The Disaster of Deregulation

THEODORE P. HARRIS[1]

If, as its proponents proclaim, deregulation is such a success, then why is the travelling public so unhappy? Why are airlines screaming about imminent financial ruin? Why is air travel seemingly choking itself to death? For the last few years, air travel has received the most complaints at the FTC, as public opinion polls have seen the airline industry plummet from the most admired to the least trusted.

The airplane is arguably among man's greatest inventions, certainly in the twentieth century. That its full benefits and capabilities would be denied to the travelling public seems unthinkable, but our national stewardship of this remarkable invention during the past decade has, in my opinion, been abysmal. By the late 1970's, the airline system was providing approximately ninety percent of our public, intercity transportation. It was our national mass transportation system.

More than one hundred large and small airlines have failed in the last few years. This past year began with eleven large airlines and has seen the bankruptcy or liquidation of five of them. Three others are on the "endangered species" list.

The industry is insolvent, with only three airlines considered viable, and those three do not really compete with one another. What little com-

1. Mr. Harris is chairman of Airline Industry Resources, Inc. (AIR), a McLean, Virginia-based strategic planning organization. A graduate of Fordham University, he holds an M.S. Degree in Transportation from the University of Tennessee, and was a Transportation Fellow at the University of North Carolina and the University of Maryland.

petition is left is generally that authorized by bankruptcy judges who, incidentally, have also supplanted the DOT and the White House as major decision makers on international routes.

Airlines have become unregulated, monolithic companies providing inferior air transportation service at arbitrary prices. Their objective is to segment the market, not to serve it. They force feed passengers through a patchwork of hub-and-spoke routes without regard to transport efficiency or public convenience, not to mention national interest objectives such as the efficient utilization of public resources and the national defense.

It is time to get back to some basics about air transportation so that we can understand where we are and where we need to go. In the middle-1960's, I was fortunate to have had the opportunity to develop and teach probably the first undergraduate course devoted to commercial airline management. This required the identification for the inherent and competitive advantages of the commercial airliner. Simplistic as they may sound, they are relevant today —perhaps more than ever:

1. The commercial jet airliner is ten times faster than any other mode of transportation.
2. It can travel nonstop in a straight line — the shortest distance from origin to destination.
3. It is unencumbered by geographical obstacles like mountains and rivers (nothing was said of politicians and cowboy economists).

On the downside, air travel is inherently dangerous and very expensive (in large part to overcome the danger) and it requires considerable public investment for airports and airways.

The goal of air transportation, as a branch of transportation science, is the increasingly efficient movement of people, products, and ideas — through the air — over time and space. Efficiency is measured not just in terms of cost, but also in terms of time — man's most perishable commodity.

This incredible time component of air transportation has proven to be an important catalyst in the rapid social and economic development of the United States. And yet we are throwing it away with high fares and circuitous routings through choking hubs operated by what is now the oldest fleet of inefficient geriatric jets in the developed world.

Air travel speed, the correlative of time, has effectively been cut in half — compromised by hub-and-spoke operations that can double travel time on almost all but nonstop routings. Travel in a straight line from origin to destination? Not through a hub. Circuity — the extra miles flown — can run fifty percent or more of actual nonstop mileage in today's fuel guzzling hub operations. The added landings and takeoffs in hub rotations are not only expensive, they create severe peaking congestion of airways, runways, and gates — and cries for more airports. They add greatly to travel time and stress, discouraging travel on the one hand, while turning one day business trips into expensive overnight excursions on the other; or worse — as airlines today are finding out — no trips at all.

Today's air travel is rife with all types of oppressive discrimination in terms of price, service, and place (regions of the country). It would require volumes to document. This discrimination ultimately affects most, those who can least afford it. Fares often bear no relationship to the cost of the service provided. Sure there were low, predatory fares for a period in the mid 1980's. Among other things, they helped to destroy our intercity bus system — transportation for the common man. They also created the imperative for consolidation and hub fortress development to eliminate competition.

For many, even the speed of air transport is no longer a factor: many people simply cannot afford the higher fares or meet the complicated restrictions attached to so-called "discount" fares. And fares were further increased by as much as twenty percent earlier this week (Editors Note: Statements made in April 1991). Americans are, in effect, being denied access to what is left of our national, public air transportation system. There is nothing subtle about the discrimination that materializes in the form of a 300% increase in adjusted, unrestricted coach fares in the last ten years — the only truly comparable pre - and post - deregulation fare categories. Is there really "common carriage" available to all when an airline ticket requires round-trip travel between Tuesday and Thursday with a Saturday night stay over; fourteen (and now extend to 21-30) day advance purchase; nonrefundability; no itinerary changes, and; "capacity controls" (which means that a fare may not be available even though there are plenty of empty seats)? And, in all probability, that ticket provides a circuitous routing through a hub. The 1978 air travel dollar bought steak. Today, it buys hamburger.

Consider this: The replacement value of our nation's 560 taxpayer-owned commercial airports and the airways system is estimated at more than $1 trillion. According to the *Aviation Daily*, the Wall Street market value of the stock of all of the major airlines is currently less than $15 billion, or one point five percent of the value of our airport system. Yet that one point five percent dictates whether airline service is provided, under what schedules, and at what price — all with no input from the same public that owns the airports. The tail is wagging the dog — and a very small tail at that. This is the functional equivalent of turning over the interstate highway system for the sole use of the trucking industry.

The quality of leadership and innovative management to which the public has entrusted the air transportation service is of no surprise. Regulatory fitness standards have succumbed to political expediency. An asset-rich, national air transportation system has literally been carved up and devoured, much of it at the expense of tens of thousands of once-dedicated and professional airline employees who are the real martyrs of deregulation. The pride and spirit that made airlines one of our most outstanding and socially responsible industries has been bludgeoned to death in the ruthless pursuit of greed. The industry has been the deregulated victim of insidious moral and ethical decay at all levels. Greed is the real Icon.

And where was leadership at the DOT? The "industry-lap dog" mentality of that agency is best evidenced by automatic merger approval that sent fares skyrocketing and service levels plummeting across the country. That the forces of ruinous competition were driving the industry into mass bankruptcy should have been more than enough reason to reverse deregulation in 1984-1985. But the DOT, at the behest of major airlines, even joined lawsuits to prevent the states from requiring airlines to behave ethically. Remember the DOT Burnley regime's "clean bill of health" for Eastern Air Lines following the "exhaustive" inspection in mid 1988? Couple the bankruptcy examiner's findings of nearly $750 million in probably fraudulent Eastern asset transfers by Lorenzo's Texas Air Corporation, and the criminal indictments in New York of Eastern managers for alleged crimes involving maintenance records falsification in the same time frame, and you have a good idea of a cynical quality of the DOT's leadership and industry ethics in the 1980's — worse than vacuous. An ironic postscript to the Eastern tragedy was the recent guilty plea for maintenance violations entered by the Trustee because Eastern was "no longer concerned about its public image." The travelling public is in bad shape when it has to depend on the U.S. Attorney in Brooklyn to enforce the Federal airline safety regulations. Eastern's employees objected to a policy that said it was cheaper to fix the books than it was to fix the airplanes. It cost them their careers.

Deregulation failed because key assumptions of its cowboy proponents were plain wrong and they were too arrogant to heed the chorus of warnings. They saw the very positive results of the sound Ford Administration policy, known as "Regulatory Reform," developed in the middle-1970's and concluded that if a little "reform" was good, then complete deregulation would make celebrities (and millionaires) of them all. Events have demonstrated, again and again, that there are very significant economies of scale in the airline industry — something that every airline executive knows. Yet the deregulationists claimed that because economies of scale did not exist, the industry was "perfectly competitive." And then there was the "contestability theory," which assured monopoly market discipline through the threat of "potential" competition that would have had even a monopolist trembling in his boots.

Deregulation and our airline system were ultimately doomed because deregulation's cultist proponents focused their attention only on the air carrier part of the travel equation. If they had the breadth of vision to look at the system as a whole, they might have recognized the system for the public utility that it is. Individual airlines are not public utilities — but the air transportation system is and it needs to be treated as such by the federal government. Unrestrained competition in public utility type services is notoriously counterproductive and ultimately leads to the kind of concentration we have seen in air transportation.

Deregulationists continue to claim that fares are lower and that traffic experienced "explosive growth" in response to deregulation. The truth is that traffic grew at about the same rate in the ten years before deregulation as it did in the ten years after. Fares, according to recent studies, are much higher—not lower—for highly restrictive and circuitous air travel. Even the government admits that fares are much higher at hub cities, such as Denver. At many smaller cities, average fares are two or three times what they were in the 1970's, with full allowance for inflation—that is, if they still have airline service.

Airlines continue to quote their own "yield" figures as evidence that fares are lower. Yield is based on actual miles flown, not on straight line (great circle) distance. Thus, they include very significant levels of circuity that lower average yields and leave the *intended* false impression that fares must be lower.

Technology was once the lifeblood of the airline industry. Advanced jumbo jets, new propulsion systems, and dramatic fuel saving innovations all fell victims—and the global leadership of our aircraft manufacturing industry is being held hostage—to the dramatically changed circumstances of deregulation. The airlines retrogressed to old, first generation jet equipment in order to feed hub-and-spoke operations, with some carriers (such as United) buying back the very airplanes they had earlier disposed of as obsolete. Two months ago, United retired its first 727—a twenty-eight year old airplane. Boeing refurbished its 737 jigs and the DC-9 became the MD-80—the airplanes that deregulation built.

The Civil Reserve Air Fleet (CRAF) is the civilian airline component of the Military Airlift Command. In times of national emergency it can be activated by the President impressing civil aircraft for military use—something of a flying volunteer fire department. In its forty year history, CRAF had never been activated because there was plenty of available civil airlift. Not so anymore. The real long haul "lift" capability of the CRAF fleet has fallen by more than fifty percent since the start of deregulation. CRAF was activated for the very first, time by the President for use in Operation

Desert Shield. There are many in the industry who doubt our country's ability to support an all-out airlift in the event of a prolonged war in the Persian Gulf, in part because of CRAF. It is not surprising that the shift to older, short haul equipment needed for hub operations resulted in a sharp reduction in the number of long haul, civil aircraft capable of carrying heavy loads. This caused the National Defense Transportation Association to warn the President in 1987: "The nation's shortfall in long-range cargo airlift capacity is substantial, and as such, constitutes a dangerous threat to national security."

I believe our nation's airport and airway system is operating at only a fraction of its designed capacity. The congestion problems are caused by hub-and-spoke operations spawned by deregulation. A B-747 or DC-10 occupies the same amount of runway and airway space as a DC-9, B-737 or B-727, but carries more than three times as many passengers (at lower seat mile costs). Yet the larger widebodies (which were a blessing on regulated routes where traffic could be consolidated for nonstop flights) did not lend themselves to hub-and-spoke operations. Contrary to airline assertions, hub-and-spoke systems are defensive mechanisms. They are hardly innovative — merely reincarnations of sixteenth century freight transportation systems. The initial objective of hub systems was survival in the early turbulence of deregulation. Today they provide market control and domination by blocking out competition, tying up gates and slots, and controlling feed through code-sharing.

The U.S. mail has taken a terrible beating under deregulation, particularly since CAB sunset in 1985. Unlike linear route systems, hubs do not operate during the late night/early morning hours favored by the Postal Service and the major combination carriers discontinued night freighter services. Increased transit time and missed hub connections have seriously eroded the reliability and quality of air service provided to the Postal Service. Add to that the fact that airline mail rates shot up by almost fifty percent following CAB sunset and the difficult problems faced in moving the mail by scheduled airlines can be appreciated.

Up until the structural changes brought about in 1985 by CAB sunset, CAB-approved business rules required travel agents to work first and foremost in the best interests of passengers, booking the most convenient flight at the lowest fare. Airline rules prohibited travel agents from discriminating either for or against individual airlines. The name is the same and the office may look the same but the travel agency business has undergone a metamorphosis. Incentive and override commissions, "preferred" and exclusive airline supplier relationship are the norm as powerful airline Computer Reservation Systems monitor closely travel agent sales activities. Most travel agents now work for airlines first with the passenger a distant second. Consortiums, franchise schemes, and large chains have been created from once independent travel agent ranks driving up commissions almost sixty percent—and thus the cost of air travel. *Caveat emptor.*

Regional and commuter airlines have come under the domination of megacarriers through "code-sharing" programs, which represent a nadir in industry ethics, already at an all time low. Schedules are no longer made for the convenience of the local market, but for the convenience of the hub operator. In the words of one commuter official: "The only thing worse than a code-sharing agreement for passengers is no code-sharing agreement for the commuter airline."

The airlines of today are vastly different from those promised by the deregulationists. I have touched briefly on only a few of the pratfalls of deregulation.

In 1966, the Department of Transportation was created. Its "Declaration of Purpose," applicable today, stated in part:

> "The Congress therefore finds that the establishment of a Department of Transportation is necessary in the public interest and to assure coordinated, effective administration of the transportation programs of the Federal Government; to facilitate the development and improvement of coordinated transportation service, to be provided by private enterprise to the maximum extent feasible; to encourage cooperation of Federal, State, and local governments, carriers, labor, and other interested parties toward the achievement of national transportation; to provide general leadership in the identification and solution of transportation problems; and to develop and recommend to the President and the Congress for approval national transportation policies and programs to accomplish these objectives with full and appropriate consideration of the needs of the public, users, carriers, industry, labor, and the national defense."

It seems to me that on almost all counts we are not measuring up. Much damage has been done to our airline system and, consequently, to the nation and to the public it was built to serve.

Last year's DOT Report on Airline Competition was no more than just another pro-deregulation puff piece by the Flat Earth Club at the Department of Transportation. Is it possible that one of the latest bromides from the cult of deregulationists and the DOT will prevail? Let the foreign airlines operate in the U.S. domestic market? Let them buy U.S. carriers and control our airport and airway system? The Secretary says so. Our air transport industry, once the envy of the world, has become a mere shadow of what it should be. *Consider this*: *Aviation Daily* reported on March 6th that a twenty-five percent share in Japan Air Lines would cost $3.6 Billion. On that basis, Japan Air Lines alone is worth more than what's left of all major U.S. airlines *combined*.

DOT has thoroughly discredited itself and forfeited any right to leadership. It is time we acknowledged the truth: Deregulation is really a major failure from almost every vantage point. It has nearly destroyed what had been the finest airline system in the world. Congress must take back leadership in commercial aviation if we are ever to restore vitality to this once vibrant industry and rebuild our intercity public transportation system.

Sam Skinner proclaimed recently that the deregulation debate is over. For once he is right, and the results are obvious.