

COMMENT

RESEARCH, LOCAL SERVICE AND THE CAB

BY SECOR D. BROWNE*

There is a general assumption that the aerospace industry is concentrated in the northwest, the west coast, and perhaps Texas. That definitely is not true; a map showing distribution of aerospace and aviation industry does include all but eleven of our 50 states.

The question is: "After the 747 and the DC-10, What?" The answer is, if we don't do something, after the 747 and the DC-10 there will be nothing. Those aircraft, plus the L-1011, appear to be the last major transport aircraft to be built. It may sound odd to raise this point at a time when we all know there is a problem of over capacity in the nation's airlines. But this problem is temporary.

It takes from five to seven years for an airplane to get born. Right now we need some aircraft types and within five to seven years we will need more. At this moment we need a replacement for the tired Convairs. We need something to replace the F27.

We need clean, quiet engines beyond those powering the DC-10 and the 747. Somewhere down the line, and maybe not too far away, we need an airbus—a two engine, 250 passenger aircraft suited for high density markets such as the Northeast Corridor, the west coast and others. We certainly need a short takeoff and landing aircraft. Someday, we not only will need, but must have, a supersonic transport.

What's at stake in our aerospace industry? 80 per cent of the aircraft in the free world's fleet are American made. The meaning is clear to our balance of payments.

If we don't maintain our markets, we will lose the 80 per cent. We will lose the balance of payment in-flow, and we will have an out-flow as our carriers re-equip with foreign aircraft.

It's interesting to note that airplanes are one of the few outstanding technological achievements left in our export package.

The Italian Government ran an ad recently in the Wall Street Journal and the Washington Post. It was aimed at the ten per cent surcharge and listed what the Italian Government and the Italian people bought, in an attempt to show what good customers they are of the U.S. It was curious that the only major category of advanced technology or equipment was

* Chairman, Civil Aeronautics Board. This comment is based upon an address delivered by Chairman Browne in Wichita, Kansas on January 28, 1972.

airplanes—some \$131 million worth. Most of the items were things like food and raw materials, things that the Italians either consumed or finished and shipped back to us.

Many of the tape recorders here today are made by the Japanese. We use Italian office machines. We use German milling machines and we drive Japanese, French, Swedish, English, Italian and German automobiles. Clearly airplanes and aircraft exports are among the few outstanding products we have with which to compete in the world's market.

What am I worrying about? What's missing?

To put a \$25 million airplane into production, like the Boeing 747, one is going to be about \$1.5 billion dollars in the hole at the maximum negative cash flow. Previously this flow, this kind of muscle, came from the role of the Department of Defense which, with steady production of bombers and tankers and the development of engines and airframes, made possible the 707 and the DC-8 family. The reason there is a 747 and a DC-10 today, in my judgment, is that there is a C-5. The C-5 paid for the development of the General Electric engines that power the DC-10. A parallel program paid for the development of the Pratt and Whitney engines that now power the 747.

Our industry today simply can't raise the kind of financial resources to go from development through to production. And that's Boeing, Douglas, General Electric, Pratt and Whitney, Lockheed, either singly or in my view, in competition. Today, our industries are competing, not with other industries, but with governments—the French, British, German, Italian and Japanese.

We are undergoing a reverse brain drain. Boeing has made a deal with the Italians to develop a short takeoff and landing vehicle. General Electric has entered into a deal with SNECMA—the French State engine factory—to develop a ten ton thrust cleaner, quieter engine which will power many of the future generations of aircraft. If we ever re-engine any part of our present fleet, that will probably be the engine.

I don't blame the managements of any of those companies. They have the responsibility to keep their engineering teams together and they have responsibilities to their stockholders. I think we, as people of this country, as taxpayers, and as the government, also have a responsibility. I'd like to emphasize I am not talking about research and development. I'm talking about the burden of cash flow to get through tooling, through inventory, through production costs.

Having painted this black picture, what do I suggest we do? Well, I propose something that I call an Aerospace Reconstruction Finance Corp. I use those words because I think this entity should be financial in nature—not technical. It should be either independent or under the wing of the Treasury, and should be small.

Probably the only mistake of the SST program, in my view, was that it did have a project office, following the Defense Department procurement procedures, which meant that there was a 125 man team—a good one—but a 125 man team between the airlines and the manufacturers. There was considerable concern on all our parts that what was being developed and what might come out of it was the government's airplane, not the airlines' airplane.

I don't think we need to re-design anything. I repeat, all we want to do is provide the financial muscle to continue the historic process whereby the air carriers develop their requirements, the manufacturers bid, the carriers make down payments, progress payments and final payments. All I want the government to do is undergird this process, provide *that* portion of the risk which is simply beyond the ability of the airline industry and the manufacturing industry to handle.

What I propose will also preserve the element of competition and some element of risk. I suggest that this undergirding be achieved first by means of guaranteed loans; second, by an improved depreciation policy to encourage the carriers to replace obsolete equipment and finally, by revised interest policies. Presently we have the curious situation whereby Japan Air Lines or Alitalia or Air France can get money from ExIm Bank for about half of what our carriers have to pay in the private sector.

I'm not suggesting a choice between social programs, like education, health or housing. These are all important. What I'm suggesting is a means to provide and preserve one of our major bases of wealth in order to provide something which we can tax in order to have the resources to have these programs. We must have something to sell in the world market. Otherwise I am afraid we will turn into a nation of service industries very busily taking in each other's laundry.

Moving to another topic, the carriers, in my view, have turned the financial corner. From the pre-tax loss of \$194 million in 1970, the newspapers now show that the carriers are about going to break even as a group for 1971. In 1972, even without a possible three per cent fare increase, I'd say the carriers, as a group, should net between 200 and 250 million dollars.

There are various indicators. October of 1971 had a \$65 million swing from October of 1970. In 1970 the trunks alone lost \$40 million. In October, 1971 the trunks alone made \$25 million. October, November, and December traffic has been up between seven and nine per cent over a year ago.

Why has this come about? First of all because of some improvement in the economy. But also because of actions of responsible airline management in combination with what I like to call responsive regulation. Airline managements have taken hold of costs. They have reduced capac-

ity. The Board has provided an improvement in yield by granting a six per cent fare increase, and by permitting multilateral capacity reductions.

There are a couple of caveats if the carriers are to realize a \$200 to \$250 million profit this year. The first is labor. Almost 50 per cent of the airline dollar is spent for labor. Recent increases, before the wage/price freeze, were in my view, far beyond anything which could be matched by productivity improvement. The wage/price control, I hope, will help. But I feel it is up to the Congress to put some sort of transportation labor control into effect, and pressures to do this, of course, have been increased by the dock strike.

The second caveat is the capacity problem. The history of airline overcapacity simply must not be repeated. Last year the system load factor of the airlines was 48 per cent. This was seven per cent below what the Board has found to be a reasonable standard. This year the airlines are scheduled to put more than 60 wide-bodied jets into operation. These simply cannot be put into service on a one-for-one basis, substituting one wide-bodied for one 707 or DC-8. This is going to be tough on the industry—both the manufacturer and the airline. It's going to mean stretch outs, possibly cancellations, probably groundings. But we cannot put more seats back into the air.

Furthermore the airlines must get over the myth of market share. If you're flying 35 per cent of the seats in a market, as an airline, and you have 25 per cent of the traffic, you are, in my view, clearly out of your mind. You hurt the public; you hurt other carriers and you hurt yourself. This is an area of management responsibility. I've made this point before, and I make it again because now is the time when airlines are planning, and when they must face these hard decisions. But if there is no restraint in the matter of capacity, and no control of labor, there will be no \$200 to \$250 million profit. The Board will continue to be responsive, but I think we must ask the airlines and the manufacturers to be responsible in these areas.

Finally, let's focus on the topic of Service to Small Communities. To the Civil Aeronautics Board, the names London, Paris, Lebanon, Melbourne and Athens, must *also* mean London, Kentucky; Paris, Texas; Lebanon, New Hampshire; Melbourne, Florida, and Athens, Georgia.

Over two years ago the Board initiated a study into the problem of airline service to small communities. The Board was aware that things were far from well.

Changing times require changing ideas. We are honoring our pledge to Congress to re-think the entire question of air service to small communities, and to bring forward new and different ideas.

We considered six alternatives:

1. changing or abandoning the subsidy class rate;
2. seeking a subsidy increase;
3. implementing a non-Federal subsidy program;
4. subsidizing air taxi operators;
5. instituting a contract bid system;
6. doing nothing.

We found that the greatest promise for better service at a reasonable cost to the taxpayer seems to be in a new approach—the contract bid system.

The regional carriers have responded very well to the needs of the system over the years. But the transportation system, particularly air transportation, is dynamic, and changes have taken place which require a new look at the means by which the smaller communities are served. In the years just after World War II, the regional carriers were small, local enterprises operating 21-28 seat DC-3 aircraft purchased at low cost from the government and the trunklines. Their principal purpose was to provide service over fixed, linear routes between small communities and hub cities, for both connecting and local traffic, at relatively low subsidy cost to the Federal Government. The usual pattern of service was, and remains, two round trips a day.

By law, the regional carriers are aided by federal subsidy payments for their non-competitive services to smaller points. Although the subsidy bill has increased in recent years to about \$59 million in fiscal year 1971, the nation has received outstanding value for its money.

In recent years, four basic changes have taken place in the nation's small community transportation system.

First, during the 1960's, the nation's highway system was vastly expanded and improved as the result of a multi-billion dollar program.

Second, there has been a shift in population, in plains and mountain states. The population has declined in the rural centers, yet these communities must continue to have air service.

Third, during the 1960's, regional carriers grew through merger and route expansion. They have sought and received longer and denser routes and access to new, large hub terminals to afford new and improved single-carrier services to many points. The carriers have grown in terms of equipment, and many of them now provide token scheduled service at the smaller communities. Some of them operate aircraft which can no longer use the airports at some of the communities which require airline service.

Fourth, since the mid-1960's, air taxis operating demand services and commuter carriers operating scheduled services under a blanket exemption from virtually all regulatory requirements, except as to safety have expanded nationwide. They provide scheduled service to about 150 points

that are not certificated. In addition, such carriers serve numerous certified points and markets and provide replacement service for certificated carriers at about 60 points. The record of the commuter carriers' substitution service has been mostly good. They have been able to give greater frequencies, better schedule timing, and improved performance.

The emerging and critical problem is the increasing difficulty the regional carriers have in responding to the needs of the communities on their systems. Each year the regional carriers—faced with rapidly mounting costs—are incurring substantially increased subsidy needs to continue to provide small community air service at their smallest system points with their 40-to 55-seat equipment. Simultaneously, they have been seeking to reduce their small community service obligations by means of deletions, consolidations, and suspensions. In many cases, a temporary suspension is sought and granted to the local carrier in conjunction with a third level carrier offering replacement service at some of the small communities. Further, as route systems have expanded, schedules necessarily have been suited to the needs of higher density large and medium points on the systems, and service to smaller points is becoming less responsive to needs.

Coupled with these problems, the smaller communities have been faced with sharply rising airport costs, and in many cases simply do not have airports capable of handling the larger jet equipment used by the regional carriers.

Faced with the need to insure continued responsiveness of the system to needs of all the communities, the Civil Aeronautics Board has decided to seek a special appropriation and special statutory authority to test an experimental contract method of supporting and selecting carriers to provide small community air service. We will propose that with the authority to take bids and grant contracts without certification, we could conduct a limited number of tests in various areas of the country, perhaps Kansas, Alaska and North Dakota, to determine whether the contract method is workable. If this were confirmed, subsidy expenditures would be more directly related to the services provided, rather than as now, to a local service carrier's system as a whole. It should be emphasized that this would be a limited experiment. The present system would, of course, remain in effect during the experiment.

The main features of the proposal would be to allow all carriers, including air taxi and commuter carriers, to submit bids for the provisions of a pattern and quality of service specified by the Board after taking into account the needs of the small community concerned in the experiment. Additional service could be provided independently of the contract. Contract awards, based on bids submitted by reliable and responsible carriers, and subject to performance safeguards, would be for a two or three-year

term. Contractors would be advised that they would have no vested grandfather type rights for follow-on contracts which might be awarded.

The Board would ask qualified operators to bid to provide such services as the Board determined necessary.

The matter of safety of course would remain with the FAA. The matter of economics is the Board's business. To insure that a successful contractor would complete the service in the period which he had undertaken, the Board would require surety and bonding of some form.

We would have to seek appropriations to be able to let contracts for let's say these three areas of three systems. Our guess is that this will cost about \$2 million per year for the three systems which we would propose. This might not increase the present subsidy, because we might be able to relieve local service carriers of enough of their burden to keep the subsidy cost at the same, or lower, level.

Renegotiation rights during the life of the contract would be expressly precluded. Uneconomic bids would be unlikely if contractors are on notice that higher payments cannot be obtained through renegotiation. As a definitive check, the Board would develop detailed procedures to enable the staff to carefully screen out unrealistic bids, and each contractor would be subject to performance bonding or similar financial guarantees which would have the effect of assuring completion of the contract and, in the event of failure, would provide funds for the immediate institution of service by a substitute carrier.

Such procedures would also spell out minimum standards for filing bids and would include such matters as corporate financial condition, insurance, experience of officers and employees, and adequacy of compliance with all applicable FAA safety standards. The Board would also issue the detailed specifications against which bids would be tendered. It is contemplated that the Board's staff and the community would participate in the development of specifications covering the service that would fulfill that community's needs.

In the past, academic critics of the existing subsidy system have suggested the possibility of a bidding system as an alternative. However, the pros and cons of such a system have never received a practical test, and there is no empirical basis for altering the present system. The Board believes that the problems of continued adequate service to smaller communities are sufficiently serious, and the possible benefits of a bid system are sufficiently promising, to warrant a limited experiment at the earliest possible time.

What we need is the authority to conduct the experiment. What we need is the experience.

