFFORD IT IN A LESS RESTRICTIVE REGIME RAISES A MUCH MORE FUNDAMENTAL QUESTION ABOUT THE EXTENT TO WHICH GOVERNMENTS SHOULD INTERFERE WITH THE PRIVATE DECISIONMAKING PROCESS. IS SOCIETY PREPARED TO ORDAIN THAT BUSINESS TRAVEL IS MORE IMPORTANT TO THE WELL-BEING OF MANKIND THAN LEISURE TRAVEL? TOURISM IS AN IMPORTANT AND RAPIDLY GROWING INDUSTRY AND THE DESIRE FOR INTERNATIONAL TRAVEL IS FELT BY CONSUMERS THROUGHOUT THE WORLD. INDEED, A RECENTLY COMPLETED IATA STUDY INDICATED THAT IN 1979 LESS THAN 21 PERCENT OF THE NORTH ATLANTIC TRAFFIC WAS BUSINESS TRAVEL.* IT IS ESTIMATED THAT OVER SIX AND A HALF MILLION OVERSEAS VISITORS WILL TRAVEL TO THE UNITED STATES THIS YEAR AND EQUAL OR GREATER NUMBERS OF TRAVELERS WILL BE GOING FROM THE UNITED STATES TO OTHER COUNTRIES. THE DESIRE FOR PLEASURE TRAVEL IS A FORCE TO BE RECKONED WITH.

WE FEEL THAT UPON REFLECTION A CAPACITY CONTROLLED INTERNATIONAL AIR TRANSPORT SYSTEM GEARED PRIMARILY TO THE NEEDS OF BUSINESS TRAVELERS WOULD APPEAR TO BE UNACCEPTABLE TO MOST DEMOCRATIC GOVERNMENTS -- WHO, AFTER ALL, ARE ULTIMATELY SUBJECT TO PUBLIC REVIEW OF THEIR ACTIONS; TO INNOVATIVE SECOND GENERATION AIRLINES THAT DESIRE TO EXPAND; AND FINALLY, TO MOST OF THOSE BUSINESS TRAVELERS

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* BASED ON AN INFLIGHT SURVEY OF 22,000 PASSENGERS.

WHO EITHER DIRECTLY OR INDIRECTLY ARE DEPENDENT ON CONSUMERS FOR THEIR PROFITS.

THERE ALSO IS A SERIOUS QUESTION OF WHETHER BUSINESSES DURING THIS PERIOD OF RISING COSTS WILL CONTINUE TO RELY ON EXTENSIVE PERSONAL CONTACT. DOING BUSINESS IN PERSON IS PROBABLY FAVORED BY MOST PROFESSIONALS. BUT TELECOMMUNICATIONS IS AN IMPORTANT SUBSTITUTE FOR PERSONAL CONTACT AND HAS A HIGH CROSS-ELASTICITY WITH AIR TRAVEL. WITH PROFITS FALLING AND COSTS RISING, CORPORATIONS ARE QUESTIONING THEIR TRAVEL BUDGETS AND LOOKING AT ALTERNATIVES. FOR EXAMPLE, LARGE MEETINGS CAN NOW BE CONDUCTED BETWEEN AND AMONG 12 U.S. CITIES OVER AT&T'S PICTUREPHONE SYSTEM. WITH THIS SYSTEM YOU CAN DO VIRTUALLY ANYTHING YOU CAN DO IN A DIRECT MEETING INCLUDING THE EXCHANGE OF DOCUMENTS. AND A ONE HOUR CALL BETWEEN WASHINGTON AND LOS ANGELES COSTS LESS THAN A SINGLE PASSENGER'S AIRFARE IN THIS MARKET. WHILE A VIDEO-PHONE SYSTEM WILL NOT DISPLACE BUSINESS TRAVEL IT IS BUT ONE EXAMPLE OF VARIOUS INNOVATIVE COMMUNICATIONS SYSTEMS THAT CAN CUT SIGNIFICANTLY INTO THE BUSINESS TRAVEL MARKET. PRIVATE TELECOMMUNICATIONS IS BECOMING A HIGHLY COMPETITIVE INDUSTRY AS COMPANIES LIKE AT&T, XEROX, IBM AND EXXON SEEK TO ATTRACT NEW BUSINESS CUSTOMERS FOR THEIR SERVICES. THESE ELECTRONIC COMUNICATIONS SYSTEMS DO NOT HAVE TO STOP AT FOREIGN BORDERS, AND ARE NOT HINDERED BY NAVIGATION AND LANDING FEES.

Certainly, business travel is not about to disappear -- and should contine to grow. But will it grow as rapidly as in the past? Will that high frequency easy-access system be as important in 1990 as many allege it is today? Does the business community really need instant direct access year round in virtually every market? Perhaps the greatest threat over the next decade to the cozy world of international aviation is not the U.S. government, but rather the industry cost structure when measured against the costs of other industries which are now benefitting from cost saving techno-logical innovations.

This discussion leads directly to the next myth that deregulation is inconsistent with fuel conservation. A system system designed only to provide instant access to high-frequency high-convenience air travel is a system that requires only moderate load factors which in turn compels the least fuel efficient use of the aircraft. But there is no reason why business travelers cannot have instant access to as much of the aircraft as they need (at prices that reflect potential seat waste), while the rest of the aircraft is filled with passengers willing to accept lower seat access for lower prices. Indeed, many airlines are offering this service mix already in both regulated and less regulated market environments.

<u>Third Myth</u>: "That open competition is inconsistent with sound energy policy which may require severe restrictions on leisure travel to assure maintaining service for business travelers."

The conservation of scarce resources is a subject of immense concern to most societies around the world. But just what is conservation? One generally accepted meaning of this term is <u>physical efficiency</u> -- getting the maximum output from a unit of input. As will be discussed in a moment, our studies indicate that competition will generate the most energy-efficient system. A second meaning of conservation is to make the most economical use of our resources. By this we mean that the benefit from the use exceeds the cost including the discounted future value of using less today in order to have more tomorrow. Over the years, the marketplace has proven to be the most reliable tool for producing this result. It is for this reason that President Carter has argued so intensely for the decontrol -- not greater control -- of oil prices in the United States.

There are those who construe conservation to mean nonuse. Some industry observers have already concluded

THAT WE WILL NOT HAVE ENERGY FOR PLEASURE, THAT WE MUST ABOLISH "FRIVOLOUS WEEKEND FLIGHTS AT $89 TO CALIFORNIA" AND RESTRICT AND REGULATE CAREFULLY THE NUMBER OF SEATS TO BE OFFERED TO THE PUBLIC.* SUCH A DEFEATIST ATTITUDE IS BOTH UNWISE AND UNCALLED FOR. WHILE AIRLINES WOULD BE FORCED TO CUT BACK SERVICE -- LEAVING MILLIONS OF DISAPPOINTED TRAVELERS -- OTHER SECTORS OF THE WORLD ECONOMY WOULD BE CONTINUING TO BURN OIL FOR PURPOSES MANY OF WHICH MAY BE LESS SOCIALLY DESIRABLE THAN AIR TRAVEL FOR PLEASURE. IN A COMPETITIVE SYSTEM, THE AIRLINES NOT ONLY VIE AGAINST EACH OTHER FOR TRAVELERS BUT THEY COMPETE AS WELL AGAINST OTHER GOODS AND SERVICES FOR THE CONSUMER'S DOLLAR. AS RISING COSTS OF FUEL FORCE THE COST OF AIR TRANSPORTATION UP, CONSUMERS WILL DECIDE WHAT USE OF THAT LIMITED RESOURCE GIVES THEM THE GREATEST SATISFACTION. THIS WILL FORCE CARRIERS TO MAKE HARD DECISIONS ABOUT INTERNATIONAL ROUTES. FOR EXAMPLE, SOME AIRLINES MAINTAIN YEAR-ROUND DAILY SERVICE IN LONG-HAUL MARKETS THAT PEAK IN THE SUMMER. RISING FUEL COSTS MIGHT SUGGEST THAT WINTER SERVICE SHOULD BE LESS FREQUENT OR PROVIDED VIA A STRONG INTERMEDIATE POINT EITHER

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* MALDUTIS, THE AIRLINES: DEREGULATION AND FUEL CONSUMPTION (SALOMON BROTHERS, JULY 12, 1979).

ONLINE OR ON AN INTERLINE BASIS.

AIR TRANSPORTATION ACCOUNTS FOR ONLY 3.5 PERCENT OF TOTAL U.S. ENERGY CONSUMPTION AND ABOUT 7 PERCENT OF FUEL CONSUMED FOR TRANSPORTATION. THE INTERNATIONAL FIGURES PROBABLY ARE SIMILAR. THIS IS AN EXTREMELY SMALL PERCENT OF FOSSIL FUEL CONSUMPTION AND WOULD REMAIN SO EVEN IF THE WORLD EXPERIENCES A 2- OR 3-FOLD INCREASE IN AIR TRAVEL OVER THE NEXT FEW YEARS. IF THE MARKET IS ALLOWED TO OPERATE, THE AIRLINES CAN BID NEEDED INCREASES IN FUEL AWAY FROM OTHER ENERGY USERS WHO CAN SWITCH TO OTHER SOURCES LIKE COAL OR GAS. SUCH AN OUTCOME BENEFITS US ALL. A SYSTEM OF RESTRICTIONS AND CONTROLS WILL LEAD TO A DISAPPOINTED PUBLIC, A STAGNATING INDUSTRY AND MISALLOCATION OF RESOURCES.

<u>FOURTH MYTH</u>: "THAT COMPETITION MAY LOOK GOOD DURING THE BOOM IN THE BUSINESS CYCLE BUT HISTORY HAS SHOWN THAT EXCESSIVE DISCOUNT PRICING DURING GROWTH PERIODS HAS LED TO OVERCAPACITY AND FINANCIAL DISASTER DURING THE DOWNTURNS."

THE ARGUMENT THAT AIRLINES MUST BE REGULATED BECAUSE THEY MAY LOSE MONEY DURING A RECESSION IS PARTICULARLY DIFFICULT TO UNDERSTAND. ALL INDUSTRIES ARE SUBJECT TO THE IMPACT OF

BUSINESS DOWNTURNS WHETHER OR NOT THEY ARE REGULATED. IN GENERAL, OVER THESE CYCLES, THE AVERAGE FINANCIAL PERFORMANCE FOR U.S. AIRLINES, WITH A FEW NOTABLE EXCEPTIONS, HAS BEEN IN THE RANGE OF A 6 TO 8 PERCENT ROI WHICH IS BELOW THE AVERAGE FOR MOST UNREGULATED INDUSTRIES OF SIMILAR SIZE. BASED ON THE EVIDENCE AVAILABLE TO US, WE HAVE NOT SEEN THAT FOREIGN CARRIERS HAVE FARED MUCH BETTER DESPITE TIGHT RATE REGULATION AND POOLING ARRANGEMENTS. IT'S VERY DIFFICULT TO BELIEVE THAT ANY INDUSTRY BLESSED WITH THE RATE OF GROWTH THAT AVIATION HAS HAD OVER THE LAST 20 YEARS COULD, IN THE AGGREGATE, DO SO POORLY. IN A COMPETITIVE ENVIRONMENT, EACH AIRLINE WILL HAVE MAXIMUM FLEXIBILITY TO DEVELOP A PRICING AND SERVICE SCHEME TO BEST SEE IT THROUGH A RECESSION.

DURING PAST RECESSIONS, REGULATORS HAVE BEEN GUILTY OF VERY COUNTERPRODUCTIVE BEHAVIOR -- ENCOURAGING THE AIRLINES TO RAISE PRICES AT A TIME WHEN TRAFFIC WAS FALLING. LEFT TO THEIR OWN DEVICES, THE INDUSTRY COULD NOT HAVE DONE MUCH WORSE AND MIGHT HAVE DONE SUBSTANTIALLY BETTER.

A NUMBER OF OUR CRITICS HAVE POINTED OUT THAT THE U.S. HAS BEEN FAR FROM CONSISTENT, OVER THE YEARS, IN OUR ADVOCACY OF COMPETITION. THEY SUGGEST THAT OUR DEVOTION TO THE PRINCIPLE OF COMPETITION WILL WANE RAPIDLY IF BAD TIMES LEAD TO LOSSES.

THIS SEEMS UNLIKELY. WE HAVE COME TO REALIZE THAT RESTRICTIVE POLICIES DO NOT HELP AND PERHAPS HINDER ECONOMIC RECOVERY. INDEED, IN THE LAST MAJOR RECESSION, THE LESS REGULATED SECTORS OF THE INDUSTRY DID MUCH BETTER THAN THE MORE REGULATED CARRIERS. FOR EXAMPLE, A NEW ENTRANT, SOUTHWEST AIRLINES, WAS MAKING A LOT OF MONEY IN AN UNREGULATED ENVIRONMENT THROUGHOUT THE STATE OF TEXAS BY OFFERING A LOW FARE SERVICE FROM A NUMBER OF CITIES TO HOUSTON AND DALLAS. ANOTHER EXAMPLE IS THE BOARD'S TREATMENT OF MAINLAND - HAWAII SERVICE. IN 1969, THE BOARD INCREASED THE NUMBER OF AIRLINES SERVING HAWAII FROM 3 TO 8. IT AUTHORIZED DIRECT SERVICE FROM 21 ADDITIONAL POINTS AND CREATED SUBSTANTIAL NEW COMPETITION. DESPITE THE WORLDWIDE DOWNTURN IN TRAFFIC, ON THESE ROUTES FARES WENT DOWN, SERVICE IMPROVED, TRAFFIC GREW AND ALL THE <u>UNRESTRICTED</u> CARRIERS DID QUITE WELL. FINALLY, EVEN DURING THE LAST RECESSION WE MADE IT CLEAR TO PAN AMERICAN AND TWA THAT WE WERE NOT GOING TO BAIL THEM OUT OF THEIR FINANCIAL DIFFICULTIES AND BOTH CARRIERS WERE FORCED TO TAKE DRASTIC STEPS TO STAY ALIVE. TODAY, THE INDUSTRY IS AGAIN GOING INTO A DIFFICULT PERIOD. BECAUSE OF THE GENERAL EASE OF ENTRY, THE BOARD'S POLICY IS TO GRANT GREATER PRICING FLEXIBILITY TO THE CARRIERS SO THAT THEY CAN DETERMINE A PRICING POLICY TO MINIMIZE LOSSES. THE CARRIERS ARE NOW

LOOKING FOR THE RIGHT PRICING STRATEGY TO SEE THEM THROUGH THIS DIFFICULT PERIOD. THERE WERE NO SIMPLE ANSWERS UNDER REGULATION AND THERE ARE NONE NOW. HOWEVER, EACH CARRIER HAS MUCH GREATER LATITUDE TO EXPERIMENT. THE LOW FARE SPECIALISTS LIKE SOUTHWEST, AIR FLORIDA AND MIDWAY AIRLINES ARE DOING WELL AND THEIR TRAFFIC CONTINUES TO GROW EVEN THROUGH THE RECESSION.

ONE OF THE ARGUMENTS AGAINST INTERNATIONAL DEREGULATION IS THAT NO GOVERNMENT WOULD ALLOW ITS NATIONAL AIRLINES TO GO BANKRUPT; AND IF IT SUBSIDIZED THE CARRIER, THE UNITED STATES WOULD ALLEGE UNFAIR COMPETITION. THE UNITED STATES UNDERSTANDS AND ACCEPTS THAT VERY FEW, IF ANY, COUNTRIES WOULD SUFFER THE LOSS OF THEIR FLAG CARRIERS AND THAT SUBSIDIES MIGHT BE PAID TO KEEP THEM AFLOAT DURING A RECESSION. BUT A SUBSIDY PAID TO KEEP A NATIONAL CARRIER OUT OF BANKRUPTCY IS FAR DIFFERENT FROM A SUBSIDY DESIGNED TO DRIVE A COMPETITOR FROM THE MARKET. I DOUBT THAT ANY GOVERNMENT WOULD BE INCLINED TO BEAR THE COSTS OF SUCH AN ATTEMPT. BUT EVEN THE MOST LIBERAL BILATERALS HAVE PROVISIONS TO GUARD AGAINST THIS SORT OF PREDATORY PRICING BEHAVIOR.

ACTUALLY, IT WOULD BE MUCH MORE EFFICIENT AND EQUITABLE TO PROVIDE DIRECT SUBSIDIES FROM GOVERNMENTS TO ALLOW THEIR

NATIONAL CARRIERS TO PURSUE NON-ECONOMIC BUT SOCIALLY DESIRABLE OBJECTIVES, THAN TO HAVE CONSUMERS SUPPORT AN INEFFICIENT COMPETITOR THROUGH HIGHER FARES. DIRECT SUBSIDIES SERVE TWO VALUABLE ROLES. FIRST, THEY CLARIFY NATIONAL PRIORITIES SUCH AS MAINTAINING A GOVERNMENT OWNED AIRLINE OR MAINTAINING EMPLOYMENT OR MAINTAINING A NATIONAL AIRFRAME INDUSTRY OR WHATEVER AND PAY THE COST OF THAT PRIORITY UP FRONT OUT OF TAX DOLLARS.* SECOND, A DIRECT SUBSIDY HELPS TO KEEP MANAGEMENT ACCOUNTABLE TO THE STOCKHOLDERS, BE THEY PUBLIC OR PRIVATE. IF THE CARRIER CANNOT EARN A RETURN AT THE MARKET FARE LEVEL, THE PUBLIC HAS A VISIBLE MEASURE OF ITS INEFFICIENCY. WHEN EXCESSIVE COSTS ARE HIDDEN BY EXCESSIVE FARES, BOTH THE PUBLIC AND THE STOCKHOLDERS LOSE.

THERE IS NO SUCH THING AS PERFECT COMPETITION BUT NEITHER IS THERE PERFECT REGULATION. LEFT TO THEIR OWN DEVICES, AIRLINE MANAGEMENTS CAN MAKE DECISIONS AS WELL AS ANY OTHER CORPORATE MANAGEMENTS. THEY CAN DO JUST AS WELL, IF NOT BETTER, OVER THE BUSINESS CYCLE WITHOUT REGULATION AS THEY CAN WITH IT; AND THIS IS REASON ENOUGH NOT TO INTERVENE.

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* THIS IS EXACTLY THE REASON FOR THE SUBSIDY PROGRAM SET UP TO SUPPORT ESSENTIAL AIR SERVICE TO SMALL COMMUNITIES IN THE UNITED STATES.

FIFTH MYTH: "THAT CAREFUL REGULATION AND CAPACITY CONTROL CAN ACHIEVE LOWER FARES THAN CAN OPEN ENTRY AND COMPETITION."

LOW FARES ARE NOT A SPECIFIC GOAL OF U.S. POLICY. RATHER, THEY ARE ONE OF THE INHERENT BYPRODUCTS OF COMPETITION. COMPETITION SHOULD GENERATE A RANGE OF CHOICES AT A VARIETY OF PRICES. THUS, DURING 1979 FOR EXAMPLE, BETWEEN NEW YORK AND FRANKFURT AND AMSTERDAM, THERE WERE A NUMBER OF AIRLINES OFFERING A WHOLE RANGE OF FARES DOWN TO WIDELY AVAILABLE DISCOUNT FARES OF ABOUT 4.8 CENTS PER PASSENGER MILE. DURING THAT YEAR THESE REDUCTIONS, ADJUSTED FOR INFLATION, SHOW THAT CONSUMERS USING THOSE DISCOUNT FARES SAVED ALMOST $9 MILLION OVER WHAT THEY WOULD HAVE PAID A YEAR AGO FOR A SIMILAR TRIP BETWEEN NEW YORK AND FRANKFURT OR AMSTERDAM.

LOW FARES ALSO CAN BE HAD THROUGH REGULATION. BUT AT WHAT COST? LAST SUMMER ONE COULD BUY A SUPER APEX FLIGHT BETWEEN SYDNEY AND LONDON WITH A LOW FARE-PER-MILE RANGING FROM 5.2 DOWN TO 3.1 CENTS DEPENDING ON THE SEASON. UNFORTUNATELY, THE GOVERNMENTS HAVE DETERMINED THAT THIS FARE CAN ONLY BE OFFERED BY QANTAS OR BRITISH AIRWAYS WITHOUT THE POSSIBILITY OF STOPOVERS OR INTERLINE CONNECTIONS. IN THIS CASE, LOW FARES ARE ACHIEVED NOT BY PROMOTING EFFICIENCY

THROUGH COMPETITION BUT BY EXCLUDING EFFICIENT OPERATORS FROM THE MARKET AND THEREBY ASSURING EXTREMELY HIGHLOAD FACTORS. THIS APPROACH MAY JEOPARDIZE THE VERY INTERNATIONAL NETWORK THAT THE INTERNATIONAL COMMUNITY SO VIGOROUSLY DEFENDS. EXCLUSION OF THIRD NATION CARRIERS FROM COMPETING INVITES RETALIATION AND PROTECTIONISM. RESTRICTIONS OF THE NUMBER OF SEATS AVAILABLE AT LOW FARES BENEFITS THE LUCKY FEW AT THE EXPENSE OF THE MANY WHO ARE NOT OFFERED THE SAME CHOICE. IMPOSITION OF ARTIFICIALLY HIGH PRICES ON THOSE WHOSE NEEDS GO BEYOND BASIC, ADVANCE-PURCHASE, POINT-TO-POINT AIR TRAVEL, DAMAGES THE INTERNATIONAL NETWORK AND THOSE WHO USE IT. AND IN THE END, IN THE LONG RUN, EVEN THE ARTIFICIALLY FAVORED LOW FARE CONSUMERS WILL PROBABLY BE HURT AS COSTS -- UNCHECKED BY THE MARKETPLACE -- FORCE FARES TO RISE MORE RAPIDLY THAN THEY WOULD IN A COMPETITIVE ENVIRONMENT.

SIXTH MYTH: "THAT IT IS FOOLISH TO TALK ABOUT OPEN SKIES WHEN THE INDUSTRY IS SO DEPENDENT ON EXTERNAL CONSTRAINTS SUCH AS LIMITED AIRPORT CAPACITY, AIR TRAFFIC CONTROL, TOURIST ORGANIZATIONS, ETC."

"WE CAN'T DEREGULATE EVEN IF WE WANTED TO," IS THE PREMISE OF THIS MYTH. ITS ADVOCATES ARGUE THAT AIRPORT

CONGESTION, AIR TRAFFIC CONTROLLERS AND ENVIRONMENTALISTS JUST WOULD PREVENT AN OPEN SKIES POLICY FROM WORKING. THIS ARGUMENT CAN NOT WITHSTAND CLOSE ANALYSIS. IN THE FIRST PLACE, MOST OF THE POTENTIAL COMPETITORS ARE ALREADY FLYING TO ALL THOSE AIRPORTS ANYWAY; ONLY NOW THEY MUST OPERATE UNDER VARIOUS HANDICAPS IMPOSED BY RESTRICTIVE BILATERALS. SECOND, WE HAVE FOUND IN THE UNITED STATES THAT MOST AIRPORT OPERATORS WILL BEND OVER BACKWARDS TO GET SPACE FOR A NEW ENTRANT OR FOR AN INCUMBENT THAT WANTS TO EXPAND. NEW SERVICE MEANS MORE BUSINESS FOR THEM AND FOR THEIR COMMUNITIES. GROUND CONGESTION, WHILE A PROBLEM, CAN BE MODERATED BY SCHEDULING NEW FLIGHTS AT OFF-PEAKS (AND PRICING THEM TO ATTRACT TRAFFIC) AND, WHERE AVAILABLE, BY INCREASING SERVICE TO SATELLITE AIRPORTS (AGAIN, REFLECTING THE LOWER COSTS OF UNCONGESTED OPERATIONS IN FARES THAT WILL ATTRACT TRAFFIC TO THEM). CONGESTION IS NOT A NEW PROBLEM AND SOLUTIONS MUST BE FOUND REGARDLESS OF WHETHER THERE IS GREATER COMPETITION. FINALLY, ALTHOUGH THERE ARE FOUR AIRPORTS IN THE UNITED STATES THAT ARE SUBJECT TO LANDING SLOT RESTRICTIONS, NEW AIRLINES HAVE BEEN ABLE TO INITIATE SERVICE AT ALL OF THEM.

THE PROSPECT FOR THE 80'S

COMPETITION LEADS TO MANY POSITIVE RESULTS: GREATER EFFICIENCY AND INNOVATION, A GREATER VARIETY OF SERVICE FOR CONSUMERS, GREATER PROFIT OPPORTUNITIES TO AIRLINES AND TO A PROPER ALLOCATION OF SCARCE ENERGY RESOURCES.

ALL THESE BENEFITS SUGGEST THAT GOVERNMENTS SHOULD SUPPORT THE EXPANSION OF COMPETITIVE MARKETS IN THE 1980'S. WHETHER THEY WILL, HOWEVER, IS NOT SO CLEAR. GENERAL MARKET ECONOMIC PRINCIPLES STATE THAT WHEN FIRMS ARE ABLE TO FREELY ENTER AND EXIT A MARKET, THE PRICE, QUALITY AND AND QUANTITY OF THE PARTICULAR PRODUCT PRODUCED WILL BE SET BY THE INTERACTION OF BUYERS AND SELLERS. EFFICIENT SELLERS ARE THOSE THAT CAN EARN A PROFIT AT THE MARKET PRICE. INEFFICIENT SELLERS LEAVE THE MARKET EITHER VOLUNTARILY OR VIA BANKRUPTCY. MANY OF THE WORLD'S AVIATION LEADERS HAVE GENERATED A COMPENDIUM OF ALL THE REASONS AND THEORIES WHICH EXPLAIN WHY MARKET ECONOMICS CAN NOT WORK OR IS NOT WORKING IN THIS INDUSTRY. THESE ARGUMENTS HAVE LITTLE OR NOTHING TO DO WITH THE MARKETPLACE OR EFFICIENT PRODUCTION. THOUGH OFTEN COUCHED IN ECONOMIC TERMINOLOGY, THEY ARE INTENDED PRIMARILY TO PROTECT VARIOUS SPECIAL INTEREST GROUPS.

Whether the number of competitive markets grows or contracts significantly over the next decade will depend largely on the willingness of policymakers around the world to reject the constraints that flow from protectionist arguments in favor of the more open regime favored by market economics. It is highly unlikely that a market system will supplant the current hodgepodge over the next decade. Some important industrialized countries such as Japan, Australia and Italy appear to be staunchly opposed to greater competition as are many developing nations. But, in the long run the establishment of a broad based free trade zone in air transportation, as in most other industries, will be crucial to the continued improvement of the international air transport network.

For lesser developed countries the road ahead is especially difficult and to make a governmental commitment to greater competition is equally difficult. The abundance of consumer goods available in most industrialized countries is appealing to peoples of most nations. And, the commingling of societies made possible by today's air transport and communications networks have surely contributed to these countries' desires for the benefits of industrialization. Last year Philip Caldwell, the President of Ford Motor

COMPANY NOTED:

> RISING EXPECTATIONS ARE JUST AS EVIDENT WHEN IT COMES TO GOVERNMENTS. IT HAS BEEN SAID THAT EVERY EMERGING NATIONAL WANTS FIRST AND FOREMOST A STEEL MILL AND NATIONAL JET AIRLINE OF ITS OWN. AT LAST COUNT THERE ARE NOW AT LEAST 30 NEW STEELMAKING FACILITIES AND MORE THAN 50 NATIONAL AIRLINES IN COUNTRIES THAT DID NOT HAVE EITHER AS RECENTLY AS 25 YEARS AGO.*

THE INTRODUCTION OF THESE CAPITAL INTENSIVE INDUSTRIES INTO LESSER DEVELOPED ECONOMIES IS TODAY OFTEN ACCOMPANIED BY TARIFFS, QUOTAS AND OTHER TRADE RESTRAINTS DESIGNED TO PROTECT INFANT DOMESTIC INDUSTRIES. PERHAPS FOR DEVELOPING COUNTRIES SOME PROTECTIONISM IS A LOGICAL APPROACH TO THEIR PERCEIVED NEED FOR ECONOMIC SELF-SUFFICIENCY AND GROWTH. BUT IN GENERAL AND CERTAINLY FOR INDUSTRIALIZED COUNTRIES, THE IMPOSITION OF MARKET RESTRAINTS IS ULTIMATELY SELF-DEFEATING AND COSTLY TO CONSUMERS.

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*PHILIP CALDWELL, "U.S. BECOMING ECONOMIC COLONY FOR FAILING TO MEET WORLD CHANGES," FINANCIER, FEBRUARY 1979, P. 21.

Over the last twenty years the United States has watched, and, to a great extent aided, the economic recovery of a war torn Europe and Japan. By the end of the seventies -- a decade of domestic political turmoil -- many U.S. industries suddenly woke up to the reality that foreign competitors controlled a large share of their major domestic markets in such goods as steel, automobiles, textiles and televisions. Today, countries like West Germany and Japan are seeing their strong positions beginning to be eroded by newly developing economies in countries like Korea and Singapore.

In the absence of trade barriers, economists see these trends as positive because they promote efficiency, specialization and competition, all of which benefit consumers. But as the sales of imports rise, domestic producers and labor in aging industries become concerned. They raise the specter of foreign dominance of key industries like steel and textiles -- contending that the country will become vulnerable to external developments. Generally those who argue most strongly for protection are the affected producers and their labor forces. Thus, we recently witnessed that virtually simultaneously our domestic steel industry charged European steel producers with predatory dumping

WHILE AGREEING TO AN INDUSTRY WIDE LABOR SETTLEMENT THAT WILL RAISE WAGES APPROXIMATELY THIRTY PERCENT OVER THREE YEARS.

ARGUMENTS FOR CONTROLLED TRADE ARE SUPERFICIALLY APPEALING BUT, IF ACCEPTED, ARE ULTIMATELY DETRIMENTAL TO DOMESTIC CONSUMERS AND THE WORLD ECONOMY. PROTECTIONISM SHELTERS HIGH COST INEFFICIENT PRODUCERS WHICH LEADS TO HIGHER PRICES AND REDUCED SUPPLY. QUOTAS -- WHICH HAVE AN AVIATION COUNTERPART IN RESTRICTED ROUTE RIGHTS, CAPACITY RESTRAINTS AND POOLING ARRANGEMENTS - ARE MOST DESTRUCTIVE BECAUSE THEY LIMIT THE CONSUMERS' PHYSICAL ACCESS TO A PRODUCT. NOT ONLY DOES THE PRICE RISE ABOVE THE COMPETITIVE LEVEL BUT THE QUOTA PREVENTS FUTURE CHANGES IN RELATIVE COSTS. INCENTIVES FOR EFFICIENCY ARE ELIMINATED, AND RESOURCES BECOME LOCKED INTO LESS PRODUCTIVE ACTIVITIES WHICH DELAY THEIR TRANSFER TO MORE PRODUCTIVE USES. IN AN INTERDEPENDENT WORLD THAT MUST BECOME MORE EFFICIENT, THE CURRENT TREND TOWARD INTERNATIONAL PROTECTIONISM BY INDUSTRIALIZED NATIONS REPRESENTS A SERIOUS THREAT TO STABILIZING THE WORLD ECONOMIC ORDER.

OVER THE YEARS THE INTERNATIONAL AIRLINES HAVE BEEN HEALTHY ADVOCATES OF MARKET CONTROLS. FIRST, ON THE GROUNDS

THAT AIR TRANSPORT WAS AN INFANT INDUSTRY, THEN BECAUSE IT WAS A PUBLIC UTILITY AND TODAY BECAUSE THE SYSTEM IS SO COMPLEX AND BECAUSE IT CONSUMES OIL. ALTHOUGH THE AIRLINE PEOPLE ADVOCATE A MULTILATERAL APPROACH, IT IS AN APPROACH THAT TRADITIONALLY HAS BEEN PREMISED UPON PROTECTIONISM. AS DISCUSSED UNDER THE SECOND MYTH, A LARGE SEGMENT OF THE INTERNATIONAL AVIATION COMMUNITY HAS SPENT A GOOD DEAL OF TIME AND MONEY IN AN EFFORT TO CONVINCE GOVERNMENTS AND THE PUBLIC AT LARGE THAT THE SYSTEM WILL COLLAPSE WITHOUT ROUTE RESTRICTIONS, PRICE CONTROLS AND DETAILED COORDINATION OF RATES. THEY HAVE, WITH SOME SUCCESS, OBSCURED THE MARKET ECONOMIC REALITIES OF AIR TRANSPORTATION WITH WHAT APPEAR TO BE LARGELY SELF GENERATED INTERNATIONAL COMPLEXITIES.

VERY FEW UNITED STATES AIRLINES INITIALLY FAVORED DOMESTIC AIRLINE DEREGULATION. AND, OUR INTERNATIONAL OPERATORS WERE AS SURPRISED AS FOREIGN CARRIERS AND THEIR GOVERNMENTS BY THE U. S. GOVERNMENT'S QUANTUM LEAP TOWARD A COMPETITIVE INTERNATIONAL SYSTEM. YET, THESE PRECIPITOUS CHANGES HELPED THE U.S. AIRLINES TO BECOME SOME OF THE MOST EFFICIENT IN THE WORLD AND TODAY THEY ALL FAVOR DEREGULATION. TO THE EXTENT THAT FOREIGN GOVERNMENTS CONTINUE TO ACCEPT

THE PROTECTIONIST'S ARGUMENTS -- WHICH WERE ACCEPTED BY THE U.S. GOVERNMENT FOR 40 YEARS -- A SERIOUS EFFICIENCY GAP BETWEEN U.S. CARRIERS AND MOST FOREIGN CARRIERS WILL LIKELY DEVELOP. AS THE GAP BETWEEN THE EFFICIENT AND INEFFICIENT PRODUCER WIDENS, THE PRESSURES ON GOVERNMENTS TO INCREASE RESTRICTIONS MOUNT. THE ABILITY TO MAKE ADJUSTMENTS BECOMES MORE DIFFICULT AND ULTIMATELY THE SOCIAL COSTS TOO HIGH. THE UNITED STATES IS FACING THIS TEST TODAY IN A NUMBER OF INDUSTRIES. THE PRESSURES ON THE GOVERNMENT ARE INTENSE AND DESPITE THE PRESIDENT'S GENERAL COMMITMENT TO FREE TRADE, THE OUTCOME IS DIFFICULT TO PREDICT.

IF GOVERNMENTS CHOOSE THE PROTECTIONIST ROUTE FOR THEIR AIRLINES, THE CHANCES FOR A BROADLY BASED COMPETITIVE INTERNATIONAL AIR TRANSPORT SYSTEM WILL SURELY DIM. IN THE SHORT RUN THIS MEANS THAT THE EFFICIENT CARRIERS WILL EARN LARGER PROFITS AND THE INEFFICIENT WILL CONTINUE TO OPERATE. IN THE LONGER RUN A RETURN TO PROTECTIONISM -- OR MERELY FAILURE TO ADD TO THE COMPETITIVE AGREEMENTS THAT NOW EXIST -- WILL SERIOUSLY HURT THE INDUSTRY AS RISING PRICES FIRST FORCE THE VACATIONER AND ULTIMATELY THE BUSINESS COMMUNITY TO CUT BACK ON AIR TRAVEL. THIS IN TURN WILL

SURELY HURT THE AIRCRAFT INDUSTRY WHICH IS NOW DEVELOPING INTO AN INTERNATIONALLY COMPETITIVE INDUSTRY.

TODAY THERE IS COMPETITIVE AIR TRANSPORTATION IN A NUMBER OF NORTH ATLANTIC MARKETS AND SOME NEW COMPETITIVE ROUTES FROM THE U.S. TO THE PACIFIC AND THE MIDDLE EAST. THERE ARE A FEW OTHER MODERATELY OPEN AGREEMENTS NOT INVOLVING THE UNITED STATES. THE ANSWER TO HOW MUCH COMPETITION TO EXPECT IN THE 1980'S DEPENDS LARGELY ON THE EXTENT TO WHICH GOVERNMENTS WILL BE WILLING TO MOVE AWAY -- EVEN IN CAREFULLY MEASURED STEPS -- FROM THE PROTECTIONIST THINKING THAT HAS DOMINATED AVIATION POLICY FOR SO MANY YEARS.

ON THIS ISSUE THERE SEEM TO BE DIFFERING TRENDS. ON THE ONE HAND THE UNITED KINGDOM HAS TAKEN A NUMBER OF STEPS TO MAKE BRITISH AIRWAYS MORE EFFICIENT AND TO EXPAND THE MARKET OPPORTUNITIES OF OTHER PRIVATELY OWNED AIRLINES. WE ALSO KNOW THAT THE COMMISSION OF THE EUROPEAN COMMUNITIES ISSUED A REPORT LAST SUMMER FAVORING THE REMOVAL OF BARRIERS NOW BLOCKING A MORE COMPETITIVE AIR TRANSPORT SYSTEM BETWEEN AND AMONG THE COMMON MARKET COUNTRIES. THE REPORT NOTED SOME OF THE DIFFERING OPERATING CHARACTERISTICS BETWEEN U.S. DOMESTIC SERVICE AND INTRA-EUROPE SERVICE

WHICH IT CONTENDS ENABLE OUR CARRIERS TO OPERATE MORE EFFICIENTLY. THE COMMISSION SUGGESTS THAT A MORE INTEGRATED AND COMPETITIVE NETWORK MIGHT ENABLE EUROPEAN CARRIERS TO ACHIEVE SOME OF THESE SAME EFFICIENCIES.

ON THE OTHER HAND SOME OF THE GOALS OF THE NEWLY FORMED INTERNATIONAL ASSOCIATION OF LATIN AMERICAN AIR CARRIERS MAY TEND TO HINDER GROWTH OF A COMPETITIVE EFFICIENT SYSTEM. MANY OF THE GOALS OF A REGIONAL AIRLINE ORGANIZATION SUCH AS THE SHARING OF TECHNICAL EXPERTISE AND TRAINING FACILITIES OR THE MAINTENANCE OF A JOINT SPARE PARTS INVENTORY MAY BE QUITE DESIRABLE. HOWEVER, THE PRESIDENT OF AEROPERU STATED THAT THE INITIAL POSITION OF THE ORGANIZATION WILL BE TO PROTECT LATIN AMERICAN TRAFFIC FOR LATIN AMERICAN CARRIERS BY REDUCING FIFTH AND SIXTH FREEDOM OPERATIONS BY NON-LATIN AMERICAN CARRIERS. THIS OBJECTIVE, IF ACCEPTED AS A POLICY GOAL BY THE MEMBER CARRIERS' GOVERNMENTS, WILL CERTAINLY BE COUNTER-PRODUCTIVE TO IMPROVING THEIR CARRIERS' EFFICIENCY AND KEEPING DOWN THE COST TO CONSUMERS.

THERE IS VERY LITTLE UPON WHICH ECONOMISTS SEEM ABLE TO AGREE. BUT MOST DO AGREE THAT THE BENEFITS OF FREE TRADE TO INDIVIDUAL NATIONS AND THE WORLD AS AN ECONOMIC

UNIT FAR OUTWEIGH THE COSTS THAT MAY BE BORNE BY PARTICULAR SPECIAL INTEREST GROUPS AS A CONSEQUENCE OF THIS POLICY. WE HAVE SEEN ON THE NORTH ATLANTIC AND IN THE UNITED STATES OVER THE PAST THREE YEARS THAT COMPETITION CAN GENERATE SUBSTANTIAL CONSUMER BENEFITS AND TRAFFIC GROWTH. WE HAVE SEEN THAT IN A COMPETITIVE SYSTEM THE CARRIERS CAN DO EXTREMELY WELL IN PROSPEROUS YEARS AND CAN SURVIVE THE BAD ONES.

WHEN GOVERNMENTS ACT AS PROPRIETORS IT IS UNDERSTANDABLY DIFFICULT FOR THEM TO SEPARATE SHORT RUN REVENUE CONCERNS FROM LONGER TERM GOVERNMENTAL INTERESTS. THE DEGREE OF COMPETITION THAT DEVELOPS OVER THE NEXT DECADE WILL DEPEND PRIMARILY ON THE WILLINGNESS OF GOVERNMENTS TO QUESTION SERIOUSLY THE POLITICAL ECONOMIC ARGUMENTS RAISED BY THEIR AIRLINES AND TO MAKE TOUGH CHOICES ABOUT THE LONG RUN TRADE-OFFS BETWEEN CONTINUED PERVASIVE PROTECTIONISM AND A MORE COMPETITIVELY ORIENTED SYSTEM. MOST COUNTRIES -- INCLUDING THE UNITED STATES -- MUST MAKE THIS CHOICE ABOUT A NUMBER OF INDUSTRIES. AIRLINES ARE NOT UNIQUE IN THIS RESPECT. THEY ARE PRIMARILY JUST ANOTHER CONSUMER SERVICE THAT SHOULD OPERATE IN RESPONSE TO COMMERCIAL REALITIES.

THE UNITED STATES GOVERNMENT WILL CONTINUE TO URGE OTHER GOVERNMENTS TO MOVE IN A LIBERALIZING DIRECTION. NOT SOLELY, AS OFTEN ALLEGED, BECAUSE OUR AIRLINES ARE STRONG AND WILL DO WELL. SOME ARE NOT STRONG AND WILL NOT DO WELL. RATHER, THE UNITED STATES IS MOTIVATED BY THE SUBSTANTIAL CONSUMER BENEFITS THAT WILL ACCRUE TO THE TRAVELING AND SHIPPING PUBLIC AND TO THE AIRLINE INDUSTRY FROM A COMPETITIVE SYSTEM. THE DOLLAR VALUE OF THESE BENEFITS FAR EXCEED THE PROFITS OF THE INDUSTRY. IN A WORLD OF RESOURCE CONSTRAINTS, AND GROWING INTER-DEPENDENCE, ENHANCING THE EFFICIENT FLOW OF COMMERCE THROUGHOUT THE WORLD SHOULD BE A HIGH PRIORITY. THE UNITED STATES BELIEVES THAT IT IS, AND BELIEVES THAT A MORE COMPETITIVE AIR TRANSPORT SYSTEM IN THE 1980'S WILL CONTRIBUTE TO ACHIEVING THAT GOAL.

THE UNITED STATES WILL BE A FLEXIBLE NEGOTIATOR WITH COUNTRIES THAT ARE RECALCITRANT PARTNERS IN LIBERALIZATION -- PARTICULARLY WITH THIRD WORLD NATIONS. BUT WE HOPE THAT THESE COUNTRIES WILL COME FORWARD WITH NEW IDEAS THAT SHOW SOME MOVEMENT TOWARD AN EXCHANGE OF COMPETITIVE OPPORTUNITIES. ALSO OVER THE NEXT FEW YEARS WE HOPE TO BEGIN WORKING WITH OUR LIBERAL TRADING PARTNERS ON AGREEMENTS THAT CAN EXTEND GREATER MUTUAL BENEFITS THAN MAY BE ACHIEVED THROUGH A MORE TRADITIONAL BILATERAL AGREEMENT.