INTERNATIONAL AIR TRANSPORTATION COMPETITION ACT OF 1978

HEARINGS

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 3363

TO AMEND THE FEDERAL AVIATION ACT OF 1958 IN ORDER TO PROMOTE COMPETITION IN INTERNATIONAL AIR TRANSPORTATION, PROVIDE GREATER OPPORTUNITIES FOR UNITED STATES AIR CARRIERS, CREATE A STRUCTURE AND ESTABLISH GOALS FOR DEVELOPING UNITED STATES INTERNATIONAL AVIATION NEGOTIATING POLICY, AND FOR OTHER PURPOSES

AUGUST 22, 23, AND 24, 1978

Serial No. 95–131

Printed for the use of the
Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE
34-912 O WASHINGTON : 1978

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CONTENTS

	Page
Opening statement by the Chairman	1
Text of S. 3363	3

LIST OF WITNESSES

AUGUST 22, 1978

Adams, Hon. Brock, Secretary, Department of Transportation; accompanied by Raymond A. Young, III, Deputy Assistant Secretary for Policy and International Affairs; and Vance Fort, Office of the Assistant General Counsel for International Law	18
Prepared statement	34
Cooper, Richard N., Under Secretary of Economic Affairs, Department of State; accompanied by James Atwood, Deputy Assistant Secretary of State for Transportation	39
Prepared statement	51
Ignatius, Paul R., president, Air Transport Association of America; accompanied by Norman Philion, executive vice president; and Donald Comlish, vice president, international affairs	56
Prepared statement	65
Meiser, Robert N., executive director and counsel, International Airforwarder and Agents Association	70
Prepared statement	73

AUGUST 23, 1978

Boros, Howard S., general counsel, Air Charter Tour Operators of America	129
Prepared statement	135
Danielian, Ronald L., executive vice president and treasurer, International Economic Policy Association	141
Prepared statement	146
Driscoll, Edward J., president, National Air Carrier Association; accompanied by Glenn Cramer, chairman, Trans-International Airlines; William Hardenstine, senior vice president, World Airways; and Charles Moni, special assistant to the president, Evergreen International Airlines	103
Prepared statement with attachments	114
Letter of October 20, 1978	127
Kahn, Hon. Alfred E., Chairman, Civil Aeronautics Board; accompanied by Donald Farmer, Director, Bureau of International Aviation	79
Prepared statement	95
Questions of the committee and answers thereto	101
Smith, Richard, director, legislative affairs, Flight Engineers' International Association, Pan American Airlines Chapter, AFL–CIO	148
Attachment	153

Page

Opening statement by the Chairman 161
Beckman, Robert M., counsel, Laker Airways Limited, on behalf of Sir Freddie Laker, managing director 229
Prepared statement 231
Frommer, Arthur, member, Legal and Governmental Affairs Committee, U.S. Tour Operators Association; accompanied by Charles Morin; and Richard Littell, counsel 205
Prepared statement 213
Hitchcock, Cornish F., attorney, Aviation Consumer Action Project; accompanied by John Sims, legal director 216
Prepared statement 221
Hydeman, Lee, vice chairman, subcommittee on aviation, Section on Administrative Law, American Bar Association 185
Prepared statement with appendixes 190
Seawell, William T., chairman of the board, Pan American Airways, Inc 162
Attachments 176

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Altschul, Selig, president, Aviation Advisory Service, Inc., letter of August 1, 1978 261
Cooper, Richard N., Under Secretary for Economic Affairs, Department of State, letter of September 21, 1978 46
Hamilton, Miller, Hudson & Fayne Travel Corp., statement 242
Hammarskjöld, Knut, director general, International Air Transport Association, letter with enclosure of August 25, 1978 245
Ignatius, Paul R., president, Air Transport Association of America, letter of September 5, 1978 69
Miller, James A., president and chairman of the board, American Society of Travel Agents, Inc., statement 233
O'Donnell, John J., president, Air Line Pilots Association, International, statement 237
"Services in America's International Trade: The Air Travel and Tourism Sector," article 248
Trans World Airlines, Inc., statement 239

INTERNATIONAL AIR TRANSPORTATION COMPETITION ACT OF 1978

TUESDAY, AUGUST 22, 1978

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, D.C.

The subcommittee met at 10:05 a.m. in room 235, Russell Senate Office Building, Hon. Howard W. Cannon (chairman of the committee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. The hearings will come to order. This morning marks the continuation of the subcommittee's examination of our international aviation policy and negotiation process.

The subcommittee held 2 days of hearings last year, November 29, and December 1, on Bermuda II and its effect on international aviation strategy.

I believe those hearings were a positive airing of the problems associated with the British agreement. Since that time I've been pleased by the progress made by this administration in obtaining pro-competitive, bilateral agreements.

However, short-term success cannot vitiate the Congress obligation to provide a more stable, unified, and directive process for negotiating international aviation agreements.

The history of our aviation policy under current law has been a poor record on balance. I personally witnessed the growth of a cartelized, closed international aviation system, a disorganized and at times quarreling policy group among the agencies which share responsibility for developing and implementing our international aviation policy.

I have witnessed the U.S. Government stand by helplessly as foreign countries imposed outrageous and discriminatory charges and regulations on our air carriers, and I've seen Bermuda II, which in my opinion was the culmination of both poor organization and unfocused policy direction.

These past 4 years are the reasons for these hearings, and the bill which Senator Pearson and I introduced as S. 3363. This bill has two primary objectives: To establish a permanent, competitively oriented international aviation policy, and to institutionalize a unified, cooperative organization responsible for implementing that policy.

As I noted in my remarks introducing S. 3363, I believe that this administration has gotten its act together and is making the present organization work.

However, today's cooperative effort is the exception, so I'd like to explore organizational changes which might increase the chances of continuing the current success under future administrations.

In addition to general policy and organizational questions, I want to explore several specific questions raised by recent bilateral agreements. One concept which causes me concern is the fare mechanism included in the United States-Israel bilateral, requiring the disapproval of both governments before a proposed fare could be rejected.

It may well be a short-term policy which will be conducive to low fares, and I'm not overly concerned with such a clause in this one instance, because Israel is not a likely candidate for predatory behavior against U.S. carriers.

However, its inclusion raises the policy question of allowing or promoting the proliferation of such a fare mechanism. It would appear to me that such a fare control abolishes needed safeguards against potential predation by a foreign carrier or its government.

I am interested in the administration's response to this concern, about the long term effect of such a policy in an international marketplace, which includes actual and potential subsidization of some airlines.

I am also interested to know if there has been any exploration of alternatives to insure appropriate market-oriented fares without abandoning all controls.

Second, I have heard a good deal lately about an open skies policy, specifically that the administration plans to offer such a proposal to Germany. I have an open mind on such a concept, but I want to hear the administration and any open skies opponents make their best case for their respective positions.

Third, as I have in the past, I want to question those testifying about the President's proper role in international aviation agreements. I am skeptical that a case can be made that a carrier selection impacts foreign policy. It would seem to me that the President's proper involvement in route designation should be handled within the context of bilateral negotiations.

Finally, I wish to emphasize that Senator Pearson and I have introduced this bill as a focus to these hearings, but we are not locked in on any of the specifics contained in the bill. However, I do believe that changes are needed legislatively to bring some permanent order out of the all too frequent chaos that has been the anathema of our international aviation policy and the delight of our negotiating opponent.

[The bill follows:]

95TH CONGRESS
2D SESSION

S. 3363

IN THE SENATE OF THE UNITED STATES

AUGUST 1 (legislative day, MAY 17), 1978

Mr. CANNON (for himself and Mr. PEARSON) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

A BILL

To amend the Federal Aviation Act of 1958 in order to promote competition in international air transportation, provide greater opportunities for United States air carriers, create a structure and establish goals for developing United States international aviation negotiating policy, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "International Air Transportation Competition Act of 1978".

DECLARATION OF POLICY

SEC. 2. Section 102 of the Federal Aviation Act of 1958 (49 U.S.C. 1302) is amended—

(a) by inserting "(a)" after the words "SEC. 102";

(b) by renumbering subsections (a) through (f) as paragraphs (1) through (6), respectively;

(c) by adding after the word "Act" the words "with respect to interstate and overseas air transportation,"; and

(d) by adding the following new subsection (b):

"(b) In the exercise and performance of its powers and duties with respect to foreign air transportation, the Board shall consider the following, among other things, as being in the public interest and in accordance with the public convenience and necessity:

"(1) The maintenance and furtherance of a high degree of safety in foreign air commerce.

"(2) The maximum degree of competition consistent with maintaining an international air transportation system which facilitates commerce among nations, encourages air carriers and foreign air carriers to offer prices and services which are responsive to market demand, provides travel opportunities for the widest possible segment of the public, and meets the needs of the Postal Service and the national defense.

"(3) The prevention of unfair, deceptive, predatory, or anticompetitive practices in foreign air transpor-

tation, and the avoidance of undue industry concentration, excessive market domination, monopoly power, and other conditions that would tend to allow one or more air carriers or foreign air carriers unreasonably to increase prices, reduce services, or exclude competition in foreign air transportation.

"(4) The desirability of giving expedited treatment to foreign air carriers from nations with whom the United States has entered into the least restrictive air transportation agreements.

"(5) The need to provide domestic route authority to air carriers with extensive international operations in order to provide a better integrated air transportation system, prevent waste of available capacity, and strengthen the competitive position of United States international air carriers.".

SALE OF CHARTER TRIPS BY DIRECT CARRIERS

SEC. 3. Section 401 of the Federal Aviation Act of 1958 (49 U.S.C. 1371) is amended by adding the following new subsection:

"(p) The Board shall permit air carriers directly engaged in the operation of aircraft to organize and sell directly to the public charter trips in foreign air transportation to the following extent:

"(1) during the first year following enactment of

this subsection, 10 per centum of the total number of charter trips flown by the carrier in foreign air transportation during the previous year;

"(2) during the second year following enactment of this subsection, 25 per centum of the total number of charter trips flown by the carrier in foreign air transportation during the previous year;

"(3) during the third year following enactment of this subsection, and each year thereafter, 40 per centum of the total number of charter trips flown by the carrier in foreign air transportation during the previous year.".

SCHEDULED AUTHORITY FOR SUPPLEMENTAL CARRIERS

SEC. 4. Section 401 of the Federal Aviation Act of 1958 (49 U.S.C. 1371) is amended by adding the following new subsection:

"(q) Each air carrier holding a certificate of public convenience and necessity to perform supplemental air transportation under subsection (d) (3) of this section, and which operated more than fifty million revenue passenger miles in foreign air transportation during the twelve months ended March 31, 1978, is eligible to obtain a certificate to engage in scheduled foreign air transportation in no more than five nonstop city-pair markets under the following procedures:

"(1) no later than sixty days after enactment of this subsection, each such carrier may file with the

Board a list of city-pair markets in which it seeks nonstop scheduled authority under this subsection;

"(2) any interested party supporting or opposing such authority shall have sixty days from the date of filing by the supplemental carrier in which to file comments and documentary evidence in support of or in opposition to the grant of such authority;

"(3) each supplemental carrier shall have thirty days from the filing of such comments to file a reply;

"(4) within sixty days after replies are due, the Board shall issue an order granting or denying the applications for such new authority.

The Board shall grant such authority unless opponents can prove that a grant would cause irreparable harm to the traveling public and that denial is required by the public convenience and necessity. Nothing in this subsection shall limit or prevent the grant to any supplemental air carrier of additional authority to perform scheduled air transportation under subsection (d) of this section or section 416.".

FOREIGN AIR CARRIER PERMITS

SEC. 5. Section 402 of the Federal Aviation Act of 1958 (49 U.S.C. 1372) is amended as follows:

(a) Subsection (b) is amended to read:

"(b) The Board is empowered to issue such a permit if it finds (1) that the applicant is fit, willing, and able

properly to perform such foreign air transportation and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder, and (2) either that the applicant has been designated by its government to perform such foreign air transportation under the terms of an agreement with the United States or that such transportation will be in the public interest.".

(b) In subsection (d), strike the words "Such application shall be set for public hearing and the", and insert in lieu thereof the word "The".

CONSOLIDATION OF SCHEDULED AND SUPPLEMENTAL AIR CARRIERS

SEC. 6. Section 408 (b) of the Federal Aviation Act of 1958 (49 U.S.C. 1378) is amended by adding the following additional proviso: "*Provided further*, That there is a rebutable presumption that any consolidation or merger of the properties of an air carrier and supplemental air carrier is in the public interest.".

INTERNATIONAL RATEMAKING AGREEMENTS PROHIBITED

SEC. 7. Section 412 of the Federal Aviation Act of 1958 (49 U.S.C. 1382) is amended by adding the following new subsection:

"FOREIGN AIR TRANSPORTATION

"(c) Notwithstanding any other provision of this section, the Board shall not approve any contract or agreement affect-

ing foreign air transportation that limits the level of capacity among air carriers and foreign air carriers in markets in which they compete or which fixes rates, fares, or charges between or among air carriers and foreign air carriers (except for joint rates, fares, or charges).".

PRESIDENTIAL AUTHORITY

SEC. 8. Section 801 of the Federal Aviation Act of 1958 (49 U.S.C. 1461) is amended as follows:

"PRESIDENT OF THE UNITED STATES

"SEC. 801. (a) The issuance, denial, transfer, amendment, cancellation, suspension, or revocation of, and the terms, conditions, and limitations contained in, any permit issuable to any foreign air carrier under section 402 shall be subject to the approval of the President.

"(b) Any order of the Board pursuant to section 1002(j) of this Act suspending, rejecting, or canceling a rate, fare, or charge for foreign air transportation by a foreign air carrier, and any order rescinding the effectiveness of any such order, shall be submitted to the President before publication thereof. The President may disapprove any such order when he finds that disapproval is required for reasons of the national defense or the foreign policy of the United States not later than ten days following submission by the Board of any such order to the President.".

INTERNATIONAL NEGOTIATIONS

SEC. 9. Section 1102 of the Federal Aviation Act of 1958 (49 U.S.C. 1502) is amended as follows:

"INTERNATIONAL AGREEMENTS

"OFFICE OF INTERNATIONAL AVIATION NEGOTIATIONS

"SEC. 1102. (a) There is established within the Executive Office of the President, the Office of International Aviation Negotiations (hereinafter in this section referred to as the 'Office'). The Office shall be headed by the Director and Chief Negotiator for the Office of International Aviation Negotiations (hereinafter in this section referred to as the 'Director') who shall be appointed by the President, by and with the advice and consent of the Senate. As an exercise of the rulemaking power of the Senate, any nomination of the Director submitted to the Senate for confirmation, and referred to a committee, shall be referred to the Committee on Commerce, Science, and Transportation. The Director shall hold office at the pleasure of the President, shall be entitled to receive the same allowances as a chief of mission, and shall have the rank of Ambassador.

"SPECIAL COUNSEL

"(b) Within the Office there shall be there Special Counsels. One shall be appointed by the Civil Aeronautics Board, one appointed by the Secretary of Transportation, and one appointed by the Secretary of State. The classifica-

tion, level of compensation, and duration of appointment shall be determined by the appointing agency. The compensation of each Special Counsel shall be paid for by the appointing agency. The Special Counsels shall be assigned full time to the Office, shall serve as liaisons between their appointing agencies and the Office, and shall assist the Director in performing the functions of that Office.

"DUTIES OF THE DIRECTOR AND FUNCTIONS OF THE OFFICE

"(c) The Director shall be the chief representative of the United States in all negotiations dealing with international aviation. The Director shall report directly to the President and the Congress, and shall be responsible to the President and the Congress for monitoring the administration of international aviation agreements. The Director shall be the chairman of the Aviation Policy Committee and the International Aviation Advisory Counsel established under this section. In addition, the Director shall be responsible for such other functions as the President may direct.

"POWERS OF THE DIRECTOR

"(d) The Director and Chief Negotiator for the Office of International Aviation Negotiations may, for the purpose of carrying out the functions of that office—

"(1) subject to the civil service and classification laws, select, appoint, employ, and fix the compensation

of such officers and employees as are necessary and prescribe their authority and duties;

"(2) employ experts and consultants in accordance with section 3109 of title 5 and compensate individuals so employed for each day (including traveltime) at rates not in excess of the maximum rate of pay for grade GS–18 as provided in section 5332 of title 5 and while such experts and consultants are so serving away from their homes or regular place of business, to pay such employees travel expenses per diem of lieu of subsistence at rates authorized by section 5703 of title 5 for persons in Government service employed intermittently;

"(3) utilize, with their consent, the services of personnel, and facilities of other Federal agencies;

"(4) promulgate such rules and regulations as may be necessary to carry out the functions vested in the Director;

"(5) enter into and perform such contracts, leases, cooperative agreements, or other transactions as may be necessary in the conduct of the work of the Office and on such terms as the Director may deem appropriate, with any agency or instrumentality of the United States, or with any public or private person, firm, association, corporation, or institution;

"(6) accept voluntary and uncompensated services, notwithstanding the provisions of section 665(b) of title 31; and

"(7) adopt an official seal, which shall be judicially noticed.

"USE OF OTHER FEDERAL AGENCIES

"(e) The Director shall, to the extent deemed necessary for the conduct of international aviation policy, draw upon the resources of, and consult with, Federal agencies in connection with the performance of the functions of the Office. The Department of State, Department of Transportation, and Civil Aeronautics Board shall cooperate with the Director in providing assistance and personnel upon the request of the Director to engage in the preparation for and conduct of international aviation negotiations.

"AUTHORIZATION OF APPROPRIATIONS

"(f) There are authorized to be appropriated to the Office of International Aviation Negotiations such amounts as may be necessary for the purpose of carrying out its functions for fiscal year 1979 and each fiscal year thereafter any part of which is within the five-year period beginning on January 1, 1979.

"DEVELOPMENT OF INTERNATIONAL AVIATION POLICY

"(g) The international aviation negotiation policy of the United States shall be coordinated by a permanent Avia-

tion Policy Committee chaired by the Director and Chief Negotiator of the Office of International Aviation Negotiations and comprised of the three Special Counsels referred to in subsection (b), and any other members as may be appointed from time to time by the President. The Aviation Policy Committee shall consult on a regular basis with the International Aviation Advisory Counsel which shall be comprised of representatives from groups, agencies, and organizations designated by the Director to include a wide spectrum of views and interests. These shall include representatives of the President's Domestic Council, the Department of Commerce, the Department of Defense, airport operators, scheduled air carriers, charter air carriers, airline labor, consumer interest groups, travel agents and tour organizers, and any other groups, institutions, or interest groups which the Director deems to be appropriate. The International Aviation Advisory Counsel shall advise the Aviation Policy Committee on both broad policy goals and individual negotiations, when appropriate.

"GOALS FOR INTERNATIONAL AVIATION POLICY

"(h) In formulating United States international air transportation policy, the Congress intends that the Aviation Policy Committee shall develop a negotiating position which emphasizes the greatest degree of competition that is com-

patible with a well-functioning international air transportation system. This includes, among other things:

"(1) freedom of air carriers and foreign air carriers to offer fares and rates which correspond with consumer demand;

"(2) the fewest possible restrictions on charter air transportation;

"(3) the maximum degree of multiple and permissive international authority for United States air carriers so that they will be able to respond quickly to shifts in market demand;

"(4) the elimination of operational restrictions to the greatest extent possible;

"(5) the integration of domestic and international air transportation;

"(6) an increase in the number of nonstop United States gateway cities;

"(7) opportunities for carriers of foreign countries to increase their access to United States points if exchanged for benefits of similar magnitude for United States carriers and the traveling public with permanent linkage between rights granted and rights given away; and

"(8) the elimination of discrimination and unfair

competitive practices faced by United States airlines in foreign air transportation, including excessive landing and user fees, unreasonable ground handling requirements, undue restrictions on operations, prohibitions against change of gauge, and similar restrictive practices.

"OBSERVER STATUS FOR CONGRESSIONAL REPRESENTATIVES

"(i) The Director shall grant to at least one representative of each House of Congress the privilege to attend international negotiations as an observer if such privilege is requested in advance in writing.

"ACTIONS OF THE BOARD AND SECRETARY OF TRANSPORTATION

"(j) In exercising and performing their powers and duties under this Act, the Board and the Secretary of Transportation shall do so consistently with any obligation assumed by the United States in any treaty, convention, or agreement that may be in force between the United States and any foreign country or foreign countries, and shall take into consideration any applicable laws and requirements of foreign countries and the Board shall not, in exercising and performing its powers and duties with respect to certificates of convenience and necessity, restrict compliance by any air carrier with any obligation, duty, or liability imposed by

any foreign county: *Provided*, That this section shall not apply to any obligation, duty, or liability arising out of a contract or other agreement, heretofore or hereafter entered into between an air carrier, or any officer or representative thereof, and any foreign country, if such contract or agreement is disapproved by the Board as being contrary to the public interest.".

The CHAIRMAN. We're very happy to have here this morning as our lead-off witness Secretary of Transportation, Brock Adams. I would look forward to hearing from you, Mr. Secretary.

STATEMENT OF HON. BROCK ADAMS, SECRETARY, DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY RAYMOND A. YOUNG, III, DEPUTY ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS; AND VANCE FORT, OFFICE OF THE ASSISTANT GENERAL COUNSEL FOR INTERNATIONAL LAW

Secretary ADAMS. Thank you very much, Mr. Chairman. In order to save time and to specifically discuss our position on the questions you have raised, I request permission that my statement appear in full in the record, and I will summarize the points orally.

The CHAIRMAN. It will be made part of the record in full. But I hope you will elaborate on the parts that address the particular issues they have raised.

Secretary ADAMS. I will elaborate on each of them, Mr. Chairman.

I also would request permission to insert into the record the U.S. Policy for Conduct of International Air Transport Negotiations, which the President issued yesterday and which sets forth instructions to our negotiating teams.

The CHAIRMAN. Without objection, that will be made a part of the record.

[The following information was subsequently received for the record:]

UNITED STATES POLICY FOR THE CONDUCT OF INTERNATIONAL AIR TRANSPORTATION NEGOTIATIONS

INTRODUCTION

United States international air transportation policy is designed to provide the greatest possible benefit to travelers and shippers. Our primary aim is furthering the maintenance and continued development of affordable, safe, convenient, efficient, and environmentally acceptable air services. Our policy for negotiating civil air transport agreements reflects our national goals in international air transportation. This policy provides a set of general objectives, designed particularly for major international air markets, on the basis of which United States negotiators can develop specific negotiating strategies.

Maximum consumer benefits can be best achieved through the preservation and extension of competition between airlines in a fair marketplace. Reliance on competitive market forces to the greatest extent possible in our international air transportation agreements will allow the public to receive improved service at low costs that reflect economically efficient operations. Competition and low prices are also fully compatible with a prosperous U.S. air transport industry and our national defense, foreign policy, international commerce, and energy efficiency objectives.

Bilateral aviation agreements, like other international agreements, should serve the interests of both parties. Other countries have an interest in the economic prosperity of their airline industries, as we do in the prosperity of ours. The United States believes this interest is best served by a policy of expansion of competitive opportunity rather than restriction. By offering more services to the public, in a healthy and fair competitive environment, the international air transport industry can stimulate the growth in traffic which contributes both to profitable industry operations and to maximum public benefits.

GOALS OF U.S. INTERNATIONAL AIR TRANSPORTATION POLICY

The U.S. will work to achieve a system of international air transportation that places its principal reliance on actual and potential competition to determine the variety, quality, and price of air service. An essential means for carrying out our international air transportation policy will be to allow greater competitive opportunities for U.S. and foreign airlines and to promote new low-cost transportation options for travelers and shippers. Especially in major international air transport markets, there can be substantial benefits for travelers, shippers, airlines and labor from increasing competitve opportunities and reducing protectionist restrictions. Increasing opportunities for U.S. flag transportation to and from the United States will contribute to the development of our foreign commerce, assure that more airlift resources are available for our defense needs, and promote and expand productivity and job opportunities in our international air transport industry.

TRANSLATING GOALS INTO NEGOTIATING OBJECTIVES

U.S. International Air Transportation Policy cannot be implemented unilaterally. Our objectives have to be achieved in the system of international agreements that form the basic framework for the international air transportation system.

Routes, prices, capacity, scheduled and charter rules, and competition in the marketplace are interrelated, not isolated problems to be resolved independently. Thus, the following objectives will be presented in negotiations as an integrated U.S. position:

1. Creation of new and greater opportunities for innovative and competitive pricing that will encourage and permit the use of new price and service options to meet the needs of different travelers and shippers.
2. Liberalization of charter rules and elimination of restrictions on charter operations.
3. Expansion of scheduled service through elimination of restrictions on capacity, frequency, and route and operating rights.
4. Elimination of discrimination and unfair competitive practices faced by U.S. airlines in international transportation.
5. Flexibility to designate multiple U.S. airlines in international air markets.
6. Encouragement of maximum traveler and shipper access to international markets by authorizing more cities for non-stop or direct service, and by improving the integration of domestic and international airline services.
7. Flexibility to permit the development and facilitation of competitive air cargo services.

EXPLANATION OF OBJECTIVES

1. *Pricing.*—The U.S. will develop new bilateral procedures to encourage a more competitive system for establishing scheduled air fares and rates. Charter pricing must continue to be competitive. Fares, rates, and prices should be determined by individual airlines based primarily on competitive considerations in the marketplace. Governmental regulation should not be more than the minimum necessary to prevent predatory or discriminatory practices, to protect consumers from the abuse of monopoly position, or to protect competitors from prices that are artificially low because of direct or indirect governmental subsidy or support. Reliance on competition and encouragement of pricing based on commercial considerations in the marketplace provides the best means of assuring that the needs of consumers will be met and that prices will be as low as possible given the costs of providing efficient air service.

2. *Charters.*—The introduction of charters acted as a major catalyst to the expansion of international air transportation in the 1960's. Charters are a competitive spur and exert downward pressure on the pricing of scheduled services. Charters generate new traffic and help stimulate expansion in all sectors of the industry. Restrictions which have been imposed on the volume, frequency, and regularity of charter services as well as requirements for approval of individual charter flights have restrained the growth of traffic and tourism and do not serve the interests of either party to an aviation agreement. Strong efforts will be made to obtain liberal charter provisions in bilateral agreements.

3. *Scheduled Services.*—We will seek to increase the freedom of airlines from capacity and frequency restrictions. We will also work to maintain or increase

the route and operating rights of our airlines where such actions improve international route systems and offer the consumer more convenient and efficient air transportation.

4. *Discrimination and Unfair Competitive Practices.*—U.S. airlines must have the flexibility to conduct operations and market their services in a manner consistent with a fair and equal opportunity to compete with the airlines of other nations. We will insist that U.S. airlines have the business, commercial, and operational opportunities to compete fairly. The United States will seek to eliminate unfair or destructive competitive practices that prevent U.S. airlines from competing on an equal basis with the airlines of other nations. Charges for providing airway and airport properties and facilities should be related to the costs due to airline operations and should not discriminate against U.S. airlines. These objectives were recognized by the Congress in legislation enacted in 1975, and their attainment is required if consumers, airlines, and employees are to obtain the benefits of an otherwise competitive international aviation system.

5. *Multiple Airline Designations.*—The designation of new U.S. airlines in international markets that will support additional service is a way to create a more competitive environment and thus encourage improved service and competitive pricing. Privately owned airlines have traditionally been the sources of innovation and competition in international aviation, and it is, therefore, particularly important to preserve for the U.S. the right of multiple designation.

6. *Maximum Access to International Markets.*—Increasing the number of gateway cities for non-stop or direct air service offers the potential for increasing the convenience of air transportation for passengers and shippers and improving routing and market opportunities for international airlines. In addition, enhancing the integration of U.S. airline domestic and international air services benefits both consumers and airlines.

7. *Cargo Services.*—We will seek the opportunity for the full development of cargo services. Frequently demand for such services requires special equipment and routes. Cargo services should be permitted to develop freely as trade expands. Also important in the development of cargo services are improved facilitation, including customs clearance, integration of surface and air movements, and flexibility in ground support services.

NEGOTIATING PRINCIPLES

The guiding principle of United States aviation negotiating policy will be to trade competitive opportunities, rather than restrictions, with our negotiating partners. We will aggressively pursue our interests in expanded air transportation and reduced prices rather than accept the self-defeating accommodation of protectionism. Our concessions in negotiations will be given in return for progress toward competitive objectives, and these concessions themselves will be of a liberalizing character.

Proposed bilateral agreements which do not meet our minimum competitive objectives will not be signed without prior Presidential approval.

Secretary ADAMS. Mr. Chairman, I would first like to comment generally on the bill and then indicate my position on the individual sections.

I would like to state at the outset that I think our international aviation policy has benefited greatly from the scrutiny of the Congress. Your hearings of last year and these hearings are very important. They indicate that there is a high level of interest in these matters in the Congress.

I recall that one of the problems I faced when I arrived in office as the Secretary of Transportation, was that the British had renounced the basic United Kingdom-United States agreement 7 months before. I accept and agree with your criticism that at the time we arrived, the U.S. negotiators were not unified. I think that the United Kingdom negotiators were aware of this. We had not gotten very far with our negotiations, and that was the reason for recommending that we have a single ambassador-negotiator in the 5 months that were remain-

ing. Faced with the prospects of a halt in air service that summer, the Bermuda II agreement was an attempt in a 5-month period to begin to put into effect the procompetitive position in which President Carter believes and which is set forth in the policy section of S. 3363. It was only the beginning. We consider the later agreements, which I will refer to specifically, as being the type of agreements we wish to pursue, and I will communicate this to the United Kingdom in September, Mr. Chairman, when I discuss matters with their Minister of Transportation.

The final general comment, Mr. Chairman, is that we do have scheduled now on the floor of the House the domestic aviation regulatory reform bill, which matches the bill the Senate has passed. We hope to have that bill in conference, Mr. Chairman, early in September, and we are very hopeful that the bill will be enacted and sent to the President during the month of September. That will complete, with respect to reduction of regulation, the domestic air service. We are also moving in the international area, especially to prevent growth of cartels. Let me turn now to the specific provisions of S. 3363.

The formal statement of policy which is in section 2, is strongly pro-consumer and procompetitive. We are in agreement with this policy. It is the policy that has guided our recent negotiations. Mr. Chairman, when you have had an opportunity to review the U.S. negotiating policy which has just been issued by the President which was by all agencies in the Government, and you will see that it follows what you have outlined in section 2.

We would question one part of section 2 and may I say Mr. Chairman that I appreciate the opportunity this hearing provides to discuss these issues. We are concerned about subparagraph 4, which provides for giving expedited treatment to carriers from nations with whom we have least restrictive air agreements. Mr. Chairman, the United States does not select the foreign air carriers, and we do not control who the foreign government will designate. We do agree with the principle that there should be expedited treatment for the carriers designated by the foreign government; so that they promptly receive their rights under the agreement, just as we demand from those governments that our carriers receive their rights under the agreement. Therefore, issuance of permits to all properly designated carriers should be expedited.

In addition, the term "least restrictive" would be very difficult to define.

When you start trying to define in an international scene with a series of sovereign governments, which agreements are the more least restrictive, it is a very difficult thing to do. Therefore, Mr. Chairman, we hope you might reexamine that subsection.

Mr. Chairman, section 3 of S. 3363 proposes that air carriers be permitted to sell foreign charter trips directly to the public. We know that there are a certain number of carriers that would like to do this. However, this provision raises the issue that might have a very severe, adverse impact, particularly on the smaller tour operators that now provide service in a number of the smaller communities throughout the United States. You could end up drying up the availability of the tour operators who are really the salesmen for the supplemental carriers and for charter operations, and prevent them from being able to organize these groups and put them together.

We certainly do not oppose to going with a more competitive system. We have indicated, with respect to foreign carriers that we don't want them to be able to control all charters out of their area by putting them all through one tour operator and not letting any other operator participate. So I'm not saying we are opposed to section 3 of the bill, but I think it raises issues that we need to continue to discuss and receive further testimony on as to which structure will be more competitive in the long run. In other words, which will offer more services to the American public and more alternatives for obtaining air travel at a lower cost? The tour or charter business is becoming enormous now on both sides of the Atlantic, and there is the question of whether or not we would be injuring something that generally works well. I know there are some bad spots here, but they are generally from financial management and not from the structure itself.

However this issue is resolved, Mr. Chairman, I do believe that the same principles should be applied to direct sale of both foreign and domestic charter trips.

Turning to section 4 of the bill, let me say that we do support the principle of automatic entry for foreign air transportation as we have supported it in domestic legislation. Section 4 would automatically permit major supplementals to provide scheduled service in five foreign markets. We think Mr. Chairman, the way to approach improving the competitive position of supplemental carriers is rather to spell out their right to perform scheduled service as well. We know there have been past inequities to the supplemental carriers, but we think those inequities are now being addressed. We have two further concerns about this provision. One is philosophical, and one is practical.

First, to the extent that an automatic entry provision is enacted in the foreign air transportation, and we are in agreement with that concept, we believe it should be open to all qualified carriers, rather than being restricted to just supplementals.

Second, and this is from a practical standpoint, Mr. Chairman, we do not yet have enough sufficiently liberal bilateral agreements. We're getting them. The United States Government will be negotiating a large number this year. We can put three negotiating teams in the field at any one time. But we don't have enough of them at the present time to open this kind of entry into very many markets.

So, I would hope, Mr. Chairman, we might examine the form of section 4 further but I would like to emphasize we are in agreement with the entry concept. We would be most happy to work with you on this issue.

Section 5 of the bill deals with the CAB issuance of permits to foreign air carriers. We believe, and this ties to my earlier testimony, that to the extent that applications are made for operating permits by foreign carriers pursuant to bilateral civil air transport agreements, where their governments have properly designated them, the applications should be granted on a simplified and expedited basis, so that issuance of the permit is not held up. If you do not accept the designation, then you get into a very long round of whether or not the carrier can come in.

So we support this provision, Mr. Chairman. We think that it is a very good step in precisely the right direction.

Section 6 of the bill would establish a rebuttable presumption favoring consolidations or mergers of supplemental and scheduled airlines. Mr. Chairman, this goes back again to my earlier comments. We see the thrust of what you have placed before us for discussion, which is: should supplementals become a part of the scheduled system, or should they remain as they have been, a separate category but with an ability to compete effectively with the scheduled carriers?

The proposed section 6 suggests that we should expedite consolidation or merger. We have some real questions about that, Mr. Chairman, because it goes to the issue of the disappearance of supplementals through being merged into the scheduled carrier system?

Our present suggestion is that we grant more rights to supplementals but not to move in a direction that could lead toward a greater monopolization of the business. We have supported, in the domestic reform legislation, the ability of supplementals to apply for scheduled authority. This moves the two closer together. But there is a concern in the Government that if supplemental carriers should disappear by merger, we would lose a different and competitive aspect of the air carrier business. So we would like to work with you further on that.

Mr. Chairman, section 7 of the bill would prohibit the CAB approval of capacity or pricing agreements affecting foreign air transportation. In the domestic regulatory reform legislation which has passed the Senate and which you sponsored, we have supported the prohibition of domestic capacity and price fixing agreements. We believe that is proper.

We are concerned, however, Mr. Chairman, that the international air transportation system is not a mirror image of our domestic system, where we are able to do many more things than we can with the foreign transportation system. For instance, we have to get permission from sovereign countries for our carriers to land there at all. And the whole international aviation structure depends on successful achievement of bilateral and multilateral air service agreements with other nations. We have to have international agreements achieved.

In other words, we can't operate in a vacuum in the foreign area because we do not have the controls that we have with regard to domestic aviation.

I note you will have Chairman Kahn before you and I am sure he will discuss the present CAB show-cause proceeding on U.S. participation in IATA. We will participate in that proceeding. In the DOT, we also have underway a broad study to review the U.S. carrier participation in IATA traffic conferences. While we believe that the procompetitive principles of the domestic regulatory reform legislation generally should apply to foreign air transportation, we understand that we have to deal with a number of countries that have a very different viewpoint on IATA.

Therefore, we believe that at the present time, we should continue to examine this matter through the Board's show-cause proceeding. The Board is moving on this and we believe that it is proper that they do so.

Section 8 of S. 3363 would amend section 801 of the Federal Aviation Act, which currently provides for Presidential review of certain CAB actions.

From long experience in dealing with this industry in the Congress and watching it from the early 1960's, I understand what the concern of the committee is with the Presidential review over CAB decisions. But, Mr. Chairman, these concerns have been addressed by the issuance of Executive order 11920. And, we do not believe that the 801 review authority really should go only to matters dealing with foreign carriers. It goes to domestic carriers involved in foreign air transport, too. As the Supreme Court held in the *Waterman* case, what our carriers do in going abroad and what foreign carriers do in coming to the United States are both parts of the same fabric. And the Court has therefore held that the CAB orders that are subject to Presidential review under section 801 are not reviewable in the courts. This is in recognition of the constitutional responsibility vested in the President for the supervision of national defense and foreign affairs.

Given this Presidential authority, under article II of the Constitution and the judicial decisions, we believe that Presidential flexibility should not be curtailed. This 801 authority allows the President to accomplish foreign policy objectives short of having to do this in the negotiation and implementation conduct of the executive agreement itself. In other words, absent 801 powers, if you got a real problem of confrontation, it might have to be resolved through the actual agreement itself. This would be much more cumbersome and would complicate the bilateral agreements and negotiations.

Therefore, we hope, Mr. Chairman, that section 801 will be left as it is.

Let me give just one example of why it is important. Recently, we had a dispute with the United Kingdom over the low fare proposals of Braniff. The CAB played a very important and a very constructive role in that. But in the last analysis, the President had to use his 801 power in conjunction with the power to negotiate the air agreements in order to resolve the dispute and avoid a flat confrontation.

The CHAIRMAN. Mr. Secretary, that's the second half of a vote. We'll recess very briefly. I will vote and come back. Besides, I want to think about what you just said.

[Brief recess.]

The CHAIRMAN. The hearings will resume.

All right, Mr. Secretary, you may proceed.

Secretary ADAMS. Thank you, Mr. Chairman.

We were discussing the President's 801 authority and the fact that we do not believe it should be curtailed.

Mr. Chairman, in your opening statement you mentioned the bilateral agreement with Israel, and you voiced concern about the fare provision for U.S. and Israeli airlines which, effective August 1, 1979, will require approval of both governments before a proposed fare can be disapproved. The administration is reviewing the desirability of whether we would extend this concept to other bilateral civil aviation regimes.

It is one that must be very carefully considered because you have to have a procompetitive environment in order to be certain that it can work well. The President needs the ability and flexibility to use the section 801 process, as well as negotiating bilateral agreements, to effectively accomplish this sort of policy.

In sum, Mr. Chairman, the President's 801 authority is essential if we are to have the ability to continue to negotiate effectively with various countries on international air services.

The CHAIRMAN. You say that the President's authority under section 801 needs to be retained to prevent the institution of fares which are predatory or which have otherwise violated the public interest. It seems to me that you are getting the President involved awfully deeply in the day-to-day operations.

If you're going to have the President make these determinations on the basis of predatory fares, that goes a long way beyond what I perceive as the proper role from the standpoint of the conduct of foreign policy.

Secretary ADAMS. Mr. Chairman, we do not propose that the President be involved in basic marketing decisions and the day-to-day operations and setting of fares. But as we move into this new, very procompetitive system, where the carrier management is going to be establishing fares on the basis of the marketplace, if you arrive at a situation where there has been a mistake and predatory fares are being used, then the President has to be able to use his foreign policy powers in order to see that the agreement is being lived up to. The agreements themselves provide that there shall be no predatory fares.

The CHAIRMAN. Yes. But the President couldn't use these foreign policy powers here if he's got an agreement that says that both countries must either approve or disapprove the fares.

In other words, we're letting some other country control our foreign policy, if that is truly a foreign policy consideration.

Secretary ADAMS. We always retain the ultimate foreign policy power to say that the agreement is not being followed. The ultimate weapon is to renounce. Prior to that, you have consultations.

In each agreement we have a period for consultation between the two nations. The number of days will vary but the purpose of the consultations is to give the United States the opportunity to say this agreement is not being lived up to.

The CHAIRMAN. But it would take a year to get rid of a predatory fare under those circumstances.

Secretary ADAMS. We usually are capable of doing it through the consultation process under the agreement or by going into arbitration with them. If we are not successful, then, yes, we may have to renounce the agreement. And that is why we have been very careful with the Israeli-type agreement. We think these fare provisions they are procompetitive and are something that should be extended into markets where they will work.

And, of course, the U.S. retains the power to protect U.S. interests by retaliating against the air carrier of another country by taking part 213 or similar actions against the carrier. We do not like to do this, but it is part of the foreign policy considerations that I've tried to address in our discussion of section 8.

With regard to section 9, Mr. Chairman, this section would establish within the Executive Office of the President an Office of International Aviation Negotiations, headed by a Director and a Chief Negotiator, with counsel from State, DOT, and the CAB.

Mr. Chairman, I have repeatedly stated since being in the position of Secretary of Transportation that we, the United States, should

speak with one voice on international aviation matters and that our negotiators should be fully instructed before entering into a negotiation.

We have been successful in doing this. The policy is clearly enunciated. We have an interagency group now that is chaired by the State Department, with the long-term policy developed by the DOT and the individual negotiating teams given specific instructions before they depart. We have had complete CAB cooperation in staffing and helping us as we have proceeded with each one of the recent negotiations.

I think this approach works and is working well.

If you appoint another layer, Mr. Chairman, we then have another group that has to form and we have to go through another layering operation. We would hope that this would not be done because we now have all the agencies working together effectively. It has taken us a year to get this in place, and I think the scope of the recent agreements reflects the success of this approach.

We're concerned that if we go to the system suggested in the bill, agency efforts would again be fragmented with each one of the various agencies with responsibility having to feed into a Director.

Either we would have to establish in the White House operation a rather large staff, or we would have to draw from the very people that are doing the job now.

This would just put one more layer on top of the present structure, and we would have to coordinate through that, like we're coordinating at the present time.

I would hope that we would not approach it in that fashion.

We don't think that what we have is perfect, Mr. Chairman, by any stretch of the imagination. But we are trying to get a system established so that, in the negotiations, all the people that are affected have an opportunity to see what is going on and how it is working. We don't think the establishment of a separate office in the White House would help that.

Mr. Chairman, you had one final question.

The CHAIRMAN. Let me just comment on that now and we'll go into it a little later in the questions.

But I did say that I thought the system right now seems to be working rather well. But I must say that it wasn't always so. And I happen to take the position that you held prior to your change to your present frame of mind.

What I was trying to look at here was the long-range prospect so that we would have a system that would work under whatever type of conditions we were under at that particular time, whether it be one administration or another.

So that was really the thrust of what I was trying to do.

Secretary ADAMS. Mr. Chairman, I have not changed my feeling that we have to have a single voice and we have to negotiate these agreements effectively. You are talking about what system will best do that. The concern that I had, when I was serving in the House of Representatives and when I started in this job, was that we were not elevating international aviation negotiations to a high enough level in the Government, where they would receive the attention they need.

We now have that, and if it fails in some fashion, I think the Congress should address it at that point and say how they want the system structured. There are a number of possibilities of where you can place the responsibility. But my tendency would be, Mr. Chairman, to look toward the established agencies that are doing it now.

You had a question, Mr. Chairman, about the German negotiations and the kind of proposals we are developing. Under Secretary of State Cooper is here and will discuss this matter in detail. We were working on this yesterday afternoon.

I would like just to say that we are in agreement, as a policy matter, that the administration will present to the Germans in Bonn on September 12 the possibility of a so-called open skies agreement. In other words, carriers would be able to fly from any point in Germany to any point in the United States, in return for their granting to the United States certain specific rights, that they have not in the past, including beyond rights, elimination of restrictive practices and so on.

Dr. Cooper will discuss the specific negotiating paper, but I mention this upcoming negotiation in closing, Mr. Chairman, as an example of how important bilateral action problems are now being worked out. We're debating U.S. policy and then developing the negotiating papers that will be placed on the table.

The CHAIRMAN. I would hope that you don't get locked into a position until after we've concluded these hearings that we're going into now in order to formulate what Congress thinks is the proper international aviation policy.

Secretary ADAMS. Mr. Chairman, we have tried, as I know you are aware, to very carefully work with the committee as each of these negotiations have come along, our position for the German bilateral is in the process of development. We've been working on it the last 2 days, and you will hear just where we are. The final papers, of course, have not even been drafted yet. We want you to be aware of where we are.

That concludes my statement, Mr. Chairman. I appreciate the opportunity to be here.

The CHAIRMAN. Well, thank you very much, Mr. Secretary, for your statement. I must admit some disappointment that you didn't find more that you liked about S. 3363, but before getting into specific questions about the legislation, I'd like to ask you a few questions about some of the broader issues.

First, in my opening remarks, I explained my concern with the type of fare mechanism contained in the Israel bilateral. I understand that DOT supported its inclusion. I would appreciate your analysis of the merits of the two country disapproval in the Israel and other bilaterals.

Secretary ADAMS. Mr. Chairman, what this does is to remove governmental interference with the rates from the day-to-day marketing procedures of the carries, and it places governments in the position of discussing rates only when both governments feel that a particular carrier has engaged in either a monopolistic or a predatory practice.

The success of such an approach depends upon a competitive environment, and we believe that we have this in our relationship with Israel. Our agreement with Israel allows them to fly to a certain number of cities. Five cities have now been allocated, which is about their

total capacity. In exchange for that, we got multiple designation rights and charter rights into Israel, which we had not had before, and this fare provision, which really puts us in the position of the ultimate procompetitive setting of fares by market forces.

We will look step by step as we go through country by country to determine whether we have the kind of competitive environment that warrants such a policy.

The CHAIRMAN. What is the DOT position on open skies generally and with respect to the German bilateral?

Secretary ADAMS. We believe that we should start first with the German bilateral. If we can attain the seven negotiating objectives that are set forth in the President's policy statement we should then make an "open skies" proposal as a policy matter to the Federal Republic of Germany.

Once again, we are dealing with a situation where the capacity of the German carriers and the competitive environment there will provide for entry to a limited number of places within the United States. And we have rights to fly from the whole of the United States to the Republic of Germany.

So, we're willing to put that on the table in exchange for their removing restrictions on our carriers, particularly on our carriers going to points beyond the Federal Republic.

Iti s a very delicate and difficult negotiation, and we feel that this competitive thrust is appropriate.

The CHAIRMAN. How do you answer the argument that we're giving away much more than we're getting under the open skies policy with other countries?

Secretary ADAMS. What the Federal Republic would be receiving with the airline capacity that they have in terms of the number of new U.S. points their carriers would serve, would represent a limited impact on the U.S. market as a whole. We are on the verge, we hope, of achieving a complete change in marketing procedures throughout all Europe. We have now a Dutch agreement and an Israeli agreement, and if we can negotiate a good one with the Federal Republic, we see a significant change in the European system which was restrictive and characterized by pooling agreements. And we will have our trading partners, like the Federal Republic, in agreement with us on how to proceed.

It is a very important negotiation, Mr. Chairman.

The CHAIRMAN. This wouldn't necessarily do away with pooling agreements that exist now, would it?

Secretary ADAMS. If we can enter into this agreement with the Federal Republic, it would erode the viability of such agreements as far as they are concerned. We have then the potential for proceeding with the Dutch and the other countries who will have to consider from their viewpoint whether or not they want to get into the new market that's opening.

This is a very important block in our total policy of obtaining a competitive environment. As you mentioned in your earlier statement, this is an industry that had been cartelized in Europe for many years——

The CHAIRMAN. I want to compliment you on the administration's policy statements, which you announced yesterday. It is procompetitive. It's clear, and it was developed openly providing opportunity for those concerned to establish their views.

I do have a question, though, about the general concept which we included in S. 3363, and is not contained in the administration's policy.

As you know, many of our airlines have complained that current policy is to trade permanent market opportunities, that is, new points, for short-term, low-fare policies.

Therefore, S. 3363 emphasizes permanent linkage between rights granted and rights obtained in bilateral agreements. Is there some reason that the administration decided not to attempt to link permanently low fare, competitive rights with any new market awards?

Secretary ADAMS. We have, Mr. Chairman. The seven objectives that are in the negotiating package are long-term policy objectives and not just a short-term operation.

The long-term effects are that the carriers operating in those areas will benefit—and that's one of the reasons that multiple designation of U.S. airlines is one of the objectives. The carrier managements can come in with a lower fare proposition. And our pressing for country of origin charter rights, will give our carriers the right to greater services at lower fares. So, we think that there is a linkage and the routes to which we grant access are tied to what our people need in nations with which we are negotiating.

In other words, what we want as a nation for our carriers, labor, and the people that are traveling in the European nations, is different from what the European nations want from us. The same is true of Japan, too. I didn't mean to limit it just to Europe.

The CHAIRMAN. I would direct your attention to the seventh point on page 13 of the legislation where we state that one of the goals for international aviation policy is the creation of opportunities for carriers of foreign countries to increase their access to U.S. points, if exchanged for benefits of similar magnitude for U.S. carriers and the traveling public with permanent linkage between rights granted and given away.

Would you say that the policy that you have announced now is consistent with that particular objective that we have stated?

Secretary ADAMS. We think that it is consistent. Mr. Chairman. Are you concerned that maybe we have a problem with the words "permanent linkage"?

The CHAIRMAN. That's right, between rights granted and rights given away.

Secretary ADAMS. We believe there is such a linkage in these agreements. If they don't work, we of course reserve the right to renounce them. But our objective is to trade competitive opportunities rather than trading restrictions with countries. That is the new tilt, and we believe they will be permanently linked.

The CHAIRMAN. Well, if a country went to restrictive pricing, then could we withdraw their route opportunities?

Secretary ADAMS. The answer is: one, we can renounce; two, short of that, we have a consultive procedure, which we can go through so that the ultimate weapon of renunciation is not used. And we fully intend to follow that policy.

The CHAIRMAN. DOT opposes the merger clause in S. 3363, and I would appreciate you expanding on the reasons why. As you know, when scheduled carriers operate charters, they can utilize marginal pricing and feed principles which make for a considerable savings to the consumer. Even if DOT, CAB and State have the best intentions to give supplemental airlines more competitive opportunities, they certainly will start late in the race, perhaps too late for some, such as ONA.

A charter and scheduled carrier merger is the type of horizontal integration which seems to me to be in the consumer's interest and considering the size of any of the supplementals, would be a businessman's right in an unregulated industry.

Why then do you oppose this opportunity, when the only alternative would mean bankruptcy for some supplementals?

Secretary ADAMS. We would not necessarily oppose a merger before the Board or use of an expedited process, Mr. Chairman, if bankruptcy of the particular carrier were threatened.

But you're talking about putting a statutory system in place that would in effect press the supplementals into vanishing. We have not arrived at the point where we think that ought to happen further than it has already. I'm well aware of what we started with and what we have left. This is a very difficult, unresolved question. I've tried to answer you, Mr. Chairman, by saying we tend to favor an approach that would enable the supplementals to stay in business and would give them the opportunities to do it, rather than announcing a policy that the supplementals should merge and go out of business.

The CHAIRMAN. Of course, currently, the supplementals can't merge because a scheduled carrier can't hold a supplemental certificate, so you'd have to have some change in the law, as I see it.

Do you agree with that?

Secretary ADAMS. That's correct.

The CHAIRMAN. Now, Secretary Adams, you've been one of the most outspoken critics of our Government organization for handling bilateral negotiations. You suggested several months ago that DOT become the lead agency in international negotiations. More recently you were reported by the press to support the Cannon-Pearson approach, and I quote from the August 10, 1978 edition of Aviation Daily, quote:

> At a Washington press briefing Adams praised provisions in the Cannon-Pearson International Aviation Bill, which would give to a single person at the executive level ultimate responsibility over international issues. "I have said all along that there ought to be one person that all the countries and groups can go to, a high level policy person to carry out the international aviation policy."

Does your statement now reflect the opinion of the White House or the opinion of Brock Adams in DOT?

Secretary ADAMS. My position, Mr. Chairman, is that what we have now is working well. I am satisfied that we have addressed the problem of getting a single negotiating team in the field and that we've established a policy to be pursued in our negotiations. I am opposed to creating another office in the White House, as I testified.

My personal opinion, is that if the Congress ends up putting it anyplace, they should put it in an existing agency, and I have stated that that should be DOT.

But I am not recommending that that be done now. If you wish to consider that in 1984 or at some point when you feel that the system has broken down, that is the time to do it. But at this point I am satisfied that my concerns have been answered. I do not want to see another agency created beyond the executive agencies that we have now to handle this problem.

The CHAIRMAN. Your defense of section 801 was very eloquent, but I am not yet persuaded. I am reminded of that old saw: A woman convinced against her will is of the same opinion still.

The arguments are based on hypotheticals and contingencies, and the only concrete example given is the Braniff low-fare Texas-London proposal, which I believe was handled under section 1002 of the Federal Aviation Act and related to action which was proposed to be taken against British Caledonia, an action which would be subject to section 801 under my bill.

On the other hand, the misuses of section 801 are well known and notorious. In your testimony, you state:

> Our bilateral civil aviation relations are replete with instances of disputes involving carrier designation, and these disputes upon occasion threaten to erupt into major problems in our civil aviation relations with the objecting countries.

Since history is replete with such instances, could you cite a few for the committee, explaining the foreign policy impact of selecting one airline as opposed to another?

Secretary ADAMS. Mr. Chairman, consider the situation where we determine that there should be multiple designations of U.S. carriers, due to the new equipment and the benefits of competition. One approach is to say that our regional carriers, which can gather traffic and now have the equipment to provide service from inland cities to Europe, should be designated. This has foreign policy ramifications in that particularly some of our larger trading partners have some capacity problems like the United Kingdom at Heathrow; the Japanese at Narita. We then have to balance off as a foreign policy matter whether and to what extent there is going to be disruption if a particular carrier is designated.

At the same time, in the domestic area, if you're going to have regional carriers going out, then you need to offer opportunities for the former solely international carriers to provide linkage within the domestic markets. That's why the DOT supported fill-up rights for Pan American in the cities that they already serve, so that they could continue to exist and compete in this competitive fabric.

Mr. Chairman you will have a situation evolve such as occurred during the negotiation of Bermuda II, where at midnight on the night of termination there was a question as to who was going to be designated into which city, British Caledonian and British Airways into some, whether Laker would be allowed in and so on. We were about to have all air traffic stop, which would have been a major international incident between two friendly countries. We had to have both the negotiation power and 801 as a backup in order to avoid that kind of confrontation.

The CHAIRMAN. We are in the second half of a vote. I'm going to let you think about that a little bit because I think you did everything but answer the question.

Secretary ADAMS. I'll try harder.

The CHAIRMAN. Then I'm going to suggest that you give us a specific example.

I'll be back as quickly as I can.

[Brief recess.]

The CHAIRMAN. The committee will come to order.

You may proceed.

Secretary ADAMS. Mr. Chairman, I think first we should state that it is our position that the 801 power should be used sparingly. It should not be involved all the time with domestic carriers' concerns.

Let me give you two examples, of why you need this residual power available to the President.

First, you need it as a check in the event that, for example, you have a CAB decision which would choose two high-fare-type airlines to provide the exclusive service to a particular country. That selection—particularly if it involved service to a country where the protectionist system is very strong—prevent the President from carrying out his foreign objectives of creating a more competitive international aviation economic environment.

Second, Mr. Chairman, we have been talking all morning about the competitive relationships with our trading partners in what we call the competitive environment. We are also negotiating with a number of governments that do not believe in competition—and I'm referring now to the Socialist countries, such as Romania, or if the Soviet Union wished to expand Aeroflot services, or if we were to renew diplomatic relations with China, which would raise additional foreign policy considerations because of the relationship between the Peoples' Republic of China and the Taiwan Chinese Government. In all of these cases, the United States would have certain very important foreign policy concerns relating to designation that might not come before the CAB when a U.S. carrier of application was being considered. As you know, there are certain rights to our carriers that already exist, for example with respect to China. I don't say they are rights that we are at this point either pressing or that that government is recognizing.

These kinds of negotiations and these kinds of situations are examples Mr. Chairman, of where you need a residual Presidential authority under 801.

Now, if we get to the situation in the world where we have free market forces existing all over, the need for this 801 power is reduced. Indeed, it is reduced in importance once the great stream of bilaterals has occurred, because countries are requesting that designations to particular places be put in the agreement rather than leaving them to later determination.

Finally, Mr. Chairman, we are dealing with the executive branches of these other countries, and they do designate their carriers. Sometimes you get into very specific questions about designations; I gave the example of the United Kingdom's British Caledonian vis-a-vis Laker question.

But, while I stress again that it will not be exercised often, the President needs the ability in conducing foreign affairs to take these issues into account to see that our Nation is properly represented.

I hope I answered your question.

The CHAIRMAN. Not quite, but we'll get there.

In your statement you say our bilateral civil aviation relations are replete with instances of disputes over issues involving carrier designations, and these disputes upon occasion threaten to erupt into major problems in our civil aviation relations with the objecting countries.

I wonder if you would supply for the record two or three of these instances that are replete and also to include some of the objecting countries, those that have objected to the supposed designation of one of our carriers.

Secretary ADAMS. We'll do that Mr. Chairman.[1]

The CHAIRMAN. In your testimony you note that the past problems of politicizing carrier designations have been addressed by the issuance of Executive Order 11920. However, subsequent to that order President Carter overturned the Board's selection of Pan Am for Dallas-London, giving the route to Braniff instead.

This was done amid stories of Texas congressional visits to the White House on behalf of Braniff and strong influence by some members of the White House staff. In fact, Pan Am fired its former law firm as a result of being outmaneuvered in the 801 process, and Chairman Kahn reported he considered resignation as a result of the President's action.

Now, in light of that experience, how do you defend the effectiveness of Executive Order 11920 and on what foreign policy grounds was it necessary to select Braniff over Pan Am?

Secretary ADAMS. Well, Mr. Chairman, the thrust of that decision—and I am not trying to say I know everything that may have been in the President's mind at the time that he made the decision—but the thrust of it was that if regional carriers, which could gather feed traffic into a particular point, were able to offer competitive nonstop service, that would produce a better U.S. international air transportation system from the standpoint of our foreign economic policy objective of creating a more competitive international air transport system. And adding more carriers to the international air system through multiple designations, would encourage fare competition among all carriers. These, I am sure, were some of the bases for the President proceeding as he did.

Now, whether we agree or disagree with the particular decision, it had the definite foreign policy basis of carrying out the President's procompetitive foreign policy in the area of the international aviation system. The use of and the ability of regional airlines to go abroad has been something that has never been questioned in his mind as being a good foreign policy objective.

The CHAIRMAN. Well, you've discussed domestic economic matters, but I don't see what the foreign policy consideration is. You haven't defined it clearly to me. Maybe I'm just not getting your point.

Secretary ADAMS. Well, the objective is to place——

The CHAIRMAN. You said competitive—competition between U.S. carriers. There is only one carrier on that route.

Secretary ADAMS. I'm talking about international markets and about keeping the possibility of lower fares in those markets from simply

[1] At press time the material requested had not been received.

vanishing by having a single high-fare, American competitor with a single high-fare, foreign competitor in a market. You have seen the thrust of lower fares coming from a designation like this.

The CHAIRMAN. Well, are you suggesting that Pan Am was the high-fare carrier? It seems to me, if I heard it correctly, they were willing to authorize or to give super apex fares.

Secretary ADAMS. Mr. Chairman, I am not suggesting that, because I do not feel I should debate the merits of one carrier as opposed to another, but I am indicating to you that the existence of more U.S. competitors in international markets is a legitimate foreign policy objective, and that was one of the bases indicated by the President as to why he selected one carrier rather than another. But as I say, I am not trying to say one carrier is high, one is low, one is in between, because that function isn't in the DOT, Mr. Chairman.

The CHAIRMAN. Let me ask you in all candor, do you really think there was a foreign policy objective included in that decision?

Secretary ADAMS. Yes, sir.

The CHAIRMAN. OK.

Thank you very much, Mr. Secretary. There's no point in you and I arguing about it.

Secretary ADAMS. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF HON. BROCK ADAMS, SECRETARY, DEPARTMENT OF TRANSPORTATION

Mr. Chairman and Members of the Committee: The complexities of domestic aviation policy, which you have been a leader in addressing, have benefited greatly from Congressional scrutiny. I believe that the improvements we are beginning to see in air service domestically can also be achieved internationally. The International Air Transportation Act of 1978 which you have introduced will promote understanding of the issues involved in international aviation and focus attention on the international aviation policy of the United States Government.

As you are aware, the President has given high priority to aviation policy—both domestic and international. It is something in which I have taken a personal interest and to which we have, devoted some of the best resources of the Department of Transportation. I look forward, with you, Mr. Chairman, to the enactment of a strong aviation regulatory reform bill before Congress adjourns. A lot of effort on the part of the Congress and the Executive Branch has gone into that bill. It has been effort well spent. The aviation consumer—and the aviation industry both labor and management—will reap benefits from this new effort in the years to come.

While we have been working to achieve domestic regulatory reforms, we have also been trying to match this on the international front. Since the beginning of this Administration, we have concluded new or significantly modified agreements with some of our major aviation partners, including the Netherland, Belgium, Great Britain, Israel, Mexico and Singapore.

During the coming months, we will be negotiating with Germany, Japan, South Korea and several other nations. As a Nation, we can be proud of our negotiating efforts. The results have been the expansion of service opportunities for American business and labor and increased travel opportunities for American citizens.

Even more importantly, we have developed within the administration a comprehensive statement of the U.S. Government's policy for the conduct of international air transportation negotiations. This policy will provide basic guidance for U.S. delegations engaged in negotiating the many bilateral agreements which are now pending. This formal statement of policy—which is strongly proconsumer and procompetitive—embodies those principles which have guided our negotiations over the past year.

We recognize that when we deal in the international arena, we deal with other sovereign governments who may be pursuing ends or working from premises which are somewhat different from our own. We believe, nevertheless, that the citizens and the carriers of all nations will benefit from this new look and we are firmly pursuing these policy goals.

Against the background of what we have already accomplished in the area of international aviation policy, I would like to discuss the specifics of S. 3363.

Mr. Chairman, you indicated in your statement introducing the bill that the concepts it contains should be thoroughly discussed and debated. The complexities of international aviation deserve and require careful consideration and thorough discussion, and I appreciate the open minded approach you are taking with these hearings. I welcome this opportunity to share with you and the members of the Committee my thoughts on the provisions of S. 3363.

SECTION 2

Section 2, which provides policy direction for international aviation, is good and we can accept it. This Administration, in developing its formal statement of international aviation policy, has stressed the development of greater competition among airlines. Competition is the key to assuring the availability of affordable, safe, convenient and efficient air transportation for the consumer. This same theme is contained in the proposed Policy Declaration of S. 3363. We believe that this policy direction will be best achieved when reliance is placed on competitive market forces to achieve the greatest level of benefits in international air transportation.

I would like to express two concerns about proposed subparagraph (4), which speaks of providing "expedited treatment" to carriers from nations with whom we have "least restrictive" air agreements. First, the CAB does not select foreign air carriers. They are designated by their governments. This should be recognized by providing for expeditious issuance of permits to such carriers as they are properly designated. Second, I foresee a great deal of controversy in determining which agreements are the "least restrictive", unless considerably more direction is given on what are the criteria and how they are to be weighted.

Mr. Chairman, I do not believe subparagraph (4) adds materially to the policy declaration and I would hope that you would consider deleting it.

SECTION 3

Section 3 would permit air carriers to sell foreign charter trips directly to the public, with the percentage of trips that can be directly marketed increasing in steps to 40 percent of a carrier's total charter operations. This section raises several issues which we feel will require further thought and analysis.

Clearly, a large segment of the aviation industry engaged in operating charter trips would welcome the opportunity to market their product directly to the public. And that opportunity would be consistent with this Administration's aviation regulatory philosophy. In addition, by being able to market charters directly to the public, carriers would presumably gain greater efficiency; productivity would increase and prices could be lowered.

However, some argue that authorizing air carriers to sell charters directly to the public will have a serious adverse effect on many of the nation's tour operators. The views of those who fear their interests could be severely affected should be carefully assessed before determining whether the overall public interest would be served by this provision.

The traffic limitations contained in the bill should also be examined. We do not necessarily object to the specific percentages, but it is not clear by what rationale they were selected and, without that background knowledge they appear somewhat arbitrary. In our view, it might be more appropriate not to place any statutory limitations upon direct sales but to permit the Board to raise or lower the number of direct sales that would be allowed as warranted by market conditions.

Finally, although I recognize that the focus of this bill is on international aviation, we should expect the same principles to be applied to direct sale of charter trips whether they be foreign or domestic. I am not certain differential treatment is necessary or desirable.

SECTION 4

Section 5 would automatically permit the major supplemental carriers to provide scheduled service in five foreign markets. While we support the principle of automatic entry, we have several reservations about this provision.

We realize that supplemental carriers have been prevented from entering scheduled service for many years. However, a number of recent or anticipated developments should be borne in mind. The courts have recently ruled that the Board was incorrect in refusing to consider granting scheduled authority to supplemental carriers, and the Board is now considering applications from several supplemental carriers to enter scheduled service. And the domestic aviation regulatory reform legislation now before Congress would clearly spell out the right of the supplementals to perform scheduled service as well. Thus, the past inequities to supplemental carriers which this provision seems to address are already being corrected.

We have two further concerns about the provision: one philosophical and one practical. First, to the extent that an automatic entry provision is enacted for foreign air transportation—and we are in agreement with the concept—we believe it should be open to all qualified carriers, rather than being restricted to just the supplementals or any other particular class of carrier.

Second, there is also a problem from a practical standpoint: we do not yet have sufficiently liberal bilateral agreements with enough countries to open entry into very many markets.

For these reasons, we would not support Section 4 in its present form, although I should emphasize that we are in agreement with this entry concept and we will be glad to work with you on this issue.

SECTION 5

Section 5 deals with CAB issuance of permits to foreign air carriers and would authorize issuance when the CAB has found that the carrier is fit, willing and able and that either the transportation to be provided is in the public interest or that the applicant carrier has been designated by its government to provide the service under the terms of an agreement between that government and the United States. The Department of Transportation believes that, to the extent that foreign air carrier applications for operating permits are made pursuant to bilateral Civil Air Transport Agreements, by airlines duly designated by their governments, the applications should be granted on a simplified and expedited basis. Therefore we support this provision.

SECTION 6

Section 6 would establish a rebuttable presumption that consolidations or mergers of supplemental and scheduled air carriers are in the public interest. DOT does not believe this is the best way to proceed at this time.

We recognize that in the present environment the competitive balance between the scheduled and supplemental air carriers is under strain. However, the authority to offer scheduled service, rather than a liberalized merger policy, at this time is the best way to approach the problems confronting the supplemental carriers. The objective should be to put supplemental carriers in a position where they can compete effectively with scheduled carriers, not simply have them disappear.

The domestic aviation regulatory reform bill would permit supplemental carriers to apply for scheduled authority. That bill also would change the standard for approving consolidations and mergers by requiring that the Board not approve transactions which would result in, or would be in furtherance of, a conspiracy or combination to monopolize the business of air transportation in the United States. We believe that approach is preferable to the proposed section 6.

SECTION 7

Section 7 would prohibit CAB approval of capacity or pricing agreements affecting foreign air transportation. The domestic regulatory reform legislation recently passed by the Senate would outlaw domestic capacity and price fixing agreements and impose tougher antitrust standards on other agreements approved by the Board. We believe this is proper. However, the international air

transportation system is not the mirror image of our domestic transportation system, and we believe that we should fully consider the implications of a unilateral act by the United States which would prohibit U.S. carriers' participation in the International Air Transport Association rate making machinery.

The success of the Administration's international aviation policy depends upon our bilateral and multilateral civil aviation relations. We cannot achieve results in a vacuum. We cannot even land our planes in a foreign State without the agreement of its Government.

On June 9, the Civil Aeronautics Board instituted a show cause proceeding to review its approval of U.S. carrier participation in IATA rate agreements.

In its Order, the Board noted that it was aware that alteration or withdrawal of its approval of the traffic conference mechanism would have far-reaching consequences for the international airline system, and appropriately the Board extended the normal comment period to 120 days.

DOT has also instituted a broad study to review U.S. carrier participation in IATA traffic conferences. While we believe that it is proper that the pro-competitive principles presently embodied in the domestic regulatory reform legislation be generally applied to foreign air transportation, we have not yet completed our review of IATA and we are not yet ready to either endorse or oppose this portion of section 7.

Section 7 would also prohibit Board approval of any agreement which limits capacity in competitive markets. We do not believe that a complete ban without any escape valve for extraordinary circumstances is necessarily desirable. It is long established U.S. policy to oppose capacity limitation agreements. Presently no U.S. carrier is a party to an agreement which limits capacity. However, we cannot preclude the possibility that a situation may arise in which an agreement among carriers for the purpose of allocating capacity might be necessary in unusual circumstances unique to international markets. Therefore, the Department of Transportation feels that the better policy is to leave unamended the present statutory scheme which gives the Board the power to approve such an agreement subject to a finding that it is in the public interest.

SECTION 8

Section 8 would amend section 801 of the Federal Aviation Act, which presently provides for Presidential review of certain CAB actions. In essence, the President's authority would be limited to reviewing rates charged by foreign air carriers and to matters involving issuance of permits to foreign air carriers. The President's review authority over CAB decisions in proceedings involving U.S. carrier route or rate matters in foreign air transportation would be eliminated.

The Department of Transportation is opposed to these changes. We believe that, notwithstanding the intermittent assertions that section 801 gives rise to the politicization of the airline regulatory system, the present statutory scheme should not be altered. Past problems have been addressed by the issuance of Executive Order 11920. The scope of the President's review authority should not be curtailed.

We do not believe, Mr. Chairman, that we should assume because 801 review authority relates to foreign air transportation, only decisions concerning foreign carriers should be subject to review. The world of international relations is much more complicated than that. The United States Supreme Court recognized this fact in the *Waterman* case. The Court held, and after 30 years the law remains, that CAB orders that are subject to section 801 Presidential approval are immune from judicial review. This is in recognition of the constitutional responsibility vested in the President for the supervision of national defense and foreign affairs.

We all know that the President has broad authority and responsibility under Article II of the Constitution to conduct the foreign relations of the United States. The present statutory scheme, supported by judicial decisions, reflects this responsibility and provides the President with the power to approve or disapprove CAB orders involving the full scope of foreign air transportation that raises foreign affairs and national defense considerations. We believe that the President must have this broad review authority in order to effectively negotiate bilateral aid transport agreements with foreign countries.

Foreign policy and national defense are inherently potential issues in all carrier selection and rate decisions involving international air transportation. Furthermore, it is the President and not the CAB that is entrusted with the respon-

sibility to conduct the foreign policy and insure the national security. I am not now talking about an "Imperial Presidency." I am talking about the realities of the bilateral air transport negotiating process.

A Presidential decision, based upon foreign policy considerations, in a matter regarding any U.S. carrier route or rate issue in international transportation, which is ignored by the CAB, will force the President to use the more cumbersome, and less sure, bilateral negotiating process to accomplish the foreign policy objectives. Since the agenda in formal bilateral negotiation cannot be unilaterally determined by the United States, legislation which forces the President to resort to that mechanism will surely be more costly to the U.S. than if the problem were resolved in the course of section 801 review of the CAB decision.

Recently, the U.S. was involved in a dispute with the United Kingdom involving low fare proposals by Braniff International Airlines. Although the CAB played a very important, aggressive, and constructive role in supporting Braniff's right to introduce the proposed fares, in the last analysis it was the President, using his 801 powers in conjunction with his authority to negotiate bilateral air transport agreements, who was able to resolve the dispute with the British and ward off a potentially disruptive confrontation.

A slightly different scenario can be readily imagined where the proposed fare of a U.S. carrier is so objectionable to a foreign government that its implementation would threaten our civil aviation relations with that country. It would be unwise to make carrier management and the Civil Aeronautics Board the final arbiter of the appropriateness of these fares. We should not be in the position of tying the President's hands while one carrier, pursuing its own interest, is given the license to jeopardize an entire bilateral regime.

Finally, Mr. Chairman, I would direct your attention to one last example. The U.S. recently signed a bilateral agreement with Israel which, effective August 1, 1979, will require the approval of both governments before a fare proposed by a designated U.S. or Israeli airline for air transportation between the U.S. and Israel can be disapproved. The Administration is currently reviewing the desirability of extending this concept to other bilateral civil aviation regimes. Under the concept of mutual disapproval, it is essential that the President retain the right to review foreign and U.S. airline fare proposals in order to prevent the institution of fares which are predatory or otherwise violative of the public interest.

A similar need exists for Presidential power to review CAB decisions involving U.S. carrier selection for international routes. Under the procedures established in our bilateral Air Transport Agreements with other nations, a U.S. carrier which is certificated by the CAB to provide air transportation to a foreign State for the first time, must obtain the appropriate operating authority from the receiving State. If such certification is objected to by the receiving State, we cannot rule out the possibility that the President may, in order to preserve the viability of our civil aviation relations with the State, be required to disapprove or modify a CAB route award to a domestic carrier. Our bilateral civil aviation relations are replete with instances of disputes over issues involving carrier designations, and these disputes, upon occasion, threaten to erupt into major problems in our civil aviation relations with the objecting countries.

The essential point, Mr. Chairman, is that it is the President, and not the CAB or the courts, who is responsible for insuring that new carrier certification and new fare proposals by carriers will not be destructive of our bilateral and multilateral civil aviation relations. We believe, therefore, that retention of the President's current 801 authority is essential if the United States is to continue to be successful in international air services negotiations and in maintaining and strengthening ongoing relationships with other countries in aviation matters.

SECTION 9

Finally, Mr. Chairman, let me turn to section 9 of S. 3363. This section would establish, within the Executive Office of the President, an Office of International Aviation Negotiations, to be headed by a Director and Chief Negotiator appointed by the President. Special Counsel appointed from the State Department, DOT and the CAB would assist the Director.

I believe it is essential that the U.S. Government speak with one voice on international aviation matters. In donng this we must accommodate a multiplicity of interests, and a variety of resources must be used effectively if our international aviation policy is to be successful.

Even with the appointment of Special Counsel, and the direction that DOT, State and the CAB cooperate with the new Office, the establishment of another separate office in the White House would significantly reduce the involvement and responsibility of these agencies in the preparation and implementation of civil air transport bilaterial agreements. We, therefore, oppose these provisions of S. 3363.

Over the last 12 months, we have worked hard to make interagency coordination successful. Competitive agreements stressing the elimination of restrictive practices have been reached with a number of countries. The new scope of recent agreements signed with the Netherlands and Israel, for example, reflect this.

The process which we have developed is working. We are concerned that a separate Office of International Aviation Negotiations would once again fragment respective agency responsibilities that today are being coordinated. I would stress, Mr. Chairman, that I am entirely in accord with the principal objectives underlying this provision of S. 3363. But I believe that these objectives are better achieved by what we are doing than by setting up another office that would be disruptive rather than helpful to our continuing efforts to assure successful and effective aviation negotiations.

The present system is producing satisfactory results and we are concerned that the proposed organization would actually be a step backwards. If a separate office were created, it appears that one of two scenarios would emerge. To perform its statutory functions adequately, the new office would either have to build a very large staff infrastructure within the Executive Office of the President—a policy clearly contrary to current bipartisan views on government reorganization—or it would maintain a relatively small staff and depend heavily on the agencies currently providing bilateral negotiations staff work. This layering effect not only would be costly in terms of money but also would reduce efficiency. Agency responsibility would be fragmented, and coordination efforts would have to increase. It is for these reasons, Mr. Chairman, that we oppose section 9 of the bill.

CONCLUSION

Mr. Chairman, let me reiterate in closing that I very much appreciate your efforts in introducing S. 3363 and in holding these hearings which focus on international aviation activities and provide them the attention they deserve. The issues are many and they are complex. S. 3363 addresses these issues in a very thoughtful manner, and I appreciate the opportunity to discuss them with you and the Committee.

This concludes my prepared statement. I would be pleased to answer any questions you or other members of the Committee may have.

The CHAIRMAN. Our next witness is the Honorable Richard N. Cooper, Under Secretary of Economic Affairs, Department of State.

STATEMENT OF RICHARD N. COOPER, UNDER SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF STATE; ACCOMPANIED BY JAMES ATWOOD, DEPUTY ASSISTANT SECRETARY OF STATE FOR TRANSPORTATION

Mr. COOPER. Senator, thank you.

I'm pleased to appear before the subcommittee today.

I have with me Mr. James Atwood who is the Deputy Assistant Secretary of State for Transportation.

This is a topic of vital interest both within the United States and abroad. The issue has become the subject of particular interest and considerable controversy in the past year because of the determination of the Carter administration and a significant number of Members of Congress to provide for more competitive international transport environment.

The Congress, and particularly this subcommittee, is considering and hopefully will approve legislation which will remove these barriers to competition domestically.

The Department of State welcomes, therefore, the initiative of Congress in introducing legislation which seeks to extend these objectives to the international sphere.

Compared with a good part of the rest of the world the United States has always pursued a liberal aviation policy, just as it has traditionally espoused liberal trade policy. But it is also evidence that international aviation has become encumbered with a number of restraints after over 30 years, and it's questionable whether international aviation still needs the mantle of excessive Government protection.

Following an interagency review it was the unanimous view that increased emphasis should be placed on removing the fetters from the international aviation system. The result is the statement of U.S. policy for the conduct of international air transportation negotiations which was approved by the President last week and issued yesterday.

At the root of that policy is the conviction that competition is good for all concerned, governments, airlines, the traveling public, shippers, labor, national economies, and the world economy generally.

This principle means lower fares, more liberal charter rules, expansion of direct service to more cities, freedom to designate several U.S. airlines on a given route, elimination of restrictions on capacity, and removal of discriminatory or unfair practices in international aviation.

We have to recognize that many governments and aviation interests abroad do not fully share our philosophy. With those that do, the conclusion of satisfactory agreements will be relatively easy. With those at the opposite extreme who are openly hostile and believe our policy approach is simply wrong, we're going to have to be patient. We are not out to teach the world a lesson, as some may imply, but equally, we will not retreat because others do not share our viewpoint. Gradually, we'll work steadily at creating a more competitive environment in international aviation.

We believe, however, that there are many countries that can be persuaded that our policy is a good one. We have successfully concluded liberal aviation agreements with a number of these countries. The new agreements with the Netherlands and Israel are perhaps the most notable.

Our recent charter and air fare arrangements with the United Kingdom ameliorate some of the restrictive features of Bermuda II, although we continue to be concerned over British reluctance to ease the limitations of the number of airlines that may be designated.

We have also concluded liberal new agreements with Belgium, Mexico, Singapore, and Yugoslavia, among others.

The final and conclusive judgment on our policy will be made in the marketplace. Demand for air transport in recent months has far exceeded the airlines projections. The dramatic proliferation of low-fare choices for the traveling public, as well as the new gateway services and new types of service, have played a key role in this resurgence of the industry.

To be sure, there have been some teething troubles, as airlines and the public adjust to the new demands, but we're confident that these are temporary problems.

Mr. Chairman, it's impossible to conduct a searching review of aviation policy and its negotiating strategy without at the same time reexamining in equally rigorous fashion the mechanisms formulating implementing that policy.

As a result of a recent review directed by President Carter, relevant agencies have agreed to the following division of responsibilities and organization which generally reaffirm earlier studies of this problem. The Department of State continues to chair an interagency committee with responsibility for the coordination and development of position strategies and procedures for international aviation negotiations. State provides the foreign policy guidance, including foreign economic policy, for the committee's deliberations.

State also continues its role as head of the interagency negotiation delegations. It coordinates and clears all contacts and communications with respect to negotiations, and provides, in coordination with DOT and CAB, day-to-day contact with foreign governments on aviation issues and problems.

DOT has responsibility for developing broad transportation policies and the long-range objectives of the executive branch with respect to its international aviation objectives, makes recommendations to the interagency committee as to countries and issues which should be given priority, and it participates as a principal in the interagency committee in developing positions and strategies for particular negotiations. DOT representatives may be members of all delegations.

The CAB participates in the interagency committee and all delegations. It also consults with DOT on matters of long-range transportation policy and objectives. The Board continues to develop economic regulatory policies with respect to international airlines, to make recommendations related to the implementation of international agreements, and to contribute staff support in preparation for the negotiations.

Other departments and agencies may participate in the discussion of the interagency committee and as members of delegations as required.

The current system, in our view—and I believe also that of other agencies—is working well, precisely because all of the relevant agencies and departments have had an opportunity for input to reach the negotiating position and negotiating strategy.

Let me turn now to S. 3363.

The general thrust of this bill coincides with the President's policy in its emphasis on greater competition, increased services, and innovative fares.

Section 2 sets forth a series of goals which are fully consistent with and supportive of the President's aims and objectives in international aviation.

The Department supports the strong thrust toward competition emphasized in this section.

We also support subsection (b) (5) on the need to provide domestic route authority to airlines engaged extensively in international operations.

I've given detailed comments with respect to sections 3, 4, 5, 6, and 7 in my written testimony.

We support the thrust of most of these changes but generally believe that the CAB should be given discretion to use the authority contemplated by these provisions as it believes best in the particular circumstances.

Section 8 would limit the President's section 801 authority to foreign air carriers. The State Department does not believe this limitation on the President's authority is warranted.

The current section 801 authority is a necessary and essential attribute of the President's foreign policy powers under the Constitution.

In this connection, we do not consider that foreign policy encompasses only our political relations with other countries. Our international aviation policy is part of U.S. foreign policy.

The President should, therefore, have authority to disapprove CAB recommendations concerning international routes for U.S. carriers which he concludes are inconsistent with its aviation policy.

Section 8 would also limit the President's authority to rates for foreign air transportation by foreign carriers. The State Department opposes such a provision for the same reason indicated with regard to section 801(a).

Section 9 would establish an office of international aviation negotiations in the White House. The existing mechanism for dealing with international aviation negotiations is, in our judgment, responsive to our needs and has been successful in a series of recent negotiations in which we have made major breakthroughs in achieving U.S. objectives in international aviation.

The President recently reviewed the interagency mechanism which concluded that no major changes were warranted. Furthermore, he does not want, if it can be avoided, to add new formal responsibilities to the White House.

Most of the laudable features of section 9 are reflected in the present administrative procedures. First, in light of the President's recently announced reaffirmation of the existing interagency structure, some of the previous confusion about leadership within the United States on international aviation has been dissipated. Further, the Aviation Policy Committee reflected in this section already exists, as I previouly described.

The International Aviation Advisory Council is also reflected in our present system, coordinated by the CAB, for obtaining broad public input prior to formulating our negotiating positions.

The present structure, which operates under close supervision from and with the support of the White House, gives us the needed flexibility to improve and we can see some dangers in locking any system into place by statute.

Finally, we think there would also be dangers in shifting the focus of negotiating responsibility from the State Department to the White House.

The negotiating load is heavy. At one point this summer there were four bilateral negotiations being conducted simultaneously. The proposed White House office under such circumstances, could not be a small one, and there's obvious reason to be cautious about such a major enlargement of the White House staff.

Further, the line between negotiations and other aspects of international aviation, such as implementation of agreements and dealing

with periodic aviation problems, is a narrow one. And this is one of the reasons that the President recently decided that State should retain the central coordinating role.

Section 9 also spells out a list of 8 negotiating objectives. In general, we support these objectives. They are similar to those set forth in the recent policy statement approved by the President.

However, we would believe it is preferable not to establish such objectives by legislation. The intent of Congress would be amply established by section 2 of the bill. How these goals are implemented in the negotiating process should be decided through the normal recourse of policy statements such as the one just issued, interagency coordination, consultations with the Congress, and inputs from industry, labor and the traveling public.

To sum up, the State Department supports the general aims reflected in this bill but has difficulties or reservations with certain provisions.

We also believe that it would be desirable to amend other provisions of the Federal Aviation Act; in particular, we would support the expansion of section 416 of the act to permit the CAB to grant exemption authority to foreign air carriers.

I would also urge another change in the Federal Aviation Action. Section 1117 of the act requires that official U.S. travelers use U.S. airlines on flights to and from the United States and between points outside the United States when U.S. airline service is available.

The State Department believes that the time has come to relax this provision for three reasons. First, it was enacted in 1974, at a time when U.S. international airlines were in very difficult financial straights due to a recession and the sudden fourfold increase in oil prices.

That period is, happily, behind us.

Second, this provision has resulted in unreasonable limitations on travel choices and severe personal hardships. In many cases, the result has often been greater expense to the U.S. Government, to the taxpayer, and greater burdens on Government employees than if more natural routings were permitted.

In the end, our taxpayers end up bearing the cost of this inefficiency. Finally, a relaxation to permit greater use of foreign airlines abroad would be more consistent with one of the major aims of our aviation policy. That is, to foster a more open and less restrictive system.

Mr. Chairman, I have heard part of your colloquy with Secretary Adams, and on one point in particular which should have been and is not covered adequately in my written statement, concerns the long-run nature of the low fare policy. And there I would just like to add to what he said, that we conceive the agreements that we have been negotiating recently to be "permanent"; that is, as permanent as any of these arrangements are, not only in their routings, but also in the other provisions of the agreement; that is, the provisions concerning charters, the provisions concerning multiple designation, and the provisions concerning fares.

In particular, we look to the charter provisions and the multiple designation as providing the kind of competitive environment combined with the general low fare provisions which will assure low fares in the long term.

And it would be our intention that if these agreements are violated by the other side in those respects, that we would have recourse to the normal actions we have recourse to whenever an international agreement with the United States is violated by the other side. First, consultative procedures, second, limited retaliation, and ultimately, renunciation of the agreement.

So we do not see ourselves as giving permanent route rights for temporary low fares situations. On the contrary. We try to establish a regime which will have some durability in all its aspects.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you for a very clear and thoughtful statement. Again, I want to ask you a few questions that are broader than the bill before the committee.

First, is the State Department planning to send to the German Government a proposal for an open skies bilateral? And exactly what does the term "open skies" mean to the United States?

In other words, does it mean complete freedom from regulatory barriers or are there still some regulatory standards remaining, such as protection against predatory fares?

Mr. COOPER. Yes. In answer to your question, Mr. Chairman, we do propose to send the proposal to the Federal Republic of Germany. We were not going to formulate that proposal in final form until after these hearings by earlier agreement with you. But subject to that condition, we have reached agreement on the major elements of what our proposal would be.

We have not actually written them down formally yet, as I say, in order to get what guidance we could from the hearings as a whole.

The term "open skies" is perhaps a misleading one because it's ambiguous. It's not well defined.

And when we use the term "open skies" in this context, we are talking about a narrow concept. That is, it means the ability of airlines in either country to fly to all points in the other country.

Obviously, that is not all there will be to our proposal. We have a number of other features which we are very strongly interested in.

Let me, with your permission, simply enumerate what the kinds of things we have in mind are.

On the question of beyond rights—that is, the rights of U.S. carriers to fly beyond their landing points in the Federal Republic—we would suggest that we retain beyond rights but eliminate the restrictions that now exist on the sectors for beyond rights, that we would ask for unlimited beyond rights for U.S. carriers, but would offer no change in the existing beyond rights for the German carriers. And for the airlines of both sides, we would eliminate the Bermuda I capacity provisions which exist in the present agreement.

Third, we would reaffirm the clear right to designate multiple airlines.

Fourth, we would suggest a new fares articles under which both countries must agree before a proposed fare is disapproved whether the fare is filed by a U.S. airline, by a German airline, or by a third-flag airline.

On their fifth freedom operations, both U.S. and German airlines must be permitted to match the fares of third and fourth freedom carriers.

Fifth, we would ask for a liberal change in gage provisions allowing all changes of gage, including so-called fan changes, but subject to the condition that capacity of the outgoing aircraft or aircrafts does not not exceed the capacity of the incoming aircrafts.

Finally, we would ask for liberalized charter rules, country of origin rules plus guaranteed access to the other country's charter market through agreed maximum criteria.

For example, that neither country may have advanced booking periods exceeding 14 days, say, or minimum stay exceeding 4 days, that kind of thing.

So what we're looking for in the total package is one which greatly extends landing rights on both sides, although, obviously, given the geographic dispersion of the United States, we would expect this to be a major attraction to Germany, on the one hand; on the other hand, extensive beyond rights, clear multiple designation, liberal charter rules, and a fare article which is designed to assure a competitive fare environment.

This seems to us to be, as Secretary Adams said earlier, an extremely important negotiation. We hope very much that the German Government will find it possible to respond favorably to this kind of package, which would be a very important one in the annals of international aviation.

The CHAIRMAN. Why do you support the Israeli fare mechanism, or any other mechanism which eliminates all control over predatory behavior?

In other words, is it consistent for the State Department to oppose steel dumping by the Japanese and yet agree in advance to accept whatever commercial tariff another country is willing to permit?

Mr. COOPER. No. This is not quite as open-ended as your question implies.

What is required under the fare provision is that both countries must disapprove of the fare. But there are other provisions of the agreement which, for example, prevent or prohibit subsidization of airlines. So that if, for example, the partner country were to engage in predatory fares in the sense that the airline was subsidized, the agreement covers that, and the country in question would be in violation of that part of the agreement.

The CHAIRMAN. But wouldn't you be up against a situation where you'd have to renounce the agreement, and it would take a year to get rid of the predatory fare?

Mr. COOPER. We have a series of steps short of renunciation which permit, which would engage in discussion of that.

We could call for formal consultations under the agreement and raise with the other country our objections. In the end, it is true that if we had to go to renunciation of the agreement, it takes some period of time on that.

We do, however; I would not want to emphasize that we are underlining them, but we do have provisions in other legislation and in particular, the Trade Act of 1974, which permit us to deal with a genuine case of government-supported predatory practices.

So it's not as though we're naked on this issue.

Let me say one further thing on this. Obviously, this is not a provision which we enter lightly with any and all countries. We con-

sider very carefully the countries with whom we're negotiating, the spirit with which they enter in it, and their general philosophy toward international trade in general and civil aviation in particular.

The CHAIRMAN. But you have entered that agreement with the Israelis and you're proposing to do it with the Germans.

Mr. COOPER. That is correct; yes.

The CHAIRMAN. Now, in your statement you object to the new structure suggested in S. 3363, citing a number of serious consequences.

Now, Senator Pearson and I used the Office of the Special Trade Representative as a model for the new office which we proposed.

I'd like to ask you if the State Department opposed the establishment of the special trade representative, and have you had any great problems coordinating with that office?

Mr. COOPER. In answer to the first question, I cannot do it offhand. That was introduced into legislation some 16 years ago. I suspect that the State Department did not oppose it openly, but I'll have to get an answer for the record whether there was any opposition.

The CHAIRMAN. Will you supply that for the record?

Mr. COOPER. Yes.

[The following information was subsequently received for the record:]

UNDER SECRETARY OF STATE
FOR ECONOMIC AFAIRS,
Washington, D.C., September 21, 1978.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate.

DEAR MR. CHAIRMAN: During my appearance before your Committee on August 22, 1978, in connection with international aviation matters, including S. 3363, you asked me to provide for the record information on the position taken by the Department of State several years ago with regard to the establishment of the Office of the Special Trade Representative (STR) in the White House. The following information is furnished.

The organizational issue in connection with the Trade Expansion Act of 1962 was whether the responsibility for negotiating international trade issues should remain with the Department of State, be assigned to other Departments (such as Commerce and Agriculture), or be vested in the White House. The House Ways and Means Committee believed that responsibility for trade negotiations should be taken from the Department of State and placed with a department or agency that would not, in the committee's view, be tempted to subordinate U.S. trade interests to U.S. foreign policy interests.

It is fair to say that the State Department was unhappy with the prospect of losing primary responsibility for the conduct of trade negotiations. Nevertheless, the Department recognized the need for broad congressional support for the trade bill. Consequently, the Department fully supported the administration's position, which was expressed by President Kennedy on May 17, 1962, in a letter to Congressman Wilbur Mills:

"I understand that the committee has provided for a Special Representative of the President to assume principal responsibility for negotiating each trade agreement under the Act, and that the committee bill will provide for an interagency mechanism to perform a number of advisory functions, now provided for under Executive Order 10741. I have no objection to these changes."

The Department of State did not and does not share the view that its handling of trade negotiations over the years had been deficient. The then Under Secretary of State George W. Ball, in an oral statement before the Senate Finance Committee in support of the Trade Act of 1962, stated on August 15, 1962, that:

"I would not, therefore, put much stock in the myth that America has been improvident in past negotiations and that our negotiators have consistently gotten the worst of it.

"Such a view does more credit to our modesty than our judgment. Speaking for the Department of State, which has had the major responsibility for the actual negotiations of trade agreements, I can assure you quite categorically that this belief is held nowhere outside of the United States. It is myth that stops, so to speak, at the water's edge.

"The officials of our Government, who over the years have participated in trade agreement negotiations, have served this country well. If this were not so, we could expect to find the tariff rates of Europe today well above those of the United States—and they are not."

Sincerely,

RICHARD N. COOPER.

Mr. COOPER. As to problems of coordination with the special trade representative, that has had its ups and downs over the years. It depends as much on personalities as on structures. Let me just say that during the two periods of which I've had some personal experience in this—that is, the middle 1960's and during the last 1½ years—there have not been serious problems of coordination between the State Department and the special trade representative.

Collaboration has been very close, as you know, in both of those periods. The special trade representative was engaged in intense major international negotiations of the type that do not come along frequently.

The so-called Kennedy Round in the mid-1960's and now the Tokyo Round of trade negotiation—and my impression is that that has involved a heavy input of manpower, not only by the Executive Office, but also by State, Congress, Treasury, Agriculture, and other departments—and my impression is that the coordnation has been a satisfactory one. But in each case, there has been a very major effort in international negotiation that has been focused on trade, in my personal experience.

The CHAIRMAN. Given the poor track record of the past administration's ability to organize effectively for international negotiations under the current law, why should the Congress feel confident that future administrations would continue the cooperative and effective example that this administration has set? I'm particularly concerned that when the high public exposure created by Bermuda II and the low-fare agreements fades away, aviation bilaterals will resume their stepson role on the State Department priority list.

Mr. COOPER. Let me give you what assurance I can on the last score.

I think that we are embarked on a new policy. As I told you privately earlier, we now have 150 countries in the world. They don't all yet have their own airlines, their own airports involved in international civil aviation, but they're all moving in that direction. And I suspect that the negotiations of bilateral agreements, both new ones and provisions of existing ones, is going to be an important item on our negotiating agenda for a long period of time. And certainly, the State Department will continue to give high level attention to this issue.

On your first question, as regards the degree of cooperation among agencies, there are, of course, intangibles there. It depends partly on personalities of the individuals, partly on the direction of the President and the White House. That, however, would be true under any organization, under any formal organization. And I can only say that the present system is working, as Secretary Adams said, exceedingly well. All of the agencies involved, and not just the principal agencies,

but those that have a less central interest in civil aviation, are pulling together, and the system is working very well. And we expect it to continue to work well for at least another 6 years.

The CHAIRMAN. I am going to have to break for another vote. I'll ask you this next question so that you can be thinking about it.

Would you cite for the committee a specific example where Presidential carrier selection under section 801 was used, overturning a CAB decision, and explain the clear foreign policy reasons why one private carrier was required to be selected over the Board's proposed carrier.

You can think about that until I get back.

[Brief recess.]

The CHAIRMAN. The committee will come to order. All right, sir, you may proceed.

Mr. COOPER. The collective memory on the use of section 801 is the room is limited. But I'm reminded of two examples. One goes back to the late 1950's, I guess, in which the then President Eisenhower refused to accept a designation of an American airline to Japan on the grounds that our foreign policy relations with Japan at that time were so delicate and so sensitive in a variety of areas that to add another—that is, a third American airline—in aviation relations with Japan would have overloaded the circuit.

So, that was an exercise of 801 by President Eisenhower on foreign policy grounds.

Much more recently, of course, we've had the case last year where the President redesignated an airline on the North Atlantic run, and there Secretary Adams said the consideration was not one of what you might call overall bilateral relations with the country in question; rather, it was one of trying to push ahead along the lines that your bill reflects and which the President's statement reflects, of getting greater competition into international civil aviation.

And the President's judgment that that was a legitimate objective of foreign economic policy and it was the President's judgment that a better way to do that was to designate an additional airline on the North Atlantic run and especially a regional airline, where they tie into a new set, develop a new market in a way that hadn't been done before.

So, it was a judgment ultimately by the President, that in pursuit of his foreign economic policy objectives, an airline other than the one chosen by the CAB would better serve those objectives. No reflection on the airline chosen by the CAB, it's just that in light of his objectives, this would be a better way to accomplish that.

The CHAIRMAN. In your statement you opposed the prohibition against CAB approval of international rate-setting agreements. I have some difficulty in accepting the premise that other governments might be more restrictive than an international cartel.

At least a country which insisted on high fares would feel the market pressure of tourists selecting a destination which offered low fares. As you're currently demonstrating, we can negotiate competitive fare agreements with a number of countries.

Can you provide a specific hypothetical or actual example in which a fare-setting agreement among carriers has worked in the public interest?

Mr. COOPER. I think what my position on this is one in terms of general principles. I would be the last, in view of my views expressed in my statement on the subject to sit here and defend before you past fare-setting procedures.

On the contrary, the full thrust of our policy is to get greater competition, get lower fares for international aviation.

So, I don't want even to attempt to defend past fare-setting procedures. We may find, however, under the conditions that we're trying to establish, periods in which it may be necessary or it may be desirable to establish fares, for example, to pick up the kind of case which you alluded to earlier, which is a predatory pricing case.

What is predatory to one person may be competitive to another person or party; in this case, my response to that question went specifically to the question of Government subsidies which are reasonably well defined. But one can imagine situations in which one party considers a fare truly predatory and has various arguments on its side, and the other party doesn't agree, and they simply agree to mediate and for a trial period set a fare.

I don't want to rule that out as the proposed legislation would have done. Having given that example, neither would I want to suggest that that would be normal practice. I would regard that as being the kind of thing that would be done only in very unusual circumstances, but the proposed legislation would rule out that kind of thing, and that's what gives us unease.

The CHAIRMAN. The United States has trade agreements with other nations for various goods and services. Why does the President need specific authority over airline flights and carrier designations, when he doesn't need authority to set the price of computer hardware and designate Univac rather than IBM to market an individual company or similar examples like that?

Mr. COOPER. Civil aviation is really extraordinarily unusual in the whole panoply of international economic relations.

As you point out, there are many bilateral commercial transactions between countries, and we do not have the kinds of powers that exist and which we're proposing to retain in the area of international aviation. The distinctive feature about international civil aviation is that it really requires another government to agree that our carriers can land there.

So, that the government is intrinsically involved in the process in a way which it is not in foreign trade. In foreign trade, partly for historical reasons and partly because of the nature of the transaction, the presumption is: Unless a country imposes an embargo or something like that, the presumption is that the goods and services will flow across national boundaries, and so the regime has been a laissez-faire one, much more of a laissez-faire one. The transactors are frequently, almost always, leaving aside the Socialist countries private transactors; whereas you know in the area of international civil aviation outside the United States, most of the airlines are government owned airlines.

Governments have adopted a regime which partly for legitimate safety reasons but partly it has to be said for protective reasons have had much greater government involvement in civil aviation than in other areas.

We are trying to break down the protective aspects of it on the one hand. On the other hand we have to recognize the practical reality of our dealing with other countries, that there is heavy government involvement in this particular business, heavier than in other businesses.

The CHAIRMAN. While we're on the subject of trade, does the President have a similar authority in merchant shipping, for example, to fix rates and fix routes, trading points in merchant marine shipping?

Mr. COOPER. The question is what burden you put on the word "similar" there. There is authority under the legislation for heavier Government involvement in merchant marine shipping than in other aspects of trade. It is not so extensive as it is in civil aviation, but there is sort of a partial analog there between merchant marine shipping.

As you know, there is the practice in merchant marine, of shipping conferences, and it is a rate setting mechanism, and the FMC has to at least implicitly approve the rates that are set.

So, there is a rough analog there.

The CHAIRMAN. The President doesn't retain any authority in that area, does he?

Mr. COOPER. Well, I'd like Mr. Atwood to comment in greater detail on this. The transactions that I've been involvd in do involve Socialist countries, and there, yes, the President has been involved in setting down the conditions under which ships from Socialist countries have come into American ports.

But perhaps Mr. Atwood could expand upon the point.

Mr. ATWOOD. I think what Secretary Cooper said is basically right. As I understand the thrust of your question, by and large the President is not involved in rate-setting matters, with some exceptions. In actions that are taken, for instance, under the Trade Act to discipline a foreign country for unfair practices against American carriers, the President does have a role to play in reviewing any final action.

Also, in legislation now being considered by the Senate in the area of controlled carriers or government-owned carriers, the bill, as passed by the House and as being considered by the Senate, would give the President ultimate review authority over actions of the Federal Maritime Commission to disapprove the rates of foreign carriers, when they are owned by foreign governments.

So, that's comparable to what we face.

The CHAIRMAN. That's pretty much parallel to what the provision is that we have in our bill here, isn't it?

Mr. ATWOOD. I don't believe so.

The CHAIRMAN. He would retain some punitive power, and that's really what you're talking about there.

Mr. ATWOOD. Yes. He would retain review power over disapprovals of the foreign carrier rates. To that extent, it would be similar; yes.

The CHAIRMAN. Is the Israeli fare condition dependent upon the fact that the airlines of the other countries are not subsidized, and if so, I would say it doesn't present as much of a problem, except of course in determining whether a hidden subsidy exists with respect to a certain air carrier.

Mr. COOPER. In considering whether to go forward with this kind of fare provision, which is a novel one, we did address at some length

the problem of subsidized airlines, and that's why I said what I did earlier, that this is not a provision that we would contemplate using in every aviation agreement because of the possible problem of subsidized airlines.

We've used it judiciously where we've felt that not only was there no consequential subsidy of the airline, but that the general—if I can call it that—philosophy or policy of the country was such that subsidies to the airline were unlikely to occur in the future.

Furthermore, as I mentioned before, there is a provision in the agreement which touches on the question of subsidy—Government subsidy to the airline.

The CHAIRMAN. Well, thank you very much, Mr. Cooper. We appreciate your testimony.

While we've got Mr. Atwood here, I wonder if I could ask him how he's coming now on negotiations on discriminatory provisions in some of these foreign countries. I know you've made some progress. Could you give us an update?

Mr. ATWOOD. Well, I wish I had better news for the committee. It's an extremely difficult area. I'm finding it one of the most frustrating I've encountered because, as you mentioned, the discriminations are often very subtle, very difficult to prove conclusively, and they are ones which foreign governments are going to relinquish only under considerable pressure.

We've found particularly frustrating in our dealings with South American countries the discriminatory fuel prices which our carriers are often being forced to pay in major airports in South America. We've worked very closely with the Department of Transportation on these matters.

Some relief has recently been obtained in Japan on the matter of the user charges at Narita Airport. We're continuing to push these points in South America, but I think, in a number of cases, we're simply going to have to get tougher than we've been so far.

The CHAIRMAN. Is Australia still the highest landing fee charge country today?

Mr. ATWOOD. Yes, I believe it is.

The CHAIRMAN. Have you made any progress at all in the equitable fee arrangement there?

Mr. ATWOOD. No, not yet. It's been interwoven with the other negotiations going on with Australia, and we've had a very difficult time thus far.

The CHAIRMAN. Well, thank you very much, gentlemen. We appreciate you being here today.

[The statement follows:]

STATEMENT OF RICHARD N. COOPER, UNDER SECRETARY OF ECONOMIC AFFAIRS, DEPARTMENT OF STATE

Mr. Chairman: I am pleased to appear before the Subcommittee today to discuss with you a topic of vital interest within the United States and abroad—U.S. international aviation policy. While this has always been an important issue, it has become the subject of particular interest and considerable controversy in the past year because of the determination of the Carter Administration and a significant number of Members of Congress to provide for a more competitive international air transport environment, free from restrictions and unnecessary governmental intervention. The Congress and particularly this Sub-

committee is considering and hopefully will approve legislation which will remove these barriers to competition domestically. The Department of State welcomes, therefore, the initiative of Members of Congress in introducing legislation which seeks to extend these objectives to the international sphere. Before addressing the specifics of S. 3363, however, I would like to present my perspective of U.S. international aviation policy.

Compared with a good part of the rest of the world, the United States has always pursued a liberal aviation policy, just as it has traditionally espoused liberal international trade policies in general. But it is also evident that international aviation has become, like domestic aviation, encumbered with a number of restraints such as limitations on entry, operating restrictions, and an inflexible pricing system. These restraints may have been necessary when the airline system was in an evolutionary stage. But after over 30 years, it is questionable whether international aviation still needs the mantle of excessive governmental protection.

Following an interagency review, it was the unanimous view that increased emphasis should be placed on removing the fetters on the international aviation system. The result is the Statement of U.S. Policy for the Conduct of International Air Transportation Negotiations, which was approved by the President last week and issued yesterday.

At the root of that policy is the conviction that competition is good for all concerned: governments, airlines, the traveling public, shippers, labor, national economics and the world economy generally. This root principle under this Administration means lower fares, more liberal charter rules, expansion of direct service to more cities, as well as the more traditional US goals of freedom to designate several U.S. airlines on a given route, elimination of restrictions on capacity, and removal of discriminatory or unfair practices in international aviation.

To establish goals and implement them domestically is one thing; to achieve them internationally where the consent of other governments is necessary is quite another matter' It is well known that many governments and aviation interests abroad do not fully share our philosophy with its emphasis on competition and openness. With those that do share our policy, the conclusion of satisfactory agreements will be relatively easy. With those at the opposite extreme who are openly hostile and believe our policy approach is simply wrong we will have to be patient. We are not out to teach the world a lesson, as some would imply, but equally we will not retreat because some others do not yet share our viewpoint.

We believe, however, that there are many countries that can be persuaded that our policy is a good one. Essentially, we offer to trade opportunities rather than restrictions. This is the core of the negotiating strategy contained in the Administration's policy statement.

We have in fact been implementing that strategy in recent months, and we have successfully concluded liberal aviation agreements with a number of countries. The new agreements with the Netherlands and Israel are perhaps the most notable. Our recent charter and airfare arrangements with the United Kingdom ameliorate some of the restrictive features of Bermuda II although we continue to be concerned over British reluctance to ease the limitations on the number of airlines that may be designated. And we have concluded liberal new agreements with Belgium, Mexico, Singapore, and Yugoslavia, among others.

The final and conclusive judgment on our policy will be made where it should be, in the marketplace. While definitive data are not yet available, demand for air transport in recent months has far exceeded the airlines' projections. The dramatic proliferation of low-fare choices for the traveling public, as well as the new gateway services and new types of service, have played a key role in this resurgence of the industry. To be sure, there have been some teething troubles as airlines and the public adjust to the new demands, but we are confident that these are temporary problems.

Mr. Chairman, it is impossible to conduct a searching review of aviation policy and negotiating strategy without at the same time reexamining in equally rigorous fashion the mechanisms for formulating and implementing policy. The two go hand in hand. We have done just that—reassessing not only our policies but the way in which the Government organizes itself to develop, coordinate and implement our international aviation objectives.

The State Department has traditionally been the lead U.S. agency on international transportation negotiations. A Bureau of the Budget study in 1962–63 led President Kennedy to designate State in this role. An extensive OMB review of the question, completed in 1970, reached the same result. It concluded that "in the conduct of diplomatic activities there can be only one Secretary of State," and it recognized the close relationship between international aviation matters and our foreign relations generally. The report concluded that "State is the most appropriate agency for coordinating the various agency inputs in preparing for bilateral negotiations," and that responsibility for both policy coordination and the conduct of negotiations should remain with the Department.

As a result of a recent review directed by President Carter the relevant agencies have agreed to the following division of responsibilities and organization, which generally reaffirms earlier studies:

The Department of State continues to chair an interagency committee, which I chair, with responsibility for the coordination and development of positions, strategies, and procedures for international aviation negotiations. State provides the foreign policy guidance (including foreign economic policy) for the committee's deliberations. State also continues its role as head of interagency negotiating delegations. It coordinates and clears all contacts with communications with respect to negotiations, and provides, in coordination with the Department of Transportation and the Civil Aeronautics Board, day-to-day contact with foreign governments on aviation issues and problems.

The Department of Transportation has responsibility for developing broad transportation policies and long-range objectives for the Executive Branch with respect to its international aviation objectives. It makes recommendations to the interagency committee as to countries and issues which should be given priority attention, and it participates as a principal in the interagency committee in developing positions and strategies for particular negotiations. DOT representatives may be members of all delegations at their option.

The Civil Aeronautics Board participates as a principal in the interagency committee and on all delegations. It also consults with DOT on matters of long-range transportation policy and objectives. The Board continues to develop economic regulatory policies with respect to international airlines, to make recommendations related to the implementation of international air transport agreements, and to contribute staff support in preparation for negotiations.

Other departments and agencies, such as the Departments of Justice and Commerce, may participate in the discussions of the interagency committee and on matters of long-range policy as they feel the need arises to make their views known. They may participate as members of delegations as required. The current system is, in our view and, I believe those of other agencies, working well precisely because all relevant agencies and departments have had an opportunity for input to reach a consensus position.

Let me turn now to S. 3363. The bill is a welcome means of focusing discussion on the key issues facing us in international aviation. It is clear that the general thrust of your bill Mr. Chairman, coincides with the President's policy in its emphasis on greater competition, increases services and innovative fares.

Section 2 sets forth a series of goals which the CAB would consider as in the public interest in carrying out its duties with respect to foreign air transportation. These goals are fully consistent with and supportive of the President's aims and objectives in international aviation. The Department supports the strong thrust toward competition in fares and services and prevention of anticompetitive or predatory practices emphasized in this section. Although domestic route awards are not normally of direct concern to the State Department, we also support sub-section (b)(5) on the need to provide domestic route authority to airlines engaged extensively in international operations. Domestic routes would strengthen the competitive position of these airlines in international services, provide them with the operational flexibility to conduct efficient and profitable operations, and enhance the travel options of U.S. citizens.

Subsection (b)(4) requires some clarification. The United States should extend expedited treatment to all airlines engaged in international operations in line with our overall policy of fostering a more open, less restrictive system, with a minimum of impediments, administrative or otherwise. At the same time, we would of course grant to foreign airlines only those opportunities negotiated in bilateral agreements or otherwise extended in exchange for opportunities granted to our own airlines.

Sections 3, 4 and 6 raise important questions regarding the role of charter and scheduled air services and the relationships between supplemental and scheduled airlines.

Section 3 would permit airlines to market directly to the public a portion of their charter flights. Although it may prove difficult to negotiate full acceptance of this concept with some foreign governments, the Department supports the concept of direct sale of charter transportation to the public. However, rather than mandate the manner and extent to which this must be done, we believe the Board should be given the discretion to use this authority as it believes best in particular circumstances. In this connection the Department also supports in principle CAB discretionary authority to sanction part charters on scheduled service.

Section 4 would require the Board to give scheduled international routes to major U.S. supplemental carriers unless it can be proven that such awards would be contrary to the public convenience and necessity. The Department supports liberal Board treatment of supplemental airlines' requests for scheduled service authority, and we should be certain the Board has full legal authority to certificate such carriers. However, the Department could not support this particular provision since it would not require supplemental airlines to meet the public convenience and necessity standard specified in the Act on the same basis as scheduled airlines. The Department sees no reason why the PC&N standard should not be applied to scheduled and supplemental carriers on the same liberal basis.

The Department has serious reservations above Section 6, which would relax the existing legal standards for judging mergers between scheduled and supplemental airlines. As the Chairman is no doubt aware, there has been a rash of proposed or speculated airline mergers in recent weeks. Each airline merger—whether between scheduled carriers or between a scheduled and a supplemental carrier—raises the possibility of anticompetitive consequences, and each merger should be judged on its own facts. We do not agree that a scheduled/supplemental merger should be viewed as presumptively lawful, particularly now that supplemental carriers are able to operate under more liberal charter rules and are approaching, we hope, the right to sell individual tickets and to conduct scheduled operations. It must also be remembered that some scheduled carriers have extensive charter operations. We submit that the existing legal standards give the Board and the courts the correct degree of flexibility in analyzing the complexities of airline mergers.

The Department supports Section 5, which would facilitate the granting of Section 402 permits to airlines designated by foreign governments under bilateral agreements. This would be a useful step consistent with our desire to facilitate international air travel and eliminate procedural and other impediments. However, there is a technical deficiency in the text related to the ownership and control of carriers. Our bilateral agreements provide that permit authority may be withheld if a foreign carrier is not substantially owned and effectively controlled by the country designating the airline or its nationals. This deficiency can be easily remedied by adding the phrase "and qualifies pursuant to such agreement" before the words "or that such transportation will be in the public interest."

Section 7 would prohibit the Board from approving inter-carrier agreements on the subjects of capacity or fares (except for joint fares). As a result, antitrust immunity for such agreements would become unavailable, and we would expect them to disappear in international markets touching the United States.

As the Chairman is aware, the Board is now considering whether to continue to permit airlines serving the United States to participate in the IATA traffic conference machinery. Foreign governments and parties have been invited to submit their views for Board consideration. Since this review is now underway and should result in a careful analysis of the issues involved, legislation at this time would be premature.

The Department believes it is important to have pricing competition in international air transport and, therefore, applauds the Board's initiative. The consequences of eliminating IATA's rate-setting function should be carefully considered. Several foreign governments have contended that, without this function, governments will have to step in and negotiate rates themselves, and certainly at present governments lack the necessary expertise and knowledge of the marketplace. However, under the right conditions, eliminating IATA rate setting would

result in less, rather than more, government interference in the industry. We are attempting to negotiate new fares articles such as that just concluded with Israel which will give individual airlines more freedom in introducing fares and which should relieve governments in most cases of having to agree on rates in the event of disputes. Meanwhile, we should allow the Board to complete a thorough-going investigation of this issue without premature legislative action.

U.S. aviation policy has opposed capacity limitation agreements among airlines consistently over the past 30 years. But in some exceptional cases such agreements may be necessary for emergency reasons or because other alternatives are less desirable in the public interest. For example, cases arise where airport capacity is not sufficient to meet airline demands. While other solutions to this problem may be preferable in most cases, the possibility of CAB-sanctioned agreements among airlines to share this scarce resource should not be legislatively eliminated. For these reasons the Department would be opposed to a no-exceptions prohibition on capacity agreements among airlines, although it agrees that they should be considered and approved only in exceptional cases.

Section 8 of S. 3363 would limit the President's Section 801(a) authority to foreign air carriers. The Department does not believe this limitation on the President's authority is warranted. The question of U.S. carrier routes often involves foreign policy considerations. The Department believes that the current Section 801(a) authority is a necessary and essential attribute of the President's foreign policy powers under the Constitution. In this connection, we do not consider that foreign policy encompasses only our political relations with other countries. Our international aviation policy is part of U.S. foreign policy. The President should, therefore, have authority to disapprove Board recommendation concerning international routes for U.S. carriers which he concludes are inconsistent with his aviation policy.

Section 8 would also limit the President's 801(b) authority to rates for foreign air transportaion by foreign air carriers. The Department opposes such a provision for the same reason indicated above with regard to Section 801(a). Moreover, we see no reason why U.S. airline fares and rates should be treated differently in this regard from fares and rates proposed by foreign airlines. The former could conceivably be just as objectionable as the latter.

Section 9 would establish an Office of International Aviation Negotiations in the White House. As I pointed out earlier in my statement, the existing mechanism for dealing with international aviation negotiations is, in our judgment, responsive to our needs and has been successful in a series of recent negotiations in which we have made major breakthroughs in achieving U.S. objectives in international aviation. The President, as I indicated, recently reviewed the interagency mechanism and concluded that no major changes were warranted. Furthermore, he does not want to add new formal responsibilities to the White House unless it is absolutely essential.

I think it is fair to say that most of the laudable features of Section 9 are reflected in the present administrative procedures. First, in light of President Carter's recently announced reaffirmation of the existing State-chaired interagency structure, some of the previous confusion about leadership within the US on international aviation has been dissipated. Further, the Aviation Policy Committee reflected in the section already exists, as I previously described. The International Aviation Advisory Council is also reflected in our present system, coordinated by the CAB, for obtaining broad public input prior to formulating our negotiating positions. We are not suggesting that our negotiating procedures are perfect; they undergo evolution as we learn new techniques and uncover new problems. But the present structure, which operates under close supervision from and with the support of the White House, gives us the needed flexibility to improve. We see considerable dangers in locking any system into place by statute.

Finally, we think there would be dangers in shifting the focus of negotiating responsibility from the State Department to the White House. The negotiating load is heavy; at one point this summer there were four bilateral negotiations being conducted simultaneously. The proposed White House office could, under such circumstances, not be a small one, and there is obvious reason to be cautious about such a major enlargement of the White House staff. Further, the line between negotiations and other aspects of international aviation—such as implementation of agreements and dealing with periodic aviation problems—is a narrow one, and this is one of the reasons that President Carter recently decided that State should retain the Central coordinating role.

Section 9 also spells out a list of eight negotiating objectives. In general, we support these objectives; in fact they are similar to those set forth in the recent policy statement approved by the President. However, we believe it would be preferable not to establish such objectives by legislation. The intent of Congress would be amply established by Section 2 of the bill. How these goals are implemented in the negotiating process should, in our view, be decided through the normal recourse of policy statements (such as that just approved by the President), interagency coordination, consultations with the Congress, and inputs from industry, labor and the traveling public.

In sum, the Department supports the general aims reflected in this bill, but has difficulties or reservations with certain provisions. We also believe that it would be desirable to amend certain provisions of the Federal Aviation Act to resolve some persistent difficulties the United States has had over the years in dealing with foreign air carriers. In particular we would support the expansion of Section 416 of the Act to permit the CAB to grant exemption authority to foreign air carriers.

I also urge another change in the Federal Aviation Act. Section 1117 of the Act requires that official U.S. travelers use U.S. airlines in flights to or from the United States and between points outside the United States when U.S. airline service is available. The Department believes that the time has come to relax this provision, for three reasons: First, it was enacted in 1974 at a time when U.S. international airlines were in very difficult financial straits dut to a recession and the sudden fourfold increase in oil prices at that time. That period is happily behind us, and the industry is now enjoying a strong resurgence. Secondly, this provision has resulted in unreasonable limitations on travel choices and severe personal hardships in many cases. The result has often been greater expense to the U.S. Government and greater burdens upon government employees than if more natural routings were permitted. In the end, our taxpayers end up bearing the cost of this inefficiency. Finally, a relaxation to permit greater use of foreign airlines abroad would be more consistent with one of the major aims of our aviation policy, that is, to foster a more open and less restrictive system.

Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is Paul Ignatius, president of the Air Transport Association.

STATEMENT OF PAUL R. IGNATIUS, PRESIDENT, AIR TRANSPORT ASSOCIATION OF AMERICA; ACCOMPANIED BY NORMAN PHILION, EXECUTIVE VICE PRESIDENT; AND DONALD COMLISH, VICE PRESIDENT, INTERNATIONAL AFFAIRS

Mr. IGNATIUS. Good morning, Mr. Chairman. In the interest of the committee's time, I propose to brief my statement and not read it in its entirety, but I would request that the entire statement be made part of the record.

The CHAIRMAN. We will make it part of the record in full and you may summarize as you please.

Mr. IGNATIUS. Thank you. On my right is Don Comlish, who is vice president for international affairs of ATA, and on my left is Norm Philion, who is executive vice president of ATA, and who at an earlier point served as a vice president for international affairs.

Mr. Chairman, we support efforts to promote competition in international transportation. We look to the Congress for a resolution of important policy questions in order to assure that the growing foreign air commerce needs of the Nation, including a strong and healthy U.S. international air transport system, are met.

You accompanied your legislation with a statement in which you characterized the bill as a means to restructure and redirect U.S. international negotiating policy. You said further, as you have often said

on similar occasions, that the bill contains ideas for consideration during the hearings, that you do not have preconceptions against any changes in portions of the bill, and that you welcome constructive suggestions.

Our testimony has been developed in response to this spirit of inquiry and we hope that it will be helpful to the committee. The bill's main purpose is comprehensive in nature—to establish policy direction for the conduct of international negotiations and to insure a satisfactory and responsive organizational structure.

While we will suggest alternatives to some of the specific measures in the bill that we think merit your consideration, we nevertheless hope that our alternative suggestions will not obscure our principal reaction, which is one of appreciation for your effort to deal with longstanding questions in international aviation negotiations and to seek equitable solutions in the public and in the national interest.

Now, in some cases our comments will be of a general character, because the industry is still examining some specific provisions in the bill. Most of our comments are based on agreements that our member carriers have reached in the discussions that we have held with them prior to this hearing.

And I would note parenthetically, Mr. Chairman, and perhaps of interest to you, that the degree of agreement as we approach this particular hearing on legislation affecting international aviation policy is greater than it was at the time of the hearings when the discussion of domestic aviation policy was considered.

The CHAIRMAN. I hope so.

Mr. IGNATIUS. I think you will find that the case. There are still some differences, however. One of them is on section 801, the question you raised with the prior witnesses. We also have one suggestion for consideration in your legislation that I have included in an appendix to my statement and will address briefly as I complete my comments.

With regard to section 2 of your bill, the policy issues, our membership is in general agreement with the proposed policy statement. We have one or two suggestions that we would like to offer.

Our first relates to subsection 5 of the proposal. We think this can be strengthened to assure the basic objective of the legislation, which is to promote competition by amending the opening language of subsection 5 as follows:

"The need to assure that scheduled and supplemental air carriers have the opportunity to operate all forms of domestic and international authority," and the balance of the quote on page 3 is from your present subsection 5.

We think this language would help assure that all classes of certificated air carriers, regardless of their present role, would have the same opportunities to expand or change that role. We think anything short of this might be considered discriminatory. More important, we think such a policy statement would remove any necessity for a special effort to assist any particular carrier, or class of carriers, such as is suggested in sections 3 and 4 of the bill.

We also would like to suggest, Mr. Chairman, that you consider for inclusion in this bill language from the policy statement in your domestic regulatory reform bill, S. 2493. I've quoted that language on page 4 of my statement.

We'd like to see some of that language in the present policy statement, particularly with regard to an opportunity for efficient and well-managed air carriers to earn a fair and reasonable return on investment in a competitive environment in order to meet the present and future needs of the public, et cetera.

We'd ask you to give that kind of language consideration in your policy statement.

Finally, we would support the concept in subsection 4 which grants expedited treatment of foreign air carriers, but we would not like to see the legislation barring evidentiary hearings when the need for them in the public interest may be present.

Turning now to proposed increased competitive opportunities for charter air carriers, section 3 would allow sales of charter trips by direct carriers to the general public and would provide scheduled route authority for supplemental airlines, and a third section would assist supplemental air carriers to consolidate or merge with scheduled air carriers.

I suggested earlier, Mr. Chairman, that the section of the policy statement might be amended to provide opportunity for all carriers, including supplemental air carriers, for both domestic and international route authority. We think this is a desirable way of managing the transitions that may be desired, and if this were the case, we don't think that you need go further than that.

With regard to section 4 of your bill, we have a question about whether it is useful in legislation to designate a specific number of routes for any particular airline or group of airlines, whether you want to embody this in legislation. With regard to the supplementals and the routes they operate and the applications that they are making for the operation of new routes or types of services, there are matters pending now before the Board. If they are granted or are interested in acquiring scheduled authority, we think they should be required to meet the same public convenience and necessity tests that exist for presently scheduled airlines.

On the matter of mergers, we think the language in section 6 of your bill, which addresses mergers between supplemental and scheduled carriers, is too narrow. That is to say, if it is the intent of Congress to encourage mergers, then we think that the language might be broader to permit mergers and consolidations of air carriers of all types that are not unlawful or are found to be in the public interest, and therefore we would prefer to see broader language than section 6 now contains.

Your bill addresses foreign air carrier permits. I have said earlier that we think that expedited treatment for carriers that have entered into less restrictive agreements is all right, provided that we do not forego the opportunity as needed for evidentiary hearings.

With regard to less restrictive agreements, we favor them, but we believe they ought to be balanced.

On intercarrier agreements—an important section of your bill—the proposed policy declaration is founded on the concept of a competitive international air transport system. That being the case, the kinds of agreements that carriers may enter into are addressed in the policy section in an appropriate way.

In view of this, we wonder if section 412 of the Federal Aviation Act needs to be changed.

With respect to capacity agreements, the scheduled carriers agree with the intent of the legislation, and they would prefer that there not be capacity agreements, but there have been, and we can visualize in the future extraordinary or unanticipated circumstances where a bar against a capacity agreement in legislation may not serve the best interests of the United States. Therefore, we would ask you to look at whether you want an absolute prohibition against capacity agreements, or whether you might not want to include some provision for them to deal with extraordinary circumstances that might arise.

With regard to pricing agreements, this is a more difficult kind of question, we believe, because the alternatives to intercarrier agreements are not without significant problems of their own. If the present internationl machinery were abolished, how would international rates and fares then be established No one suggests that the United States or any other nation for that matter should set rates for the carriers of all nations. Therefore, unilateral action is not an acceptable alternative.

A second method might be for governments to agree through bilateral or multilateral agreements on fares or rates. We question whether this would be a desirable alternative or preferable to the present circumstances.

The third alternative would be for each airline to establish its own rates. Recently, some U.S. bilateral agreements have been constructed to allow such a disposition of the matter, but we do not believe that the United States will be able to persuade all of its bilateral partners to adopt hands-off agreements on the establishment of airline fares.

In summary then, we would urge the committee not to prohibit carrier-to-carrier agreements on rates or fares. We believe that governments and airlines should strive to make the present mechanisms more acceptable and to make them operate within the basic competitive ideals set out in the U.S. policies.

In short, we believe the better course of action at the present time is to keep open any options that the United States may have in the area of pricing.

I turn now, Mr. Chairman, to section 9 of your legislation which focuses on a problem which has troubled industry and Government for a number of years. namely, the problem of how the U.S. Government can best marshal its forces to deal with international negotiations.

The question of where to place responsibility has, as you know, recently been addressed by the administration, and that Presidential review retains the present consensus approach but sets forth more clearly the divisions of responsibility, of which you are aware and which previous witnesses have addressed.

It appears so far that the arrangements have produced better working relationships, as you note in your statement accompanying the legislation.

The proposal in your bill is intended to assure that the cooperative partnership of the agencies will continue. In other words, you want

this improved circumstance to prevail in the future. But the proposal may go further than this, as we read it, by centralizing responsibility within the White House, apparently adding another layer to Government without necessarily reducing the work force or involvement of individual agencies as they exist today.

The question of where and how to place responsibility within the U.S. Government is clearly an important subject, and our carriers think more time is needed for further study by the airline industry as a whole and perhaps others who are addressing this question.

This section of your legislation also provides for an international aviation advisory council.

We think it's useful to consider having a council, whether or not the Office of Aviation Negotiations is established, but the establishment of such a council should not alter the continued right of the carriers to be represented on U.S. delegations where their interests are being negotiated. This is, of course, a right which the Senate has long recognized.

The section on international negotiations sets out goals for international aviation policy. We think these goals will be very helpful to representatives of the United States in negotiating with foreign countries. We think they would be helpful to all of the individual agencies that are involved one way or the other.

Our preliminary review indicates some possibility of differences among our carriers, but we like a lot of what is included in those goals.

Reference has earlier been made by you, and I think in response by Secretary Adams, to what I think is subsection 7 of one of those goals on the permanency and the linkage of some of these matters. That's a particular goal whose importance we recognize and whose value we stress.

Mr. Chairman, this completes my summary statement.

I appreciate the opportunity to testify.

I would draw your attention in closing to the appendix to my statement which has to do with the confidentiality of documents furnished to our Government in the course of international negotiations. I've set forth in some detail our views on that problem and hope that they will be considered as you proceed further with the hearings and your determination as to the final outcome of this bill.

Thank you.

The CHAIRMAN. Thank you.

I'm just trying to review your attachment there to see what the point is. Do you want to comment on that at all?

Mr. IGNATIUS. Yes, sir.

As I point out in the attachment, for 39 years the U.S. scheduled air carriers on a voluntary basis have provided the U.S. Government with statistics on the origin and destination of their passengers. These have been statistics that have been crucial in awarding routes by the Civil Aeronautics Board and in various forecasting and scheduling of airline operations in order to serve the public in the best possible way.

The CAB under the former provisions of section 1104 of the act routinely made these statistics restricted for use by U.S. air carriers and U.S. Government agencies. In particular, the CAB refused to release the statistics for foreign airlines and foreign governments on the

ground that foreign governments' airlines did not furnish similar systems statistics to the U.S. Government or U.S. carriers.

With the passage of the Sunshine law, section 1104 of the act could no longer be relied upon. These, in short, are statistics of important competitive value, and the conflict, if there is one, is with the aims of the Sunshine law, on the one hand and the confidentiality of information to be held within U.S. carriers and within the U.S. Government, on the other.

The CHAIRMAN. You warn of all the problems that could result if the present international ratemaking machinery were abolished. Yet most of the relevant experience that we have about what the system would look like is the situation that's existed for the past year on the North Atlantic. Since we've had an open rates environment, passenger fares have dropped dramatically. Traffic has increased, and the carriers are all doing better than ever.

Would you care to comment on that?

Mr. IGNATIUS. I say in my statement that we would prefer that the carriers set their own fares, but recognizing the nature of international air transportation, the number of countries involved, the many considerations involved, we don't think that you should preclude one means of arriving at fares; namely, multilateral ratemaking by carriers, because the alternatives to that may be less satisfactory and because the establishment of fares by individual carriers may not prevail in all instances.

The CHAIRMAN. In your comments on section 3 you apparently see that permitting air carriers to sell limited numbers of charter tickets directly to the public is a handout to the supplemental carriers. To me, this proposal is merely one which would eliminate to some degree an artificial limitation which has been placed upon the ability of airlines to market a specific product; namely, charter transportation.

Now, this is a nondiscriminatory provision which would benefit ATA carriers as well as the supplementals when they wish to perform charter transportation. I think you have to provide a better explanation as to how your proposed revision of the policy statement would be a reasonable substitute for this proposal.

Mr. IGNATIUS. Let me attempt to do so.

First, I don't regard it as a handout to the supplemental carriers, because, as you point out, it would be a right that would be conferred upon scheduled carriers to sell charter transportation in the same way that it would permit supplemental carriers to.

The point that I would make, Mr. Chairman, is that if you want to preserve the distinction between charter and scheduled transportation, then almost the last vestige of that distinction is in the question of direct sales to the public.

We believe that if a supplemental airline sells charter seats directly, that, in effect, it is the equivalent of selling a seat on a scheduled flight. It's the essential equivalent of that. And you would then erase virtually the last remaining distinction.

Therefore, we raise a question as to whether you want to do this. If the Congress decides that it wants to, then we would hope that the legislation would also permit scheduled carriers to include part charters within scheduled flights. But essentially, the point we want to

make is one of maintaining some distinction between charter and scheduled transportation.

The suggestion of amending the policy section to give all carriers an opportunity to offer all types of services addresses much of this, but I would agree that it does not go the final step, because it may, at least in some interpretations of it, not provide for the direct selling, but lest there be no misunderstanding between you on the one hand and this witness on the other, we are not advocating in our testimony that there be direct sale of charter trips to the public in the phased way that you propose in the bill.

I agree that this would be something that would be available to the scheduled carriers as well as the chartered carriers, but we have no position that I can offer you in favor of this.

The CHAIRMAN. If section 4, which is essentially an international automatic market entry provision, was made applicable to all U.S. carriers and not just supplementals, would it be acceptable to you?

Mr. IGNATIUS. I haven't examined that with our carriers, so that I can't give you an explicit answer, but I can say that to establish in law a specific number of routes available to any particular class of carriers, whether they be scheduled or supplemental, is something that we question. We don't think—we think it's better to deal with matters of this kind through policy statements designed to promote competition rather than explicit grants in this matter.

The CHAIRMAN. Your comments with regard to the international negotiations mechanism within the Government are well taken. I am certainly concerned about adding more bureaucracy. But I wonder just how much the current successful system is due to personalities rather than structure. That's the thing that really gives me a problem.

If I were sure that the present people would be there, or someone very comparable to them far out in the future, then I would be satisfied. But I think, in looking back on history, we see quite a different picture, and I'm trying to talk in terms of some permanent solution that would perhaps insure the maintenance of the existing working relationship.

Mr. IGNATIUS. I'd like to comment on that.

When Secretary Adams first came into office I had an opportunity, along with other representatives of the aviation industry, to meet with him, and one of the points on my agenda for discussion with him was the question of international air negotiations, and I said I thought we could do better than we had, and suggested that very early in his term of office that he meet with Secretary Vance and talk this out to see if this couldn't be improved.

You've pointed out that you think it has improved. We believe that it has improved. In part, I think this has something to do with the quality and dedication of the people, but we've had good people before. I would venture a speculation that there's another factor in addition that may have nothing to do with structures and also may not have to do with personalities of individuals. It may be that there is more general agreement on policy today than there was several years ago. It seems to me there's been an evolving policy, and it's easier to have a coordinated position if the parties involved are more in agreement on the policy. And while there are still differences with regard

to policy within the Government and certainly among the airlines that I represent, I believe there has been an evolving policy and an increased area of agreement, and I would venture that that might be one of the reasons why it's working better, in addition to the fact that you've got good people and they are dedicated to doing a good job.

The CHAIRMAN. Yesterday the President released the long awaited statement on international aviation policy. As you know, I was very supportive of your efforts to receive a hearing on that statement before it was finalized. I'd like to ask you if you thing you received an adequate hearing, and does ATA have a position on the statement?

Mr. IGNATIUS. We furnished prior to the final issuance of the policy, comments to Secretary Adams on June 27, 1978, in which we applauded many of the things in the policy but made one or two suggestions for change.

There were times when I thought perhaps we weren't being given adequate opportunity to comment, but on balance—and I'm going to ask Mr. Comlish to speak on this, if that's all right, because he handled a lot of this—I think that one way or the other, ATA, as an organization, the carriers as individual companies, had an opportunity to comment. There were times when we weren't so sure that our comments were being listened to. But so far as the policy is concerned, generally we think it's pretty good.

I personally—and I think our carriers—would like to see the policy a little bit tougher with regard to one or two areas. For example, I would like to see somewhat stronger language in there on the importance to the United States of the U.S. flag carrier system. I think that's a national asset. I think it involves a projection of the United States abroad. The policy makes some reference to these matters in terms of the national interest, the defense interest, but I'd like to see that language a little stronger.

Second, I wish the policy had contained some of the language that you have in I believe it's subsection 7 of your policy goals included in your bill with regard to the permanency of some of these matters being negotiated and the linkage of them. That, we thought, was splendid language, and we would have liked to have seen that type of language included in the policy.

But, generally, we thought it was all right, save for those two comments that I made.

The CHAIRMAN. Did you have any further comments?

Mr. COMLISH. A number of carriers individually responded, as did ATA, to the Secretary of Transportation in June. It took a long time to get to that point. The administration started on this policy statement last year, and we did eventually comment.

The CHAIRMAN. But you are satisfied with the opportunity for input that you had?

Mr. COMLISH. Yes.

The CHAIRMAN. Your statement on section 801 is conspicuous by its absence. I just wonder if from that I can assume that it is one of the areas that the various carriers were in disagreement, that you haven't had the opportunity to consider.

Mr. IGNATIUS. Your assumption is essentially correct. Some years ago when we looked at this matter in another connection, there were disagreements among the carriers with regard to 801. We don't have

any position on it now. The carriers are working on it, thinking about it. I don't know if they'll come into agreement. There are some differences.

Some of the carriers will be testifying at your hearing or filing statements, and perhaps they will address this from their individual purviews when they do. But you're correct, we do not have a position.

The CHAIRMAN. Are you presently considering whether ATA will or will not develop a position on it?

Mr. IGNATIUS. We have had several meetings in connection with the bill and developing the testimony that I gave today, and at the final meeting, where we reached agreement and set forth the areas of disagreement, 801 was one of the subjects, and it was clear that there was not agreement on it.

We are continuing to work on some of the other areas of the bill where we think more time is needed. This would include, for example, the question of the office of international aviation negotiations. On 801 we're prepared to continue to work on that. We have a committee that can and will continue to address it, but I'm not sure they'll come into agreement, Mr. Chairman.

The CHAIRMAN. Now, I assume that the carriers are also divided on the question of open skies? Would it be fair to assume that the carriers that have been in the international market for years don't like that policy, but that the carriers that want to expand into a new international markets think it's a pretty good idea?

Mr. IGNATIUS. I think that that would address part of the question. The open skies question, I think we would view as one that needs to be looked at in particular circumstances. We've talked in my statement and elsewhere about balance, achieving balance in negotiations. And in one instance an open skies policy may provide opportunities for another country and oblige the United States to make concessions that might not be balanced by rights or opportunities that we would acquire in the other country of equal value.

So that in part, I think there should be a case by case aspect to the open skies question as opposed to an absolute view of it.

Second, with regard to a specific instance, there may well be competitive differences among the carriers, and I suspect, for example, in the application of this concept in the German negotiations, there may well be differences among the carriers that reflect competitive differences. They are a competitive group and they'll continue to be.

The CHAIRMAN. Does the ATA have any position on the rate provisions in the Israeli agreement which requires both countries to disapprove rates or fares before they can be overturned?

Mr. IGNATIUS. The carriers who have the most direct interest in it, I would say, at the moment have a difference of opinion about it. In part it's very new. Some of the provisions of it don't even take effect until 1979, and there's a difference of view as to how they will work out.

There's no ATA position as such on it.

The CHAIRMAN. IATA is currently in the process of making a substantial revision of its structure. Under the new system, carriers will have the option of not participating in ratemaking conferences. We've been led to believe that many U.S. carriers will choose that option.

Can you advise us on that?

Mr. IGNATIUS. I can't tell you how they will finally come out on that. There were at least two of our carriers that were represented, as I recall, on the special five- or six-man committee that looked at all of this, and the general meeting of IATA will be coming up in November, at which time the final determination will be made, as I understand it.

I can't advise you, because I simply don't know what their final views will be.

The CHAIRMAN. Well, thank you very much, gentlemen. We appreciate you being here before the committee.

[The statement follows:]

STATEMENT OF PAUL R. IGNATIUS, PRESIDENT, AIR TRANSPORT ASSOCIATION OF AMERICA

My name is Paul R. Ignatius. I am President of the Air Transport Association of America which represents virtually all of the scheduled airlines of the United States. We appreciate the opportunity to offer comments on S. 3363, the proposed International Air Transportation Competition Act of 1978, which addresses matters of deep interest to our member carriers, 19 of whom provide regular scheduled service between the United States and numerous foreign countries.

We support efforts to promote competition in international air transportation, and look to the Congress for a resolution of important policy questions in order to assure that the growing foreign air commerce needs of the nation, including a strong and healthy U.S. international air transport system, are met.

In your statement introducing the legislation, Mr. Chairman, you characterized the bill as a means of restructure and redirect U.S. international negotiating policy. You said further, as you have so often said on similar occasions, that the bill contains ideas for consideration during the hearings, that you do not have preconceptions against any changes in portions of the bill, and that you welcome constructive suggestions. Our testimony has been developed in response to this spirit of inquiry.

It is important to note at the outset that the bill's main purpose is comprehensive in nature—to establish policy direction for the conduct of international negotiations, and to insure a satisfactory and responsive organizational structure. While we will suggest alternatives to some of the specific measures in the bill that we believe might attain these purposes more effectively, we hope our alternative suggestions will not obscure our principal reaction which is one of appreciation for your effort to deal with long-standing problems in international aviation negotiations and to seek equitable solutions in the public and national interest.

As the Committee will appreciate, these policy questions involve highly complex and frequently controversial issues. We intend to offer comments on those provisions of the bill where there is agreement among our membership. In some cases, our comments will be of a general character because the industry is still examining some specific provisions of the bill in view of their great importance. We may wish to submit for the record later more detailed comments when this work is completed. We also request that you consider another international problem which is not addressed in the proposed legislation.

POLICY ISSUES

Section 2 of S. 3363 would amend Section 102 of the Federal Aviation Act by establishing a new declaration of policy specifically relating to international air transportation.

Our membership is in general agreement with the proposed policy statement, but would like to offer suggestions for strengthening it in two areas, and raise a note of caution about one of the policy issues contained in the proposal.

Our first suggestion relates to Subsection (5) of the proposal. We believe this subsection can be considerably strengthened to assure meeting the basic objective of this legislation—to promote competition—since the underlying policy statement influences all other provisions of the statute. We would, therefore, suggest that Subsection (5) be amended to read as follows: "*The need to assure that scheduled and supplemental air carriers have the opportunity to operate all*

forms of domestic and international authority in order to provide a better integrated air transportation system, prevent waste of available capacity, and strengthen the competitive position of the United States international air carriers." (suggested revised language in italic)

If adopted, this language would help assure that all classes of certificated air carriers, regardless of their present role, would have the same opportunity to expand or change that role. We believe anything short of this might be considered discriminatory. We urge the Committee to give our suggestion favorable consideration. More importantly, such a policy statement would remove any necessity for a special effort to assist any particular carrier or class of carriers such as is suggested in Sections 3 and 4 of the bill.

We also suggest that the proposed policy declaration be amended to incorporate an essential provision contained in the domestic policy statement of the Regulatory Reform Bill (S. 2493) enacted by the Senate in April. That legislation provides that ". . . the Board shall consider the following, among other things, as being in the public interest, and consistent with the public convenience and necessity :"

"The development and maintenance of an efficient and reliable air transportation system which provides an opportunity for efficient and well-managed air carriers to earn a fair and reasonable return on investment in a competitive environment in order to meet the present and future needs of the public, the foreign and domestic commerce of the United States, the Postal Service, and the national defense."

Finally, we would support the concept in subsection (4) which grants expedited treatment to foreign air carriers from nations with whom the United States has entered into the least restrictive air transportation agreements, provided that the option for evidentiary hearings is preserved and that the public interest test is continued. We favor less restrictive agreements so long as the United States has the objective of achieving agreements which are not only expansive but also well balanced and give assurance that fair market conditions will prevail.

PROPOSED INCREASED COMPETITIVE OPPORTUNITIES FOR CHARTER AIR CARRIERS

Two sections of the bill are intended to provide enlarged competitive opportunities for charter air carriers. These are Section 3, which would allow sales of charter [1] trips by direct carriers to the general public and Section 4, which would provide scheduled route authority for supplemental airlines. In addition, a third section is designed to assist supplemental air carriers to consolidate or merge with scheduled air carriers.

We suggested earlier that the policy section of the proposed legislation could be considerably strengthened to allow all air carriers, including supplemental air carriers, opportunities for both domestic and international route authority. We think that this is the most desirable way of managing the transitions that may be desired. As to Section 4, we do not think a definite number of routes for any particular airline or group of airlines should be enshrined in legislation.

We note that supplemental air carriers are already involved as applicants in several route cases which are being processed on an expedited basis. Secondly, the proposal in S. 3363 for entry authority for the supplementals is very much broader than the entry provisions found in the pending domestic regulatory reform legislation. Finally, we believe that if the supplementals are to get routes and operate as scheduled airlines, there is no reason why they shouldn't meet the same public convenience and necessity tests that are met by the existing scheduled airlines. Moreover, if our suggested amendment to subsection (5) of the proposed policy declaration is adopted, as we hope it will be, it would eliminate the need for Section 3 which could be deleted. If it is not, then Section 3 could be revised to provide authority for "part-charters" of passengers. Such a revision would allow scheduled carriers to fill otherwise unused capacity on scheduled flights with charter traffic, thereby providing improved efficiency and energy savings. In any event, we believe that individual airlines will have different views on the policy contained in Section 2, subparagraph 5 if the concept found in Section 3 remains.

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[1] Although the term "charter trips" is used, which would include cargo, we assume the intent is directed toward passengers.

With regard to Section 6 on mergers and consolidations of air carriers, we believe they should be permitted unless they are found to be unlawful or not in the public interest. Therefore, we would prefer to see broader language than Section 6 now contains.

FOREIGN AIR CARRIER PERMITS

As noted earlier, we favor a policy of less restrictive agreements so long as they are balanced. We also favor the expedited processing of permits provided that we preserve the option for evidentiary hearings so that the public interest tests of Section 102 can be assured.

Caution must be exercised in carrying out a policy of expedited treatment in order to avoid unnecessary discrimination against countries which for one reason or another do not have agreements with the United States, or against countries which are unwilling to enter into less restrictive agreements. Our reason in both cases is to avoid the retaliation that might otherwise occur against U.S. airlines operating or seeking to operate in countries of the type mentioned.

A further caution is necessary. U.S. carriers have traditionally been able to participate in public hearings at the Civil Aeronautics Board to bring out facts not apparent when the bilateral agreement was negotiated. For example, on occasion carriers have been able to show that reciprocity is not, in fact, being offered, or that a foreign carriers is not, in fact, owned by nationals of the flag which the carrier purports to represent. On other occasions, evidence of unfair or discriminatory practices in a foreign county would not have been disclosed without a public hearing.

For these reasons, while we favor less restrictive agreements, we believe that the language in Section 5 of the bill should be revised so as to preserve the option for holding evidentiary hearings where they appear to be necessary.

INTERCARRIER AGREEMENTS

The proposed policy declaration is founded on the concept of a competitive international air transport system. That being the case, the kinds of agreements the carriers may enter into are addressed in the policy section in an appropriate way. In view of this we wonder why Section 412 of the Federal Aviation Act needs to be changed.

With respect to capacity agreements, the scheduled carriers agree with the intent of the legislation, and they would prefer that there not be capacity agreements. However, circumstances may arise, as they have in the past, that pose extraordinary and unanticipated problems for governments and carriers. A capacity agreement may be the only way for U.S. carriers to gain or continue access to a foreign market. It is our feeling that an absolute prohibition on capacity agreements is not needed and is undesirable.

The question of pricing agreements is more difficult because the alternatives to intercarrier agreements are not without significant problems of their own. If the present international machinery were abolished, how would international rates and fares be established? No one would suggest that the United States, or any other nation, should set rates for the carriers of all nations. Therefore, unilateral action is not an acceptable alternative. A second method might be for governments to agree through bilateral or multilateral agreements on fares and rates. But, while the governments might be able to duplicate the technical expertise found in individual airlines for establishing rates and fares, such duplication of effort could be wasteful and tradeoffs reached for agreeing on fares could become politicized and go beyond the transportation matters involved. We question, therefore, whether government-to-government rate-making is a desirable alternative.

Another alternative would be for each airline to establish its own rates. Recently, some U.S. bilateral agreements have been constructed to allow such a disposition of the matter, but we do not believe the U.S. will be able to persuade all of its bilateral partners to adopt hands-off agreements on the establishment of airline fares. Some governments doubtless will insist on retaining their controls over rates, and an airline trying to operate a multi-stop flight which touches countries which control rates and countries which do not, would face a terribly complex and probably unworkable situation.

In summary, we would urge the Committee not to prohibit carrier-to-carrier agreements on rates and fares. We believe that the government and airlines should strive to make the present mechanisms more acceptable and make them

operate within the basic, competitive ideals set out in the U.S. policies. In short, we believe the better course of action at the present time is to keep open any options that the U.S. may have in the area of pricing.

INTERNATIONAL NEGOTIATIONS

Mr. Chairman, Section 9 of the legislation focuses on a problem which has troubled industry and government for a number of years. The problem is how the U.S. government can best marshal its forces to deal with international negotiations. The question of where to place responsibility has, as you know, recently been addressed by the Administration. That Presidential review maintained the present consensus approach but set forth more clearly the divisions of responsibility. The State Department is to chair the interagency committee and coordinate and develop positions and strategies and procedures for international negotiations. State is also providing foreign policy guidance and will continue its role as head of the interagency negotiating delegations. The Department of Transportation has taken responsibility for developing broad transportation policy and long-range objectives for the Executive Branch. The Civil Aeronautics Board has taken the responsibility to develop economic policies, and will also continue staff support in preparation for negotiations. Other departments and agencies that have been involved in the past will continue to be involved so long as the issues that arise concern them. These decisions on the division of responsibilities were designed to overcome the problems that were encountered in the past with respect to international negotiations. Thus far it appears that the arrangements have produced better working relationships, as you note in your statement accompanying the legislation. The proposal in your bill is intended to assure that the cooperative partnership of the agencies will continue. But it seems to go farther than this by centralizing responsibility within the White House, apparently adding another layer to government without necessarily reducing the work force or involvement of individual agencies as they exist today. The question of where and how to place responsibility within the U.S. government is clearly an important subject and more time is needed for further study by the airline industry and perhaps others.

This section of the legislation also provides for an International Aviation Advisory Council. We believe it is useful to consider having a Council whether or not the Office of International Aviation Negotiations is established in the White House, whether some other high level approach such as an Assistant Secretary of State for Aviation is decided upon, or if the present cooperative arrangements are continued. But the establishment of the Council should not alter the continued right of the carriers to be represented on U.S. delegations where their interests are being negotiated. This, of course, is a right which the Senate has long recognized. It may be helpful to consider legislative language to assure the continued right of participation on delegations. We particularly feel that carriers should be given a timely opportunity to express meaningful views before governmental negotiating decisions are made.

The section on international negotiations sets out goals for international aviation policy. We believe that a separate section on negotiating goals may be very helpful to U.S. negotiating teams. They might also be helpful to each individual agency that is interested in international aviation, and not simply to the proposed Aviation Policy Committee. Our preliminary review indicates the possibility of some differences of views among the airlines on some of the individual goals set forth in the draft legislation. We believe that they are of sufficient importance to justify further discussions within the industry before more specific industry suggestions are offered.

CONCLUSION

Mr. Chairman, we appreciate the opportunity we have had to testify on this very important subject. We hope our comments will help the Committee in its review of international air transport matters. As I have stated in the course of my testimony, there are some items on which we intend to submit further comments. I would add that we have one item which is separate from the issues contained in the proposed legislation, which has to do with the confidentiality of documents furnished to our government in the course of international negotiations. I have set forth the detail on that problem in an attachment to this testimony.

A CURRENT INTERNATIONAL PROBLEM

For 39 years the U.S. scheduled air carriers, on a voluntary basis, have provided to the U.S. government statistics on the origin and destination of their passengers. These statistics have been crucial in awarding routes by the Civil Aeronautics Board and in various forecasting and scheduling of airline operations in order to serve the public in the best possible way. The CAB, under the former provisions of Section 1104 of the Federal Aviation Act, routinely made these statistics restricted to use by U.S. air carriers and government agencies. In particular, the CAB refused to release the statistics to foreign airlines and foreign governments on the ground that the foreign government and airlines did not furnish similar systems statistics to the U.S. government or U.S. carriers. With the passage of the Sunshine Law, Section 1104 of the Act could no longer be relief upon.

The origin and destination statistics provide a very important competitive tool and if they are made available to foreign governments or persons representing foreign interests without reciprocal treatment, there would be a distinct competitive advantage to the foreign interest.

We urge the Congress to amend the Federal Aviation Act in such a way as to allow certain applications, reports and documents to be withheld from public disclosure. We are prepared to work with your staff to develop suitable language on this. At the very least, the legislation should ensure confidentiality unless comparable system data is supplied to the United States and its airlines by the foreign interests.

This completes my statement. I will be happy to answer your questions.

[The following information was subsequently received for the record:]

AIR TRANSPORT ASSOCIATION OF AMERICA,
Washington, D.C., September 5, 1978.

HON. HOWARD W. CANNON,
Chairman, Commerce, Science and Transportation Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As I indicated during my testimony on S. 3363 on August 22, our member airlines are still reviewing certain provisions of the bill. However, we believe it would be useful to submit for the record at this time comments on a very important matter which was not discussed during your recent hearings.

The basic objective of S. 3363 is to enhance increased competition in international air transportation. This also is the goal of recent U.S. governmental efforts in international air transport agreement negotiations. While we support that objective, as I testified on August 22, it should be noted that such increased competition will place additional strains on, and cause more congestion at, U.S. international airports unless special facilitative measures are undertaken. We believe this problem should be considered in connection with your legislation. For example:

1. ASSURING ADEQUATE CUSTOMS AND IMMIGRATION AIRPORT FACILITIES

Airport terminal facilities for Customs and Immigration inspections are not paid for by the Federal government although they are used to enforce laws to protect the health and welfare of the nation and all of our citizens. These facilities have not kept pace with the growth of international air transportation, and the result has been increasingly serious arrival delays and congestion. Proposed amendments to the Airport and Airways Development Act are expected to be considered early next year by the Congress. We urge that the Act be amended at that time to authorize expenditures for the provision of adequate Customs and Immigration facilities in U.S. international airport terminals. Since your committee also has responsibility for this legislation, we hope you will give this matter your favorable consideration.

2. PRECLEARANCE

U.S. Customs and Immigration preclearance at airports abroad has always been considered the ultimate in air transport facilitation. U.S. preclearance procedures are now in effect for many flights to the United States from airports in Canada and the adjacent islands, and they have resulted in a vast improve-

ment in public service. These procedures should be extended to overseas points as quickly as possible not only to enhance public service, but to help reduce the strains at U.S. international airports results from increased international air transport competition. Since that is the objective of S. 3363, and since Congressional support for the expansion of preclearance is needed, we urge that the importance of this facilitative measure be recognized in your consideration of this legislation.

3. DECLARATION OF POLICY

Along the same line, we believe the international aviation policy declaration contained in Section 2 of S. 3363 should include a broad statement addressing the responsibilities of the U.S. government to facilitate international air transportation. Such a policy statement in legislation designed to enhance international air transport competition would go far to assure that the facility, manpower and procedural needs of the U.S. border-crossing inspection agencies at our international airports are met. In short, what we are suggesting is that a policy declaration establishing the public interest in expanded international air service also recognize the public interest need to remove one of its major bottlenecks.

I appreciate the opportunity to submit these additional comments, and we will be pleased to discuss them further with you or your staff if that would be helpful.

Sincerely,

PAUL R. IGNATIUS, *President.*

The CHAIRMAN. The next witness is Mr. Robert N. Meiser, executive director and counsel of the International Airforwarder and Agents Association.

STATEMENT OF ROBERT N. MEISER, EXECUTIVE DIRECTOR AND COUNSEL, THE INTERNATIONAL AIRFORWARDER AND AGENTS ASSOCIATION

Mr. MEISER. Mr. Chairman, I think with luck that I should be able to shave a couple of minutes off of my allotted time. On behalf of the 30 Airfreight Forwarder members of IAAA, whose names are attached to my statement, and our 220 IATA-approved cargo agent members whose names are available on request, I sincerely welcome this opportunity to present these oral comments on S. 3363, along with a supplementary written statement which is submitted for the record, as well.

The CHAIRMAN. It will be made a part of the record.

Mr. MEISER. Thank you, sir.

Airfreight forwarders and cargo agents are substantial users of the international aircargo services of the United States and foreign air carrier members of IATA, the International Air Transport Association.

The prices charged to both the forwarders and cargo agents for these services, as you know, are currently fixed by the carriers under an exemption from the antitrust laws provided by the CAB. Paragraph 7 of S. 3363 would amend section 412 of the act to prohibit these price-fixing activities of IATA.

Obviously the forwarding agent industry as a major user of the international aircargo services of the airlines has a tremendous interest in legislation which would force discontinuance of those price-fixing activities, just the same as housewives would have cause for legitimate concern were Safeway, A. & P., and all the supermarkets in a given area legally able to get together and agree on the prices to be

charged for food and related necessities. We therefore strongly support the proposed amendment to section 412.

As our written statement indicates, airforwarders and cargo agents are a major factor in the international aircargo system. The volume of aircargo sales in the United States subject to IATA's price-fixing agreements provided by members of the industry we represent was over $870 million in 1977. Thus, we speak for a major segment of our Nation's economy.

As I have already indicated, airforwarders and agents, as major users of IATA member carrier's services, have the same interest in not being victimized by price-fixing agreements that any consumer would have.

However, as our written statement shows, we have a special additional reason for wanting IATA's price-fixing activities to end. The reason is that the airforwarders and agents are both customers and competitors of the airlines at one and the same time.

We compete with the airlines at the retail level. At the same time, at the wholesale level, we are customers of the airlines and as such, totally dependent on our airline competitors for our sole source of supply. We are like an independent refiner-retailer of gasoline that is totally dependent for crude oil on an integrated oil company that owns the only pipeline to its marketing area.

Except in our case, we couldn't even turn to trucks or ships for an alternative, higher cost source of supply. When it comes to our source of supply, the airlines are the only game in town, thanks to IATA.

The situation we face is not unique. In addition to the example of the petroleum industry I just cited, I would cite the example discussed in detail in our written statement involving A.T. & T. and a company called MCI Communications Corp.

The point we are making is that where these unique situations have been found to exist, of which I am now speaking, the Government has seen fit to intervene to assure that the independent retailer, such as we represent, has a fair opportunity to compete against competitors who are also its suppliers.

Not only are pipelines regulated. The Department of Justice has advocated that they be independently owned and operated, as well, thus, injecting a form of market force in place of the Government regulation that has not worked satisfactorily.

I refer to the testimony of Mr. John H. Shenefield before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, U.S. Senate, submitted on June 26, 1978.

In the communications field, the FCC and/or the courts have had to battle A.T. & T. for years on behalf of MCI in order to assure a fair shake for the latter and the public in that field.

Let me put it this way: If you were the only licensed ferry operator between two points and you also ran a profitable business at one end that was totally dependent on the ferry for sources of supply, what would you, as the ferry operator, do if someone started a competing business, also similarly dependent on your ferry? I speak here in terms of the price you would charge your competitor for ferry service as well as the conditions under which you would serve him.

In answering this question, we feel that you will see quite clearly why we need your help.

The CAB is investigating what it can do to assist, as was taken note of by prior witnesses; however, as the history of the A.T. & T.–MCI struggle indicates, the regulatory agencies cannot always be depended on to resist or even ferret out for examination the myriad anticompetitive devices of those it regulates.

Therefore, even if the CAB, and I refer here, of course, to the present CAB, outlaws IATA's price fixing activities, we urge you to remove all temptation or opportunity from a future CAB so that it will not backslide in the future.

The public can be expected to benefit from adoption of section 7 of S. 3363 in the form of lower prices in the air freight area. In our written statement, we show what happened to prices when the U.S. airlines were ordered to stop fixing the wholesale prices of certain domestic air freight services.

The reductions were dramatic.

We also show that if you do not enact this legislation, forwarders and agents will continue to find themselves in a vicious cross-price squeeze that is harmful not only to the retailers of air freight that we represent, but to the ultimate consumer as well.

In closing, I would like to resurrect some wisdom from the past. In an address to the British Parliament, Lord Coke is reported to have told his colleagues that monopolization ought to be avoided because "the monopolizer engrosseth to himself what should be free for all men."

We believe these words ring true today, and we urge you to keep them in mind in your deliberations on S. 3363.

Mr. Chairman, that concludes my oral statement; we've already discussed the written statement, which has been accepted. I have available a list of members of our cargo agents. There are 220 of them. I did not attach it because of its length; however, if the committee desires, we'd be happy to supply it.

The CHAIRMAN. Well, thank you very much for a fine statement. I'm glad that we had someone here who was supportive of a particular provision of the bill. Your statement focused almost exclusively on the proposed changes to section 412 and was silent on other features. Does that indicate an acceptance and a satisfaction with the way which international agreements are negotiated and, specifically, are the air freight forwarders under the current negotiating mechanism provided the opportunity of effective comment and input into the negotiation process?

Mr. MEISER. To answer your question, Mr. Chairman, the first part of your question: Our silence on the other provisions can be taken only as neutral, no position. However, on the specific matter that you have raised in the latter part of your question, that is, the participation of forwarders in the process, the answer to that is: We are not satisfied, as a matter of fact.

We have seen a lot of the advantages and rights won at the CAB in very hard fought contests being eroded now in international negotiations. And I refer here to the British and the one recently concluded with the Netherlands.

For example, the CAB decided that forwarders should have an unlimited right to charter both domestically and internationally. But when the agreements were concluded, there were restrictions placed on the charter rights of forwarders, which as I say, represented a reversal of what we obtained from the CAB.

I would like to see the industry involved in the negotiating process, the same as the carriers are permitted to participate in it. I would like to work toward that end.

The CHAIRMAN. The statement made by air freight forwarders during our hearings on the domestic regulatory reform legislation was to the effect that the method for injecting more competition into air transportation already existed under the current act and that no new legislation was needed.

Now, your testimony on behalf of IAAA here is directly opposite. That is, that we can't rely on the philosophies of the Board members to insure a competitive environment in the absence of the changes proposed to section 412 by this bill.

What do you think the Board can realistically expect to accomplish in the area of international rate setting agreements?

Mr. MEISER. Well, I would point out that we do not necessarily disagree with the position taken by the association which represents primarily the domestic forwarders on that legislation, except that we have, I think, less faith in the ability of a future CAB to follow the guidelines that are being followed today.

Now, the last part of your question was in the absence of the amendment to section 412: What ability would the CAB have—could you rephrase that for me, please?

The CHAIRMAN. I said in the absence of changes proposed to section 412. what do you think the Board can realistically expect to accomplish in the area of international rate setting agreements?

Mr. MEISER. They have instituted their own investigation, one of the stated purposes of which—they issued a show cause order suggesting that the rates established by IATA by agreement be terminated unless supporters could come forward with very persuasive reasons under Local Cartage standards for continuing that process, so I think they can accomplish, the basic objectives being discussed here.

They have strengthened ability, of course, in the area of international rates and fares that they did not have a few years ago. So, I think they can accomplish nearly as much. It's a question of will it stick over time.

The CHAIRMAN. Well, thank you very much, Mr. Meiser. We appreciate you being here.

[The statement follows:]

STATEMENT OF ROBERT N. MEISER, EXECUTIVE DIRECTOR AND COUNSEL, INTERNATIONAL AIRFORWARDED AND AGENTS ASSOCIATION

On behalf of the 30 airfreight forwarder members of IAAA whose names are attached, and the 220 IATA appointed cargo agent members of IAAA whose names are available upon request, I welcome this opportunity to present these comments on S. 3363.

Air freight forwarders and cargo agents are substantial users of the international air cargo services of the U.S. and foreign air carrier members of IATA, the International Air Transport Association. The prices charged both the forwarders and cargo agents for these services are currently fixed in per se viola-

tion of the antitrust laws by the IATA carriers, under an exemption from those laws provided by the Board.

Paragraph 7 of S. 3363, would amend Section 412 of the Federal Aviation Act of 1958 to prohibit these price fixing activities of IATA. Obviously, the forwarding/agent industry, as a major user of the international air cargo services of the airlines, has a tremendous interest in legislation which would force discontinuance of those activities, just the same as housewives would have cause for legitimate concern were Safeway, A&P and all the supermarkets in a given area legally able to get together and agree on the prices to be charged for food and related necessities. We therefore strongly support the proposed amendment to Section 412.

IMPORTANCE OF IAAA AND ITS MEMBERS

Air freight forwarders and agents have occupied an increasingly important role in the total air cargo system. Data supplied recently to the CAB indicates that some 70 to 94 percent of the total international traffic of certain major international air carriers is derived from air freight forwarders and agents.[1] Of this traffic, 29 percent is derived from forwarders and 71 percent from cargo agents.[2]

THE IATA CARTEL SUBJECTS AIR FORWARDERS AND AGENTS TO UNIQUE COMPETITIVE INJURIES

In the air cargo system, the direct air carriers provide primarily an airport to airport line haul service at wholesale. The air forwarder in effect purchases these airline services at wholesale and resells them at retail. The retail services provided by the forwarder include ground transportation, documentation, customs facilitation, the consolidation and containerization of traffic and sales and promotional activities. The airlines also sell at retail. Thus, forwarders are at one and the same time customers of the airlines' line haul services at wholesale and competitors at retail.

This dual status of the forwarder as both a major customer and competitor of the airlines is very important in the context of this proposed legislation.

To begin, as a customer paying rates fixed by agreement, IAAA forwarder members are as adversely affected by prices by the airline monopolists as any shipper that deals with the airline directly. Assuming for the moment that the airlines act in their own self interest by raising their prices to monopolistic levels, all customers of the airlines suffer.

But even worse, because of their special, dual status in the air cargo system, air forwarders have an even greater burden to bear as a result of IATA's price fixing activities than the ordinary user of the service. Because of the status of the forwarder as a competitor of the airline, the airline monopolists have incentives not only to fix the level of prices at the highest point feasible, but to arrange the structure in such a way as to favor their own direct, retail operations at the expense of their forwarder competitors, as well. This is done primarily by maintaining the general commodity container rates generally used by forwarders at artificially high, above cost levels and the bulk specific commodity rates generally available only to shippers other than forwarders at lower levels. By this means the airlines are able to support their own retail operations with revenues from forwarder traffic.[3]

It is difficult enough to cope with these practices of the airlines in a reasonably competitive market where rates and structure are determined individually. It is virtually impossible to deal them when the carriers are free to agree on such matters as a single monopolist.

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[1] Air Freight Forwarders' Charters Investigation, docket 23287, C.A.B. Order 77–7–25, dated July 8, 1977, page 19.

[2] This breakdown is based on data from the CAB's IATA Commission Rate Agreements case, dockets 28672/28776, specifically, a chart appearing in Judge Kent's Initial Decision in that case at page 147.

[3] Forwarders like to containerize their traffic as much as possible because containerized traffic does not get mixed up with that of others while in the hands of the airlines. In order to containerize, however, the shipper or forwarder must have sufficient volume to fill the container (over 3,000 pounds for the largest, most efficient units). He must also possess the technical skills and equipment that are required to load and move such massive units. As professional shippers, forwarders generally possess these capabilities while the typical shipper customer does not. In sum, the forwarder tends to containerize in spite of the high costs—a proclivity that the forwarder's airline competitors, who fix container prices, have long taken advantage of.

The functions performed by the forwarders and cargo agents are basically similar. Both perform many of the same ground, documentation and promotional functions. Both in effect "purchase" air transportation at wholesale from the airline and "resell" it at retail. Only the method of payment is different The forwarder is "paid" through the spread between the wholesale price it is charged and the retail price it can command in the market. The cargo agent is paid a commission based on the retail price fixed by the carrier. In either case, the retail profit margin afforded both forwarders and agents has historically been fixed by IATA, whether in the form of a wholesale price or a commission on an established retail price. Thus, cargo agents have the same interest in terminating IATA's price fixing activities as the forwarders for basically the same reasons.

LEGISLATION IS NEEDED TO ASSURE FAIR COMPETITION BETWEEN AIRLINES AND FORWARDERS

As the members of this Committee are aware, the CAB has launched investigations of the methods of payment of both forwarders and agents. In its general investigation of IATA, which encompasses the agreements fixing the wholesale rates charged forwarders and the airlines' retail rates which are competitive with those of the forwarders, the CAB is proposing to disapprove the IATA rate fixing of machinery unless supporters can show, under the very rigid standards of proof that pertain, that the continued existence of IATA would be in the public interest. Its just concluded investigation of IATA's commission rate agreements case addressed the propriety of IATA's practice of fixing the amounts paid to agents as commissions and found them contrary to the public interest.

It is IATA's view, however, irrespective of the Board's decision in these cases, that legislative action is needed to assure competition in the international arena.

A bit of history in an analogous industry may be enlightening.

A bit of history in an analagous industry may be enlightening.

The Federal Communications Commission regulates interstate telephone services in this country. For many years, the Commission accorded AT&T a virtual monopoly in this market. However, at long last the Commission finally decided at least to authorize competition in the markets served by AT&T's long lines division. The companies selected included MCI Communications Corp. and others.

AT&T through affiliates retained its monopoly over service in the terminal areas served by the inter city long lines, however. MCI later sought to extend its competition from point to point within the terminal areas through interconnection to AT&T's local monopoly services. But this competitive intrusion was strenously opposed by AT&T who attempted to thwart MCI's entry at every turn. At the outset, AT&T simply refused to provide service to MCI that the FCC had authorized. MCI, however, successfully overcame AT&T's initial opposition at the FCC and in the Courts.[4] AT&T then sought to achieve the same end through the filing of discriminatory rates for its monopoly service. But the Commission rejected these and other practices directed against MCI and others. AT&T appealed and once again MCI was forced to defend its right to use AT&T's services at fair and reasonable prices, which it did successfully.[5] In the meantime, MCI filed its own tariff for its retail services (known as "Execunet") based on the use of its own facilities and the service purchased from its competitor, AT&T. The FCC rejected the tariff on the grounds the service was unauthorized, but the Courts reversed.[6] On remand, the F.C.C. failed, in the eyes of MCI and the Courts,

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[4] *MCI Communications Corp.* v. *American Telephone and Telegraph Co.*, 369 F. Supp. 1004 (E.D. Pa. 1974) (motion of communications common carriers specializing in private line communication services granted and preliminary injunction issued requiring AT&T to furnish certain interconnections to MCI's network); rev'd and remanded to F.C.C. on grounds of primary jurisdiction, 496 F. 2d 214 (3rd circ. 1974).

[5] *Bell Telephone Co. of Pennsylvania* v. *Federal Communications Commission*, 503 F. 2d 1250 (3rd cir. 1974), cert. denied 422 U.S. 1026, reh. denied. 423 U.S. 886 (1975) (Court affirmed F.C.C. order requiring telephone company and its affiliate to provide interconnection services to specialized common carriers and prohibiting discriminatory rates and practices by AT&T; *American Telephone and Telegraph Co.* v. *F.C.C.*, 539 F. 2d 767 (D.C. cir. 1976).

[6] *MCI Telecommunications Corp.* v. *F.C.C.* 561 F. 2d 365 (D.C. cir. 1977), cert. denied 434 U.S. 1040 (1978).

to implement the Court's decision.[7] Only five days ago the F.C.C. fired off still another round in support of AT&T's campaign to thwart effective competition by its customer/competitors at all costs, by once again petitioning the Supreme Court to review the matter of MCI's services.[8] In the meantime, AT&T had filed further tariff restrictions against MCI's services which were rejected by the F.C.C. and Courts.[9]

The point of this long story is that the Courts and parties were burdened with years of litigation, and all of the expenditure of money and resources that were involved, and the public was long denied a service later found to be in the public interest, all because monopolist chose to deny services to a customer that was also a major competitor at a different market level. Moreover, the monopolist was aided and abetted in that endeavor by the Commission, an agency supposedly regulating the industry in the public interest. It is true that the Courts have so far uniformly declared AT&T's action to violate the governing Act. However, the final chapter of that saga remains to be written. If more precise legislative guidelines had been supplied from the outset, the public and the parties may not have been so severely inconvenienced.

There is, of course, no guarantee under the existing law that a future CAB would not similarly combine with IATA to obstruct fair and effective competition. For this reason, the legislation contained in Section 7 of S. 3363 is needed.

THE IATA MACHINERY PLACES FORWARDERS IN A COST PRICE SQUEEZE

As has been shown, in the forwarders' buying market the airlines have combined to form a very effective monopoly. The price and other terms of purchase for the product which the forwarder must buy from the airlines is fixed by agreement.

On the other hand, competition in the forwarders' selling market is intense. The CAB has long followed a policy of free entry in the air freight forwarding industry. As a result, there are over 400 U.S. air freight forwarders authorized by the Civil Aeonautics Board and twice that many cargo agents, as well as a dozen or so foreign air freight forwarders operating in the U.S. Practically all of the U.S. forwarders and all of the cargo agents and foreign forwarders are authorized in the international markets.[10]

As a result of this large dose of competition where it hurts and total lack of competition where it could help, forwarders are being mercilessly squeezed in a competitive vise. In IAA's view, either the freight business should be regulated or deregulated at all levels. The market in which the forwarder sells his product has been subjected to the forces of competition for years. It is time that the wholesale airfreight market in which the forwarder buys be made subject to competitive forces as well, in order to provide equality of opportunity and a fair return for competitors in these markets.[11]

THE INTRODUCTION OF COMPETITION INTO THE INTERNATIONAL AIR CARGO MARKET CAN BE EXPECTED TO PRODUCE LOWER PRICES FOR THE CONSUMER

We have just examined the high degree of competition in the forwarding industry. To the extent, therefore, that competition among airlines for sales to individual forwarders becomes a reality, competition among forwarders will assure that the benefits of competition—lower prices—will be passed on to the ultimate consumer in the form of lower forwarder prices.

We have no doubt that competition among the airlines at the wholesale level will lead to lower wholesale prices. This is indicated not only by the basic tenets of economic theory and a priori reasoning, but actual experience as well.

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[7] Unreported opinion of the U.S. Court of Appeals in the District of Columbia dated April 14, 1978, case No. 75–1635.

[8] Petition for cert. filed (U.S. Aug. 17, 1978) (No. 78–270).

[9] *American Telephone and Telegraph Co.* v. *F.C.C.*, 572 F. 2d. 17 (2d cir. 1978) (Court affirmed F.C.C. order requiring AT&T to eliminate tariff restrictions on the resale of its services by MCI).

[10] The board has only recently described forwarding as "a highly competitive industry." CAB order 78–8–13.

[11] For a study of the desirability of competition for the favor or the independent broad line retailer by manufacturers at the wholesale level, see W. Measday, "The Pharmaceutical Industry" (W. Adams, editor, "The Structure of American Industry," 5th ed. 1977, page 250, and in particular pages 258–59, where the institutional submarket for pharmaceutical products is discussed. Such competition was favored by the author for that industry even though it would appear much less certain that the ultimate consumer would reap the benefits of lower prices in that case than in the case of air cargo transportation.

Thus, prior to 1971, in the same manner that IATA fixes prices today, the U.S. air carriers were allowed to fix air freight container prices domestically. The Board, however, was persuaded to lift its protective shield from the domestic container agreement. (CAB order 71–4–163, April 23, 1971.) After the protective shield was lifted, container prices dropped over $1.00 per cwt. to a level more than $2.00 per cwt. below the rate for bulk traffic.[12]

In view of the prior experience of the industry, we would expect the enactment of S. 3363 to produce significance price reductions. With this bill Congress has an opportunity to make a real contribution towards the fight against inflation and toward improved efficiency in the air cargo system. The benefits that can be expected from this legislation are not of the pie-in-the-sky variety, but are strictly down-to-earth.

THE PROPOSED AMENDMENT TO SECTION 412 SHOULD BE CLARIFIED TO DETERMINE WHETHER IT EXTENDS ALSO TO COMMISSION RATES FIXED BY IATA FOR CARGO AGENT'S SERVICES

We have previously shown that the cargo agent has the same basic interest in the enactment of a legislative bar to IATA's price fixing activities as the air freight forwarder, and in our view the language in S. 3363 can be read to preclude agreements fixing commission rates paid to agents as well as retail rates charged the public.

However, your intent is not absolutely clear on this issue. To remove any doubt, we suggest that the language of the bill be clarified specifically to cover commission rates paid or the Congressional intent otherwise be clarified. This would preclude another Board in the future from backtracking on the accomplishments of the present Board in outlawing these inherently anti-competitive agreements which are in per se violation of the anti-trust laws.

The requested clarification would assure that the principles of competition announced as the objectives of this legislation are applied not only to the forwarders represented by IAAA, but to its cargo agent members, as well. Section 7 of S. 3363, as so interpreted, would provide relief across the total spectrum of air freight services, rather than simply a part of the spectrum, which would be the case if only wholesale rates charged forwarders and retail rates were covered by the bill. As the present Board has found, the public would be benefitted by competitively established commission rates not only through an improvement of services by the cargo agents, who for the first time would be given the opportunity to earn a fair return for services rendered, as determined by the market, but also through the offering of price reductions on related services provided by nearly all cargo agents.[13]

In addition, we are in favor of broadening the base of the cargo industry. As volume due to lower competitively established airline prices expands, the business of cargo agents can be expected to expand, as well. We believe this expansion would be in the public interest.

In conclusion, we would note that the first stated objective of S. 3363, as it appears in the preamble, is to "promote competition in international air transportation." (emphasis added) As major consumers of the air transportation services of the international air carriers, air freight forwarders and cargo agents are vitally interested in achieving that objective. We accordingly urge adoption of section 7 of S. 3363.

The CHAIRMAN. That concludes the hearings for today. We will resume tomorrow beginning at 9:30 a.m.

[Whereupon, at 1:25 p.m., the hearing was adjourned, to reconvene at 9:30 a.m., on Wednesday, August 23, 1978.]

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[12] The agreement had fixed a discount per hundred weight of $1 from the bulk freight rates then on file. After the agreement was terminated, the discount for containerized traffic jumped to over $2 per hundred weight. Today, based on rates of American Airlines, Inc., officially on file at the CAB, the discount on a minimum weight container shipment from New York to Los Angeles is $2.88 per cwt.—nearly triple that which was fixed prior to 1971—and the discount deepens even further as the shipment weight increases.

[13] As was found in the CAB investigation of the IATA commission rate agreements, cargo agents typically provide not only air freight services for their customers, but also surface transport services, custom brokerage services, etc. Initial Decision of Judge Katherine A. Kent, served Mar. 15, 1978, docket 28672, page 145. Accordingly, benefits received by agents in the form of higher, competitively established commission rates could be used to effect reductions in the overall or collective price charged customers for this total range of services.

INTERNATIONAL AIR TRANSPORTATION COMPETITION ACT OF 1978

WEDNESDAY, AUGUST 23, 1978

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, D.C.

The subcommittee met at 9:30 a.m. in room 235, Russell Senate Office Building, Hon. Howard W. Cannon (chairman of the committee) presiding.

The CHAIRMAN. The hearings will come to order.

Today is the second day of hearings by the aviation subcommittee on S. 3363, the International Air Transportation Competition Act of 1978.

Our first witness will be Dr. Alfred Kahn, Chairman of the Civil Aeronautics Board.

Mr. Chairman, we are happy to have you here this morning, and you may proceed, sir.

STATEMENT OF HON. ALFRED E. KAHN, CHAIRMAN, CIVIL AERONAUTICS BOARD; ACCOMPANIED BY DONALD FARMER, DIRECTOR, BUREAU OF INTERNATIONAL AVIATION

Mr. KAHN. Thank you, Mr. Chairman.

As you have suggested, I would like to submit my written statement for the record and try to, in about 10 minutes, summarize it. And we'll try very hard not to tell you things which you already know. And perhaps I ought to just stop talking right now.

It really is an enormous pleasure to be here, sir, and I'm particularly happy to talk to you about international aviation policy for several reasons, all of which are familiar to you.

First of all, this is a subject which we at the Board have devoted a great deal of attention during the past year, and second, because of the genuine progress that I think we've made in active collaboration with other government agencies.

I'm not going to impose on you by retelling that story, although I do so in my written statement. I just want to observe, though, the danger that Bermuda II might become a precedent for future agreements has, by no means, disappeared.

That is why I particularly welcome your renewed attention to the subject. This fall, as you know, we have scheduled very important negotiations with the Dutch to try to nail down that breakthrough

agreement that we reached with them in the protocol forum last March; with the Germans, as you know, who are critical, we think, in terms of making a gigantic step forward; and with the Japanese—negotiations which are critical for a different kind of reason.

So these hearings are very timely.

What I would like to do is to confine my oral presentation to a summary of our Board's views on the specific provisions of the bill. On section 2, the declaration of a procompetitive policy, I hope it is clear from everything the Board and I have said during the past year, that we strongly endorse your intention here to amend the policy declaration of the Federal Aviation Act, to reflect a clear congressional intention to effect a permanent liberalization of the international aviation system.

The fact that President Carter and all the parties to the negotiations are now dedicated to a competitive aviation order is no reason for Congress to refrain from putting that dedication into law.

On the contrary, such a declaration by Congress will strengthen our resolve and our hand in difficult negotiations that lie ahead by making it even clearer to all parties that the U.S. Government is committed to working to this end, and—very important—that our ability to compromise those principles by accepting restrictions on which so many foreign governments insist is severely limited.

It is very helpful in the negotiations to be able to say to a foreign negotiator, we can't do this because Congress would be very, very angry.

Sometimes we say it even if we're not sure you will be angry. And of course, as in the case of domestic aviation——

The CHAIRMAN. I'm sure we will be, so you can continue doing that.

Mr. KAHN. I try not to abuse that, Senator Cannon.

Of course, also, as in the case of domestic aviation, a clear congressional declaration of principle will assure that future administrations and future negotiators will not easily slip back into the protectionism and cartelization.

Having expressed enthusiasm in general about your intentions. I must cavil about two particulars.

Subparagraphs 1, 2, and 3 of section 2 seem to me unexceptionable, exactly what we think we need—Congress simply making a general policy declaration.

But I do think it is a mistake to try to spell out in specific terms how your general intent is to be effectuated, or what the specific results should be.

Subparagraph 4, particularly, to which I think Under Secretary Cooper has brought your attention as well, which proclaims the desirability of giving expedited treatment to foreign air carriers of nations with which the United States has entered into liberalized bilateral agreements, sounds like a very good idea, but I believe it is not.

We at the Board are giving a very high priority to putting our parts of international agreements into effect just as quickly as possible and we have made a great deal of progress. We have reduced the amount of time that it takes on a 402 application by over 30 percent and we expect to do even better. And we have no objection to a legislative directive that tells us simply to get those things out quickly.

But subparagraph 4 calls not just for expedition; it calls for dis-

crimination between countries, and I think that is wrong for two reasons. First, as a matter of principle, we think it conflicts with our general goal of a more competitive marketplace and that calls for moving fast on all applications, not just using differential delays to reward our friends and punish our opponents.

And a second reason is this: That it is our Government's policy, as you know, to trade opportunities for opportunities. So when we entertain an application from a foreign carrier for opportunities to which it is entitled under a bilateral—even an illiberal bilateral—it will ordinarily be because our carriers got something in exchange.

Even, as I say, if it is an illiberal bilateral. So it may be just as important for us to move promptly in those cases in our 402 proceedings as it is in cases that come under a thoroughly liberal bilateral agreement.

So our recommendation would be that you delete paragraph 4, but perhaps substitute an instruction that we quickly process all applications by foreign carriers for rights to which they are entitled under a bilateral agreement.

I feel also that the specificity of subparagraph 5 might have similar anticompetitive connotations. This is the one that would encourage the Board to provide domestic route authority to air carriers that have extensive international operations, who shall be nameless.

It is a worthy cause; I agree with it. But because it is so specific, it seems almost to be of less importance than the things that it leaves out.

What about domestic and international route authorities for supplementals—I realize that there is another provision about that to which I will return in a moment—or more international authority for domestic carriers?

Is this provision intended to mean that we should be less interested in those? We feel that the best statutory approach is to cover this specific objective in a broad policy declaration directing the Board to expand opportunities for all air carriers without creating or maintaining regulatory handicaps for any of them, whether explicitly or by implication.

The CHAIRMAN. Of course, I'm reminded, you know, about that story about the mule and the farmer that could not get him to work, so he took a 2 by 4 and he hit him over the head as hard as he could right between the eyes and said, "Before he starts to work, you have first got to get his attention."

Now maybe we've got your attention on this point here by spelling it out, even if you don't think that we ought to specifically pinpoint it in legislation.

Mr. KAHN. Well, I think you have to think about it in terms of legislation. You've got my attention. There's no question.

I guess when the President overturned us on Dallas-Fort Worth and put Braniff in on the ground that it had domestic route authority; Pan Am's situation got my attention.

The CHAIRMAN. Incidentally, on that, I notice that you gave Braniff the route out in my State last night, for which I thank you. But I came up with a great idea which I would like to try out on you.

Obviously, the big question now in light of the proposed German agreement is that is the first open skies agreement for the United

States, and I'm wondering if we shouldn't send a telegram to all countries in the world telling them the one that offers the most concessions at the earliest possible time will get that kind of agreement.

Mr. KAHN. Well, what we need is a letter from one Senator Cannon that would marvelously clear the mind.

The CHAIRMAN. All I can say is don't do me any more favors, because I found out from my Governor this morning that Braniff now doesn't have authority to fly from the Public Service Commission in Nevada, and therefore, they can't possibly begin service before September 13.

And so, as a result, you have solved their problem without solving it. You have given us another carrier, but one that can't haul a load of passengers for at least another 3 or 4 weeks.

Mr. KAHN. Well, let me go back and find out. I would assume that Federal preemption would take over. That is, if we certificate the carrier.

The CHAIRMAN. I don't think so. Not on the intrastate passengers.

I think we have had that point made quite clear before. We got into that in the so-called California cases in the past, the PSA cases.

I think that the Federal Government doesn't preempt insofar as strictly intrastate carriers' operations are concerned.

There's no question that they could fly passengers in beyond traffic, that is Las Vegas/Reno, and beyond, and Reno/Las Vegas and beyond, but solely intrastate passengers, I think, are still subject to the PSC approval. And the PSC advises me now, and the Governor, that there is no way that they can get that authority before September 13.

Mr. KAHN. I wasn't aware we pulled that boner, Senator. I will go back and find out. Obviously, the reason for us selecting Braniff, I think we did make clear that we thought it would give us the least problems under Kodiak because Braniff is not an applicant in this case. But let me go back——

The CHAIRMAN. Well, I thank you for your expeditious action, anyway.

Mr. KAHN. On section 3, which has to do with the direct sale of charter trips by supplementals, we think that this is an important liberalization and one that would help equalize competitive opportunities between supplementals and scheduled carriers.

We have a proposal on this before the Board now, and so it would not be proper for me to comment in detail on the merits. But I certainly can say, at least as an economist, that I know of no general economic basis for imposing a priori restrictions on vertical integration in an industry like this. That is on principle, at least.

I must say that I'm not supposed to have an opinion, but in principle, I think this is unexceptionable.

Again, your proposed formulation is unnecessarily and unwisely specific. What, for example, is supposed to happen after the third year? If the bill intends to allow vertical integration, why stop it at 40 percent after 3 years.

I can understand and agree with your feeling that it is probably desirable to phase this change in gradually. I think that is wise. But how do we know if the rate of phasing you are going to embody in the law is the correct one.

The fact is that I think neither you nor the Board is capable of knowing in advance how far and how fast to go. And it seems to me that what argues for is not specifying a timetable and specific limits. In the legislation, those limits may prove to be too generous or too stingy, too fast, or too slow.

It seems to me what it argues for is instructing the Board to develop the transition mechanism for, at least if you want to prescribe a transition, for asking the Board to monitor the results and change the pace and the limitations as events prove desirable.

That is a minor point because on principle, obviously, I'm expressing agreement to the extent that it is proper for me to do so.

Section 4, the automatic scheduled authority for supplemental carriers, I think you will agree that the Board has clearly demonstrated its agreement with the general purpose of this part of your bill.

We do have the *Benelux* case, which explores exactly the possibility of our certificating low fare, multiple carrier competition, and of course, there are supplementals involved in that case and we are handling it in the fastest possible manner in order to take full advantage of the competitive opportunities provided by the recent Dutch and Belgian agreements.

And so we do think it is desirable, highly desirable, for Congress to confirm that supplemental carriers may engage also in scheduled air transportation.

That is to say, to make it perfectly clear that a supplemental could get scheduled authority without surrendering its supplemental certificate. But beyond that, we are concerned once again that the bill specifies the process too precisely at the very time when we are trying to eradicate the barriers to entry to the old club of scheduled airlines.

S. 3363 would sanction the development of a new club, restricted to a stipulated group of carriers, even though I agree with the implicit premise that these carriers have by their contributions to competition demonstrated their claim to sympathetic consideration.

At least by implication, it runs counter to our objective of expanding international aviation opportunities generally for all carriers. Perhaps most importantly, the possibility of foreign governments resisting new U.S. designations may be greater if those designations are the result of a congressionally dictated quota rather than issuing from a carefully considered route proceeding.

Besides, I do think that the provision is unnecessary.

Section 5, eliminating the hearing requirement for foreign air carrier permits, we enthusiastically support this provision. It would eliminate the requirement that a hearing be held on route applications by foreign air carriers and it would amend the public interest standard in section 402 that applies to these cases.

Both of these promise to reduce unnecessary barriers to timely Board action on such applications, and since I agree so totally with you on this section, I won't waste your time by telling you why, although, of course, it is in my written statement.

I would like to emphasize that while you are considering amendments to 402(d), I suggest that you pause to consider deleting the hearing requirements on 402(f) as well, which deals with the Board's power to alter, amend, or terminate permits.

You have, quite properly, focused on the need for prompt action in granting a foreign air carrier permit. It is equally important, we think, that we be empowered to act promptly to amend or terminate one, as required by the public interest.

I do urge you to give favorable consideration to that. Were it not for the fact that your other reform bill and the one in the House as well, both contain important provisions that would extend our section 416 exemption power to include foreign direct and indirect air carriers, and relax the restrictions on its use, but for that fact, I would spend a lot of time urging you to put it in here. But I am ready to thank you in advance for the other one.

This afternoon, the Board has to meet because I got an urgent telephone call from a shipper in Richmond, Va., that he had—this was last Friday—that he had 172 cows and pigs waiting to be shipped across. The only carrier he was able to find was AeroUruguay, and we did not have the authority to exempt AeroUruguay.

It is that kind of inflexibility that is proving so injurious to American shippers. We will stretch the law to the limit and see whether we can get those cows and pigs out of the country, but it would be very helpful, of course, to have that authority.

Section 6, in my opinion, that would alter our powers over consolidations and mergers by creating a rebuttable presumption in favor of approving combinations of scheduled and supplemental air carriers, is unnecessary and potentially anticompetitive.

Even under existing case law, it is the opponents of a merger who must bear the burden of proving its undesirability. So the change that this proposal would make is, in a sense, not great. Still, if Congress were to pass this section, it would be telling that the burden of proof on the opponents of the merger ought somehow to be even heavier than it now is, suggesting that there is something wrong with our present review process. And yet, I'm not aware of any responsible finding that the Board or the antitrust agencies, for that matter, have been too tough on mergers so far.

After all, the ultimate legal test of mergers is whether they will impair the effectiveness of competition in the marketplace.

I find it difficult to understand why there should be a proposal to apply a more lenient test in a statute whose entire thrust is toward relying increasingly on competition to protect the public.

Section 7 on the prohibition of international ratemaking agreements—here's one where I really do have to plead inability to discuss. As you know, we have a show-cause order out on this, which recognizes the incongruity, but of course, we are accepting comments on it.

On section 8, on the Presidential authority to review the Board's international decisions, the Board hasn't taken a definitive position on the 801 process. We think the pertinent considerations are of a kind best left to Congress.

I certainly could not argue that there are not legitimate foreign policy issues in these Presidential decisions such as might well justify Presidential review.

But lest you think I am engaging in a total copout, I will observe that I have personally stated that Presidential intervention in the selection of one U.S. carrier over another to serve a particular route—

I have found that very troublesome. Indeed, I have found it fundamentally objectionable as a matter of principle and not, I assure you, because I have had the experience of being overturned myself in one such case.

I don't doubt that even in such cases, foreign policy considerations may be at stake. I am talking simply about selecting one U.S. carrier over another on a particular route. But the connection with foreign policy is surely remote, and the undesirability of the present situation seems to me undeniable.

It is manifestly troublesome for the President to have the authority, and therefore the temptation, to change without explanation, without the possibility of judicial review, to change the administrative decisions of an independent regulatory agency reached through elaborate quasi-judicial procedures in the sunshine with full justifications and a written opinion on the basis of a public record.

The exercise of this kind of authority seems to me so undermining of public confidence in the integrity of the process, and the connection with foreign policy seems to me so remote, that I should think a President might be relieved to be relieved of it.

The CHAIRMAN. I don't know about the last half of that statement, but I certainly agree with you on all of the rest of that statement up to that point.

Mr. KAHN. Thank you.

On section 9, I will be very brief, since you have already heard from Under Secretary Cooper and Secretary Adams. When I testified last fall in favor of setting up some sort of formal interagency council for this purpose, the procedures were really very inadequate.

The much-needed mechanism for formal consultation among the agencies was not clearly established and recognized. There was still bureaucratic jockeying for leadership—indeed, for the dominant, if not, exclusive, role in the process. And as a result, we were far from having developed and agreed to a consistent philosophy and an integrated strategy, and we were having great difficulty pursuing one in those circumstances.

The situation has enormously improved. The interagency committee is extremely active in matters ranging from broad policy formulation to the supervision of moment-to-moment negotiating tactics. We meet sometimes from moment-to-moment in the midst of difficult negotiations to decide what to do next.

And in my judgment, setting up some other agency for this purpose would be both unnecessary and counterproductive. At the same time, I continue to believe, as I did then, that the institutionalization of this mechanism by statute would be highly desirable. There have continued to be incidents or near incidents of negotiation by one or another member of the group, uncoordinated by the group, and the temptation persists to engage in independent action in fragmented negotiations, in uncoordinated, premature, public discussion of unresolved issues in ongoing negotiations, all of which, it seems to me, a formal statutory constitution of the group would discourage.

Institutionalization of the present arrangement will also help insure its continued effective functioning in the future after the present members have gone on, and it will insure continuity of the coordinated

effort, which is, I take it, the major objective of the proposed legislation.

We do, however, oppose establishing a new separate agency in the Executive Office of the President because it would be both unnecessary and duplicative. We would strongly prefer to see Congress establish the present interagency group formally. There is no way of escaping the need of involving in the international aviation negotiation process the several agencies with clear aviation responsibilities in this area. Setting up yet another agency will not eliminate the need for a consensus, and I honestly believe that you could not do better than turning to the Department of State in selecting a chairman for the group and in selecting the actual negotiators.

There is also the question that the bill obviously contemplates that the new office would develop its own staff. I believe this would require a large organization and it would be in large measure duplicative of present organizations and I think other people have said that to you, so I will stop at that point.

On the matter of the International Aviation Advisory Council, we already involve all interested parties representing the carriers, labor, consumer groups in advising the interagency committee and the negotiating teams. But I see no reason why that mechanism, too, should not be institutionalized as the bill will do in constituting a formal international aviation advisory council.

The present arrangements are ad hoc. The interested groups do not have complete assurance that they will be regularly consulted and I see no reason not to give them that assurance.

I would suggest to avoid against excessive specification, that the bill, leave it to the interagency committee to define the interest to be represented and the working arrangements, and also that the group be authorized to pay the expenses of the members to all meetings and negotiations.

In summary, Mr. Chairman, we feel that things are going very well in our international aviation policy, in no small measure because of the continuous interest and scrutiny by this committee.

We know where we want to go and we feel we are very well organized to mount the best possible effort to get there. We therefore strongly approve the effort in S. 3363 to have Congress proclaim that policy, give guidance to its development and effectuation, and give legitimacy to the institutions that have evolved to carry it out.

We ask you only to avoid in your zeal issuing to us instructions so detailed and prescriptive that they may become a straightjacket, or to impose unnecessary additional machinery on our process.

Thank you, Senator.

The CHAIRMAN. Thank you, Dr. Kahn, for a very excellent statement. We have come to expect excellent statements that we receive from you, and you don't disappoint us.

As one zealot to another, I want to assure you that I would have no difficulty leaving a great deal of discretionary authority in the present CAB.

On the other hand, I would leave none to some of the past Boards that I can recall. I am willing to compromise with you: If you will promise to be the eternal Chairman of the CAB then we will give you very general instructions in this bill.

In retrospect, considering your ongoing review of the supplemental carrier's revenues, was the Board right or wrong on its decision to disallow super Apex fares?

Mr. KAHN. I wish I could be sure, Senator. I really don't know.

It could well be that the President was right. We are, as you know, watching very carefully the developments, particularly over the North Atlantic. I don't think there's any question that the charter organizers, the tour operators have taken a beating. That is to say, the charter mode has been very substantially replaced by increased scheduled service.

It is much less clear what has happened to the supplementals. So far as we can tell, you certainly can't say that our fears about the supplementals have been proved justified; they have not.

There is no clear evidence that they have fallen short, in their entire operations, of the very satisfactory levels of 1977.

I think what the President did was salutary in this way: that by disallowing that protection that we tried to put in, he gave us not only an excuse, but explicit instructions, to push ahead very fast to increasingly liberalize the opportunities for charters generaly, and for the supplementals in particular. And I'm not sure that we would have been able to go as fast as we have gone—for example, in our liberalization of charter rules, the public charters are now out, and in our attempt to move to multiple permissive opportunities for the supplemental carriers in international trade—had it not been for what the President did.

So I guess the jury is still out on that, Senator.

The CHAIRMAN. You and the administration witnesses have been beating your collective chests during these hearings about the much improved Bermuda II. And while I would not deny that some improvement was made to the original agreement, it is hard to get excited about the improvement to a bilateral that could not get much worse.

Now I've heard concerns raised about possible British objections to TWA's winter schedule for Newark-London service under the capacity limiting provisions of Bermuda II.

Can you provide us any information on this case and can the committee be assured that the U.S. position will be strongly opposed to any capacity restrictions?

Mr. KAHN. You can be absolutely assured of that, Senator. I agree with you totally that the March negotiations with the British certainly represented a very important relaxation of one threat of Bermuda II.

But I am not chortling about how Bermuda II is going and I think you are entirely right that the way TWA's proposal to fly from Newark is being treated is another demonstration of the dangers that we see in that.

Our people are going over to England in September, and we will do absolutely everything we can to get them to permit TWA to fly from Newark. But I cannot be sanguine precisely because of Bermuda II.

I should point out that Don Farmer here is, as you probably know, head of our Bureau of International Aviation.

The CHAIRMAN. In your testimony, you object to the provisions requiring expedited treatment for applications of carriers from countries with the least restrictive agreements.

Now our intent with that clause was to provide some added incentive to other countries to enter into less restrictive bilaterals. If that causes anxiety, are there any other legislative incentives that we can properly offer to foreign governments to increase the attractiveness of procompetitive agreements?

Mr. KAHN. Well, I think the best thing you can do, Senator, is first of all, what you do in the declaration of policy, make it clear that the United States should not grant rights to foreign carriers under bilaterals, except in exchange for improved competitive opportunities, including improved opportunities for American carriers.

If you hold our noses to that grindstone, then you can be reasonably sure that when a 402 comes to us, an application, whether it is from a country that has a relatively illiberal bilateral or one that has a relatively liberal one, you can be sure that that particular application, is in exchange for some real benefits for the United States.

And in those circumstances, I think we ought to move just as fast as we can on that as on the others.

I don't mean to stand or fall on my feeling about the other. It does seem to have an illiberal connotation and I think it is much better for you to have those positive statements.

You handle 402s fast and don't give rights that lead to 402s, except in exchange for liberalizations for American carriers.

The CHAIRMAN. Now you object in your statement to the percentage limits that we put in for the sale of charter trips by direct air carriers. And certainly, there is no magic in those particular numbers.

One reasonable alternative would be to leave that detail to the Board for a rulemaking procedure to be started.

Our reason for including percentage limits is that we have no desire to subvert the tour operators. We want charter operators to be able to sell their product at their own risk, when no tour operator is willing to take the financial risk.

Now do you believe the present Board would be guided by similar motives if we left the percentage limit to the Board for a rulemaking process?

Mr. KAHN. Well, I think the Board surely would, Senator, if you include it in there, some expression of your desire to preserve market opportunities for the tour operators. But we are dealing here with a question of equity, really. The tour operators, insofar as their business is to sell air transportation charters, setting aside the ground packages, are, in large measure, a creation of the artificial restrictions that the Board has imposed in the past on charters and on supplementals.

That is the whole scheme of protective tariffs and that has given rise, in large measure, to an expanded tour operator industry, and therefore, the tour operators do have a legitimate complaint.

Now that those barriers are coming down, many of which were, in effect, created artificial opportunities for them. So I can't quarrel with Congress if it says, well, we feel that these people deserve a fair treatment.

Now whether you achieve that by enjoining the Board to take that into account or by putting in percentage limits, is a little bid hard for me to argue with.

I guess just in principle, I believe in administrative flexibility providing Congress provides the statements of the goals by which they are to be guided.

The CHAIRMAN. In your testimony, you object to the test we apply to mergers between supplementals and scheduled carriers. Our current law prohibits mergers between these classes of carriers because the scheduled carriers can't hold a supplemental certificate.

Would you support simply removing that legal prohibition?

Mr. KAHN. Yes. I would.

The CHAIRMAN. Getting off the track for a moment on this particular bill, I would be interested in your conceptual views on mergers in general.

Mr. KAHN. I am both tempted and scared, since we have cases before us in the present situation of the industry, where entry is not yet free—I mean, we've made a lot of commotion and gotten a lot of publicity, but we are far from there, if you define "there" as the situation in which you have something approaching free entry in the industry.

In that situation, I think it is reasonable to put a heavy burden of proof, not an insurmountable one, but a heavy burden of proof on carriers who wish to diminish the number of existing certificating carriers. When, as I say, we are not yet in the situation where you have perfectly free entry. That is to say, we are in a situation which we depend upon the carriers that are there for the competition that we hope to have in this industry.

And we are opening up opportunities for them to enter one another's markets and that is our main expectation of effective competition, at least in the years immediately ahead.

In those circumstances, it is troublesome to have them devote their entrepreneurial energies to putting together companies rather than putting together airline services. At the same time, I do fully recognize that individual mergers may make competition more effective rather than less, and I think we have to be open to demonstrations that the suppression of competition, either of existing competition or of potential competition, where there are applicants already for authority in the same markets, maybe offset by efficiency advantages, by putting together more powerful competitors, aggressive competitors, and the like.

And I guess that is my reaction on the one hand, and I guess on the other hand, the best I can do.

The CHAIRMAN. At the present time we have 32 certificated domestic airlines. Now, some people argue that to reduce that number by mergers is on its face anticompetitive. Yet, with all of those airlines, only 1 or 2, and infrequently 3 compete in any one market, so it seemed to me that the United States could have 5 airlines with nationwide service, and the result would be nearly twice as much competition as we have with 32 airlines.

Now, I'm not advocating we get down to five airlines, but what difficulties do you see in two fairly healthy smaller carriers combining to make a larger, more competitive one?

Mr. KAHN. Well, of course, again, I have to be terribly careful, since we have one such case in front of us. All I can say is that the reason I feel that they must overcome a justified expression of concern is that taking this hypothetical case of two nonexistent airlines in which each of them may well be on the verge of applying for entry into the other's territory, so that in particular markets we may be

in a situation because of the Board's new policies and because of their demonstrated planning intentions, we may be on the verge of a situation in a whole bunch of markets, that if two carriers are there converting it to three; or if there are three carriers there, converting it to four; or if one carrier, converting it to two; and in those circumstances, the immediate effect of the merger might well be to give up that opportunity for accentuating competition in that way.

However, I must repeat that they may well be able to demonstrate, these two hypothetical carriers, that the loss in numbers of not going from two to three would be offset by their far greater ability to compete with the existing carriers.

And I have said many times, you don't measure effectiveness of competition simply by numbers of competitors.

The CHAIRMAN. I don't have a question for you on your statement about the President's 801 authority, but I want to compliment you on it. As I indicated a little earlier, the personal view you provide is the most candid view of 801 that I have heard from anyone connected with the process.

I could not agree with you more that the connections between carrier designation and foreign policy to me is certainly very, very remote. And again, I want to compliment you on that.

What is the Board's position on open skies agreements, such as the one the State Department has proposed to send to Germany? And also I want to ask you what the Board's position is on the Israeli fare rejection mechanism?

Mr. KAHN. We are not—forgive me for starting with a negative—but we are not advocating universal open skies for a large number of reasons, the most obvious ones of which are that the world is filled with restrictions against the opportunities of American carriers, and we want to be certain that we don't squander our bargaining chips without being certain that we get an exchange.

Relaxations of those discriminations, some of them very severe, we want to make sure that we get a quid pro quo. The German situation, however, as I guess Undersecretary Cooper pointed out to you yesterday, is so strategic, not only because of the size of the German market—I mean, it is our second largest market in Europe. But also because of the location of Germany and the importance of Germany in the continent.

And in the context of ECAC, the European group that generally when it talks as a group, talks in a very protective, restrictive, reactionary way so that it seems to us that for that reason, if we could get from the Germans the kind of liberalizations that we want, it would be an enormous step forward in terms of achieving exactly the goals that you have set forth in this proposed legislation.

And I think Secretary Cooper outlined to you the specific provisions of that. That does not mean, for example, that we are proposing to give Germany unlimited fifth freedom rights beyond the United States. We recognize that if we were to give them the right to go from anywhere in Germany to any city in the United States that that offers them a much larger market than we are offered by having the right to go to any city in Germany.

And therefore we would insist on liberal fifth freedom rights, relaxation of capacity restrictions on beyond-Germany flights on numbers of seats and so on and change of gauge.

So, this seems to us a case in which that bargain might be of vital importance in terms of trying to achieve what we want to achieve, again, in terms of obliterating or going farther to obliterate the residual atmosphere of Bermuda II.

There are still countries that come to us and say: "You did it for the British. Aren't we friends of yours, too?" Now, that gets to the Israeli fares agreement, as I recall you were asking me about. The fact that it takes both sides to reject a fare, that seems to us of very great value in the particular context of the German case, because we are just as intent, perhaps even more intent, to make it impossible for the German Government to disallow low fares for Germans who might be contemplating traveling to the United States as we are to be sure that Americans have the opportunity to have low fares and not have them disallowed, as the British would have disallowed them when we were talking about Braniff and Delta flying out of the United States to other countries.

That is to say, we are very much concerned about the American balance of payments, and we don't think it would be a satisfactory arrangement, particularly with a wealthy country like Germany which has a large potential tourist population whom we would like to attract here. We don't think it would be satisfactory to have a country of origin fare provision because that would leave the Germans free to sustain high fares coming in a westerly—in trips that originate in a westerly direction.

Now, with any of these pro-competitive agreements, there is inevitably a calculated risk. That is true of domestic policy as well, and your bill, which as you know, we are enthusiastic about, no honest person can say that he is 100-percent certain that everything is going to work out beautifully, that nobody is going to be hurt, that there may not be problems.

But we are applying these principles very selectively. We would not dream of applying them, let's say, I would not think, to collectivist countries.

The German economy is similar to ours. We do not think that there is a danger of predation, but of course if we think that does arise, then our hands are tied, because of the bilateral suspension requirement. There's always the possibility of negotiation or consultation, and of course, ultimately, if we find it is not working, of renunciation but we think it is a risk well worth taking, because we see this enormous possible advantage.

The CHAIRMAN. The question has been raised as to whether or not the Israeli agreement fare mechanism is legal, since the Federal Aviation Act requires Board review of foreign transportation fares and rates and now the United States has agreed not to do this.

Mr. KAHN. Well, this is one of those happy cases in which I can begin by saying I'm not a lawyer. The second is that our general counsel seems to feel that the executive agreement will make it legal, but beyond that maybe Don has something. He's a lawyer.

The CHAIRMAN. You are not suggesting that because we say it's legal, it's legal, were you?

Mr. KAHN. I've never done that, Senator.

Mr. FARMER. All of the agencies involved, Senator, examined the question of legality, and I think came to the same conclusion that because the President is reviewing these fare matters anyway, that he can agree with a foreign country as to how he will review them.

The CHAIRMAN. Well, all of the agencies agree that it is legal. It must be then, because that is the only thing I've known all of the agencies to agree on so far.

Mr. KAHN. Don't test us on anything else, Senator.

The CHAIRMAN. Well, my concerns were set at ease yesterday by the administration's expressed intent to limit open skies agreements to countries who truly are committed to an open, competitive environment.

Still the nagging problem that is perhaps hardest to come to grips with is the question of government subsidies to foreign air carriers.

Now, I know that you spent a great deal of time thinking about this, and I would appreciate hearing your thoughts, and I am also curious about your views of the ability of the Board to find hidden subsidization given current auditing capacity and reporting requirements.

Mr. KAHN. I'm not sure I can give you an adequate answer to the last part, butI would like to think about it and come back to you and perhaps submit something for the record.

As you say, I have thought about the subsidy question a lot, because there isn't a single airline executive abroad where foreign regulatory officials don't immediately say, you commercial idiot, what do you know about subsidies?

But there is not a single one that is able to carry the conversation to the next sentence; that is to say, they just say subsidy and then think I'm supposed to roll over and play dead.

One can of course argue in principle that if subsidies are granted, it can make route competition impossible and may necessitate government interventions.

But the critical question is: How much? You must go beyond and try to assess the danger. After all, we subsidized our carriers last year to the tune of $75 million. Now, I'm making a serious point. We don't know to what extent the subsidies that are provided to foreign carriers are merely recompenses to them for their obligation to undertake economic operations.

All we know is that that is certainly important abroad just as it is here. And that kind of subsidy associated with the burden of taking losses for serving political purposes of social purposes is no competitive threat to anybody else.

No. 2, so far I have been able to observe, subsidies are granted grudgingly and defensively. On the grudgingly. Every time some foreign airline executive comes to me and utters this horrible word subsidy, it always turns out it is not his airline that is being subsidized. It is always some other carrier, and I never have found that other one, and I have talked to a lot of foreign countries, and each one assures me that his government holds them on a very tight string and grudgingly provides the subsidy.

As best as I can tell what that means is that most countries of the world are determined for reasons of prestige or national security to

keep an airline alive and therefore to fill holes in their income statements to the minimum extent to keep them alive.

But I do not see any evidence of them anywhere. No carrier has ever been able to give me any evidence, as I say. They always stop at the first sentence of it, being used aggressively to either try to drive American carriers out of the markets of the world.

And when I talk to American carriers, though they are worried about subsidies and complain properly about discriminatory treatment, none of them doubts its ability to compete effectively with the other airlines in the world.

But if it should turn out as we get more effective competition, that some country is aggressively using subsidies and denying our carriers a fair opportunity to compete, then it seems to me that that is the time for us to intervene by imposing countervailing duties or even by imposing specific restrictions on the subsidizing country, rather than sit back and accept a regime of protectionism and cartelization and say: well, we can't have any competition because somebody might abuse it.

As I have said, that's a little bit like committing suicide for fear that you might catch a cold. Rather, let's have the competition and then use these rather specific discriminating protections if the occasion arises.

And of course that leads to a point, well, how are you going to identify it, and I'm just sorry I can't give you an adequate answer to that now, but after all, we do it in other industries.

The CHAIRMAN. Let me ask you a further question on that. What about in these open skies agreements that you enter into requiring more detailed reporting, proposing reporting requirements beyond what you presently have?

Mr. KAHN. That may be a very useful technique. I promise you we will think about that, Senator. That might be a way of doing it, that is, to insist on access to the books in some way that we do not now have in the event that this kind of problem arises.

But I think the other protection has got to be that you do it only with countries which seem willing to play essentially the same game of fair competition as we are.

The CHAIRMAN. One subject that is on both domestic and foreign air transportation and has caused some concern is the deregulation of military cargo rates.

I understand there's a difference of opinion on how military cargo rates should be handled, and there is a new cargo deregulation law. I hope the Board is planning to resolve the uncertainties surrounding these rates in the near future.

As I understand it, a number of the military contracts will soon be up for bid. I well remember when we provided for a floor on the rate to help insure that we had a CRAF capability available to the military when the need arose.

Mr. KAHN. Well, we will move just as quickly as we can, particularly on the narrow question of domestic military cargo, which our General Counsel believes we simply do not have the authority to regulate anymore. But we will of course accept, put it out for comment. We are planning specifically to put out for comment the letter we received from, I think, four members of the House Aviation Sub-

committee arguing that the legal interpretation of our General Counsel is wrong, and we will of course ask specifically for comment on that.

I have worried about the calendar and our General Counsel tells us we really don't have to worry about that; that is, we can extend the present situation perhaps long enough to give us an opportunity to make an intelligent decision, but I agree that we must resolve that as quickly as possible, Senator.

And I hope that you and your people will comment on that yourselves, since you obviously must have some views on it.

Mr. BARCLAY. Chairman Kahn, the committee is constantly given the analogy that 20 years ago the maritime industry in the United States had approximately 60 percent of foreign trade, and we now have 5.

Do you have a response to that?

Mr. KAHN. More usually the situation in the maritime industry is brought to my attention not by Americans, but by foreigners who are pleading for free competition, taxing us with a certain amount of inconsistency, and my aswer is: Well, I try to be consistent, and the situation seems to be totally different in terms of the ability and indeed the eagerness of American carriers to compete on fair terms with foreign carriers.

It just seems to be a totally different situation. I don't know that much about the maritime industry, I do confess, but it seems clear that our shipbuilding industry has a just much higher cost than foreign shipbuilding industries.

With respect to the airlines with the manufacture of aircraft, the situation is reversed. We clearly have the most powerful effectively competitive industry in the world. The same seems to be true of our airlines. They seem to have lower costs by any measure that we are able to make, and it is precisely for that reason that the other governments do have to subsidize in one way or another.

I think if it proves that at some time in the future the competition is wiping out our airline industry—and obviously if I thought that was even a reasonably high probability, I would have much greater reservations about what we're doing—but if that proves to be the case, then I suppose Congress will want to examine it and decide whether the national security is threatened by that and change our policies.

But you must make your estimates of the greatest probability. And in our judgment, the advantages to the American public as well as to the air carriers of more competitive regimes seems so great—and on the basis of the experience of the last year, which I don't think you can build a whole future world on, but certainly you can say that the fears that were expressed a year ago have proved unjustified, to put it mildly—that experience suggests to us that the opportunities are so great that as best as we can tell, we would be very foolish not to go there, always reserving the necessity for watching and seeing how things developed to see if we guessed right.

The CHAIRMAN. Well, thank you very much, Mr. Chairman. We appreciate you being here. And Mr. Farmer, you have been very helpful to us.

Mr. KAHN. Thank you, Senator.

[The statement follows:]

STATEMENT OF HON. ALFRED E. KAHN, CHAIRMAN, CIVIL AERONAUTICS BOARD

Mr. Chairman and members of the subcommittee, I am grateful for this opportunity to discuss with you the Board's view on international aviation policy generally, and on S. 3363, the International Air Transportation Competition Act of 1978, in particular. I am happy to do so for many reason, all of them I know familiar to you: first, because this is a subject to which we at the Board have devoted a great deal of attention and energy during the past year; and second, because of the genuine progress we have made during that year, in active collaboration with the other interested government agencies, in promoting the principles of free competition in international aviation.

The last time I was before your Committee to discuss this subject, the focus of my attention—and yours—was on the Bermuda II bilateral agreement with Great Britain, which, whatever else should fairly be said about it, included several central provisions—and also reflected certain critical omissions—basically in conflict with those principles; and we were all very much concerned about the danger that Bermuda II might become a precedent for future agreements. That danger has by no means entirely disappeared—that is why I particularly welcome your renewed attention to this subject; but I think you will agree that we have made remarkable progress both in the attitudes and the goals of our negotiations—our focus is now quite clearly on promoting competition and serving the interests of consumers of airline services—and in the results we have achieved.

The first and most important result has been the great intestification of competition over the North Atlantic, the enormous benefits it has conferred on travelers, and the demonstration that the conferring of these benefits can be compatible with financial health for the industry. The lesson of this experience is that competition works. The story behind this resurgence of competition should probably begin with the Board's considerable liberalization of charter rules,[1] but the dramatic event was the inauguration of Laker's Skytrain service last September, followed hard on by the introduction of budget, standby and Super-Apex fares by the scheduled carriers. Consumer response was explosive. U.S.-Europe coach, deep discount and charter traffic increased 319 percent in the first quarter of 1978 compared to the first quarter of 1977. In the New York-London market, all carriers combined recorded a 39-prcent increase in scheduled traffic during the period October 1977 through March 1978 over the same period in the preceding year.

The case of Laker is a classic illustration of the pitfalls of trying to regulate and restrict competition on the basis of assumptions about what the future holds. Opponents of Laker's service predicted it would prove an economic disaster both for Laker himself and for the other scheduled services, traffic diversion from which, they predicted, would be staggering. The first of these predictions has proven to be totally wrong. Laker's Skytrain has experience extremely high load factors, well above breakeven levels. The record on the second prediction is still incomplete. The scheduled carriers have experienced substantial growth in traffic; their load factors are running well ahead of last year. The carriers say that their true earnings, however, have been inadequate. Whether this is true we will have to judge at the end of the summer season. But there is no room for doubt that their earnings are far far better than during the 1970–75 period—before these low fares were introduced, and the financial outlook for the remainder of 1978 is very encouraging.

The second kind of progress we have made during this last year has been in the direction of ensuring the continuation of this kind of competition by moving to a competitive restructuring of international aviation markets. There is still a long way to go, and ultimate success is far from assured, but we are certainly entitled to take great satisfaction—and I do hope you do as well—from the precedent-setting procompetitive bilateral agreements we have negotiated with Belgium, the Netherlands, and Israel, as well as the substantial liberalization we have achieved in our aviation relations with Mexico, Poland, Singapore and Romania, as well as the United Kingdom—yes, the United Kingdom—in terms of expanding charter opportunities, liberalizing Fifth Freedom services, ensuring the acceptance of new lowfare offerings, and otherwise making headway in breaking down unilateral operating restrictions in international aviation. All of these agreements are based upon the strategy and principle of exchanging competitive liber-

[1] In 1975 the board authorized the One Stop Inclusive Tour Charter and in 1976 approved the Advanced Booking Charter. The OTC's required only one tour stop and the ABC's provided air only charter service.

alizations—offering additional U.S. gateways and authority in exchange for expanded opportunities for U.S. carriers, charters, and the encouragement and acceptance of low fare services—the very strategy and principles I strongly advocated before you in my testimony last fall.

As I say, there is still a long way to go, and success is far from certain. This fall the United States will conduct negotiations with the Dutch, to work out the specific provisions of the breakthrough agreement that we reached in proocol form with them last March; with the Germans, who represent one of our largest markets, and whose adherence to our policy of maximizing competitive opportunities could be crucial for our dealings with the rest of the world; and with the Japanese. These hearings are obviously very timely.

Let me turn, then, to the specific sections of S. 3363.

Section 2: Declaration of a procompetitive international aviation policy

I hope it is clear from everything the Board and I have said and done during the last year that we strongly endorse your intention here to amend the policy declaration of the Federal Aviation Act to reflect a clear Congressional intention to effect a permanent liberalization of the international aviation system. Restrictive interpretations of the Act and the lack of just such a clear mandate from the Congress have in the past resulted in confusion on the part of the Administration, the negotiators and the Board, and a failure consistently and assiduously to pursue that goal.

The fact that President Carter and all parties to negotiations are now dedicated to a competitive international aviation order is no reason for Congress to refrain from embodying that dedication in law. On the contrary, such a declaration by Congress will strengthen both our resolve and our hand in difficult negotiations that lie ahead by making it even clearer to all parties—our negotiators and their foreign counterparts—that the United States Government is committed to working to achieve such a system, and that our ability to compromise those principles by accepting the restrictions on which so many foreign governments insist is severely limited. And, of course, as in the case of domestic aviation, a clear Congressional declaration of the principle maximum reliance on competitive market forces instead of pervasive government regulation will assure that future Administrations and negotiators will not easily slip back into protectionism and cartelization.

Having expressed enthusiasm in general about your intentions here, I must cavil over some particulars. Subparagraphs (1), (2), and (3) of Section 2 seem to me unexceptionable; they are the kind of general statement of Congressional intent that we need. They might well be expanded along the lines of the seven objectives listed in the Administration's policy statement. On the other hand, subparagraphs (4) and (5) we think are more specific than is necessary or desirable. The objective of the declaration of policy is to make clear Congress' general intent. Congress should, however, not attempt to spell out in specific terms how that intent is to be effectuated or what the specific results should be. For example, the policy statement should stress Congress' desire that protectionist restrictions be eliminated; it should not attempt to catalogue those undersirable practices, because all of us in this hearing room could not compile a complete list—and if we did, it would be outdated tomorrow, when some ingenious cartelist invented a new one. This comment relates as well to the goals set out for the statutory Aviation Policy Committee in Section 9(h) of the bill.

So, I refer you to subparagraph 4 of Section 2, which proclaims the desirability of our giving expedited treatment to foreign air carriers of nations with whom the United States has entered into the liberalized bilateral agreements. It sounds like a good idea, but I believe it is not. We at the Board are giving a high priority to putting our parts of international agreements into effect just as quickly as possible, and with a great deal of success. We certainly have no objection to a legislative directive to this effect. But subparagraph 4 calls not just for expedition; it calls for discrimination between countries. This is wrong, I think, for two reasons. First, as a matter of principle, we think it conflicts with our general goal of a more competitive marketplace. That calls for our moving fast on the applications of all carriers, as we are doing—not for using differential delays to reward our friends and punish our opponents. When we have problems with other nations, whether they be unilateral restrictions, faiure to grant our carriers competitive opportunities under the bilateral agreement, or any other, there are several tools available to the Board to resolve them, including at the forefront

denying their carriers operating rights—quickly—or imposing conditions on our approvals, or imposing retaliatory restrictions on them.

The second reason is that it is our government's policy to trade opportunities for opportunities. When, therefore, we entertain an application from a foreign carrier for opportunities to which it is entitled under a bilateral— even, a generally illiberal bilateral—it will ordinarily be because our carriers enjoy some corresponding reciprocal opportunity. It may be just as important for us to move promptly in such cases as in cases that come under thoroughly liberal bilateral agreements.

We therefore recommend you delete this paragraph (4), perhaps substituting an instruction that we quickly process all applications by foreign carriers for rights to which a bilateral agreement entitles them.

The specificity of subparagraph 5 of Section 2 might have similar anticompetitive connotations. This paragraph would encourage the Board to provide domestic route authority to air carriers that at present have extensive international operations. This is a worthy cause; I agree with it. But because it is so specific, it leaves out other worthy goals, and seems therefore to give them less importance; what about them? What about domestic and international route authority for supplemental carriers? Or more international authority for domestic carriers? Is this provision intended to mean that we should be less interested in these?

We believe the best statutory approach is to cover this specific objective in a broad policy declaration directing the Board to expand opportunities for all air carriers, without creating or maintaining regulatory handicaps for any of them, whether explicitly or by implication.

Section 3: Direct sale of charter trips by supplemental carriers

Section 3 of S. 3363 would permit supplemental carriers to integrate air transportation and marketing activities. This is an important liberalization, and it would help equalize competitve opportunities between supplemental carriers and scheduled carriers. Because a proposal to allow just such integration is now before the Board, I may not comment in detail on the merits of this particular case. I can say, however, that I do not know of any general economic basis for imposing *a priori* restrictions on vertical integration in an industry like air transportation. I cannot resist pointing out also that one of the most difficult issues in our proceeding will be precisely what Congress intended in creating supplemental carriers; so I would be relieved if you would tell us.

Once again, however, your proposed formulation seems to me unnecessarily and unwisely specific, and therefore it raises more questions than it answers. What, for example, is supposed to happen after the third year? If the bill intends to allow vertical integration, why cap it at 40 percent after three years? I can understand your feeling it is probably desirable to phase this change in gradually, but how then do you know the rate of phasing you propose to provide is the correct one?

The fact that you propose to set limits and a schedule shows that you have some uncertainty about the desirability of going all the way at once. That seems to me wise. But it also means that neither you nor the Board is capable of knowing in advance how far and how fast to go. What this argues for, however, is not specifying limits and a timetable in the legislation—limits that may prove to be too fast and too generous or far too slow and stingy; it argues instead for instructing the Board to examine the matter, develop a transition mechanism and schedule, and report back to the Congress; or at least, if you prescribe a transition, for asking the Board to monitor the results and change the pace and the limits as events prove desirable.

Incidentally, also, it is not clear from the present language whether foreign carriers and scheduled carriers would have the same opportunity to market tours directly as would U.S. supplementals.

Section 4: Automatic scheduled authority for supplemental carriers

The Board has, I think you will agree, clearly demonstrated its agreement with the general purpose of this part of your bill. Our *U.S.-Benelux* case, which explores the possibility of our certifying low fare multiple carrier competition, is being handled in a highly expedited manner, in order to take full advantage of the competitive opportunities provided by our recent Dutch and Belgian agreements. The Board has made no secret of its predilection for eradicating prohibitions

against the entry into foreign air transportation of any carrier that is fit, willing and able to provide it.

We therefore think it highly desirable for Congress to confirm that supplemental carriers can engage also in scheduled air transportation. Judicial review of this issue in World vs. CAB [2] endorsed World's right to apply for scheduled authority and the Board's power to grant it, but did not guarantee that a supplemental carrier could obtain scheduled authority without surrendering its supplemental certificate.

We are concerned once again, however, that the bill specifies the process too precisely. Just at a time when we are intent on eradicating the barriers to entry to the old "club" of scheduled airlines, S. 3363 would sanction the development of a new one, restricted to a stipulated group of carriers—even though I agree these carriers have by their contributions to competition demonstrated their claim to sympathetic consideration. At least by implication this provision runs counter to our objective of expanding international aviation opportunities generally for all carriers. Perhaps most importantly, the possibility of foreign government resistance to new U.S. designations may be greater if those designations are the result of a Congressionally dictated quota, rather than issuing from a carefully-considered route proceeding.

Besides, the provision is unnecessary. If you would feel more comfortable with a statutory assurance for automatic entry, we would suggest procedural guidelines similar to the ones laid out in S. 2493, the Air Transportation Regulatory Reform Act of 1978. The provisions there would permit the Board to issue route certificates to any carrier that was determined to be fit, willing, and able to perform the air transportation specified in its application and so on, unless it is proved that issuance of the certificate would not be consistent with the public convenience and necessity. We would enthusiastically support the application of that test to entry into international air transportation.

Section 5: Eliminating the hearing requirement for foreign air carrier permits

We enthusiastically support this provision, which would eliminate the requirement that a hearing be held on route applications by foreign air carriers, and amend the public interest standard in section 402 of the Act that applies to these cases. Both of these changes promise to reduce unnecessary barriers to timely Board action on such applications—something that is particularly desirable since delays in granting agreed-upon route authority have long been a source of irritation to our foreign negotiating partners.

Like my predecessors, I have actively sought to reduce regulatory lag at the board. One of our major successes has been in processing foreign air carrier applications, because we have increasingly used written show cause rather than oral, trial-type hearing procedures. These written procedures have enabled us to act more quickly on the less complicated applications without, I trust, a noticeable loss in the quality of our decisions.

You will undoubtedly hear the argument that eliminating the Section 402(d) hearing requirement will deprive opponents of essential procedural rights. We do not agree. The proposed amendment simply ensures that the Board will be able to use a measure of judgment in deciding which procedures are necessary to resolve fully the particular issues of fact and law involved in each 402 applications; it should not prevent us from using oral hearing procedures when the circumstances required. I assure you we are interested in making the correct decisions not merely the fastest.

I also applaud the proposed amendment that would allow us to issue a foreign air carrier permit without applying the traditional "public interest" test if the applicant is designated for these services under the terms of an agreement. The public interest criterion is already largely considered satisfied by the existence of a bilateral agreement authorizing the requested operating rights. The amendment will remove the need for some applicants providing certain types of evidence—an unnecessary and burdensome requirement in these cases.

While you are considering amendments to Section 402(d), I suggest that you pause to consider deleting the hearing requirement as well in Section 402(f), which deals with the Board's power to alter, amend, or terminate permits. You have quite properly focused on the need for prompt action in granting a foreign air carrier permit. It is equally important that we be empowered to act promptly

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[2] *World Airways, Inc.* v. *CAB*, 547 F. 2d 695 (D.C. Cir. 1976); cert. denied sub nom *American Airlines, Inc.* v. *World Airways, Inc.*, 431 U.S. 915 (1977).

to amend or terminate one, as required by the public interest. I urge your favorable consideration of this deletion.

In this same vein, I should point out that other reform bills—H.R. 12611 and S. 2493—contain important provisions that would extend our Section 416 exemption power to include foreign direct and indirect air carriers and relax the restrictions on its use. While I prefer the more liberal Senate amendment, which requires only that we exercise our authority in the public interest, enactment of either of these provisions would provide us with the acutely needed ability to expand our permit authority temporarily without the delay inherent in hearing procedures. During a strike, for example, a foreign air carrier may be the only one available to serve the public promptly; the present statute simply prohibits us from providing it with exemption authority to do so. I refrain from urging you to include a similar amendment in this bill only because the Senate has already passed S. 2493.

Section 6: Mergers and consolidations in international air transportation

Section 6 would alter our powers over consolidations and mergers by creating a rebuttable presumption in favor of approving combinations of scheduled and supplemental air carriers. In my opinion this amendment is unnecessary and potentially anticompetitive.

Even under existing case law, it is the opponents of a merger who must bear the burden of proving its undesirability; so the change this proposal would make is not great. Still, if Congress were to pass this section, it would be telling us that the burden of proof on the opponents of a merger ought somehow to be even heavier than it is—suggesting there is something wrong with our present review process. Yet I am not aware of any responsible finding that the Board—or the antitrust agencies, for that matter—has been too tough on mergers.

The ultimate present legal test applied to mergers is whether, all things considered, they will impair the effectiveness of competition in the marketplace. I find it difficult to understand why there would be a proposal to apply a more lenient test incorporated in a statute whose entire thrust is toward relying increasingly on competition and decreasingly on regulation—whether by governments or combinations of private parties—to protect the public.

Section 7: Prohibition of international rate making agreements

On June 9, 1978, the Board issued an order to show cause why our long-standing immunization from the antitrust laws of consultations and agreements among U.S. and foreign air carriers on the price and conditions of service for much of the world's international air transportation should not be ended. As you know, our tentative majority view is that we should not continue to approve—and thereby immunize—such agreements, specifically the IATA rate-fixing mechanisms. Since, however, this proceeding is still going on, I believe it would not be proper for me to discuss the merits of Section 7 of S. 3363.

Section 8: Presidential authority to review the board's international decisions

This section of the bill would limit the President's review of the Board's international decisions to cases dealing with foreign carriers. So it would end Presidential review of 401 route decisions and carrier selections and of our suspensions or disallowances of United States carriers' fares. The Board has not taken a definitive position on the 801 process; we think the pertinent considerations are of a kind best left to Congress. I certainly could not say that there are not legitimate foreign policy issues in these decisions, such as might well justify Presidential review.

I have, however, personally found presidential intervention in the selection of one U.S. carrier over another to serve a partcular route troublesome—indeed fundamentally objectionable as a matter of principle—and not, I assure you, because I have had the experience of being overturned myself in one such case. I do not doubt that even in such choices foreign policy considerations may be at stake. But the connection with foreign policy is surely remote, and the undesirability of the present situation undeniable. It is manifestly troublesome for the President to have the authority, and therefore the temptation, to change—without explanation and without the possibility of judicial review[3]—the administrative

[3] See *Braniff Airways, Inc.* v. *CAB* (Chicago-Montreal), C.A.D.C. Nos. 76-2043 et al., July 11, 1978.

decisions of an independent regulatory agency, reached through elaborate quasi-judicial procedures in the "sunshine," with full justifications on the basis of a public record. The exercise of this authority is so undermining of public confidence in the integrity of the process and the connection with foreign policy so remote, I should think a President might well be relieved to be relieved of it.

Section 9: Organization for international aviation negotiations

Section 9 of the bill would establish an Office of International Aviation Negotiations in the Executive Office of the President, establish an international aviation advisory group, and formalize the process of developing international aviation policy and implementing it.

When I testified last fall in favor of setting up some sort of formal interagency council for this purpose, the existing procedures were still quite inadequate. The much needed mechanism for formal consultation among the interested agencies was not yet clearly established and recognized. There was still bureaucratic jockeying for leadership—indeed for the dominant if not exclusive role in the process—and as a result we were still far from having developed and agreed to a consistent philosophy and an integrated strategy.

Largely, no doubt, because of the dissatisfaction with Bermuda II, which appeared to have taken the shape it did because of poor integration of our negotiating effort at that time, but largely, also, because of the consistently pro-competitive philosophy of the President and of the leaders in Congress, the situation has enormously improved. The inter-agency committee is an extremely active, effective planning body, in matters ranging from broad policy formulation to the supervision of moment-to-moment negotiating tactics, and in my judgment setting up some other agency for this purpose would be both unnecessary and counterproductive.

At the same time I continue to believe, as I did then, that the institutionalization of this mechanism by statute would be highly desirable. There have continued to be incidents or near incidents of negotiation by one or another member of the group, uncoordinated by the group, and the temptation persists to engage in independent action, in fragmented negotiations or uncoordinated, premature public discussion of unresolved issues in ongoing negotiations—all of which a formal statutory constitution of the group would discourage. Institutionalization of the present arrangement will also help ensure its continued effective functioning after the present members have gone on, and ensure continuity of the coordinated effort, which is, I take it, the major objective of the proposed legislation.

We oppose establishing a new separate agency in the Executive Office of the President because it would be both unnecessary and duplicative. We would strongly prefer to see Congress establish formally the present Interagency Group, chaired by the Department of State, with full membership participation by the CAB, DOT, DOJ, Commerce, OMB and the White House Domestic Policy Staff, which develops negotiation positions through consensus. There is no escapting the desirability of involving in the international aviation negotiation process the several agencies with clear statutory responsibilities in this area—avation safety, economic regulation, developing U.S. travel and tourism, the national defense, as well as general foreign policy, economic and diplomatic. Setting up yet another agency will not eliminate the need for a consensus among these groups; and I believe you could not do better than the Department of State, in selecting a chairman for the group and the actual negotiators.

S. 3363 evidently contemplates that the new, separate Office of International Aviation Negotiations would develop its own staff. This would require a large organization, which would be in large measure duplicative of present organizations. This is so because the Board and the other agencies would still have statutory obligations related to international aviation, for which they would continue to require staff, as well as maintain quite close contact with the negotiations process. The Board's responsibilities for certificating U.S. and foreign carriers, passing on international tariff filings, and so on, requires a day-to-day working knowledge of the international system. I suspect that other agencies would be in the same situation.

The level of duplication that would inevitably result seems to conflict not only with the President's reorganization objectives, but with everyone's desire to reduce the size of government.

We already involve all interested parties—representatives of the carriers, labor, consumer groups—in advising the interagency committee and the negotiating

teams, but I see no reason why the mechanism should not be institutionalized, as the bill would do, in constituting an International Aviation Advisory Counsel. The present arrangements are ad hoc, the interested groups do not have complete assurance they will be regularly consulted, and I see no reason not to give them that assurance. To avoid the pitfalls of excessive specification I would suggest the bill leave it to the Interagency Committee to define the interests to be represented and the working arrangements, and also that it be authorized to pay the expenses of the members to all meetings and negotiations.

In summary, Mr. Chairman, we feel that things are going very well in our international aviation policy, in no small measure because of the continuous scrutiny by this Committee. We know where we want to go, and we feel we are very well organized to mount the best possible effort to get there. We therefore strongly approve the effort in S. 3363 to have Congress proclaim that policy, give guidance to its development and effectuation, and legitimacy to the institutions that have evolved to carry it out. We ask you only to avoid, in your zeal, issuing to us instructions so detailed and prescriptive they became a straight jacket, or to impose on the process unnecessary additional machinery.

[The following information was subsequently received for the record:]

CIVIL AERONAUTICS BOARD,
Washington, D.C., Oct. 2, 1978.

Hon. HOWARD W. CANNON,
Chairman Committee on Commerce, Science, and Transportation,
U. S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In the course of the recent hearings conducted by the Senate Subcommittee on the "International Air Transportation Competition Act of 1978" (S. 3363), I said I might have some additional views to furnish for the record. Attached is a statement that I trust will satisfy more fully the question you raised in the hearings about the ability of the Board to uncover hidden subsidizations, with our current auditing capacity and reporting requirements.

As always, it was a pleasure to appear before you, and to exchange ideas.

With warm regards,

Sincerely,

ALFRED E. KAHN, *Chairman.*

Enclosure.

CAB RESPONSE TO SENATOR CANNON'S QUESTIONS

Senator CANNON. I would appreciate hearing your thoughts, and I am also curious about your views of the ability of the Board to find hidden subsidization given current auditing capacity and reporting requirements . . . What about in these open skies agreements that you enter into requiring more detailed reporting, proposing reporting requirements beyond what you presently have?

CAB RESPONSE. Explicit, direct subsidy of the type that shows up in carrier accounts usually is evident from public sources such as carriers' annual reports. In any event Lufthansa, the sole German scheduled international air carrier, has not received such direct payments in recent years, and large payments of this type seem to be infrequent among major aviation countries recently. The most important type of financial assistance foreign governments give their air carriers are indirect: assumptions and guarantees of debts, favorable tax treatment, and reduced charges for ancillary services such as en-route communication facilities and landing fees. These are quite difficult to evaluate, and perhaps even to detect, particularly in the very common situation where a government owns the controlling interest in the stock of its flag carrier. For instance, when a carrier converts government-held debts to equity (as Lufthansa has done in recent years), it may be difficult to prove that the transaction took place at a rate so different from the market price as to amount to a subsidy. Because of these complexities, a financial reporting system for foreign air carriers probably would have to be unduly burdensome to be effective.

Even with substantially broadened U.S. reporting requirements, it is questionable whether any reporting mechanisms we might add would be useful. For example, since 1974 our carriers have been required to report data on charges by foreign governments and foreign entities for en-route and airport facilities and services. A review by the Board's staff of recent filings has revealed several problems encountered by the carriers in completing their reports. Some foreign governments do not provide the carriers with a breakdown of the total charges by the

cost categories shown on these schedules. Carriers also have found that billings from the foreign governments are not always received in time to meet the quarterly filing requirements. The foreign governments' unit measures for reporting are not always clear and this sometimes produces inconsistencies. This experience illustrates some of the kinds of difficulty we might expect to encouter from systemic collection of data directly from foreign governments of their carriers.

Some examples of indirect subsidy can be gleaned from the information now available to us from public sources and reports submitted by U.S.-flag carriers. This information is so voluminous and difficult to interpret, however, that a comprehensive, continuous analysis of all indirect assistance even by major aviation countries probably is beyond our accounting capability. Nevertheless, assuming satisfactory access to the necessary financial information, we believe we do have the capability to monitor the German market and evaluate claims of subsidized conduct by the German air carrier. This does not mean that we claim the ability to trace every dollar through the German international aviation system; but the levels of subsidy associated with truly predatory conduct would be so substantial that the information necessary to detect subsidized predatory conduct would not necessarily have to be tremendously detailed to be satisfactory.

Your questions about our ability to obtain the necessary financial information are quite well taken, because the U.S. Government has experienced difficulty in the past obtaining information from foreign transportation firms. The usual source of this difficulty has been foreign government regulations forbidding disclosure. Thus, it probably would be necessary for us to have the cooperation of the foreign government to investigate any claim of predation by a foreign carrier, particularly when it is alleged to be able to engage in predation because of government subsidy. For this reason, our proposal in the German negotiations contains a provision that the governments will exchange accounting information necessary to review claims that a price is predatory.

If our proposal is adopted, we probably will rely primarily on the cooperation of the German Government to produce the information necessary to evaluate individual prices. If we choose to obtain financial information directly from a foreign air carrier, we now have statutory authority to inspect foreign carrier records. Section 407(e) of the Federal Aviation Act, as amended by the International Air Transportation Fair Competitive Practices Act, gave us access to the property and records of foreign air carriers. We have used that inspection authority on the ad hoc basis to examine foreign air carrier records located in the United States, although we have never attempted a full audit of a foreign carrier's records located here. We have not yet attempted to test whether section 407(e) as amended provides authority for inspections for Board personnel outside the United States. Assuming no interference by the foreign governments, we believe we have adequate authority to conduct these inspections. The effectiveness of our statutory powers to order production of records located aboard may, of course, be impaired by laws in several countries that deny or limit the production of records located in their territory. Many European countries, including Germany, have such laws.

The subcommittee should understand that, even with adequate accounting information and audit capability, the complexities of the international aviation system may render any judgment on subsidy a quite debatable undertaking. This is particularly true in the case of Germany, where virtually the entire national transportation and travel industry are controlled to varying degrees by various government entities. There also is the likelihood of an argument on whether certain operations of a large international air carrier are "cross-subsidized" from profits of other operations rather than subsidized directly by the government. I am sure you remember the difficulties associated with the cross-subsidy claims in the legislative hearings on domestic regulatory reform.

In conclusion, it is largely a judgment call whether foreign government subsidy would impair the competitive processes that our proposal to the Germans would, if accepted, stimulate. My judgment is that the proposal will work, and will bring competitive improvements that will be of great benefit to consumers, workers, and airlines. It is also my judgment that those benefits are so large, and our ability to find and correct abuses of the proposal is satisfactory enough, that we should press forward with it.

The CHAIRMAN. The next witness is Mr. Edward J. Driscoll, president of the National Air Carriers Association.

All right, gentlemen, you may proceed.

STATEMENT OF EDWARD J. DRISCOLL, PRESIDENT, NATIONAL AIR CARRIER ASSOCIATION, WASHINGTON, D.C.; ACCOMPANIED BY GLENN CRAMER, CHAIRMAN, TRANS-INTERNATIONAL AIRLINES; WILLIAM HARDENSTINE, SENIOR VICE PRESIDENT, WORLD AIRWAYS; AND CHARLES MONI, SPECIAL ASSISTANT TO THE PRESIDENT OF EVERGREEN INTERNATIONAL AIRLINES

Mr. DRISCOLL. Mr. Chairman, we are pleased to be here this morning. I would like to introduce the individuals with me.

On my left, as you know, is Mr. Glenn Cramer, chairman of Trans-International Airlines; on my immediate right, Mr. William Hardenstine, senior vice president of World Airways; and on my extreme right, Mr. Charles Moni, special assistant to the president of Evergreen International Airlines.

We are pleased to be here and to express the views of NACA and its member carriers with respect to S. 3363 and international air transportation, generally.

Mr. Chairman, we are indeed gratified and pleased that you and Senator Pearson have recognized the plight of the supplemental carriers by proposing in S. 3363 that they be given an equal opportunity to compete. This, I'm sure you realize, is long overdue for the few remaining supplemental carriers who are the survivors and the pioneers who developed low-cost charter air transportation. They have served as the competitive spur in striving to make low-cost air transportation service available to the public.

It is amazing to us, however, Mr. Chairman, that while everybody has appeared to recognize the contribution the supplementals have made to stimulate competition and make low-cost service available, to date, no new increased authority has been given these carriers to enable them to continue to compete on an equal basis in both domestic and international markets. Therefore, we are gratified that you and Senator Pearson have recognized that some overt action is required or proposed to take and correct this deficiency.

I don't intend to be overly critical of the CAB, for, indeed, under the chairmanship of Dr. Kahn and his other associates, they are striving to take and create increased opportunities and give increased authority to not only the supplementals but to all other classes of carriers. It appears to us, however, that all the other classes have already benefited and we, the supplementals, are still waiting to receive the first authority.

We do recognize the *Benelux* case, and the fact that we are applicants in it as well as others pending before the Board. We do recognize that the Board is proposing to grant exemptions to permit immediate entry into some of these markets, but even under the best of circumstances, if the Board uses the exemption route, surely competitors will challenge that in the courts, and it may result in a stay or in our having to wait even longer to enjoy the authority.

Therefore, since we at present are only authorized to engage in charter air transportation, we believe we need much more authority to give us the equal opportunity to compete.

Now, the recent changes that have been made in the rules and regulations governing charters have prompted U.S. carriers and foreign carriers to propose more and more low-cost promotional fares. This myriad of low-cost promotional fares being offered today by the scheduled carriers, both U.S. and foreign, competition in the international service has become very acute. Large charter programs that were initially committed to the supplemental carriers for this summer's operation to and from Europe have been canceled. These cancellations have resulted in carriers having to shift and reshape their plans for programs, performing substitute service for other carriers, and picking up increased operations for the military in order to utilize the capacity freed by reason of cancellations.

This problem resulted in the CAB taking emergency actions trying to aid, to stem the tide. Those actions were advanced so that public charters which they have now issued. But all of these actions combined have not stemmed the tide against the supplementals.

The supplementals, as a class, are still feeling the extreme threat of excessive competition with their hands tied behind their backs and not being able to fight effectively in the marketplace.

To dramatize this, look at what has happened in the first 6 months of this year as opposed to the 6 months of 1977. The supplemental industry suffered a severe setback in the first half of 1978; while they enjoyed a 9.8-percent rise in revenues, operating expenses increased 11.3. The operating profit enjoyed in the first half of 1977, $1.1 million, was transformed into a $2 million loss. While the industry almost broke even in the first half of 1977 after consideration of nonoperating items, the comparable 1978 experience was a $2 million net loss.

One carrier enjoyed a profit increase. That carrier had a sizable cargo as well as passenger operation. The results of the third quarter will be extremely important, as historically this has been the heaviest traffic season for the U.S. supplemental airlines. Unless there is a substantial turn-around in operating results, 1978 will be an extremely poor year.

I would like now, sir, to address the specifies of your legislation.

Section 2, the declaration of policy. We wholeheartedly support your declaration of policy but feel in two instances that it may not be broad enough or specific enough to give the necessary guidelines to the executive departments who, of course, implement the international aviation policy.

We believe that section 2 should be amended to include the following factors: (a) the development and maintenance of an efficient and reliable U.S. air transport system; and (b) the need to foster a sound U.S. air transport industry to meet the needs of U.S. commerce, the Postal Service, and the Department of Defense.

While we recognize that one might say that these are implicit in the proposed subparagraph (b) (2) of section 102, we believe it should be made quite explicit, as otherwise those responsible for implementing the policy may conclude that it serves the interest of the consumer to have excessively low fares, possibly predatory, being offered by foreign air carriers with which U.S. carriers cannot compete without considering the adverse effects such a system could have on other

competing and equally essential goals, such as the Postal Service and, more importantly, the national defense.

I believe our proposals are specifically designed to protect the interest of the consumer and the overall U.S. interest in a sound air transportation system on a more balanced basis.

If one considers the broad public interest which we believe is the criteria that should be followed, this would include consumers' and the shippers' interests.

Section 3, the sale of charters by direct air carriers. We are indeed gratified again, Mr. Chairman, that you have recognized the need of the supplementals and other charter carriers to be able to (the scheduled carriers) to sell their product to the general public.

We believe this is long overdue. We have had petitions pending before the CAB for this authority for over 2 years. The Board has not granted it domestically. However, they have granted the U.S. carriers the right to market charters, foreign-originating, ABC type. We do believe, however, that the percentages you have proposed are rather minimal and will not permit the carriers to effectively develop the markets themselves.

We recommend that carriers be authorized to market between 20 and 25 percent of the revenue passenger-miles flown by the carrier in foreign air transportation the first year, increasing to 40 to 50 percent the second year, and thereafter be permitted to market up to 100 percent of the revenue passenger-miles flown by the carrier during the previous year.

We do appreciate the interest and the support you have indicated by proposing to permit us to market our programs, but we feel we would be less than candid with you if we merely endorsed the percentages that you have suggested, as marketing by direct air carriers is absolutely essential if the air carrier and the public are to be served through the charter system.

I'm sure that you are aware that many tour operators have terminated operations, such as Pathfinder, Nationwide Leisure, and most recently, Elkin Tours. Several of our carriers have experienced large cancellations by tour operators. One carrier sustained a large cancellation as a result of Pathfinder going out of business, $12 million. Another carrier had a $10 million program with Elkin for next year. And one carrier had in excess of a $20 million program canceled as a result of a tour operator being unable or unwilling to market vis-a-vis the low scheduled service.

Mr. Laker in his testimony, we are advised, will state that the public must be assured that charter programs are going to continue to operate if they are going to utilize them. We firmly believe that. If programs can be canceled at will by tour operators and the carrier has no place to turn to continue that program himself, then the public and the carrier suffer severely.

This is what happened in the case of World Airways with their $20 million program. They could not market themselves. The tour operator had canceled. They had to go and try to find substitute service to use that unleased capability.

Again, the carrier having authority to market himself will add increased competition, not lessened competition, in the marketplace and

will aid existing tour operators by permitting affiliations with direct air carriers and/or joint marketing programs with the carrier assuming part of the risk.

Individual arrangements, however, must be left to the individual discretion of the direct air carriers, whether he markets directly through an affiliate, through joint ventures, or otherwise. Only through this method can we be assured that the public will be served in the best possible way.

Again, Mr. Chairman, every time anyone proposes to change the system that exists, we always seem to run up against the thought that the supplemental carriers are different from anybody else, that they are not permitted to engage in individually ticketed operations and should not be permitted. We think it is time, and we hope you will agree, that the stigma that has been attached to the supplemental carriers, going back to the 1962 period when we were created, is long overdue for removal.

We have recommended the use of revenue passenger miles rather than charter trips. Since this is a figure that is reported to the Board, we believe it to be more meaningful and more easily measurable and, in fact, it is necessary to get to a common denominator to determine how and what percentage you would be able to market.

Now, scheduled authority for the supplementals, we believe this authority is urgently needed to enable them to have that equal opportunity that we all talk about. While we fully subscribe to the intent and the basis of the legislation, we do, however, recommend that (1) of proposed section 401(q) be changed to permit the service to be either nonstop or via other U.S. points.

This change would enable communities that might not be able to support nonstop service to a foreign destination to enjoy single-plane service vis-a-vis another traffic point.

There are many points in the United States, we feel, that fall into this class, and we feel that we would be benefiting the marketplace by being able to add those points to the five points suggested in your legislation.

No doubt you and we have heard testimony during these proceedings that we should be required to take and get our authority through the 401 procedure. We are trying that, Senator. The question is, has anybody ever been grandfathered into the act? We believe they have. Everybody else seems to think, from their testimony, that this is unusual. You did this in 1938 and the Congress did it again in enacting section 418.

We think we have proved ourselves in the marketplace. We think the requirement for our service exists, and therefore we see no reason why we should not be given this authority by the legislative route.

Section 5, foreign air carrier permits—we fully subscribe to this section, but we would add language that we believe would be more express by stating that in issuing a 402 permit the Board shall confine itself to the actual exchange of rights embodied in the agreement; if no agreement exists, then it should be limited to comity and reciprocity.

We have had experiences where, after negotiation of Bermuda II, which excluded fifth freedom operations, the Board has gone ahead and recommended that British interests be given fifth freedom operations even though U.S. carriers cannot enjoy fifth freedom operations. We think that is wrong.

I believe Mr. Cooper's statement yesterday suggested, also, that the permits conform to the agreements negotiated.

Section 6, consolidation of scheduled and supplemental carriers—we support that. We believe in many instances a strengthened air carrier may be able to add more competition in a free, open, competitive market than if he is a weak carrier.

The international ratemaking agreements—we support the elimination of these types of agreements. We don't believe they serve any purpose. We have been the victims of these agreements, and they have been used in a very predatory manner against the low-cost system of the charter companies.

With regard to section 8, Presidential authority—we also support the intent of this section. I'm sure you are well aware that the rate-setting area, after a lengthy proceeding, the Board, the Department of Justice, everybody finding that the rates were predatory, the President overturned the Board. You asked the question this morning as to whether or not the super apex fares had been detrimental to the supplemental carriers. Not only those but some of the other low fares in existence, I would say, are the results or the cause of the results I have enumerated during the first 8 months of 1978.

As far as international negotiations are concerned, we subscribe to what you recommend. We do believe there is a need for one point in the United States that does have responsibility and authority to control international negotiations. We believe it is important from the foreign government standpoint and, more importantly, from the U.S. standpoint. We believe that setting up a special organization by statute will insure continuity from administration to administration.

I think we could look at the Bermuda II results, Senator, and say, would that result have happened had the Carter administration been in power or had there been a continuing element in the Government that could have handled the transition, because that agreement was the result of a crossover between administrations? I think we all know the results of that.

Likewise, we support the formation of the advisory council and the membership of that. We would, however, suggest that it be made clear within section 9, as it hasn't so far as congressional representation is concerned, that air carriers and other interests will also be entitled to have either observer status or technical adviser status on all delegations in all negotiations, discussions, or consultations. If the industry is expected to give effective advice on these matters, it cannot do so in a vacuum; it must be a full participant in all areas affecting negotiations.

There are a few additional matters I would like to discuss, and these relate to the agreements—basically, the United States/United Kingdom, United States/Dutch, United States/Israel, and the proposed United States/Germany.

The United States/United Kingdom air bilateral needs little comment. We consider it to be the most anticompetitive agreement the United States has ever entered into. It doesn't give what is needed, and even if, under your legislation, we were given five pairs of points, we, the supplementals, could not operate under the agreement between any major traffic point in the United States and the United Kingdom, because designations are limited on the major traffic points.

The Dutch agreement we support. We believed that was to be a model agreement to overcome the stigma, if you will, of Bermuda II. It did contain a new type rate article, a rate article, however, that preserved within the United States the right to suspend any fare that was predatory, monopolistic, or discriminatory. It also assured a free competitive systems between the United States and Holland.

However, we now get to the Israeli agreement. There we came up with a new rate clause. You have seen, I believe, the memorandum attached to our statement. We are the ones that firmly believe that that rate clause is illegal. We believe that it violates the existing Federal Aviation Act, and we believe it is not in the public interest to have a rate article that does not permit the United States to act unilaterally when a rate is clearly predatory, discriminatory, or monopolistic.

Notwithstanding all of the arguments that can be made and that we have heard made, I don't believe we have heard one that clearly addresses what happens, other than denunciation or renouncing the agreement in the event of a predatory fare exists and the other government refuses to eliminate it. I don't think we should have to have an agreement that goes to renunciation in order to take effective action to cure the problem of predation or monopolistic-type activity.

Insofar as the open skies with Germany is concerned, we are naturally concerned as to what this really means. We have been unable to come to a hard judgment because we don't believe there are enough facts available on which to make judgments. We believe, Mr. Chairman, that at a minimum the Government should be required in this context to set out an analysis showing the benefits and detriments, to get all comments on those, and then make the hard judgment.

Now, admittedly, it is going to be a value judgment, but somebody has to make that judgment. Is it made just from the seat of the pants, or is it made from exploring what the best minds in the business and the Government and the Congress can add to saying whether this is good or bad? We think that exploration is necessary. We would hope your committee would ask them to do this, and we would hope that the Government would not proceed with this negotiation until such time as that is accomplished and everyone is satisfied that this is in the best interests of the United States.

Two other items, sir, that come up as the result of testimony. One, the part charter issue is raised by both the State Department witness and by the ATA witness.

We believe that the carriers already have part charters. They can have any level of fare they want. We don't know why they keep insisting, or the Government keeps insisting that they want a charter transfer facility. That was inadvertently permitted to go into operation this

summer by the Civil Aeronautics Board who immediately terminated it after it was in effect for 1 month. That resulted in mammoth cancellations, transfers of programs that were booked with supplemental carriers on to line service, and it was creating havoc in the marketplace. So we don't see any purpose to be served by establishing these charters. They are free to establish any level or rate they want. Why they want to get into this other, we don't know.

The other thing, sir, is a matter of information, and that was your last question to Dr. Kahn concerning 288.

We do understand that the military and the Board have made arrangements whereby the 1979 fiscal year program will be handled under the 288, and that the Board in the meantime will consider what it does with that type of operation. I think there may be hearings scheduled early next year in the House on it. They could not get to it this year. They had them scheduled and canceled because, again, one of the agencies that was key was unable to give its clear position on what it wanted—the military.

So, I think that is an item to be considered. The immediate part is being covered by permitting the contracts to go forward, and the administration of the 288 system, with the remaining part to be argued out over the next several months.

Sir, that concludes our prepared statement. We are all here, and we are prepared to answer any questions that you would care to put to us.

The CHAIRMAN. In your testimony you refer to predatory and discriminatory fares in international aviation.

What, specifically, do you consider predatory? Super apex? Laker fares? Or both?

Mr. DRISCOLL. We did not consider the Laker fares predatory, sir; we considered the Laker fare to be based on a full type operation that Laker had demonstrated he could operate.

The super apex, there was little doubt in our mind that, based upon the cost of performing that, it was a predatory type fare and that it was not based on recovering the cost of performing the service, that it wasn't on a fully allocated basis.

And in that latter instance the Department of Justice concurred in our proposal when we filed it with the Board objecting to that fare. The Board itself found that to be predatory. It was the President that overturned it, sir.

The CHAIRMAN. How do you believe public policyowners should balance the predatory nature of any of those fares on the supplementals with the tremendous passenger response and obvious consumer interest in these low scheduled fares?

Mr. DRISCOLL. Sir, I'm not so sure how it balances that except to probably look at what the results are, and they are able to make judgments in advance.

Now, certainly, there has been a large public response to these low fares. I have some preliminary data that one of our economists developed for us which would show the effect possibly of some of those low fares in the scheduled service which may go as part of an answer to the question you raise, Senator.

In the first 6 months of 1978 Pan Am and TWA together experienced a 3.8-percent rise in revenues. Nonetheless, their operating profit, which totaled $4.5 million in the first half of 1977, was wiped out in the corresponding months of 1978. For the latter 6 months the operating loss was $126,000. Net profits, which totaled $1.6 million in the first half of 1977, were replaced by net losses of $12.85 million in the same period of 1978.

This turnaround resulted from higher expenses, probably incurred to accommodate the surge of low yielding fare traffic.

Now, that shows a potential result. We are not trying to say that the public is not entitled to the lowest reasonable fare. We believe they are. That is what we have tried to do. But we believe the fare has to be economical. Otherwise, in the long term, it does not satisfy the interest of the consumers.

The CHAIRMAN. I'm not familiar with those figures that you gave. Is that simply the North Atlantic? Is that systemwide, or what?

Mr. DRISCOLL. This is the North Atlantic, I believe, sir.

I would submit these for the record, if you would like.

This, as I say, is one of our economist's analysis.

The CHAIRMAN. We would like to have that submitted for the record, if you would.

[The following information was subsequently received for the record:]

The Supplemental industry suffered a severe setback in the first half of 1978 despite a 9.8 percent rise in revenues. The operating profit enjoyed in the first half of 1977—$1.1 million—was transformed into a $2 million loss. While the industry almost broke even in the first half of 1977 after consideration of nonoperating items, their comparable 1978 experience was a $2 million net loss.

This highly unfavorable charter experience is not unusual. Pan American, the world's largest charter carrier, lost $5.2 million on its transatlantic passenger charter business in the year ended March 31, 1978 and an additional $1 million loss on its charter operations in Latin America. Pan Am has, therefore, sought to raise its charter rates.[1] This will, of course, make its charter less competitive with its scheduled fare structure, the very same fares against which the supplementals must compete.

The low fares on scheduled international services do not seem to be as helpful to the scheduled carriers as might be expected. This is clear from comparing lackluster operating results in the transatlantic, where discount fares traffic is the overwhelming majority, with the glowing results of operations domestically, where discount fare traffic still remains a growing but distinct minority. (The bulk of the supplementals operations are on the transatlantic.

In the first six months of 1978, PAA and TWA together experienced a 3.8 percent rise in revenues. Nonetheless, their operating profit, which totalled $4.5 million in the first half of 1977, was wiped out in the corresponding months of 1978. For the latter 6 months, the operating loss was $126,000. Net profits, which totalled $1.6 million in the first half of 1977, were replaced by net losses of $12.85 million in the same period of 1978. This turnaround resulted from higher expenses probably incurred to accommodate the surge of low-yielding fare traffic.

At the same time, eight domestic operators (American, Braniff, Continental, Delta, Eastern, TWA, United, and Western) boosted their operating profit margin by 82 percent derived from a revenue rise of 21 percent. Costs increased less than 20 percent. Net profits for the eight carriers in the first half of 1978 were 3.7 times their corresponding 1977 level.

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[1] Filing July 19, 1978.

COMPARATIVE FINANCIAL DATA, 1ST HALF: 1978 VERSUS 1977— 8 DOMESTIC TRUNKS VERSUS TWA/PAA TRANSATLANTIC

	6-mo ended		
	June 1978	June 1977	Percent change
8 domestic carriers (AA, BN, CO, DL, EA, TWA, CIA, and WA):			
Total operating revenues	$6, 911, 069, 768	$5, 709, 620, 230	+21. 0
Total operating expenses	6, 657, 416, 059	5, 570, 462, 172	+19. 6
Total operating profit (loss)	253, 653, 709	139, 158, 058	+82. 2
Total net profit (loss)	293, 100, 102	79, 512, 451	+26. 8
2 transatlantic carriers (TWA and Pan Am):			
Total operating revenues	770, 160, 895	741, 555, 895	3. 8
Total operating expense	770, 287, 218	737, 053, 218	4. 5
Total operating profit (loss)	−126, 323	4, 502, 677	−102. 8
Total net profit (loss)	−12, 845, 552	1, 632, 971	−886. 6

COMPARATIVE FINANCIAL DATA, 1ST HALF: 1978—8 DOMESTIC TRUNKS VERSUS TWA/PAA TRANSATLANTIC

	Total operating revenues	Operating expenses	Operating profit (loss)	Net income
8 domestic carriers (AA, BN, CO, DL. EA, TWA, UA, and WA):				
American	$1, 133, 209, 000	$1, 106, 401, 000	$26, 808, 000	$31, 223, 000
Braniff	344, 140, 080	320, 311, 633	32, 828, 447	11, 269, 905
Continental	352, 719, 038	332, 516, 708	20, 202, 330	31, 592, 550
Eastern	864, 804, 693	833, 714, 089	31, 090, 604	36, 354, 622
Delta	883, 692, 248	803, 619, 585	80, 070, 663	68, 991, 411
United	1, 613, 225, 694	1, 521, 200, 934	92, 024, 760	106, 134, 319
Western	312, 614, 927	306, 150, 890	6, 464, 037	18, 916, 362
TWA-Domestic	777, 937, 112	785, 779, 408	−7, 842, 296	−11, 382, 067
Total	6, 911, 069, 768	6, 657, 416, 059	253, 653, 709	293, 100, 102
TWA-Atlantic	321, 103, 895	307, 146, 218	13, 957, 677	11, 052, 448
Pan Am-Atlantic	449, 057, 000	463, 141, 000	−14, 084, 000	−23, 898, 000

COMPARATIVE FINICIAL DATA, 1st HALF: 1977—8 DOMESTIC TRUNKS VERSUS TWA/PAA TRANSATLANTIC

1st and 2d quarters 1977	Total operating revenues	Operating expenses	Operating profit (loss)	Net income
American	$1, 133, 209, 000	$1, 106, 401, 000	$26, 808, 000	$31, 223, 000
Braniff	344 140, 080	320, 311, 633	23, 828, 447	11, 269, 905
Continental	352, 719, 038	332, 516, 708	20, 202, 330	31, 592, 550
TWA	864, 804, 693	833, 714, 089	31, 090, 604	36, 354, 622
United	883, 692, 248	803, 619, 585	80, 072, 663	68, 991, 411
Eastern	1, 613, 225, 694	1, 521, 200, 934	92, 024, 760	106, 134, 319
Delta	312, 614, 927	306, 150, 890	6, 464, 037	18, 916, 362
Western	777, 937, 112	785, 779, 408	(−7, 842, 296)	(−11, 382, 067)
2 Atlantic carriers:				
TWA	321, 103, 895	307, 146, 218	13, 957, 677	11, 052, 448
Pan-Am	449, 057, 000	463, 141, 000	−14, 084, 000	−23, 898, 000

The CHAIRMAN. You expressed difficulties with the percentages provided in section 3 of S. 3363. Most of the previous witnesses have also noted their concern with writing these percentages into a statute.

What would be your position if we mandated an expedited CAB rulemaking to establish direct charter sales but left the percentages up to the Board to decide?

Mr. DRISCOLL. Sir, from what I heard Dr. Kahn say this morning, I think we would have to say that would be agreeable.

We do believe that the instructions to the Board, though, should make it clear that it is the intent of Congress that the carriers be

authorized to market themselves and the percentages to be arrived at by the Board.

The CHAIRMAN. Most of the previous witnesses have objected to the specifics spelled out in section 4 of the bill. You have also suggested changes in that section.

Would NACA support a mandated 7-month rulemaking for scheduled international authority open to all carriers to apply and providing no maximum or minimum number of markets to be awarded?

Mr. DRISCOLL. Sir, I think I have to answer that this way. Yes; if we had our druthers, however, we would prefer what is in your legislation for the one reason, that if that legislation could be enacted, it would insure immediate action.

Now, you are saying a mandatory 7 months to get us the authority. That also would be acceptable. We couldn't turn that down, provided we could get that authority within that 7-month period. We are desperate here to have that equal opportunity to compete. We don' have it. I think you can see from our results of this first 6 months, something has to happen; otherwise, the supplementals will cease to exist, at least some of them.

You have Overseas National suspending operations. The other carriers—if you just look at results—it is a question of how long can they continue in the marketplace without some additional authority?

The CHAIRMAN. NACA and Senator Pearson and myself seem to be the only people from the testimony to date who like the new office that the bill creates in the White House for international aviation negotiations. If that suggestion doesn't fly, I am wondering what you think of Chairman Kahn's suggestion that the present structure be made legislatively permanent.

Mr. DRISCOLL. I'm not so sure, sir, that that is the answer, either. We did, in line with a GAO report, submit comments recommending that the office be in the office of the President. As an alternative to that we suggested that it be a cabinet-level officer, preferably the DOT that should head it.

I think, however, that if that is the only alternative to your legislation, that you confirm. I think we still would have possibly a revolving chairmanship, and where would the authority be given in? Would you really have what I envision your legislation is designed to do—to create an office that is an enduring and a continuing office that goes from administration to administration? Admittedly, the head of that office can change, but at least you have a professional staff that provides the continuity, and I think that is what is required.

It is the lack of continuity from administration to administration that we saw you trying to get at and that we feel is absolutely essential.

The CHAIRMAN. Throughout the NACA statement, you cite your desire for an opportunity to compete. If we take State and DOT at their word that they will not propose liberal policies to bilateral partners who provide substantial subsidies to their carriers, why are you so hesitant to have an open skies proposal under which you can choose your own market and set your own fares without Government interference?

Mr. DRISCOLL. We have said on the open skies that we're not worried as much about that as we are this rate clause that is attached to the open skies.

We say we don't have enough information to make a sound judgment on the open skies proposal at this point as to whether it is or is not in the best interest. Just given the open skies without the rate clause, I think we could come to a decision if we had basic facts that it probably might be in the best interest of the United States.

With the rate clause, once you set in motion the complete open skies, allow anybody to operate at any rate level they want, without the power of the United States to step in, except through renunciation to abort a predatory discriminatory and monopolistic fare, I think the United States takes a very grave risk, and I think our air carriers stand a very grave risk, because we do not believe that you can really determine whether a foreign carrier is a risk being subsidized.

I know we've tried. We talked to them also, as Dr. Kahn said. We know from comparing, if you will, what price of fuel they pay in Europe versus the price we pay, that there are differences. Theirs are much less than ours.

So, there are advantages that a foreign carrier has in setting much lower rates, and I guess I get down to the point, sir, that we are concerned that the U.S. Government possibly—and I say possibly—I've heard statements to this effect—believes that a foreign carrier operating lower fare service into the United States is good, because it gives the consumer the advantage of a lower fare, notwithstanding whether the U.S. carrier can compete with that or not.

Statements have been made, if you can't compete, get out of the market.

Now, I ask, does that go to a sound air transportation system for the United States? Certainly somebody in Government should be making a judgment on given fares as to whether they are predatory, discriminatory, and monopolistic. I don't think you can give that over and say we will sit down between government A and government B and decide, because basically your foreign carrier, when he files a rate, has the approval of his government to begin with.

He is owned by the government, so that therefore to expect that government to agree with the United States, I think, is not being very practical.

The CHAIRMAN. Do any of your colleagues have any comments? Mr. Cramer?

Mr. CRAMER. No; I'm here just in support of Mr. Driscoll. I feel that he has expressed our views very clearly, and we do endorse the changes that you have suggested in the legislation, and feel it is high time that we were given an opportunity to compete without the stigma that is placed on us of not being able to market our own services for the last 16 years.

We think we should gain admittance to the union finally and go ahead.

The CHAIRMAN. Mr. Hardenstine?

Mr. HARDENSTINE. I would like also to support Mr. Driscoll, and I will support Mr. Cramer. May I only say that we must find a way that either the carriers or the tour operators are able to guarantee a charter departure; without this guarantee, the public is going to shift over to the various other low fares, and you will find a disappearance of the charter mode as we know it today.

The CHAIRMAN. Mr. Moni?

Mr. MONI. Senator, I think that we support everything that has been said here, and by and large are very pleased that the program that you have offered—let me call it a resolution of many of the problems that the supplementals encounter.

We are terribly interested in the affirmation of the suggestion that the carriers be given five route segments over which to operate, and somewhat in contrast with Mr. Kahn's comments, we really don't feel that this is creating a new grandfather group. We rather believe that it is an excellent way to bring a group which has been significantly handicapped for the reasons that other people have outlined, up to a level where it has a solid enough base to really develop and become an effective competitive aspect in the air transportation business.

Evergreen is the newest company, but certainly it adheres to the record of the other members of the supplemental group, and we believe that as many people say, the record has been outstanding.

We see no reason why that same cost effectiveness cannot be translated into scheduled operating service. If the permits are granted, we would be very keen to see your program adopted.

I think that is our main feeling about it.

The CHAIRMAN. Mr. Driscoll, I wonder if you would supply for the record your total capacity for 1977 and 1978, and then the unused capacity for those 2 years as well?

Mr. DRISCOLL. All right.[1]

The CHAIRMAN. Thank you very much, gentlemen. We appreciate you being here and making your presentations.

[The statement follows:]

STATEMENT OF EDWARD J. DRISCOLL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL AIR CARRIER ASSOCIATION

I appreciate this opportunity to present to this committee the views of the National Air Carriers Association and its member carriers with respect to S. 3363 and international air transportation, generally. NACA represents the principal supplemental air carriers, the charter specialists of the air transport industry. You will recall that when we presented our views to you in connection with S. 689 and other bills relating to domestic regulatory reform, we commented on aspects affecting international air transportation. You will also recall that at the time we appeared before you we clearly stated: "What is needed is carefully-structured and evenhanded reform aimed at bringing about increased competition, greater opportunity for entry and minimum restraint on free enterprise, but which at the same time does not permit unfair or predatory competitive practices."

We are indeed gratified that you, Mr. Chairman, and Senator Pearson have recognized the plight of the supplemental carriers by proposing through S. 3363 that they be given an equal opportunity to compete. This, I am sure you realize, is long overdue for the few remaining supplemental carriers who are the survivors of the pioneers who developed low-cost charter air transportation. They have served as the competitive spur in striving to make low-cost air transportation service available to the public.

The regulatory reform proposals which you, Senator Pearson, Senator Kennedy and others have spearheaded have awakened the entire nation—regulatory agencies and, in fact, entire administrations—to the fact that changes in our air transport industry are long overdue. Even though your bill, S. 2493, has not been enacted into law, many of the changes you have advocated have already been placed into effect by the Civil Aeronautics Board and others are in the offing.

[1] See p. 127.

More low-cost service is available to the public today than ever before and the competition in the marketplace has intensified between the scheduled carriers and the charter-only carriers to the point that unless some action is taken to give the charter-only carriers that equal opportunity to compete, they may not survive. I am sure you are well aware that Overseas National has announced plans to liquidate its operation by the end of September of this year.

It is amazing to us, Mr. Chairman, that while everyone has appeared to recognize the contribution the supplementals have made to stimulate competition and make low-cost service available, to date no increased authority has been given these carriers to enable them to continue to compete on an equal basis in both domestic and international markets.

I don't intend to be overly critical of the Civil Aeronautics Board, for under the new emphasis being applied by Doctor Kahn and others, some proceedings are underway which hopefully and eventually will grant new authority to the supplemental carriers along with other applicants in route proceedings. I am sure you, as well as others, have heard the compliments of the supplemental carriers about their past and present accomplishments and statements that they will be granted authority to perform individually-ticketed service into the Benelux countries as well as other countries; that they will be permitted to operate all-cargo charter service; that restrictions on their operation in the charter mode should be eliminated; that they should be able to market their own product; but the bottom line is—to date the U.S. supplemental carriers have received no increased authority.

In January of this year we made an overview presentation to the Board, the Department of Transportation and the Congress. We outlined the plight of the supplementals and the fact that we needed that equal opportunity to compete. Eight months later we are still saying we need that equal opportunity to compete. Everybody appears to agree, but we do not have the required authority to permit us an equal opportunity in the marketplace.

Prior to going into a detailed discussion of the International Air Transport Policy, I thought it would be helpful to the Committee if I summarized briefly the status of the supplementals, how they are affected in the international transportation system, and the fact that the supplementals' overriding requirement continues to be for "an equal opportunity to compete".

Since the supplemental carriers engage only in charter service, I believe it is quite easy to understand the competition that they are up against due to the low-cost, individually-ticketed services being offered by not only the U.S. international scheduled carriers, but also the foreign scheduled carriers as well as the foreign charter carriers who are authorized to serve and provide air transportation service to and from the United States. The U.S. supplemental carriers have been the spur, which this Congress created, to foster and develop competition and they have been the leaders in providing low-cost service to enable the entire public to travel on low-cost charters. These carriers have pioneered the system of charter and have succeeded in their goals and objectives of getting rules and regulations reshaped so that today, a realistic system with minimum restrictions is in effect in the U.S. The record abroad of our carriers and indeed the United States in promoting realistic rules and regulations governing charters has not been too successful. We presently have a limited number of agreements with countries which permit operation under what we term country-of-origin rules. For the most part, foreign countries have adopted their own rules. These rules are highly restrictive requiring long advance booking or purchase, limited substitution, and other restrictions which inhibit the ability of independent carriers engaged only in charter to readily compete against low-fare systems of an individually-ticketed nature. It must be recognized that the main interest of foreign countries is in the protection of their national flag carriers and regular scheduled service rather than the promotion of low-cost opportunities in the charter field.

The recent changes which have been made in the rules and regulations governing charter service have prompted U.S. carriers and foreign carriers to propose very low-cost promotional type fares that are designed to eliminate to a large extent the need for charter service. These low-cost fares are not only predatory type fares, but are also discriminatory in that they are cross-subsidized by higher rated, individually-ticketed fares, such as, the normal economy fare.

Because of the myriad of below-cost promotional fares being offered today by the scheduled carriers, both U.S. and foreign competition in the international service has become very acute. Large charter programs that were initially com-

mitted to supplemental air carriers for this summer to and from Europe have been canceled. These cancellations resulted in carriers having to shift and reshape their plans for programs, performing substitute service for other carriers and picking up increased operations for the military in order to utilize the capacity freed by reason of cancellations.

This problem resulted in the U.S. Civil Aeronautics Board taking emergency action to grant waivers of existing rules and regulations governing the operation of charters and placing in effect some of the rules that were under consideration for adoption in the new charter-type program known as "Public Charters". The Board issued the new Public Charter rules on August 17. Even with these waivers the supplemental air carriers, the charter specialists, continued to face not only excessive competition, but an increasing awareness of their inability to compete with their hand tied behind their backs against the individually-ticketed, low-cost fares of the scheduled carriers. While the new Public Charter rules will be helpful, they will not provide the authority needed by the supplemental air carriers to enable them to compete in the marketplace.

The current situation has sharpened and emphasized the need of these smaller carriers to have an "equal opportunity to compete" in the marketplace. While we know that the Civil Aeronautics Board is considering the possibility of certificating some supplemental carriers in the individually-ticketed service, such proceeding will take an excessive amount of time and even if the Board grants exemptions and authorizes the carriers to enter the field, pending certification, such actions will no doubt be challenged in the courts. This again reemphasizes in our minds the need for this Congress to take action by legislation to authorize the U.S. supplemental air carriers to engage in individually-ticketed air transportation. There is also the necessity, as we see it, for the Congress to make sure that the Civil Aeronautics Board has the requisite authority to authorize the exemptions that are in the public interest so that they do not spend needless and frustrating hours, days and weeks arguing the matters in the courts while the public interest hangs in the balance.

The supplemental industry suffered a severe setback in the first half of 1978. While they enjoyed a 9.8% rise in revenues, operating expenses increased 11.3%. The operating profit enjoyed in the first half of 1977—$1.1 million—was transformed in a $2 million loss. While the industry almost broke even in the first half of 1977, after consideration of non-operating items, their comparable 1978 experience was a $2 million net loss. One carrier enjoyed a profit increase but had a sizeable cargo as well as passenger operation.

The results of the third quarter will be extremely important, as historically this is the heaviest traffic season for the U.S. supplemental airlines. Unless there is a substantial turnaround in operating results, 1978 will be an extremely poor year for the supplemental industry.

I will now address the specifics of S. 3363.

SEC. 2.—DECLARATION OF POLICY

While as you know, the supplementals have lived in a completely competitive environment since the beginning, they have, during this period, been subjected to predatory type actions from foreign scheduled carriers as well as U.S. scheduled carriers. Fares filed through the IATA mechanism have maintained, as I noted previously, very high normal economy fares while at the same time below-cost promotional fares which are cross-subsidized by the higher economy fares. This has the effect of making it difficult for U.S. charter-only air carriers to operate in the marketplace. Without some degree of protection from such predatory actions, the U.S. air transport system can be adversely impacted. We believe Sec. 2 should, in addition to the factors enumerated, contain the following provisions: (a) the development and maintenance of an efficient and reliable U.S. air transport system and (b) the need to foster a sound U.S. air transport industry to meet the needs of U.S. commerce, the Postal Service and the Department of Defense.

While one might say that those are implicit in the proposed Sub Sec. (b) (2) of Sec. 102, we believe it should be made quite explicit, as otherwise, those responsible for implementing the policy may conclude that it serves the interest of the consumer to have excessively low fares—possibly predatory—being offered by foreign air carriers (with which U.S. carriers cannot compete on an economic basis) without considering the adverse effect such a system could have on other competing and equally essential goals, such as, the Postal Service or, more

importantly, the national defense. The U.S. air carriers are committed to the Department of Defense under the Civil Reserve Air Fleet program, and it is our view that the public interest requires that the Board and others, in implementing decisions on international air transport policy, take this into consideration. I have attached to my statement, as EXHIBIT 1, the recent submission we made to the Secretary of Transportation in connection with he review of U.S. International Air Transport Policy. I believe our proposals are specifically designed to protect the interest of the consumer and the overall U.S. interest in a sound air transportation system on a more balanced basis. If one considers the broad public interest, this includes the consumers' and the shippers' interests. In other words, we believe that there is more to be considered in the international arena than just the traveling public's interest or the shippers' interest. We must consider the fundamental interest of the United States in having a viable, responsible U.S. air transport industry that is second to none.

SEC. 3.—SALE OF CHARTER TRIPS BY DIRECT CARRIERS

As we have indicated previously, we fully support the intent of your bill to permit direct air carriers to sell a percentage of their charter trips directly to the public. We believe this is long overdue. We have had petitions pending before the Civil Aeronautics Board requesting this authority for over two years. The Board has never formally ruled on our applications for authority to market charter traffic from the United States to foreign destinations. They have, however, granted authority for U.S. carriers to market foreign-originating ABC type traffic. We do support the philosophy of permitting direct air carriers to market charters. Likewise we agree that a gradual phase-in of direct air carriers' marketing their own charters is appropriate. We believe, however, that the percentages you have proposed are rather minimum and will not permit the carriers to effectively develop the markets themselves. We recommend the carriers be authorized to market 20 to 25 percent of the revenue passenger miles flown by the carrier in foreign air transportation the first year, increasing to 40 to 50 percent the second year and that thereafter the carrier be permitted to market up to 100 percent of the revenue passenger miles flown by he carrier in foreign air transportation during the previous year.

We do appreciate the interest and the support you have indicated by proposing to permit us to market our charter programs, but we feel we would be less than candid with you if we merely endorsed the percentages you have suggested.

Marketing by direct air carriers is absolutely essential if the air carrier and the public are to be served through the charter system. I am sure you are aware of the high cancellation rate that the air carriers have experienced in 1978. In some instances whole programs canceled as a result of individually-ticketed, low-fare competition with the charter-only carrier left with capacity no one would market, and he unable to market himself because of the existing restrictions. I am sure you are also aware that many tour operators have terminated operations, such as, Pathfinder, Nationwide Leisure and most recently, Elkin Tours. Several of our carriers have experienced large cancellations by tour operators. One carrier sustained a large cancellation as a result of Pathfinder going out of business (12 million dollars). One of the carriers had a 10 million-dollar program for the next year booked with Elkin Tours; and one carrier had in excess of a 20 million-dollar program canceled as a result of the tour operator being unable or unwilling to market vis-a-vis the low-scheduled fares. I believe, Mr. Laker made the case in his testimony that the public must be assured that the charters will operate if they are to continue to utilize them. An air carrier being able to market himself can provide that assurance. The carrier having authority to market himself will add increased competition, not lessened competition in the market-place and will aid existing tour operators by permitting affiliations with direct air carriers and/or joint marketing programs with the carrier assuming part of the risk.

Individual arrangements, however, must be left to the individual discretion of the direct air carriers; i.e., whether he markets directly through an affiliate, through joint ventures or otherwise. Only through this method can we assure that the public will be served in the best possible way.

I am sure you are aware that every time regulations are changed or the laws are changed, everyone seeks by some method to distinguish individually-ticketed service from charter service on the theory that the Congress did not intend supplemental carriers to operate individually-ticketed service. We believe it is time to put an end to that stigma which has been attached to the supplementals since

1962. We believe the public interest requires that this class of carrier be entitled to market charters or individually-ticketed service on the same basis that any scheduled carrier can or any foreign carrier can. We also believe that the grant of the power to sell directly includes all of the authority to sell through an affiliate and to utilize that affiliate subject to the limitation of what can be marketed directly on the same basis that any other charter operator or tour operator operates.

We have recommended the use of revenue passenger miles as opposed to charter trips on the basis that this is a figure normally reported to the Civil Aeronautics Board and used throughout the industry. It is really the lowest common denominator, as charter trips could be a charter by a 727, DC–8, DC–10 or 747.

SEC. 4.—SCHEDULED AUTHORITY FOR SUPPLEMENTAL CARRIERS

The authority proposed in Sec. 4 is needed urgently by the supplemental carriers to enable them, as we have said, to have an equal opportunity to compete in the marketplace. We believe the direct grant by the Congress is warranted based upon the record that the remaining supplemental carriers have demonstrated in the marketplace. They have, as we have stated, been the spur that has developed the low-cost charter system. A spur is a continuing requirement; and the supplementals should be permitted to serve as the spur in ensuring that low-cost scheduled air transportation systems are available to the public. We interpret that the proposed grant would cover all aspects of air transportation, including mail, cargo and passengers and that the certificates to be granted by the Board would be the same as certificates which have been granted to other carriers to perform foreign air transportation.

While we fully subscribe to the intent and the basis of the legislation, we do recommend, however, that sub (1) of proposed Sec, 401(q) be changed to permit the service to be either nonstop or via other U.S. points. This change would enable communities that might not be able to support nonstop service to a foreign destination to enjoy single-plane service via another traffic point.

There are many points in the United States that do generate substantial foreign travel but not sufficient to warrant non-stop service to that foreign destination. Being permitted to serve these points in conjunction with the five pairs of points for pickup of traffic, will aid in developing those points for possible nonstop service in the future. We believe that our recommendation is consistent with the overall goal of expanding international air travel into as many new potential gateway points as possible.

We have in our opening remarks called your attention to the fact that there are many proceedings pending before the Board. These are lengthy proceedings; and the Board, as we understand it, may grant exemptions to perform service in certain markets pending completion of the 401 proceeding. While we welcome this initiative of the Board, we do believe that the direct grant by the Congress will eliminate needless litigation that might be involved in the grant of exemptions and might expedite the grant of such authority to the supplemental carriers. Mr. Chairman, we cannot emphasize too strongly the need for immediate action for this, as we are disadvantaged in the marketplace and without increased authority, the remaining supplemental carrier operations will no doubt be adversely affected.

No doubt you will hear testimony during these proceedings that if the supplementals are to be certificated, let them be treated the same as all other carriers; i.e., let them apply and go through the 401 proceeding. We have applied. We are involved in 401 proceedings. We call to your attention the fact that in Sec. 418 legislation carriers were grandfathered. When the Federal Aviation Act of 1938 was adopted, carriers were grandfathered; because in both instances these carriers had demonstrated their fitness, ability to operate and there was an assumed need for their service. We believe the same factors are present here. The keynote of this legislation and of the Administrations' international aviation program is competition. We believe we have earned the right to compete. We believe the public is entitled to the competitive spur we can add to the scheduled system the same as we have added to the charter system.

SEC. 5.—FOREIGN AIR CARRIER PERMITS

We fully subscribe to the provisions of Sec. 5. We would add, however, that we believe that that section could be more express by stating that the Board in issuing a 402 permit shall confine it to the precise terms of the agreement where

an agreement exists or in the case where an agreement does not exist, such will be based on comity and reciprocity as it exists at the time of performing the air transportation service.

Recently, the Board has recommended to the President permits for foreign air carriers which go beyond the scope of the agreement entered into, specifically, fifth freedom rights for British interests when, in fact, fifth freedom was specifically excluded from Bermuda 2 and comity and reciprocity did not exist.

We see no basis in fact or in logic for granting a foreign carrier a permit in excess of the agreement between countries or to grant a permit to a foreign carrier on a greater basis than that carrier's government would accord to a U.S. air carrier.

If the principles we have enumerated are followed, we believe the ability of U.S. air carriers to obtain greater access and greater authority from foreign governments shall result.

SEC. 6.—CONSOLIDATION OF SCHEDULED AND SUPPLEMENTAL AIR CARRIERS

We fully support Sec. 6. We believe this again is a provision designed to permit in a new environment the possible merger of scheduled and supplemental carriers in the best interest of the traveling public.

There may be many instances where the consolidation of a supplemental and a scheduled will result in creating a strengthened air carrier who can better survive in a truly competitive market with all the resources necessary to meet full competition. We see no reason to deny the benefits of such an arrangement to the traveling public.

SEC. 7.—INTERNATIONAL RATE-MAKING AGREEMENTS

With regard to international rate-making agreements, we support the proposed legislation. The supplemental air carriers have felt the effects of international rate-making agreements which were designed to keep basic fares high while at the same time establishing predatory fares to compete with charters where the high fare cross-subsidized the lower. These types of agreements are not in the public interest. They can be used to monopolize by driving other carriers from the market.

We recognize the Board has instituted a Show Cause Order in connection with these matters, but at the present time we would favor legislation which would outlaw any such type agreements.

SEC. 8.—PRESIDENTIAL AUTHORITY

We fully support the intent of this section. We believe that the Board's decision with regard to U.S. air carriers in certificate proceedings or rate cases should be final. We do recognize, however, that foreign policy considerations might be present in considering foreign air carrier applications or foreign air carrier rates. Therefore, permitting Presidential review is appropriate.

I am sure the Committee is well aware that in the rate-making area, after a lengthy proceeding in which the Board determined rates were predatory, the President did reverse the Board not on foreign policy grounds, but on what he determined foreign economic policy. We don't believe the use of the term "foreign policy" in the existing statute or in your proposed amendment extends to foreign economic policy. The President, under the existing statute, is limited to foreign policy or national defense considerations. The President should not be able to overturn the Board on economic matters. The President has no authority to review decisions of the Board affecting domestic air transportation with regard to carrier selection or rate matters. Therefore, we believe it perfectly consistent for the Congress to mandate that with respect to U.S. air carries, the same pocess is followed in foreign air transportation matters; i.e., that the decision of the Civil Aeronautics Board is final.

SEC. 9.—INTERNATIONAL NEGOTIATIONS

We fully support the proposed legislation which would create within the Executive Office of the President the Office of International Negotiations. We believe this again is something that is long overdue.

International aviation organization within the Executive Branch has changed from Administration to Administration. In some, the President has had a special

assistant. In others, he has had an individual who served in that capacity along with other duties. In some, no particular individual has been specified or designated. This has not only resulted in confusion within the United States; but imagine, if you will, a foreign government trying to determine who is the responsible individual in the United States.

With all due respect to the fact that the President has recently considered this matter and has indicated that the Department of State will exercise the leadership role for negotiations; that the Secretary of Transportation will exercise the leadership for long-range policy and that the CAB will participate in both. We firmly believe that there should be one individual in any administration charged with responsibility for conducting international aviation negotiations with foreign governments. This will create stability withn our government and will provide the proper continuity so needed as administrations change, as professional staff attached to this office will continue.

We likewise support the formation of the Advisory Council and the membership of that.

We would, however, suggest it be made clear within Sec. 9 that air carriers and other interests will also be entitled to have either observer status or technical advisor status on all delegations in all negotiations, discussions or consultations with foreign governments. If the industry is to give effective advice on matters, it cannot do so in a vacuum. It must be a full participant in all areas affecting negotiations.

GENERAL

There are additional matters we would like to address. These are the type of agreements presently being negotiated by the United States. These involve the agreements with Holland, Israel and the proposed open skies agreement with Germany and possibly other countries.

INTERNATIONAL AGREEMENTS AND NEGOTIATIONS

Over the past year and a half the United States has entered into several different type international aviation agreements. Among these are: (1) the so-called Bermuda 2 Agreement with the United Kingdom, (2) the U.S./Dutch Agreement, (3) the U.S./Israel Agreement and (4) the proposed bilateral agreement between the U.S. and Germany.

The U.S./U.K. Air Bilateral needs little comment. We have stated our position quite clearly. We believe it a most anticompetitive type agreement. We opposed it prior to the charter accord that was reached subsequent to the scheduled accord and we still consider this agreement to be against the best interest of the public. First, it limits designation. Therefore, the U.S. supplemental carriers, if they are given the scheduled authority as proposed in your bill or by exemption granted by the Board, will be unable, unless a modification to the agreement is successfully negotiated, to operate scheduled service between major traffic points in the U.S. and the United Kingdom. Secondly, the agreement fails to recognize country-of-origin principles with respect to charters.

Needless to say, we trust that the U.S. will never enter into another such restrictive type agreement.

The U.S./Dutch Protocol was an endeavor to negotiate an agreement which would serve as a model for the rest of the world—based upon principles of competition and based upon the most liberal type agreement for scheduled and charter services. In addition to recognizing the country-of-origin rule concept with respect to charters, the agreement permits multiple designations of carriers for the performance of services, and contains a rate clause which recognizes the country-of-origin pricing, precluding the Dutch from suspending any fare for U.S.-originating traffic. The U.S. is likewise unable to suspend any fare for Dutch-originating traffic. While this is somewhat of a departure from previous agreements, we believe that it is understandable and justifiable on the basis that the U.S. has historically in some instances disclaimed jurisdiction over foreign-originating traffic and rules and regulations. Therefore, we consider the rate clause in the U.S./Netherlands Agreement to be acceptable and to be the basis for realistic agreements which should protect U.S. consumers, the public and the airlines from predatory, and/or monopolistic pricing.

Since the negotiation of the U.S./Dutch accord, certain proposals have been advanced in the United States for even more liberal agreements. In fact, some of these proposals have been advanced by other countries, such as, Germany. The

U.S. proposed the possibility of an open skies agreement. Germany, in considering its position, advised the United States that they too would agree to an open skies approach.

The question arises, what is an open skies approach? It has been defined as an exchange of route rights for scheduled service between two countries, whereby: (a) The United States would accept any and all operations conducted by German carriers into any point in the United States and in return the U.S. would be able to operate service from any point in the United States to any point in Germany. (b) It would contain an unquestionable authority for each party to designate as many carriers as they saw fit to conduct these services. (c) It would contain a rate clause similar to that contained in the Israeli Agreement. The rate clause would preclude the United States, without consultations with Germany and the agreement of both parties, from suspending any rate for U.S.-originating traffic even though that rate might be predatory, discriminatory or monopolistic. The rate could only be suspended if poth parties agreed that it was predatory, discriminatory or monopolistic. We understand that there is a possibility that the rate clause will be amended to include a provision to allow third-country carriers to either match existing fares or to file tariffs for lower fares.

The rate clause that I referred to was used for the first time in the Israeli Agreement. The United States, in our judgment, obtained Israel's agreement for that clause by authorizing Israel four additional traffic points in the United States. The agreement between Israel and the U.S. permits the operation of charters under country-of-origin rules as well as the right for the United States to designate any number of carriers the U.S. desires to perform scheduled service between the U.S. and Israel.

The rate clause, however, in our judgment, violates express provisions of the Federal Aviation Act of 1958 which requires the Civil Aeronautics Board to ensure that fares—at the very least for U.S.—originating traffic—are just and reasonable. By agreeing to the mutual rate clause, the U.S. would negate this requirement of the Act. I have attached, as Exhibit 2, a letter to the Secretaries of State and Transportation and to the Chairman of the CAB, dated July 13, setting forth our position with respect to that fare clause.

We trust, Mr. Chairman, that your committee will review the instant rate clause as well as the type of agreement the U.S. is proposing to use with Germany.

We do have a firm view with respect to that rate clause. With respect, however, to the open skies policy which the U.S. is proposing to follow, we have not arrived at a judgment as to whether this is good or bad for the United States. In order to make that type of judgment requires, we believe, more detailed analysis of the benefits and detriments that might flow from such an agreement. To our knowledge, such an analysis has not been prepared. It would appear that in all recent negotiations U.S. positions are being prepared without any detailed economic analysis as to what the consequences may be for granting additional traffic points into the United States. We understand the rationale for the U.S./Dutch Agreement and the quid pro quos that were exchanged. In that case the U.S. was attempting to establish a model to induce other countries to accept more competitive type agreements and agreements that permit the free flow of scheduled and charter services.

We are concerned, however, that a complete open skies policy may adversely impact the maintenance of a sound U.S. air transport system because foreign governments are able to subsidize their carriers for the performance of service at extremely low fares which U.S. carriers may be unable to match on a fully economic basis. Permitting an open skies approach would, at the same time, waive the U.S. right to unilaterally suspend fares that are predatory, discriminatory or monopolistic; and could subject the U.S. to unfettered competition, damaging the U.S. air transport system without providing the consumer or shipper with any long-term benefit.

We recommend that your committee consider requiring the U.S. Government to prepare and submit for review by all interested parties—airlines, consumers, unions and the Congress—analyses which indicate the benefits to be derived versus the detriments so that value judgments can be made. In addition, we would hope your committee would require the U.S. to retain authority to unilaterally suspend any fare for U.S.-originating traffic which is predatory, discriminatory or monopolistic.

Mr. Chairman, that concludes our prepared statement. We thank you again for this opportunity to present our views and we would be pleased to answer any questions you may have.

[Exhibit 1]

NATIONAL AIR CARRIER ASSOCIATION, INC. COMMENTS ON PROPOSED INTERNATIONAL AIR TRANSPORT POLICY

NACA, on behalf of its member carriers, submits the following comments with respect to the proposed International Air Transport Policy Statement.

While the proposed policy, goals, negotiating objectives and negotiating principles would appear, at first glance, to be designed to foster an expanding air transport system, increased opportunities for air carriers, promotion of low-cost air service, maximization of competition, the primary aim appears to be expanded opportunities for the benefit of the traveler and shipper without regard to the economic consequences, national interest objectives, U.S. balance of payments and national defense interests.

NACA and its member carriers do endorse the specific negotiating objectives and likewise endorse the principle of negotiating competitive opportunities rather than restrictions as well as actions which will expand the air transport system and provide service at reasonable prices.

Although we endorse the principles as stated, we fear that unless a more clear policy objective of the United States is enunciated, any policy that would appear to be designed only to provide the consumer or shipper with a lower price might not be in the public interest. If lower prices are the only objective, such a policy might permit foreign carriers, through predatory pricing, to increase their share of the market at the expense of U.S. carriers resulting in an adverse impact on developing a sound U.S. air transport industry. Such an action, however, would not necessarily be in the "public interest", as the public interest embraces, not only the consumer interest, but equally important carrier interest and most importantly the national interest.

The principle of exchanging competitive opportunities rather than restrictions can, in its broadest sense, mean the exchange of rights without restraint or without considering the value of items exchanged.

Competition, while endorsed by the NACA carriers, since this has been their way of life from their inception, can also, unless prescripted, be interpreted as the promotion of absolute competition without restraint, forcing the carriers into destructive rate wars with resulting adverse impacts upon U.S. national objectives, defense objectives, as well as placing U.S. air carriers in a disadvantageous position of attempting to compete as private enterprise with national subsidized foreign flag carriers. International competition is entirely different from domestic competition. In domestic competition the Civil Aeronautics Board has complete authority to regulate the degree of competition as well as to curtail competitive actions if they become destructive. Internationally, however, once a bilateral is entered into, the rights of the parties are governed by agreements and if the U.S. fails to retain authority to suspend unjust, discriminatory, predatory or monopolistic fares unilaterally, destructive competition will result. Likewise, in international markets once fares have been approved, the U.S. Government has no authority to suspend such fares even though they turn out to be predatory and/or destructive. The international market must clearly be distinguished in the minds of the government agency representatives responsible for negotiating bilaterals from domestic markets, since the carriers of the majority of foreign countries are subsidized directly or indirectly and therefore can withstand operating at losses; whereas, U.S. carriers, as private enterprise, must operate on a sound financial basis.

The U.S. has many objectives to be served in international markets. The sole objective should not be the obtaining of the lowest price for the consumer or shipper. The consumer is entitled to a reasonable price and the lowest reasonable price for the service provided. The U.S. interest should be threefold: Consumer interest, national interest and defense interest. All these must be blended into "public interest". Surely, the U.S. Government must recognize its fundamental obligations as mandated by the Federal Aviation Act to promote a sound, efficient and effective air transport system designed to promote the commerce of the United States, the national defense and the Postal Service.

NEGOTIATING OBJECTIVES

We fully support the negotiating objectives as set forth in the proposed policy. We endorse the statement that routes, prices, capacity, scheduled and charter rules and competition in the marketplace are interrelated, not isolated problems

to be solved independently. One of the most important steps this Administration has taken is to recognize the advantages to the consumer that have stemmed from the low-cost charter services the supplemental carriers have pioneered over the years and require that bilateral negotiations encompass charter services, charter rules and regulations on an equal basis with scheduled service. This should be one of the fundamental principles to govern international arrangements.

In arranging for exchanges of rights between countries, we must be cognizant of the opportunities that we exchange for the opportunities granted us. There must be some reasonable relationship between what we give and what we get. Obtaining rights to market charters to a destination where there is no demand for that service is of little value to the U.S. or its carriers; and if in exchange for such rights, we were to grant expanded opportunities for the foreign carrier to enter the United States to poach on U.S. traffic, whether scheduled or charter, would appear to make no economic sense. The U.S. Government should ensure that economic analyses are made prior to entering into negotiations as to the relative values of the proposed exchanges and confine such a trade to relative economic values unless the U.S. has determined, separate and apart from economic considerations, that (a) national interest, (b) political considerations or (c) other objectives warrant a grant of additional opportunities to the foreign government in excess of the value the U.S. is to obtain. Such considerations should be clearly identified and approved at the highest source. We assume that the statement in the second paragraph, Item C, "Negotiating Principles", was intended to cover this aspect: "Proposed bilateral agreements which do not meet our minimum competitive objectives will not be signed without prior Presidential approval.

RECOMMENDATIONS

1. Considering the foregoing, we believe that the U.S. should adopt the following: "International Air Transportation negotiations will be predicated on (a) public interest objectives which will include consumer interest, carrier interest and most importantly national interest, including national defense objectives; (b) competition between carriers in a fair marketplace while a fundamental aim must be tested and tempered to ensure that it does not adversely impact the national objectives, including national defense interest and the public interest in maintaining and preserving a sound U.S. air transport industry; (c) rights to be exchanged must be quantified and analyzed based upon a cost-benefit analysis approach and effective principles of comity and reciprocity.

2. We believe the Attachment 1, which is a restatement to your proposed preamble, more clearly sets forth what the U.S. interest should be rather than that proposed. We recommend it for your consideration.

3. The price explanation, set forth in your proposed explanation of objectives, does not, in our judgment, clearly set forth what should be the policy of the United States. We firmly believe that the U.S. must, as mandated by the Federal Aviation Act, preclude unjust and unreasonable rates in foreign air transportation. We therefore propose the following language to be added to Item 1, "Pricing":

"However, the U.S. will insist that all rates and fares are just and reasonable, and the U.S. Government will take action against any fare that is determined to be predatory, discriminatory, monopolistic or subsidized by a foreign government, as such fares could have an adverse affect upon U.S. national objectives."

4. We also propose that one of the United States objectives should be to provide all of its carriers an equal opportunity to compete in the marketplace. We therefore propose the following Item 7. to be added:

"*Equal opportunity to compete.*—We will insist that all of our carriers have an equal opportunity to compete vis-a-vis foreign carriers. While charters and scheduled service will be maintaineid as separate but interrelated systems of air transport, U.S. carriers providing charter service will be given equal opportunity to engage in scheduled services in order to improve the low-fare options available to consumers and shippers."

The approach we have suggested is based upon the Federal Aviation Act of 1958 as amended and the public interest criteria enunciated in Section 102. The approach set forth in your proposal assumes a modification of the governing statute which has not yet occurred. It seems to us that DOT must either issue

a statement consistent with the existing law or defer action until such time as the law, in fact, is amended in a manner consistent with your proposed policy.

Respectfully submitted.

EDWARD J. DRISCOLL,
President and Chief Executive Officer.

Attachment.

[Attachment 1]

U.S. POLICY FOR THE CONDUCT OF INTERNATIONAL AIR TRANSPORTATION NEGOTIATIONS

PREAMBLE

United States international air transportation policy, while designed to provide maximum possible benefits to travelers and shippers, such benefits must be subject to certain constraints. These constraints include the U.S. national interest in maintaining and fostering a sound U.S. air transport system, properly designed and adapted to serve the overall public interest, including our national objectives and national defense.

While it is recognized that maximum benefits can usually best be achieved through the preservation and extension of competition between independent airlines in a fair marketplace, we must recognize that competition in international air transportation poses certain problems for U.S. independent and privately financed air carriers who must compete with foreign flag carriers whose services are or can be subsidized by foreign governments. Consequently, competition in international air transportation must be tempered to ensure that it does not adversely impact our national objectives in maintaining a sound U.S. air transport industry and place U.S. air carriers in a posture of competing in an environment where predation, subsidized by foreign governments, impairs U.S. carriers' financial strength. Reliance on competitive market forces to the greatest extent possible, subject to the constraints enumerated in our international air transportation agreements, will allow the public to receive service at low costs that reflect economically efficient operations. Competition and low prices, provided they are neither predatory, discriminatory or subsidized by foreign governments are fully compatible with a sound U.S. air transport system and should aid national defense, foreign policy, national commerce objectives.

Bilateral aviation agreements, like other international agreements, should serve the interests of both parties. Other countries have an interest in the economic prosperity of their airline industries, as we do in the prosperity of ours. The United States believes this interest is best served by a policy of expansion of competitive opportunity rather than restriction. By offering more services to the public, in a healthy and fair competitive environment, the international air transport industry can stimulate the growth in traffic which contributes both to profitable industry operations and to maximum public benefits. However, exchange of rights should and must be based on a cost-benefit analysis and effective principles of comity and reciprocity consistent with the values to be exercised not to impair the U.S. ability to meet its national objectives, including tions, such as political, these must be specifically identified and care must be exercised not to impair the U.S. ability to meet its national objectives, including defense considerations.

[Exhibit 2]

NATIONAL AIR CARRIER ASSOCIATION, INC.,
July 13, 1978.

Subject: Rate Article—Israel/U.S. air transport Agreement.

Hon. CYRUS VANCE,
Secretary, U.S. Department of State, Washington, D.C.

Hon. BROCK ADAMS,
Secretary, U.S. Department of Transportation, Washington, D.C.

Hon. ALFRED E. KAHN,
Chairman, Civil Aeronautics Board, Washington, D.C.

GENTLEMEN: This will record formally the position we have been stating to representatives of your agencies for some time in connection with the current negotiations between Israel and the U.S. We have repeatedly advised that we consider the proposed Rate Article, that would require mutual agreement between Israel and the United States in order to suspend any rate of fare filed by carriers of either party in either country, not only to be objectionable from a policy standpoint but equally from a legal standpoint. (See Exhibit 1).

The action of the U.S. would waive its rights to take action against any fare even if the U.S. determines such fare to be unreasonable, predatory, discriminatory, monopolistic or subsidized by another government. Thus, in essence, the U.S. would be unable to act even though the fare may adversely affect U.S. interests, both airlines and consumers. We fail to understand, nor have any of your representatives adequately justified, why such an action is being taken.

The country-of-origin approach, as set forth in the Dutch Agreement, at least retains for the U.S. the right to act unilaterally to prevent adverse action affecting U.S. travelers. Insofar as the U.S. agreed not to interfere with fares for Netherlands-originating traffic, such forebearance is arguably consistent with Board precedent in a variety of contexts disclaiming jurisdiction over foreign-originating traffic.

In any case, there is a clear mandate in the Federal Aviation Act requiring the Civil Aeronautics Board to ensure that fares—at the very least for U.S.-originating traffic—are just and reasonable. By agreeing to the mutual rate clause, the U.S. Government would negate this requirement of the Act with respect to U.S.-Israel fares.

We believe the consequences of this action from the standpoint of precedent would amount to a clear repudiation of the policy heretofore followed, which was predicated upon the requirements of the Federal Aviation Act. The Israel agreement would set the stage and establish the precedent for use of similar rate articles with Germany and other major trading parties.

We urge that, prior to the consummation of the agreement with Israel (or any other country), the U.S. reconsider the adverse implications of its action, both in terms of law and policy, and return to a policy on rates that will enable the Board to take action against any rate that is unreasonable, predatory, discriminatory, monopolistic or subsidized by a foreign power.

Sincerely,

EDWARD J. DRISCOLL,
President and Chief, Executive Officer.

Enclosure.

[Exhibit 1]

JULY 12, 1978.

MEMORANDUM

Re: U.S.-Israel negotiations; proposed fare provision.

The proposal has been made during the recent U.S.-Israel bilateral air service negotiations that each government agree to accept any fares filed by air carriers of either country unless, in a particular case, both governments decide that a fare should be suspended. The effect of such a provision would be that the Board would forego its statutory obligation *unilaterally* to suspend, investigate and/or determine the lawfulness of rates for foreign air transportation in this market. Action of this kind, we believe, would be unlawful.

The Aviation Act commands that fares shall be just and reasonable and not unjustly discriminatory, and the Board's obligation to carry out that command could not be clearer. Under § 404(a)(2) of the Act, every air carrier and foreign air carrier is required to establish and observe "just and reasonable . . . rates, fares, and charges"; carriers are prohibited under § 404(b) from giving any "unreasonable preference" to any person, or subjecting any person to "unjust discrimination . . . or unreasonable prejudice . . . ." Under § 1002(j), the Board is "empowered" to suspend and investigate rates of air carriers and foreign air carriers, and, after hearing, to reject rates determined by the Board to be "unjust or unreasonable, or unjustly discriminatory, or unduly prejudicial. . . ." Section 1002(j)(5) lists factors that the Board "*shall* take into consideration" in exercising its authority, including revenue need of the carriers and "whether such rates will be predatory or tend to monopolize competition. . . . ."

These provisions are among the most important in the Act. When Congress adopted the international fare amendments in 1972, it was stated that this legis-

lation "imposes on air carriers and foreign air carriers engaged in foreign air transportation a duty to establish just and reasonable rates and practices. The bill would further the objective of the air transport policy of the United States to provide a system of reasonable rates taking into account both the interests of the carriers and the needs of consumers. It would * * * give the Board the statutory tools needed to perform its responsibility to protect the traveler, the shipper and air carriers by suspending and rejecting rates which are too high and rates which are destructively low." [S. Rept. 92–593, 92d Cong., 2d Sess. (1972), p. 2.]

Yet under the proposed provision, the Board would cede to a foreign government its statutory authority and responsibility to determine unilaterally whether fares in foreign air transportation are unreasonable or unjustly discriminatory, as well as its authority to prohibit the unlawful fares from taking effect. Unless the Israeli government concurred in remedial action, the Board would render itself powerless to prevent U.S. or Israeli air carriers from operating under the most blatantly unreasonable or unjustly discriminatory fares, even though such operations would violate the express provisions of §§ 404 and 1002(j).

The settled general rule is that when an executive agreement is in conflict with a statutory provision, the statute takes precedence over provisions of an executive agreement entered into pursuant to the Executive's constitutional authority.[1] *See Restatement of the Foreign Relations Law of the United States* (2d Ed. 1962), § 144:

"An executive agreement, made by the United States without reference to a treaty or act of Congress . . . and manifesting an intention that it shall become effective as domestic law of the United States at the time it becomes binding on the United States * * * does not supersede inconsistent provisions of earlier acts of Congress."

See also *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655, 658–59 (4th Cir. 1953), *aff'd* on other grounds, 348 U.S. 296 (1955), holding that an executive agreement not authorized by Congress and in conflict with a statute dealing with the same subject matter was void. Here, as already shown, the proposed fare provision is clearly inconsistent with an express command of Congress under the Act.

To be sure, § 1102 provides that the Board "[i]n exercising and performing [its] powers and duties . . . shall do so consistently with any obligation assumed [in] any agreement . . . between the United States and any foreign country. . . ." But nothing in § 1102 authorizes the Board or the Executives to nullify an express requirement of the Act by means of an intergovernmental agreement. They could not, for example, validly agree with a foreign government that an unfit foreign air carrier would receive a permit, notwithstanding the requirements of § 402(b). The Board itself has stated that "there is no express provision in section 1102 that the Board shall disregard any other express authority or prohibition of the Act, or that the Board shall fail to exercise any of its powers and duties to be performed under any of the other provisions of the Act. On the contrary, *the provisions of section 1102 clearly assume that such other powers and duties will, in general, be performed.* * * * Each provision of the Act must be given its intended meaning and effect so that each provision will, insofar as possible, harmonize with other provisions of the statute, thus permitting each provision thereof to be effective." [*Foreign Permit Investigation*, 34 C.A.B. 837, 839 (1961) (emphasis added).]

In the cited case, the Board adopted Part 213 of its Economic Regulations relying on authority in § 402 to condition the terms of foreign air carrier permits and rejecting the argument that outstanding bilateral agreements and § 1102 limited the Board's authority to act. "It certainly cannot be presumed," the Board stated, "that Congress has done a vain thing in providing the Board with the conditioning powers of section 402." (*Id.*)

Here, the proposed fare provision would require the Board to share with a foreign government—giving that government a veto—the statutory obligation, placed upon it alone, to determine the lawfulness of fares in foreign air transportation and to prevent unlawful fares from becoming or remaining effective. The proposal would thus abrogate in the U.S.-Israel market a basic command of

[1] Air bilaterals are entered into pursuant to the Executive's constitutional authority. Lowenfeld, *Aviation Law*, § 1.37(b) p. II–17.

the Act. It would mean that, for purposes of this market, Congress had indeed "done a vain thing in providing the Board with its [(§ 1002(j))] powers."

The proposed bilateral provision is plainly unlawful.

[The following information was subsequently received for the record.]

NATIONAL AIR CARRIER ASSOCIATION, INC.,
Washington, D.C., October 20,, 1978.

HON. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: You requested that we furnish for the record our "total capacity for 1977 and 1978 and then the unused capacity for those two years."

Our membership's capacity and utilization of that capacity in 1977 is set forth in Table 1. Capacity is expressed in terms of mean maximum hours available, that is, the carriers' fleet operated 14 hours per day, which represents, on average, a full day's flying. Table 1 indicates that the three NACA members (Evergreen, Trans International and World) experienced a 76 percent utilization of their fleets in 1977. Limiting our analysis to commercial passenger service, we find that in 1977 our members registered a 70 percent utilization factor.

However, 1978 to date has become memorable for the wrong reasons. The proliferation of deeply discounted fares on scheduled flights, both domestically and internationally, took a heavy toll in the charter business, with one supplemental airline and two of the country's largest charter operators calling it quits in the past year. The carrier was ONA; the tour operators were: Nationwide Leisure Corp. of Melville, N.Y.; and Elkins Tours of Southfield, Michigan.

It is highly noteworthy that the discount fares offered in the charter carriers' number one market, the transatlantic, are appreciably deeper than the highly touted domestic Super-Saver fares. The average discount on domestic Super-Saver fares is about 35 percent. This must be compared with 50 to 60 percent discounts being offered across the Atlantic on Super Apex, midweek non-affinity group, budget and standby fares.

Nonetheless, in the first six months of 1978, Evergreen, TIA and world flew 75 percent of the mean maximum capacity of their fleets. This constituted a slight improvement over the 73 percent of capacity used in the corresponding months of the prior year. The portion of the fleet devoted to commercial passenger witnessed improved utilization—up from 64 percent of capacity to 70 percent primarily on the basis of old commitments (see Table 2).

The situation was abetted by the withdrawal of scheduled carriers from the transatlantic market. During the first six months of 1978, passenger flights operated by IATA carriers on the North Atlantic dropped 20.6 percent. (In June 1978, the cutback over June 1977 was 30.5 percent—See Aviation Daily, October 16, 1978).

These early months of 1978, however, are essentially off-peak months. The story changes during the critically important summer peak. Not only were sales off, but the situation was aggravated by the coming on-stream of new and additional equipment that had been ordered some time earlier. World Airways took delivery of three DC–10–30's in 1978 and had two available in July and three in August. However, despite the phaseout of ONA and the virtual abandonment of the charter market by many scheduled carriers, the three NACA carriers flew less hours in July-August of 1978 than in the prior year. Coupled with added capacity, the fall-off of hours flown resulted in a drop in capacity utilized from 69 percent to 62 percent. The commercial passenger component of the business fell from 88 percent to 81 percent—at a time when commercial passenger capacity should be almost fully utilized (see Table 3).

We have September 1978 results only for one member. That member's total hours flown in September 1978 approximated his September 1977 hours only because of a sharp rise in summer military business. As for his commercial passenger business, he flew 19 percent more hours in September 1977 than he did last month.

Sincerely,

EDWARD J. DRISCOLL, *President.*

Enclosure.

TABLE 1.—3 U.S. SUPPLEMENTAL AIRLINES COMPARISON OF UTILIZED AND UNUTILIZED CAPACITY, 1977

	6 mo ended—		Year ended
	June 1977	December 1977	December 1977
I. System aircraft hours:			
Mean maximum available hours	86,316	86,119	172,435
Actual hours utilized	63,071	68,297	131,368
Percent of capacity [1] utilized	(73)	(79)	(76)
Unutilized hours	23,245	17,822	41,067
II. Commercial passenger aircraft hours:			
Mean maximum available hours	29,365	28,822	58,187
Actual hours utilized	18,661	22,279	40,940
Percent of capacity [1] utilized	(64)	(77)	(70)
Unutilized hours	10,704	6,543	17,247

[1] Hours flown as a percent of mean maximum available hours.

Source: Carrier reports.

TABLE 2.—3 U.S. SUPPLEMENTAL AIRLINES COMPARISON OF UTILIZED AND UNUTILIZED CAPACITY, 6 MO ENDED JUNE 30, 1978 AND 1977

	6 mo ended—		
	June 1978	June 1977	Percent change
I. System aircraft hours:			
Mean maximum available hours	93,788	86,316	+8.66
Actual hours utilized	70,805	63,071	+12.26
Percent of capacity [1] utilized	(75)	(73)	+2.00
Unutilized hours	22,983	23,245	−1.13
II. Commercial passenger aircraft hours:			
Mean maximum available hours	32,335	29,365	+10.11
Actual hours utilized	22,617	18,661	+21.20
Percent of capacity [1] utilized	(70)	(64)	−6.00
Unutilized hours	9,718	10,704	−9.21

[1] Hours flown as a percent of mean maximum available hours.

Source: Carrier reports.

TABLE 3.—3 U.S. SUPPLEMENTAL AIRLINES COMPARISON OF UTILIZED AND UNUTILIZED CAPACITY, 2 MO ENDED AUG 31, 1978 AND 1977

	2 mo ended—		Percent
	August 1978	August 1977	change
I. System aircraft hours:			
Mean maximum available hours	+ 44,430	39,832	+11.54
Actual hours utilized	27,453	27,608	−.56
Percent of capacity [1] utilized	(62)	(69)	−7.00
Unutilized hours	16,977	12,124	+30.88
II. Commercial passenger aircraft hours:			
Mean maximum available hours	15,569	14,045	+10.85
Actual hours utilized	12,545	12,386	+1.28
Percent of capacity [1] utilized	(81)	(88)	−7.00
Unutilized hours	3,024	1,659	+82.28

[1] Hours flown as a percent of mean maximum available hours.

Source: Carrier reports.

The CHAIRMAN. The next witness is Mr. Howard Boros, general counsel for the Air Charter Tour Operators Association.

STATEMENT OF HOWARD S. BOROS, GENERAL COUNSEL, AIR CHARTER TOUR OPERATORS OF AMERICA

Mr. BOROS. Thank you, Senator, for this opportunity.

I would like to say that we appreciate Dr. Kahn's suggestion that there is a place in this industry for the charter tour industry.

When S. 369 came up for the hearings, we asked this committee to include in the policy section of the statute, a statement to the effect that it is in the public interest to preserve the independent charter operator industry that is providing low-cost transportation.

In its wisdom, this committee decided not to include such a proviso. Today, apparently, Dr. Kahn believes the policy should be in favor of the preservation of this segment of the air transportation industry.

And, of course, we support him.

On the other hand, Dr. Kahn said the tour operators were an artificial construct in this industry, resulting from the Board's rules. I spoke to him after he testified and tried to correct this misapprehension. The charter tour operator has been guaranteeing back-to-work charter operations since the memory of man runneth not to the contrary.

Since the end of World War II, he has been doing that under the mantle of a travel agent. Of course, at that time it was considered illegal, but nonetheless it filled a need which the air carriers refused to satisfy on their own.

Today that need is being filled by the charter tour operator, legally as the risk taker.

I am going to confine my testimony to section 3. Section 3 is clearly special interest legislation designed to favor the supplemental industry. It might properly be characterized as the NACA Relief Act, which is all right, were it not to be at the expense of 800-and-some-odd charter tour operators in the United States, as well as of the public interest at large.

The proposal to directly market charters to the public is contrary to 10 years of congressional history; your past bill, S. 2493; CAB precedent; and the policy of section 2 of the very act that is before us.

Moreover, it is inequitable and perhaps even immoral in that it takes away from the charter tour operators the market which they pioneered, which they risked for, which they bled over, and which today is greeting them with financial disaster.

Now, after they have developed this market and taken the risks, apparently your legislation would say: "Let's turn that market over to the supplemental air carriers and to direct scheduled charter carriers," who incidentally, as I understand their testimony, don't want the right to market directly charters to the public.

Board policy for all these years has reflected a recognition of the true economics that when a direct air carrier is affiliated with an indirect air carrier, either vertically or through consolidation, the direct air carrier is going to prefer its affiliate.

It is going to prefer it in providing pricing, scheduling preferences, providing capacity, providing destinations. It is because of ths conflict of interest that the board disallowed TIA's application to affiliate with the Foreign Study League carrier.

That was approved by the Court of Appeals for the Ninth Circuit when it was appealed by TIA, and in that instance the ninth circuit said that it feared that such a consolidation would result in rate, capacity, and scheduling preferences contrary to the public interest.

Another court, the ninth circuit in a case called *Foremost* v. *Qantas*, found that affiliation of direct air carriers with indirect air carriers would create in their words, and I quote, "an awesome competitor," close quote, for the independent charter operator.

Let's look at the equities for a moment and brush aside the court and Board policies. The equities are quite clear. Today the charter tour operator finds himself in an inferior bargaining position by virtue of the fact that he doesn't control his own aircraft.

Can you imagine what kind of a supplicant you would be as an independent tour operator approaching a direct air carrier who had an indirect air carrier affiliate? You would get Tuesdays and Wednesdays at 12 midnight for your capacity. You would get the highest prices in the market, and you would get whatever low-season capacity the direct carrier could not market through its own affiliate.

It would not be long before the charter tour operator would find himself without competitive capacity.

Now, your bill would phase in the amount that a direct air carrier could market directly: 15 percent, then 25 percent, and then 40 percent. That is death by the garrotte rather than the guillotine.

The anticompetitive results of such vertical integration would necessarily be pricing increases for the public. For one thing, the direct supplementals do not have sales staffs suitable to marketing directly to the public. So, each one of them would have to develop a sales and a reservations unit. Each one would duplicate the other's out of competitive necessity. Each one would have to mount an advertising campaign separate from every other supplemental air carrier.

The duplication of these efforts would inevitably find their way into the charter pricing, and the public would absorb the cost of this duplication.

One of the reasons why travel agents have been so successful in the United States is that the carriers finally came to the realization that they're better off consolidating their sales through travel agents than each duplicating the efforts of one another.

But that is precisely what would happen if supplemental carriers were permitted to market directly to the public. Now, aside from the loss of the charter tour operators through direct sales by the supplementals, eventually you would find the supplementals phased out as well, and the reason is simple: The scheduled air carrier is not going to stand idly by while the supplemental markets directly to the public individually ticketed air transportation such as it would be empowered to do by a combination of the public charter which the Board has approved and your legislation here.

The retaliation of the scheduled carrier would be serious as it has been every time a new charter mode has been introduced into the marketplace.

As you are aware, Senator Cannon, there are no transcontinental ABC's any more, and the reason was the competitive response of the scheduled air carriers. There are very few charters being operated

today to northern Europe from the United States as a consequence of the predatory super apex fares and their progeny.

One other point that was brought out by Mr. Hardenstine I would like to comment on, and that is the question of cancellations. In the event that direct sales were permitted by suplemental airlines, the impulse for cancellations would be much greater than it is today.

Today the charter tour operator who cancels must pay very, very serious cancellation penalties to the direct supplmental or direct scheduled carriers. In the event that the carrier is able to market his own product, he would not pay himself a cancellation fee. Rather he would be looking for the opportunity whereby he would maximize his profits, and if it would require a cancellation of a trip in order to do so, he would be encouraged to cancel, because he would not have the economic disincentive of penalties.

I would like to leave you with just one thought before you rule on your legislation, and that is that the charter tour operator today is an endangered species. There is no question about that. Within the last 2 months two charter operators went out of business, representing 250,000 passengers a year. If this legislation becomes approved by the Congress, they will become extinct. Now, on behalf of the 800-odd charter tour operators in the United States, we beseech you not to destroy this industry inadvertently.

We also request on behalf of the public they have served that you not do away with the low-cost air transportation which the charter operator has brought to the public, and that you preserve low-cost air transportation as a right of the public, rather than sacrificing it to the ambitions of four supplemental air carriers.

Thank you. If you have any questions, I will attempt to answer them.

The CHAIRMAN. Well, I can certainly understand your position in opposing section 3 of the bill, since you believe it threatens the members of your association, and obviously you would be remiss if you took any other position. But let me explain my thinking about this issue, since I think that you mischaracterized the intent of the legislation.

It should go without saying that we have no vendettas against the tour operators or anyone else. Ironically other critics have described this section not as special interest legislation for supplementals, but as special interest legislation for the charter tour operators.

Now, this criticism is based on the assumption with which I tend to agree, that it doesn't make sense to prohibit businesses from directly selling their own products to the public, and that this legislation would still give the tour operators a monopoly on 60 percent of the charter business.

Now, your testimony notwithstanding, as far as I'm concerned, the only truly persuasive arguments against eliminating the prohibition altogether, is that existing tour operators could be harmed and that is why the bill provides a minimum of 60 percent of charter trips must be continued to be sold through the tour operators.

I was amazed by the statement in your testimony where you claim not to be requesting any preferred status. Now, let's be frank. You have special status now, and you would continue to do so under the proposed legislation.

Contrast that situation with that of the travel agent or air freight forwarders. Neither group is guaranteed any percent of the business in which they engage, and I'm sure they would be delighted with a statutory guarantee of 60 percent of the business in which they are engaged.

Now, most of the arguments made in favor of the current system are based on the need to legally find a way to distinguish between scheduled and chartered transportation. With the new public charter rules, the existence of the tour operator is one of the last factors remaining which distinguishes what is a charter from a legal point of view.

But we are not interested in perpetuating a system really in order to make nice legal distinctions. There must be sound policy reasons as well. The economic arguments which you make in your testimony lead me to believe that the cost to the direct carriers who are undertaking direct sales to the public are so excessive that the carriers would find it in their best interest to continue to use tour operators almost exclusively.

I find your testimony somewhat confusing insofar as you first predicted that the direct carriers will undercut the tour operators by offering much lower prices to the public, and then you contend that the tour operators would be wiped out and prices would go up. But what you don't seem to recognize is that the carriers have a very keen interest in maintaining a viable tour operator industry, since at least 60 percent of their business must be conducted with the tour operators.

Now, I'm not convinced that this is the type of situation where the predatory behavior which you fear can take place, namely, that the direct carriers can eliminate the indirect carriers and then increase their prices when the indirects are gone. They would still have to compete against each other.

At a minimum, I'm sure that the barriers to enter into the tour operator business are not high, judging from the fact that there are more than 800 tour operators in the United States.

It seems that the competitive spur would not be eliminated since entry would be justifiable, if it would be possible if the prices of the direct carriers become too high.

Now, having said that, I do have some questions for you: You have stated that 20 tour operators went out of business last year. That represents only 2½ percent of the total of the tour operators in the Nation: isn't that a rather good record compared to other businesses?

Mr. BOROS. Not when these 20 tour operators represented perhaps one-third of the tour operator traffic. These 800 charter tour operators are the ones that the CAB has got on its mailing list. Some of them operate one or two or three charters. Within the last month, just two tour operators have been out of business and these two tour operators represented 250,000 passengers per year.

In December of last year, another company went out of business that was one of the major Las Vegas operators, Delux Travel, of which you are aware. They were carrying something on the order of 30,000 or 40,000 passengers. Delwebb left its business voluntarily, because it was unprofitable, and that was last fall as well.

So, when we speak about percentage, we have to speak in terms of percentage of total traffic that has not been accommodated now.

The CHAIRMAN. How many tour operators does ACTOA represent?

Mr. BOROS. Twenty.

The CHAIRMAN. How many of those 20 that went out of business were members of your organization?

Mr. BOROS. Three.

The CHAIRMAN. Can you think of any example where the Government prohibits an industry from selling its own products?

Mr. BOROS. Absolutely—the oil industry—15 States passed legislation which prohibits oil companies from owning independent filling stations for precisely the same reason that I am here today, because vertical integration threatens competition, and the Supreme Court within the last month, I believe, has upheld those antivertical integration statutes.

The CHAIRMAN. But that isn't the Federal Government. That is State governments. I asked you if you could give me an example where the Government prohibits an industry from selling its own product to the public?

The Government in antitrust can, and as a matter of fact, the Government denied that same situation, with respect to the oil industry, because it was tried and it was turned down by Congress.

Mr. BOROS. Absolutely correct. In antitrust litigation the Government has sought from time to time to break up companies that have sold their own product in a vertically integrated fashion. For example, there was the Alcoa case, which I believe goes way back, at which time the Government broke up Alcoa in the hopes that it would not continue to monopolize the aluminum industry through vertical integration.

Whether that was successful or not, I don't know. Vertical integration has certain immediate appeal. The appeal is that it seems to be more efficient, but vertical integration carries with it undeniably a discriminatory sales policy. A company that has its own affiliate invariably will prefer its own affiliate to an independent. Now, that is all right, if you have a plentiful supply of the product to start with.

But aircraft are limited commodities. We don't have enough aircraft within the foreseeable future to handle the demands seen in the 1980's. Now, when you have an air carrier that not only controls this scarce supply, but is in a position of determining how and when it will be marketed, that air carrier will necessarily discriminate against the independent, and the independent will disappear.

That has been the experience in Europe, Senator Cannon, where at this time you have approximately six or eight major tour operators and almost all of them are affiliated with European flag carriers.

The CHAIRMAN. Well, you seem to believe that the charter industry is unlike any other, in that no companies will choose to specialize in wholesaling rather than retailing.

In the air freight business, the direct carriers are engaged in both wholesale and retail activities and also I mentioned, it is true in the scheduled passenger business.

Now, why can't this work for chartered passengers as well?

Mr. BOROS. Do you mean the air carrier engaging in the wholesale as well as retail?

The CHAIRMAN. Yes.

Mr. BOROS. It is my understanding that the amount of wholesaling done by the airlines in the air freight industry is confined largely to the all cargo carriers and the scheduled combination carriers rely principally upon air freight forwarders and properly so, because the air freight forwarders are the consolidators who can accord them the maximum loads at the minimum cost, which is precisely what the charter tour operator does as well.

He is a consolidator and has been. He has earned his right to be a consolidator and he is the one who has developed the charter market not the air carrier recipient who waits for the travel agent or the charter tour operator to produce the traffic for him.

Now, I'm not suggesting that we should have an exclusive preserve for any given charter operator. There is plenty of competition in this business today. I'm saying that wholesaling is a mode of distribution in the United States which has proved to be the most efficient means of reaching the public.

And I'm suggesting that you preserve the wholesaler. Now, if you are willing to put into your policy statement something to the effect that you support the preservation of the independent charter operator industry and that there should be a statutory policy whereby that industry would be evaluated even handedly along with the requirements of the supplemental air carriers for direct marketing, I think we might have a balance.

But as of this moment, the charter tour operator is statutorily unrecognized.

Mr. BARCLAY. Mr. Boros, under your analysis, do you think that good public policy should demand that charter bus operators market through tour operators?

Mr. BOROS. Well, right now the brokerage of charter buses is done through brokers licensed by the ICC and has been for—I don't know—20 years, perhaps.

Mr. BARCLAY. But the bus operators can also market directly to the public, and they use the retailer in cases where it is economic.

Mr. BOROS. Yes, they do; but it is a very, very limited activity.

To my knowledge, most bus brokerage is done through a broker who after all has also earned his place in the market place by developing the charter bus industry to the size that it presently is.

Mr. BARCLAY. I think that is our point, Mr. Boros, that you do provide an important service and that you will survive because of good economics, not because of a legislative prohibition.

Mr. BOROS. Well, currently we have been under fire by the CAB, from the regulatory policies inhibiting our activities. We have been under fire from the predatory air fares of the scheduled airlines, which the Board itself has characterized as predatory. And now we find that the market we have developed, the charter market, is going to be handed over to the supplemental air carriers, at least to the tune of 10, 15, and 40 percent.

And we are very fearful that unless the Congress makes its view clear that we have an important place to play in the air transportation industry, rather than simply letting us be tossed on the economic fates of other carriers, we will disappear.

That is my whole point.

The CHAIRMAN. Thank you very much, Mr. Boros. We appreciate you being here.

[The statement follows:]

STATEMENT OF HOWARD S. BOROS ON BEHALF OF AIR CHARTER TOUR OPERATORS OF AMERICA

My name is Howard S. Boros. I am a member of the Washington, D.C. law firm of Boros & Garofalo, P.C. I am appearing as general counsel of the Air Charter Tour Operators of America ("ACTOA"). ACTOA is an association of independent charter tour operators located throughout the United States. During the past year, ACTOA members arranged domestic and international charters for approximately 600,000 persons representing a gross volume in excess of $200 million.

ACTOA has been in the forefront of consumer causes because the consumer is the charter tour operator's bread and butter. It has continuously urged expansion of low cost transportation services. Where such services were jeopardized ACTOA has defended them—such as its vigorous opposition to minimum charter rates. Where predatory pricing practices threatened to eliminate competition, ACTOA consistently voiced its opposition both before the Congress and the Civil Aeronautics Board. The events of the past summer have vindicated ACTOA's viewpoint—charter tour operators have been eliminated from the marketplace with clock-like regularity and now scheduled rates are again on the increase.

I have been designated to present the views of our membership on section 3 of S. 3363. My testimony will be confined to that section because it presages the complete annihilation of the already reeling charter tour operator industry. Some indication of the present straits of the industry is reflected in the demise of over 20 charter tour operators during the past year. This month two of the largest operators in the country—representing over 250,000 passengers annually—closed their doors. Enactment of section 3 of S. 3363 will apply the *coup de grace* to the remainder.

Section 3 is special interest legislation which has nothing to recommend it and much to condemn it. Section 3 should be characterized as the "NACA Relief Act" because it is pointedly designed to benefit the supplemental air carriers without regard to its adverse impact upon other elements of the air transport industry and upon the public at large. On its face, the proposal to authorize charter sales to the public by direct air carriers is contrary to 10 years of Congressional history, the provisions of S. 369 as drafted by this very Subcommittee, the historic position of the Civil Aeornautics Board as well as being inconsistent with the policy provisions of sections 2(b) (2) and 2(b) (3) of the self-same bill. In this latter regard, it must be noted that air carrier charter sales to the public would be contrary to public policy as such sales will effect an unprecedented concentration of economic power in the hands of air carriers with resultant irreversible injury to the public. Furthermore, Section 3 is extremely inequitable as it strikes at the jugular of the charter tour operators—the entities principally, if not solely, responsible for development of public-type charters. Indeed, it exudes a noxiousness reminiscent of prohibited bills of attainder as it singles out a class—charter tour operators—for economic punishment. Finally, it will deprive the consumer of any meaningful bargaining power in the purchase of charter air transportation.

LEGISLATIVE AND REGULATORY HISTORY

The first public-type charter authorized by the Civil Aeronautics Board was the ITC (inclusive tour charter). In establishing this new mode the Board insisted that it be marketed by air carriers through independent tour operators who were to perform the function of chartering the aircraft for their own account as indirect air carriers and then selling the capacity to the public. Judicial review of the entire concept of ITC's created considerable confusion, for domestic ITC's were declared lawful by the Court of Appeals for the District of Columbia *American Airlines* v. *CAB*, 365 F.2d 939 (D.C. Cir., 1966), whereas international ITC's were adjudged unlawful by the Court of Appeals for the Second Circuit, *Pan American World Airways* v. *CAB*, 380 F.2d 770 (Second Cir., 1967) aff'd by an equally divided Supreme Court 391 U.S. 461 (1968).

At that point Congress intervened to enact legislation which would remove any question regarding the lawfulness of ITC's. During the course of the hearings before the Senate Aviation Subcommittee, the National Air Carrier Association, representing the supplementals, sought authority to by-pass charter tour operators by enabling direct air carriers to market ITC's directly to the public. This effort was rebuffed by the Senate. In fact, that body felt so strongly on the issue that it deprived the CAB of any discretion to permit direct sales of ITC's by supplemental carriers. Section 101(34) of the Federal Aviation Act [1] was quite clear, to wit:

"Nothing in this paragraph shall permit a supplemental air carrier to sell or offer for sale an inclusive tour in air transportation by selling or offering for sale individual tickets directly to members of the general public, or to do so indirectly by controlling, being controlled by, or under common control with, a person authorized by the Board to make such sales." [2]

Scheduled carriers were not statutorily prevented from selling ITC's directly to the public. Nevertheless, in the exercise of its regulatory powers, the Board ruled that the public interest required that these carriers also market ITC's through charter tour operators (Part 378 of the Board's Special Regulations; 14 C.F.R. 378). This has been the unwavering position of the Board regarding the marketing of public-type charters whether by supplemental or scheduled carriers. Thus, all progeny of the ITC required that the charter by an independent charter tour operator, i.e., SGC's (study group charters),[3] OMPC's (overseas military personnel charters,[4] TGC's (travel group charters),[5] OTC's (one-stop inclusive tour charters),[6] ABC's (advance booking charters,[7] and public charters.[8] In the public charter rulemaking, the Board articulated the legal reasons for requiring a charter tour operator to be the focal point of the marketing equation.

"The requirement that Public Charters must be arranged and sold by an independent tour operator is of paramount significance in evaluating their legal sufficiency. This is not just one distinction, but a whole complex of them. The essence of the charter concept is a bilateral contract, and at the center of the contractual relationships is the tour operator.[9] Unlikely scheduled service, sold either directly by the route carrier or through a travel agent, the charter operator bears the risk of operating a financially successful flight. His estimate of the potential of a particular market, and his willingness to risk his capital in charter contracts with direct air cariers, generally months before sale to the public, is the essential element in the charter industry today. Before he can sell to the public, however, he must have submitted to the Board a detailed prospectus covering each flight, including his charter contract with the carrier and the contract that will be entered into with participants. The operator must also arrange a surety bond or similar agreement with a financial institution to insure his financial viability, and in most cases a depository escrow to protect participants funds.[10]

"These important distinctions are not limited to behind-the-scenes arrangements; they are of real signifiance to the travelling public. A person planning to travel by charter flight must deal (either directly or through a travel agent) with flight plans and payment arrangements set up by the tour operator, not an airline. He will have to sign a contract with many detailed provisions concerning the itinerary conditions, and liabilities associated with the trip . . . These factors may be more important, in fact, to the individual deciding between charter and scheduled service than restrictions such as advance booking, minimum stay and/or ground packages that have characterized charters in the past . . ." (Regulation SPR–149, p. 8).

The Board has also decided on policy grounds that a direct carrier should not perform the functions of providing charter capacity and selling that capacity to the public. The inherent conflict of interest in such duality was expressly recog-

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[1] 49 U.S.C. 1301.
[2] Act of Sept. 26, 1968 82 Stat. 867.
[3] Part 373 of the CAB Special Regulations.
[4] Part 372 of the CAB Special Regulations.
[5] Part 372a of the CAB Special Regulations.
[6] Part 378a of the CAB Special Regulations.
[7] Part 371 of the CAB Special Regulations.
[8] Part 380 of the CAB Special Regulations.
[9] The tour operator is bound by bilateral contracts with the direct air carrier, the charter participant, and the financial institution securing his funds.
[10] This aspect of the operator's responsibilities is the subject of a separate Board proceeding. Docket 31735.

nized in a case where Trans International Airlines sought approval of its common control with the Foreign Study League, an indirect air carrier marketing study group charters, *inter alia*. The Board disapproved the application noting that TIA has ". . . an obligation to serve the public without discrimination and this obligation might be significantly compromised through affiliation with user interests . . ." *Reopened Transamerica Corporation and Trans International Airlines Case*, Order 71–7–119, p. 5 (July 21, 1971).[11] In upholding this decision the 10th Circuit relied upon the fear that rate, capacity and scheduling preferences would be accorded its indirect air carrier affiliate should TIA's application for common control be granted. *Foreign Study League* v. *CAB*, 178 F. 2d 865 (10th Cir., 1973). Another court observed that an airline-controlled tour operator can engage in below cost pricing by subsidizing" . . . the land portion of its below cost inclusive tour with profits from the sale of its airline seats." *Foremost International Tours* v. *Quantas Ltd.*, 379 F. Supp. 88, 95 (D. Hawaii 1974) aff'd 13 Avi. 18, 105 (9th Cir. 1975). This inherent advantage would make the airline/tour operator amalgam an "awesome competitor" (Id. at 97, fn. 8) *vis-a-vis* the independent tour operator.

This same issue arose in the 1976 regulatory reform hearings before this Subcommittee. The context was a proposal to eliminate the statutory ban against supplemental air carrier control over charter tour operators. Under that proposal the Board would have discretion to approve such control relationships. In opposing the proposition, Chairman Robson of the CAB testified as follows:

"We would expect each supplemental air carrier to acquire control of an indirect air carrier to sell individual tickets, although Board approval would be required. Such acquisitions may have serious implications for other tour operators. The ultimate result could be that all but the largest independent tour operators would be gradually squeezed out of the market; and that consequently competition in the packaging of vacation charter programs would be severely diminished." Hearings Before the Senate Subcommittee on Aviation of the Committee on Regulatory Reform in Air Transportation (94–104), p. 460—emphasis supplied.

These views were echoed by the President of Overseas National Airways, a leading supplemental of the 1960's and 1970's:

"First, to allow a supplemental carrier to control or be controlled by a tour operator simply puts the supplemental carrier in the position of taking the risk on the load factor. Particularly on the North Atlantic, there are more than enough carriers taking the risk on the load factor; and it has produced a rash of uneconomic fares and has caused the price of scheduled service for passengers desiring the ordinary convenience of on-demand schedule service, such as businessmen, to pay excessive economy class fares. . . .

"Second, the allowance of vertical integration probably would lead to a greater degree of consolidation of tour operator control and joint tour operator/carrier control, which would thus make it more difficult for small tour operators and travel agents to compete. I believe that the public will be better served if more tour operators and travel agents are promoting tours, and if small tour operators thereby find it easier to enter the market and grow, thereby providing more competition at the tour operator level and a greater variety of otur products for the public. The same reasoning applies to common control of air carriers and any other type of charter operator, such as ABC, TGC, et cetera. . . .

"Finally, it appears to me that the high degree of consolidation which vertical integration seems to have led to, or at least allowed, in the United Kingdom has been a significant contributing factor causing some major tour operator/air carrier collapses in the United Kingdom, to the financial damage of many consumers." (*Id.* at 576–7).

Last year NACA attempted to have S. 689 amended to eliminate the ban against supplementals owning or controlling charter tour operators. After extensive hearings this Subcommittee opted for the encouragement of competition in the charter industry rather than its stulificaion through verical integration of direct air carriers and charter tour operators. To implement its view this Subcommitee voted to ban such vertical integration by scheduled as well as supplemental carriers. Section 16(e) of the Air Transportation Regulatory Reform Act of 1977, states:

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[11] This rationale was followed in *Application of Kuoni Travel Limited* Order 75–11–111, Nov. 26, 1975.

"It shall be unlawful for any air carrier, or foreign air carrier, directly engaged in the operation of aircraft to be engaged in, or to control, be controlled by, or be under common control with any person engaged in selling or organizing charter trips in interstate or overseas air transportation, or in United States originating foreign air transportation."

During the few months since enactment of this proviso, nothing has transpired to justify its wholesale reversal as contemplated by Section 3 of S. 3363.

THE ANTICOMPETITIVE FORCE OF SECTION C VOIDS THE PRO-COMPETITIVE POLICIES OF SECTION 2

The primary purpose of S. 3363 is putatively "to promote competition in international air transportation . . .". Even the title of the bill, International Air Transportation Competition Act of 1978, bespeaks this objective. The policy section purports to further this objective by directing the CAB to consider as being in the public interest:

"(2) The maximum degree of competition consistent with maintaining an international air transportation system which facilitates commerce among nations, encourages air carriers and foreign air carriers to offer prices and services which are responsive to market demand, provides travel opportunities for the widest possible segment of the public, and meets the needs of the Postal Service and the national defense.

"(3) The prevention of unfair, deceptive, predatory, or anti-competitive practices, in foreign air transportation, and the avoidance of undue industry concentration, excessive market domination, monopoly power, and other conditions that would tend to allow one or more air carriers or foreign air carriers unreasonably to increase prices, reduce services, or exclude competition in foreign air transportation."

None of the benefits of Section 2(b)(2) and all of the evils condemned by 2(b)(3) will be realized by enactment of Section 3. The sole proponents of Section 3 are three (World, TIA and Evergreen)[12] and, perhaps, four (Capitol) supplemental air carriers. The principal U.S. charter carriers and the domestic trunklines are opposed. Clearly, Section 3 is calculated to benefit a discrete, special interest of a handful of carriers. And this benefit is to be achieved at the expense of 800-odd charter tour operators.[13]

Charter tour operators are dependent upon direct air carriers who charter equipment. As scheduled air carriers progressively limit equipment dedicated to charter transportation, these tour operators are becoming even more dependent upon supplementals. What reasonable expectations can charter operators have of fair treatment by supplementals should these carriers be granted authority to market their own equipment directly to the public? None!

At present, due to shortages of suitable charter aircraft, direct carriers virtually dictate the prices and terms under which they will make charter capacity available to tour operators. This situation will worsen should direct air carriers be confronted with a conflict of interest between their own ambitions in marketing charters directly to the public and the requirements of charter tour operators for mutually exclusive capacity. It would be pollyannish to believe that direct carriers will parcel out equipment to its competitors, charter tour operators, as against its own requirements with Libra-like equality. Obviously, charter tour operators will be allotted only that capacity which cannot be profitably utilized by direct carriers in their own charter operations. During peak seasons, virtually no aircraft will be made available to charter tour operators. During all seasons, they will be left with undesirable Tuesday and Wednesday departures at top dollar prices while direct carriers operate on weekends at whatever prices—for accounting purposes only—they deem advantageous. Should direct carriers wish to eviscerate the charter tour operator industry, they can do so by withholding equipment and/or by undercutting charter tour operators' prices to the public. Direct air carriers can cross-subsidize land packages. The predatory practices condemned by Section 2 of proposed S. 3363 will become the rule rather than the exception. And direct carriers will have every incentive to cross-subsidize land packages—

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[12] World has stated, however, that ". . . supplemental carriers such as World do not have an existing sales staff to market and sell large numbers of seats. . . . World's sales staff is not organized to market and sell large numbers of individually ticketed seats." Direct Brief of World Airways, p. 2, *Supplemental Carrier Fill-Up Case*, Docket 32398.

[13] This number is the CAB's approximation of the independent U.S. charter tour operator population.

as the Court properly feared in the *Quantas Case, supra*—because the airplane itself must be the financial focus of the direct air carrier. This ineluctable consequence derives from the fact that the air transportation industry is becoming increasingly capital-intensive, and that intensity is a direct function of the cost of aircraft. Hence, efficient utilization of aircraft and crews is the primary *modus operandi* of an airline.

The inevitable market domination caused by integration of charter operating and marketing activities will be higher prices to the public and a lesser variety of services. A handful of air carriers will decide the prices of charter transportation for the public. These carriers also can be counted upon to exploit existing proven markets rather than to innovate to new destinations. Clearly, once possessed of oligopolistic control, direct air carriers will have little incentive to experiment. Thus, all of the evils of monopoly will surface through the ill-conceived functional integration contemplated by Section 3.

It is worth noting that the proposal here is contrary to the trend throughout the United States. In the oil industry, 15 states have enacted statutes prohibiting oil producers from owning or controlling retail outlets. A groundswell of public opinion as well as Congressional sentiment is supporting a ban on oil producer ownership of pipelines. Numerous antitrust suits are pending to fragment large corporations that are threatening to reduce competition through horizontal and vertical integration. However, once such integrations have taken place they are extremely hard to undo, witness the years of antitrust litigation prior to decision on the merits. Here, this Subcommittee is proposing a vertical integration in the air transportation industry which will shake the charter industry to its foundations.

To be sure, the proponents may maintain that the proposed bill is not as severe as it may seem because integration will take place only gradually, i.e., 10 percent of the charter carriers capacity during the first year, 15 percent during the second, and 40 percent during the third. Such an argument would merely reflect the value judgment that the garrote is preferable to the guillotine because it is slower. Nevertheless, the result is the same in both forms of execution.

This Subcommittee must determine whether Section 2, with its pro-competitive and anti-monopolistic sentiments, is real or fictitious. Its position on Section 3 will conclusively determine that question.

THE DISECONOMICS OF DIRECT CHARTER SALES

This Subcommittee has clearly not focused upon the economic waste that would attend charter sales to the public by direct air carriers. None of the supplemental airlines has any marketing expertise. Two of the five existing supplementals, Evergreen and ONA have 11 sales offices each. Capitol and World have 12 each, and TIA has 14 sales offices. These facilities are the minimum necessary to handle charter tour operator demand. Should the supplementals undertake direct sales to the public they would be compelled to proliferate offices throughout the United States. Competitive necessity would require each to duplicate the facilities of the other. This would be but the beginning of the increases in overhead. Intensive advertising compaigns would have to be launched, particularly if the supplementals were to compete with scheduled air carriers for direct charter sales. From the outset, the contest would be uneven. The first casualties would, of course, be the charter tour operators. They would soon be followed by the supplemental air carriers. Because the scheduled trunks will not permit supplementals to engage in individually ticketed transportation, under the guise of charters, without unleashing a devastating competitive response, the ensuing waste would naturally be borne by the public in terms of higher prices. Such a result can hardly be deemed in the public interest.

Of equal importance, the economic advantages of planeload transportation will be eroded should direct sales by charter carriers by authorized. Currently, the direct carrier charters the entire capacity of its aircraft. The risk to fill such capacity is assumed by the back-to-back charter tour operator. Because of this financial assurance the direct carrier can price its product on a planeload basis. Should the risk for filling the aircraft be assumed by the operating air carrier, the financial equation will change. Direct air carriers will operate at less than 100 percent load factors and will absorb the empty seats themselves. Necessarily, such a practice will compel pricing increases to the eventual detriment of the public. It is only by separating the operating from the marketing functions, in the highly competitive atmosphere which presently exists, that the public can be assured that the economics of planeload transportation will be preserved.

But this is merely the tip of the iceberg. The public is certain to be prejudiced by direct carrier sale of charter transportation because such carriers will have little incentive to operate economically marginal trips. When tour operators contract for charter capacity they do so at their peril; they also cancel such trips at their peril because cancellations involved substantial penalty payments to direct carriers. These same economic strictures do not obtain where the direct carrier is marketing its own charter trip. It does not assess a penalty against itself for concellation. Indeed, should a more profitable economic opportunity present itself, that carrier may cancel a previously contracted for charter with impunity—with an unexpressed—"let the consumer be damned." Indeed, those practitioners of hardline economics might well question managerial judgment which did not pursue such a Draconian course. What price the public interest?

EQUITABLE CONSIDERATIONS MILITATE AGAINST ENACTMENT OF SECTION 3

This Subcommittee must appreciate the history of the charter industry before it undertakes to radically change its face. This industry has achieved wide public acceptance through the efforts of charter tour operators. Even prior to their licensing as indirect air carriers, charter tour operators were the principal performers of back-to-back charters. They did this under the mantle of "travel agents", but in fact they were the risk-takers because the airlines insisted that they be so. Since 1966, the charter tour operators have been the only marketers of ITC's, TGC's, OTC's, SGC's, and ABC's. They have assumed all of the pioneering risks in developing these forms of charters. The OMPC operator has done the same in the area of military charters over the vigorous opposition of direct air carriers. This Subcommittee would not take all of these markets for which the charter tour operators have been responsible and turn them over to the direct air carriers who opposed their development. This is neither fair nor defensible.

Whence stems the urgent need of supplementals for direct sales authority? As a rule they are healthy financially. Capitol Airways earns money with clock-like regularity. TIA, backed by the Transamerica Corporation, is also profitable. Even the relatively small Evergreen has encouraging economic prospects. Only World and ONA have suffered a significant and continuing losses. ONA need not be a subject of concern as it is leaving the charter arena on September 15th after garnering exceptional capital gains from the sale of its DC-10 aircraft. World has sustained losses in 1977 and 1978. However, both it and TIA have now been granted scheduled rights which they anticipate will produce significant profits. They do not require legislative assistance, particularly when such assistance will be at the expense of the 800 member charter tour operator industry and the 219,000,000 population of the United States.

By contrast, the lot of the charter tour operators is dismal. Over 20 charter tour operators have closed their doors during the past 12 months. Failures dot the map in Michigan, New York, Pennsylvania, California, Illinois and Massachusetts. The universal explanation for these closures is predatory scheduled air fares accompanied by the heavy hand of restrictive CAB regulations. It is the charter tour operator that needs legislative assistance—or at least recognition—not the few, albeit powerful, supplementals. However, we are not requesting any preferred status. ACTOA merely seeks an opportunity to compete in an open marketplace without being subjected to the unfair competitive practices implicit in being required to charter equipment from competitors. In such an oligopolistic environment, the charter tour operator cannot long survive.

CONCLUSION

Charter tour operators are an endangered species. If Section 3 of S. 3363 is enacted, they will become extinct. Before this Subcommittee orders obliteration of the charter tour operator industry in response to the ambitions of four supplemental carriers, we beseech it to consider the public benefits charter tour operators have conferred in the past and are capable of creating in the future. We request such consideration on behalf of 800 charter tour operators and their employees and, on behalf of the principle that low-cost air transportation is a public right which should not be compromised to protective private interests.

The CHAIRMAN. The next witness is Mr. Ronald Danielian, executive vice president and treasurer, International Economic Policy Association.

STATEMENT OF RONALD L. DANIELIAN, EXECUTIVE VICE PRESIDENT AND TREASURER, INTERNATIONAL ECONOMIC POLICY ASSOCIATION, WASHINGTON, D.C.

Mr. DANIELIAN. Thank you, Mr. Chairman.

I have a prepared statement and a report. The prepared statement, I hope, can be placed in the record along with the report. I will go through the prepared statement and skip sections of it in order to expedite the testimony in the 5- or 6-minute range.

My name is Ronald Danielian, and I am executive vice president and treasurer of the International Economic Policy Association, a nonprofit research organization founded in 1957.

During the early 1970's I also dealt directly with tourism and related matters in the Commerce Department.

My testimony today centers upon our just completed report which, with the chairman's permission, I should like to submit for the record.[1]

It deals with the broader question of service industries in the U.S. balance of payments and the role that the tourism and air transportation sector plays within that category. We are concerned with U.S. policies and the necessity to obtain an international balance in the concessions and agreements on international aviation. I am concerned that there has not been a full appreciation of the noncompetitive environment for U.S. transportation service companies nor an appreciation of the seriousness of the balance of payments situation.

Some of the noncompetitive practices which inhibit our ability to earn a fair share of the travel dollar were outlined to this committee when the Fair Competitive Practices Act of 1974 was passed, and they continue to exist today.

In the competitive North Atlantic market in 1976, for instance, every major foreign carrier was either government-owned, supported, or directed. U.S. negotiators should view our position in the face of these realities and take into account the competitive nature of the marketplace and the relationship of potential market sizes for the competition of the transportation and travel dollar.

Our study further points out the tie-in between airlines, for instance, and tour operators in Germany where 52 percent of the present international flying market to the United States uses travel agencies. Such tie-ins, whether government induced or not, make it very difficult for the United States to penetrate, on an equal footing, the foreign markets. The ability to freely own and operate a tour agency in a country where the great bulk of international tourists use travel agents can mean the difference between profit and loss in supplying air services.

The competition for tourist dollars has centered on the key factors of market access and share of the potential travel earnings, as well as foreign exchange returns to the country concerned.

For some foreign nations, their main objective is to obtain a requisite market share and foreign exchange taking into account not just transportation earnings but also tourist spending involved.

In our negotiating process we must recognize this nature of the market. Reliance on country-of-origin rules or an open-skies policy

[1] See p. 248.

in the face of the nature of the foreign competition could ultimately reduce the returns to U.S. national income and affect the 40,000 or so direct jobs of U.S. international air transportation companies' personnel involved in international aviation.

In the tradeoff, for instance, between price concessions and unlimited free access to the U.S. market, our present international aviation negotiating framework appears to be dealing in unequal benefits. Thus, when we are given free access to four countries in Europe, France, Germany, the Netherlands, and the United Kingdom, representing a base potential for travel to the United States of 26 million individuals, they will receive access to our market which represents a total potential of at least twice that amount.

Further, when we obtain the rights for one or two U.S. airlines to operate on routes to the four countries concerned, each one of their carriers—four in all—will receive multiple access to our total market.

Further, if we accept country-of-origin rules there is a serious question whether we have received open and adequate access to foreign markets. If we accept open skies, we will find U.S. private companies pitted against government-controlled, financed, or directed companies. In fact, the U.S. Treasury and all OECD nations are concerned about the level of public support for manufacturing industries which has, in essence, skewed markets and reinforced government determinations to protect their home industries for employment and other political reasons.

In last week's *Business Week* there is an article about Assistant Secretary Bergsten flying off to Ottawa earlier this month because the Treasury Department was concerned about the Canadian Government's willingness to put up $40 million to lure a Ford Motor Company new engine plant across the border. The United States has been worried about government inducements to floundering companies which keeps them in competition with efficiently run organizations.

In the Netherlands, for instance, the Dutch Government last year handed out subsidies to 38 heavy engineering companies, 25 textile firms, 13 building materials and furniture manufacturers, as well as other companies. The theory surrounding free trade, including the philosophy of comparative advantage cannot operate when such noncompetitive outside forces interfere. And there is no difference between the Dutch and Canadian Government examples in the manufacturing field, and the Dutch example of providing KLM equity funding of $62.5 million in 1972, $74 million in 1975, as well as the increase in the amount of available government guaranties for KLM loans in 1975 to a value of $148 million.

It seems to me that we should differentiate between the consumer need for lower and more competitive fare structures and the proliferation or dilution of the market which can have adverse effects on U.S. shares and the balance of payments. I don't want to be misunderstood on this point, Mr. Chairman, for I, as a consumer, personally would agree with the lowest possible air fare structure in aviation, commensurate with the costs of providing the service and, of course, with high safety and maintenance standards. Open competition is an efficient way of insuring the best possible fare structure for the international traveling public. But in an international industry structure

dominated by government-linked corporations, truly private or profit-oriented industries can find the competitive process noneconomic.

We should maintain a balance in our negotiation process that trades commensurate benefits. The Congress has dictated this policy in the goods trade area after observing in the 1960's what was considered to be unequal trade-offs in certain areas. Thus, our objectives in gaining reciprocity of service must be aimed at the total market and at denying, for instance, the European members the advantage of individual bargaining which restricts our access to their whole market, while opening up our total market to 5 or 10 government -run, -directed, or -subsidized carriers.

In addition, we should not ignore market sizes and the foreign exchange considerations in diluting routes at the same time as we offer foreigners a larger competitive market from which to draw earnings.

Equal access to equal markets is critical but so is insurance against noncompetitive factors that can be used by foreign governments to increase their market shares to the detriment of our own international industry.

And as I have stated before, the nature and character of the marketplace must be taken into account. The administration policy statement released by Secretary Adams on August 21 stresses the competitive factors but appears to minimize these special market characteristics.

In particular, we must be concerned about the total U.S. balance of payments picture and the declining dollar, and it is difficult for me to see how giving up a substantial market share in the United States to foreign carriers will enable us to improve our performance.

Moreover, as the committee is well aware, there are other important political and national defense factors in the health of U.S. international carriers in worldwide competition which argue for a policy of balance in dealing internationally with the highly complex area of variation agreements.

I would hope that the considerations I point to in our study and my testimony will be assessed carefully to achieve a true balance.

I should like to add, Mr. Chairman, I was very pleased to note what Chairman Kahn of the CAB said with regard to, making sure that we get a quid quo pro. He did indicate that most airlines around the world will keep their airlines alive because of various social reasons. They are government-run and directed. And he went on to say that you really have to make estimates on the greatest probability of whether there is harm or not to U.S. airlines from the competitive point of view.

Well, it seems to me that if governments of most airlines around the world will try to keep their airlines alive at any cost because of various social reasons, et cetera, we already have an estimate of a probability in terms of what may happen in the competitive area.

One need only look at what happened recently in the Pacific, I guess, with regard to shipping companies. It was a non-market-oriented country—the Soviet Union—but they undercut rates in order to gain a market share. It is the foreign exchange and market share that is the important consideration for most countries.

Thank you.

The CHAIRMAN. Well, thank you for your statement.

It seems to me that your arguments lead to the conclusion that we will never be able to achieve a competitive international environment, and we might as well give up trying right now, the reason being that many governments with which we deal have socialist or modified socialist economic systems. Thus in many cases the government owns or controls the major national industries, including the airlines.

Now, since this situation is unlikely to change, under your reasoning, we must retain a restrictive policy indefinitely.

It seems that your conclusions rest upon the proposition that foreign governments will be willing to subsidize major losses by their airlines indefinitely.

Do you really think that is the case?

Mr. DANIELIAN. I think it is the case in some instances. First, let me move to the first part of your question; and that is whether we have to give up the ghost in terms of being able to negotiate with foreign countries to relax the international transportation picture.

I don't think that is necessarily the case. It has taken us a long, hard fight in the goods trade area. Congress in 1974 passed the Trade Act of 1974—dealing mainly in goods not in services—to try and strengthen the arm of Government in its negotiating process, strengthen the International Trade Commission so it can deal with subsidies and unfair advantages and unfair competition. I think, basically, that we will probably have to do that for all service industries, including the international aviation industry—strengthen the Government network, maybe under section 5 of your bill, to deal with these kinds of situations and not try to deal with them after the fact. In dealing with them after the fact, it is going to be very difficult to get a foreign government to give up what it already may have gained, let's say in a year, of open routes, et cetera.

With regard to the second part of your question, I think I may have answered it.

The CHAIRMAN. Well, you didn't specifically address the part that I asked, if you thought that foreign governments would be willing to subsidize major losses by their airlines indefinitely.

Mr. DANIELIAN. I think it would depend upon the routes concerned. In some cases, foreign governments obviously would not. They would want to run the airlines as efficiently as possible. Where there were very heavy losses, I think any prudent individual, including a finance minister of a foreign country, would say it is time to get out of the kitchen and stop throwing good money after bad. On marginal routes, I think that foreign governments would be more inclined to keep its services up in order to gain a market share. I think it really depends on the amount of routes involved and the margins involved.

The CHAIRMAN. I would like your reaction to the arguments that by being able to bargain individually with countries we are able to drive wedges into previously anticompetitive blocs, and therefore achieve a far more procompetitive condition.

Mr. DANIELIAN. In bargaining with individual countries you may be able to obtain a little bit better benefits, but in bargaining with individual countries, you ignore the total market size of what you are dealing for.

You know, in the goods trade area, Europe considers itself one bloc, and they want us to negotiate with them in the GATT as one bloc.

But when it comes to service areas, particularly airline services, they look at themselves as individual countries, and they want us to involve ourselves in discussions with 5 or 10 individual carriers.

To the extent that you can make a real breakthrough with one of those countries and carry that breakthrough on to all of the others, I would have to say, yes, you can achieve success. But I would question whether you were going to be able to really achieve that, and whether you are going to be able to balance what you gain with each individual country against the total market size.

The CHAIRMAN. Don't the U.S. private carriers have an advantage in efficiency and ability to compete over government-controlled airlines who have traditionally been highly inefficient?

Mr. DANIELIAN. As I understand it, Mr. Chairman, the CAB figures show that yes, U.S. carriers are about the most efficient in the world in terms of operations.

Again, it would have to remain to be seen whether or not in the face of foreign government subsidies, let's say, on certain marginal routes, whether they would be able to continue or whether they would have to cut their losses in some areas and concentrate on other areas.

Mr. BARCLAY. Mr. Danielian, would you agree with Dr. Kahn's analysis that basically we should try to move with our international bilateral, still a more competitive system and simply keep a watchful eye out, and if some of the dire predictions start coming true, then that is when we ought to take a step back, perhaps?

Mr. DANIELIAN. Well, I would view that, based upon what has happened over the last 15 years—and again, in the service area, I have nothing to compare it with, but you do have something to compare it with in the trade goods—or since the passage of the Trade Expansion Act of 1962, we have had certain problems with various nations around the world in areas where we are very, very competitive.

Take, for example, the European Common Market and agricultural trade. Agricultural trade accounts for between 18 and 20 percent of our export of goods, yet we have gotten ourselves into a system with Europe that, in essence, precludes our ability to sell some of our agricultural surplus. And in agricultural goods we are one of the most efficient producers in the world.

So based upon that example, at least in the goods area, the door has now been closed to us, and we are trying to go back in the present round of negotiations after 10 years and redress that situation. I am not so sure we are going to be successful. Therefore, I would say that in the services area, I think it is going to be extremely difficult to go ahead and give concessions and then come back later and say, "It hasn't worked," or "There might be a problem; let's talk about it," because it has been very difficult in the goods area for us to go back to certain nations and say, "There is a problem; let's talk about it."

Mr. BARCLAY. Well, then exactly what course would you recommend as opposed to the way we are going?

Mr. DANIELIAN. I would like to see a strengthening of the Government mechanism in the ability and the swiftness of the Government itself, both in Congress as well as in the executive branch, to take action to foreclose any situation where somebody, once getting their foot in the door, would find themselves really in for good. It might be

situations where you try things on a temporary basis where it is fully understood that what is negotiated and what is agreed to is a temporary basis, for 12 months or for 24 months, and we'll come back—there is no automatic extension—we are going to come back after that and see what exactly is going to happen and exactly what has taken place and whether or not it is to our benefit.

The CHAIRMAN. Thank you very much, sir. We appreciate your being here and giving us the benefit of your views.

[The statement follows:]

STATEMENT OF RONALD L. DANIELIAN, INTERNATIONAL ECONOMIC POLICY ASSOCIATION

Mr. Chairman: My name is Ronald L. Danielian. I am Executive Vice President and Treasurer of the International Economic Policy Association which was founded in 1957. During the early seventies, I also dealt directly with tourism and related matters in the Commerce Department. IEPA is a nonprofit research organization based in Washington. Its investigations into public policy issues in the international economic arena have included the U.S. balance of payments, trade, investment and tax questions, as well as natural resource issues. While IEPA's members are generally representative of American industry and we benefit from their professional expertise, I am appearing here today on behalf of the Association generally and not any individual member company or companies.

My testimony today centers upon our just completed report which, with the Chairman's permission, I should like to submit for the record. The report, entitled "Services in America's International Trade: The Air Travel and Tourism Sector", deals with the broader question of service industries in the U.S. balance of payments and the role that the tourism and air transportation sector plays within that category. We are concerned with U.S. policies and the necessity to obtain an international "balance" in the concessions and agreements on international aviation. I am concerned that there has not been a full appreciation of the noncompetitive environment for U.S. transportation service companies nor an appreciation of the seriousness of the balance of payments situation.

Some of the noncompetitive practices which inhibit our ability to earn a fair share of the travel dollar were outlined to this committee when the Fair Competitive Practices Act of 1974 was passed, and they continue to exist today. Also, the CAB study cited on page 20 of our report catalogued the tie-in between foreign governments and their airlines. The Department of Commerce 1976 study entitled "U.S. Service Industries in World Markets: Current Problems and Future Policy Development" outlined some of the specific problems faced by U.S. service industries. That study noted that 76.7 percent of the foreign carriers providing service to the U.S. market were either wholly government-owned, or received substantial government subsidies. In addition, in the competitive North Atlantic market every major foreign carrier was either government-owned, supported or directed. U.S. negotiators should view our position in the face of these realities and take into account the competitive nature of the marketplace and the relationship of potential market sizes for the competition of the transportation and travel dollar.

Our study further points out the tie-in between airlines, for instance, and tour operators in Germany where 52 percent of the present international flying market to the United States uses travel agencies. Such tie-ins,[1] whether government induced or not make it very difficult for the United States to penetrate, on an equal footing, the foreign markets. The ability to freely own and operate a tour agency in a country where the great bulk of international tourists use travel agents, can mean the difference between profit and loss in supplying air services.

The competition for tourist dollars has centered on the key factors of market access and share of the potential travel earnings, as well as foreign exchange returns to the country concerned. In the reply from the Netherlands to a European Travel Commission study, the government's involvement in tourism receipts was described as devoted to "more emphasis on employment-foreign ex-

[1] For example, see page 6 of the accompanying study with reference to Air France and its direct ownership of tourist agencies and air freight forwarders.

change maximization, (and) environmental protection." [2] Their main objective is to obtain a requisite market share and foreign exchange taking into account not just transportation earnings, but also tourist spending involved. Thus parts of that system (including the transportation part) are more concerned with the whole and not whether the revenues in one sector alone are commensurate with the services given, especially where government supported, subsidized, run or directed services are involved.

In our negotiating process we must recognize the nature of the market. We should be vigilant that what we give us is of help not only to the U.S. consumer but also to the nation as a whole and that we do not give up more than is necessary to obtain what we believe to be an even balance in concessions. Reliance on country-of-origin rules or an open skies policy in the face of the nature of the foreign competition could ultimately reduce the returns to U.S. national income and affect the 40,000 or so direct jobs of U.S. international air transportation companies' personnel involved in international aviation.

In the trade-off, for instance, between price concessions and unlimited free access to the U.S. market, our present international aviation negotiating framework appears to be dealing in unequal benefits. Thus, when we are given free access to four countries in Europe (France, Germany, The Netherlands and the United Kingdom) representing a base potential for travel to the United States of 26 million individuals, they will receive access to our market which represents a total potential of at least twice that amount. Further, when we obtain the rights for one or two U.S. airlines to operate on routes to the four countries concerned, each one of their carriers—four in all—will receive multiple access to our total market. It is ironic that in the European Community, member nations want to be viewed as one market when dealing with other countries on trade in goods as, for example, under the GATT negotiations. However, in air transport matters they insist on being regarded as individual countries—just as if the United States were to consider the 50 American states as single entities for the certification of a plethora of carriers.

Further, if we accept country-of-origin rules there is a serious question whether we have received open and adequate access to foreign markets. If we accept open skies we will find U.S. private companies pitted against government controlled, financed or directed companies. In fact, the U.S. Treasury and all OECD nations are concerned about the level of public support for manufacturing industries which has, in essence, skewed markets and reinforced government determinations to protect their home industries for employment and other political reasons. In last week's Business Week there is an article about Assistant Secretary Bergsten flying off to Ottawa early this month because the Treasury Department was concerned about the Canadian government's willingness to put up $40 million to lure a Ford Motor Company new engine plant across the border. The United States has been worried about government inducements to floundering companies which keeps them in competition with efficiently run organizations. In The Netherlands, for instance, the Dutch government last year handed out subsidies to 38 heavy engineering companies, 25 textile firms, 13 building materials and furniture manufacturers as well as other companies.[3] The theory surrounding free trade, including the philosophy of comparative advantage, cannot operate when such noncompetitive outside forces interfere. And there is no difference between the Dutch and Canadian government examples in the manufacturing field, and the Dutch example of providing KLM equity funding of $62.5 million in 1972, $74 million in 1975, as well as the increase in the amount of available government guarantees for KLM loans in 1975 to a value of $148 million—in essence, a "call" on a government guarantee which greatly facilitated the company's ability to obtain financing in the private sector. In the absence of such help, competitive market forces would have mandated a curtailment of less profitable routes (or losing routes) just as U.S. international airlines experienced after the 1973–74 oil cost escalation.

It seems to me that we should differentiate between the consumer need for lower and more competitive fare structures and the proliferation or dilution of the market which can have adverse effects on U.S. shares and the balance

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[2] See: *Tourism International Policy,* Tourism International Press, London, England, 4th quarter, 1977.

[3] See: *Europe's Subsidy Spree,* Dun's Review, August 1978, p. 57.

of payments. I don't want to be misunderstood on this point, Mr. Chairman, for I as a consumer personally would agree with the lowest possible air fare structure in aviation, commensurate with the costs of providing the service and, of course with high safety and maintenance standards. Open competition is an efficient way of insuring the best possible fare structure for the international traveling public. But in an international industry structure, dominated by government linked corporations, truly private or profit-oriented industries can find the competitive process noneconomic. The extreme example of this effect in the transportation service industries can be seen in the predilection of the Soviet Union to undercut shipping rates in the Pacific, for instance, in order to gain market share which may damage the profitability of U.S. private shipping companies and take foreign exchange away from our shores.

We should maintain a balance in our negotiation process that trades commensurate benefits. The Congress has dictated this policy in the goods trade area observing in the 1960's what was considered to be unequal trade-offs in certain areas. Thus, our objectives in gaining reciprocity of service must be aimed at the total market and at denying, for instance, the European members the advantage of individual bargaining which restricts our access to their whole market, while opening up our total market to five or ten government run, directed, or subsidized carriers. In addition, we should not ignore market sizes and the foreign exchange considerations in diluting routes at the same time as we offer foreigners a larger competitive market from which to draw earnings.

Equal access to equal markets is critical but so is insurance against noncompetitive factors that can be used by foreign governments to increase their market shares to the detriment of our own international industry. And as I have stated before, the nature and character of the marketplace must be taken into account. The Administration policy statement released by Secretary Adams on August 21 stresses the competitive factors, but appears to minimize these special market characteristics. In particular, we must be concerned about the total U.S. balance of payments picture and the declining dollar; and it is difficult for me to see how giving up a substantial market share in the United States to foreign carriers will enable us to improve our performance. Morover, as the Committee is well aware, there are other important political and national defense factors in the health of U.S. international carriers in worldwide competition [4] which argue for a policy of balance in dealing internationally with the highly complex area of aviation agreements.

I would hope that the considerations I pointed to in our study and my testimony will be assessed carefully to achieve a true balance.

The CHAIRMAN. The next witness is Mr. Richard Smith, director, Legislative Affairs, Flight Engineers' International Association.

STATEMENT OF RICHARD SMITH, DIRECTOR, LEGISLATIVE AFFAIRS, FLIGHT ENGINEERS' INTERNATIONAL ASSOCIATION, PAN AMERICAN AIRLINES CHAPTER, AFL–CIO, GARDEN CITY, N.Y.

Mr. SMITH. Mr. Chairman and staff, I am Richard Smith, director of Legislative Affairs of the Pan American Airways Chapter of the Flight Engineers' International Association.

We thank you for the opportunity to appear before you today.

I have made my comments a bit briefer than you have before you, so if you will bear with me in the text.

By mid-1970 depressed economic conditions forced Pan American to furlough large numbers of flight crews. Even today, despite nearly 2 years of strong growth in international air transportation, Pan

[4] For some examples, see "The United States Flag System in International Air Commerce: An Analysis of Public Policy Implications," IEPA, June 1974.

American has been unable to recall 40 percent of the membership of my labor union. My furloughed colleagues, skilled professional airmen, are unable to resume their careers because U.S. flag carriers no longer carry a fair proportion of the international air traffic of our country. The erosion of our market share is not due to a lack of competence, or a lack of efficiency, or a lack of spirit or a lack of aggressiveness on the part of our American flag carriers; the erosion is due to factors that are beyond the ability of our private enterprise air carries to control: virtually all foreign airlines are instruments of the state whose flag they fly; foreign airlines have gained market share at the expense of American carriers because it has been the concerted policy of their governments to negotiate for maximum self-advantage.

We applaud the purpose of S. 3363. We favor competition and we are anxious to see the benefits of low-cost international transportation extended to an ever widening segment of the American public. But there is a decided difference between the competitive environment of the domestic and international aviation sectors. We have grave misgivings about the way the shift of regulatory philosophy is being managed in the international sector.

We believe that current policies in the international sector are leading to a progressive weakening of our international aviation viability. According to Mr. Klem of the CAB staff in a memo of June 28, the U.S. airline share of our international traffic is now down to 40 percent. We believe that weakened international carriers are not in the public interest. Neither the traveler, the airline shareholder, or the airline employee will gain if our international aviation strength is permitted to slowly ebb away.

We appear before you today to say that we are fearful that the new bilateral negotiation strategies proposed and followed by various elements of the executive branch of our Government, if permitted to continue unchecked, will place our American private enterprise carriers at ever greater competitive disadvantage.

We are startled at the naivete displayed by the CAB and DOT staffs regarding the economic and political mechanisms that operate in the international air transport sector. For instance, Mr. Klem of the CAB, in attempting to justify a policy of "open skies" with the Federal Republic of Germany, has stated in a memorandum to the members of the CAB that U.S. air carriers will prevail in an environment of unrestricted competition because U.S. air carriers are low cost and could "outprice-compete" Lufthansa if "open skies" led to cut-throat competition regardless of whether Lufthansa was subsidized.

We are concerned about "open skies" because it is our belief that in all-out competition even a combination of the strongest airlines in the United States would be no match for Lufthansa and the treasury of the Federal Republic of Germany.

Moreover, the strength of the Federal Republic's treasury may not be the determinant in an all-out competitive test. We are not so certain that Lufthansa, on the basis of marginal costs, might not be one of the most efficient airlines in the world. In fact, we believe that there are probably at least six other airlines in the world that would meet or

beat the marginal operating costs of the very best airline in the United States, international or domestic.

Nowhere in his voluminous discussion does Mr. Klem support with substantive evidence the critical assumption in his argument for open skies, the inherent marginal operating superiority of U.S. airlines. Admittedly, assessing the comparative marginal operating efficiency of U.S. and foreign carriers is difficult because very few airlines in the world publish the depth of detail about direct operating costs that American carriers do. There is comparative data on employment levels. But anyone with international experience knows that overall employee productivity may be misleading because the public policy of many of our foreign competitors mandates heavier employment for social policy reasons.

Certainly, basing the rationale for an international negotiating strategy on unsubstantiated assumptions about relative competitive strength could lead to severe damage of both our national interest and the interests of consumers. The record shows that foreign airlines are not low-fare advocates.

Mr. Kahn mentioned he only gets the argument about our merchant marine from foreign carriers. We would like to make that argument for ourselves.

Need we point out, Mr. Chairman, that the United States once had a fine merchant marine and was a maritime power on the high seas. Today our merchant fleet carriers only 5 percent of our national ocean commerce. Twenty-five years ago the suggestion that our merchant marine could slip from its 60 percent market share to 5 percent would have been given little credence. We believe that our international air carriers today are as vulnerable as the merchant marine was 25 years ago, whether or not Government theorists agree.

Fortunately, Mr. Chairman, the language of S. 3363, strictly interpreted, would prevent the decline of our industry, and we commend the chairman and Mr. Pearson for their farsightedness. Because an important series of bilateral negotiations are soon to start, we ask that you suggest to the Secretary of State that the U.S. bilateral negotiators be instructed to exercise restraint in negotiating while S. 3363 is given its final legislative form.

For the use of the committee in its consideration of the final form of S. 3363, we are submitting as an attachment to this statement our comments on the DOT draft International Aviation Policy that is part of the DOT hearing record of June 27, 1978. These comments explain the basis of our doubts about aspects of the international aviation policy framed by DOT. We would be pleased to answer any questions that Members of the committee and staff of the committee might have regarding our perception of the threat that ill-advised implementation of the new policy represents.

With specific regard to the language of S. 3363 we have a few suggestions:

First, labor should have a direct, statutory role in bilateral negotiations.

We are good economists and good bargainers. We strengthen the competence of the U.S. team. In recent negotiations a labor technical

advisor has been part of the U.S. delegation. We ask that this role be made permanent participant.

With regard to the supplemental airlines, we are in agreement that it is only fair that their certificates be broadened to permit scheduled service. We suggest that the goal of producing more competition might be encouraged most effectively if the supplementals were required to seek scheduled routes between city pairs that do not enjoy daily or frequent service by U.S. carriers.

The effect of this provision would be to place U.S. carriers in head-to-head competition with foreign airlines rather than head-to-head competition with each other. I assure you that the supplemental airlines would not be relegated to secondary markets—from Chicago only SAS operates same-plane service to Scandanavia; KLM to The Netherlands; Air Lingus to Ireland; Lufthansa to Germany, and Swissair to Switzerland.

Today these are effectively foreign monopoly air routes on which competition would surely be beneficial.

Mr. Chairman, we hope you will permit us to submit additional written comments to the committee as these proceedings make appropriate.

With regard to U.S. airlines and their employees, the bill should include a policy statement that a strong U.S. air carrier presence be encouraged and maintained in the international aviation system, and we strongly concur with the comments of the NACA representatives as to the inclusion of that in the policy statement.

The CHAIRMAN. Thank you very much for a fine statement. I find much in your statement with which I agree. I might say that on those examples you gave, if we do adopt an open skies policy, then, of course, that would do away with the probability that you would have, monopoly single-pair points, such as you described.

So that I think that would help with what you are suggesting really ought to be done.

With respect to Germany, which has a market-oriented economy, I would seriously doubt that Germany is likely to subsidize Lufthansa to the point that they could outcompete a strong competitor from the United States.

I think we do have very efficient competitors in this country. And in that connection, I might say that I think the actions that the Pan Am employees took are certainly commendable at the time Pan Am was having its difficulties not too long ago. They certainly ought to be commended for helping get that carrier back on its feet to the point where it is making some substantial progress.

I was a little surprised to see that you still have such a high percentage of your people that have not been recalled to duty yet.

What does that represent in terms of numbers?

Mr. SMITH. 510 men right now.

The CHAIRMAN. Is that picking up at the present time?

Mr. SMITH. Well, I think the company is taking a look at what is happening in regard to these bilateral negotiations and particularly the open skies proposal, as well as what is happening in regulatory reform and the rights that are contained in that bill, questioning them-

selves whether they should be recalling anyone at this time or whether they should be preparing for further furlough.

The CHAIRMAN. Well, we would certainly hope they would not have to prepare for further furloughs. As you know, I have long been a supporter of the fill-up rights for Pan Am, and I have been critical of the fact that they don't have domestic points to service to assist them in their international route structure.

And I hope they will make some progress in that area.

Mr. SMITH. Well, I think our real problem here is that as we have indicated in the statement that the U.S. carriers have lost considerable in the way of erosion of their portion of the international marketplace.

We did some figures on this. In the year 1968, the U.S. carriers had 55.8 percent of the international market. In 1972, they had 54.5 percent. In 1976, they had 50.3 percent. And if Mr. Klem can be believed in his memo of June 28 to the CAB, we now have 40 percent of the total market.

The CHAIRMAN. Yes; of course that was under a restrictive-type of policy and carriers did not have the opportunity to compete.

I would think if U.S. carriers were given better opportunity to compete, given their efficiencies at the present time, that they would be able to outcompete and help regain part of that share of the market.

The restrictions have been imposed on the points that they serve and this sort of thing has been one of the deterrents.

Mr. SMITH. Well, of course, the big test is whether the low fares philosophy and multiple permissive awards are working, and I think that is related to how Pan American and TWA are faring under the low fares that are now in operation.

We have some other data which, to be honest, only recently become available because it is second-quarter data for both Pan American and TWA.

You might be interested in that. We analyzed the second-quarter reports of Pan American and TWA in the North Atlantic where the test is really underway and compared them with the same period last year.

The results are as follows: For Pan Am to cite a 5.4-percent cut in yield for revenue passenger-miles as a result of the low fares in its scheduled passenger services. Pan Am's total Atlantic traffic was up only 6.7 percent. A 14.2-percent increase in scheduled passenger-miles was largely offset by 13.1 percent decline in charter passengers. Unit costs rose 10.2 percent. Per seat-mile from 5.61 percent to 6.18 percent. The break-even load factor rose from 53.6 percent last year to 63.2 percent this year. And Pan Am booked a $3,398 million loss from North Atlantic operations this year, when you include interest expense compared to a $6 million profit a year ago.

I know that is a lot of figures. TWA's figures are very close to that, except that their break-even load factor is now up to 66 percent on the North Atlantic. And the real problem with this is the declining yield situation.

What we are concerned about is that as revenues increase, the marginal cost of putting people on board those aircraft rises. As the fares begin to peak, the cost of putting those people on board rises and con-

tinues to rise, and soon those lines will cross. And at the point where they cross, the airlines, the U.S. airlines, Pan Am and TWA in this case, are going to have some horrendous losses.

If you suppose that there will be a slight economic decline and the additional possibility of traditional capacity in the market with the production of new aircraft——

Mr. SMITH. Thank you.

The CHAIRMAN. Thank you very much. We appreciate your being here and making your presentation to us.

The CHAIRMAN. By the way, you did ask if you could supply additional information and the answer is "yes."

[The attachment referred to earlier follows:]

PAN AMERICAN FLIGHT ENGINEERS,
Garden City, N.Y.

To: The Department of Transportation, Washington, D.C.
From: Richard Smith, Director, Legislative Affairs, FEIA/PAA Chapter.

During the hearing of June 27, 1978, the panel addressed questions to the labor representatives. The questions deserve considered answers. This letter of comment addresses three of those questions in the context of the values and objectives we believe a U.S. international aviation policy must reflect.

Although our comments on the draft policy are critical we want to make it clear that we are not intransigently against "deregulation." We are very much in favor of permitting international air carriers (carriers) the flexibility to create new markets, new services, and lower fares. But we believe that the pace of change must be disciplined and controlled in order that the effects of each change can be carefully identified and measured. To no one's surprise the experts who created most federal transportation policy in the past turned out to have had very cloudy crystal balls. Economic forecasting is not a science and is far from a perfect art. However, our international air transport industry is too crucial to the welfare and security of this country to be hazarded by wishful theorizing. Until we see incontrovertible proof that the new regulatory scheme of things will bring substainable benefits to consumers, labor, and shareholders we must challenge the wisdom of the hasty transition to the "free market" competitive order now under way.

Before we respond to specific questions of the Hearing we must reiterate our general misgiving about the draft policy. As published we find the statement so vague, ambiguous, and non-specific that it defies careful, substantive review. Until its authors make known the precise definition of what is meant by such phrases as "reliance on competitive market forces to the greatest extent possible" or "competition between airlines in a fair market place," the policy statement is defective and incomplete. The air service goals of (1) affordable, (2) safe, (3) convenient, (4) efficient, (5) environmentally acceptable service are all almost equally good. But it may turn out that they are not all simultaneously achievable. We need to know what the specific policy will be when choices must be made between these goals: What is the decision rule for a choice between competition and energy conservation? How do you choose between preservation of American carriers, American jobs, consumer benefits, and "reliance on competitive market forces?"

Please not that in principle we do not fault the broad objectives of the preamble but we do question its failure to consider the interest of labor. (We deal with this point later.) However, what we find in the main body of the statement leaves us with considerable misgivings. In summary, we believe that the guidelines for negotiation are not in the best interests of either the consumer or the employees and shareholders of our international air carriers. We believe that certain critical assumptions underpinning the policy are faulty and that if the policy were to be implemented as proposed it would provide foreign air carriers with the means to drive U.S. carriers out of the international air lanes. It is evident to us from interpretive statements of government officials that the policy is based on erroneous, incomplete, and overly simplified assumptions about the

methods with which airlines compete. The policy assumes that free market conditions can exist in international air transportation and that where they do not exist the U.S. can impose them. The policy seems to ignore unique characteristics of air transport service which are markedly different from the classical mechanisms of competition.

In the answers following to questions addressed to labor at the Hearing will be found amplification of the points summarized above.

Question 1. What should we (DOS, DOT, CAB) be negotiating for (in the interest of labor)?

The first priority of the aviation labor force is the preservation of employment and the improvement of conditions under which we work. In view of the high level of professionalism and dedication with which we have performed our jobs we have a right to expect employment security.

The economic malaise that the international air carriers suffered in the 1970s was not of our making but the labor force has borne a heavy cost in unemployment and the disruption of its working conditions. We do not want to be treated as summary statistics: Faceless elements in economic equations that describe the ebb and flow of labor in and out of airlines, in and out of the airline industry, all in accord with great and immutable laws. Labor does not want to be treated as some inanimate resource to be shuffled here or there by the fates and a government bureaucracy. We ask that our need for order and stability in our lives be respected.

There is no good purpose to be served in a cataclysm of restructure in the international segment of the U.S. airline industry. But the policies now put forward, if not modified, will surely result in more unwarranted dislocation and hardship for the aviation labor force. Because the airline industry may have been overregulated for too long does not justify throwing order, control, and restraint out the window.

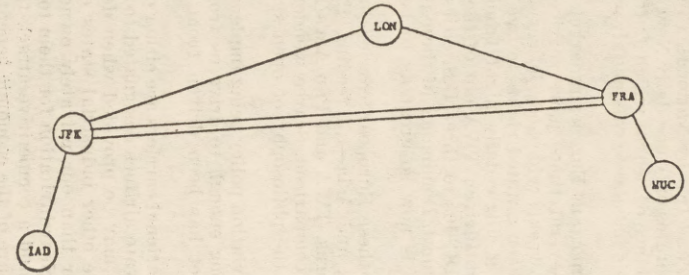
We expect our government to negotiate to protect our jobs; to preserve our people as they are and where they are without further dislocation. We expect our government to negotiate so that our international carriers can return to conditions of growth in order that furloughed employees can be brought back to work.

If our government negotiates for equal economic benefit, all of our expectations can be met. International aviation is growing and with that growth can come the expansion of opportunity that is due the aviation labor force in the United States.

Unfortunately, our international airlines have been on the decline since the early 1970s because they have not been able to compete effectively against the special advantages that foreign flag carriers enjoy.

The foreign flag carriers across the North Atlantic are directly or indirectly subsidized in the acquisition of equipment. (Even our Exim bank subsidizes our competition by making available to foreign airlines favorable financal terms unavailable to U.S. carriers in our own "free market" financial centers.) Operating deficits are covered when required and foreign carriers have "feed-in" and "beyond" route systems that funnel traffic over their transatlantic routes. The route structures that support the passenger collecting effectiveness of our foreign competitors is a product of their government's conscious policy. As a result, foreign airlines have expanded their routes and service in the U.S. at an ever accelerating rate. Today, in several important markets their domination is complete.

PAN AMERICAN TRANSATLANTIC ROUTES : NONSTOP & ONE STOP SERVICE - U.S. to GERMANY (SUMMER 1978)



LUFTHANSA TRANSATLANTIC ROUTES - NONSTOP & ONE STOP SERVICE - U.S. to GERMANY (SUMMER 1978)

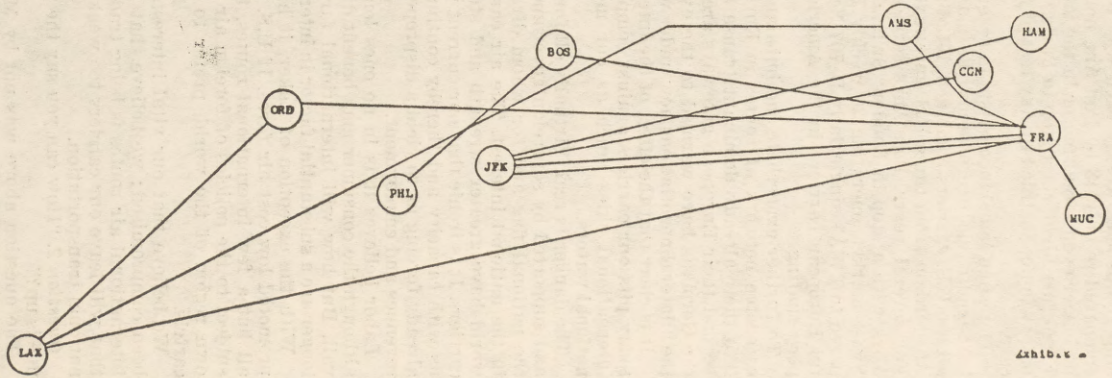


Exhibit 8

Consider the situation which exists this moment in the transatlantic market to Germany. Exhibit A illustrates the route structure of Lufthansa and Pan Am. It can be seen that Lufthansa has a boa constrictor's grip. Lufthansa provides non-stop transatlantic service to four German cities. Pan Am provides non-stop service to one. Lufthansa provides non-stop service to four U.S. cities. Pan Am provides non-stop services to only one. Lufthansa operates 45 non-stop frequencies weekly each way over the North Atlantic in German markets compared to only 13 by Pan Am, none by TWA, and two by National. (TWA is no longer even a real factor in the market. It operates only one daily New York/Frankfurt flight via a stop in Paris.) This imbalance of benefit which Lufthansa enjoys is not justified by any test of fairness. This imbalance was not always the case.

The same imbalance exists in several other important European markets. SAS in Scandinavia overwhelms the market with several times more service than all the U.S. carriers combined. KLM provides 26 weekly wide body jet services to Amsterdam from three U.S. gateways, and has been granted rights to two more. For several years, Pan Am's service has been a single daily flight from New York with a stop in London. Swissair has all but driven TWA out of the U.S.-Swiss market, operating 20 weekly B–747 and DC–10s to three U.S. cities compared to TWA's single daily B–707 New York-Geneva. Dominance of these powerful European carriers in the American market is now so great as to be self-perpetuating.

To further exacerbate the imbalance, each of these European carriers has an extensive network of routes in Europe, Africa, and Asia—all feeding directly into their already dominant transatlantic patterns. TWA and Pan Am's routes beyond their European gateways are pitiful by comparison. Scarce wonder that the Germans have warmed to the extension of the philosophy of open skies in the bilateral negotiations now under way.

It is clear that the effect of the international aviation policy being implemented today pits our carriers against competitors strong enough to drive us from the international skies much as our merchant fleet has been driven from international waters.

The danger is real. Virtually all foreign international carriers are either owned and supported by sovereign governments or private airlines designated to carry the national flag and for whom direct support may be provided when deemed in the national interest. The air carriers of the other industrial states of the world have greater strength and staying power than our privately owned air carriers. It is ironic that our current policy is a clear invitation for them to flood us with capacity and thereby continue and expand a competitive attack that is already forcing us to yield a disproportionate share of the economic benefit, both revenues and employment.

Labor believes it is in no ones long term interest for this trend to continue although the consumer may benefit during the period when unrealistic fares prevail. But how will international fares be set if U.S. international carriers no longer are a substantial factor in international air transportation?

With the exception of Laker, it has always been U.S. air carriers that have promoted low cost air fares. If U.S. air carriers lose their ability to operate on all but a few international routes, the American consumer would find himself subject to the policies of foreign air carriers who, need we remind you, in their own region of the world, prefer to operate under the protection of high fare cartels.

We believe that our vital interests in our jobs and working conditions have been compromised; we believe that the long term viability of U.S. carriers on international air routes is being traded off for a transitory burst of competition that will leave our carriers too weak to continue as substantial factors in international transportation.

Question 2. "How can you say the policy is not working when traffic and revenue is up?"

The question above was put by Mr. Shenefield at the time that a labor witness expressed doubts about the wisdom of the new policy. In summary, our answer to Mr. Shenefield is that the argument he endorses, demonstrates an unrealistic appreciation of how airlines compete in the provision of their services.

Once again we repeat that we have no problem with applying medicines that move the airline industry towards more competition. But the medicines have to be carefully prescribed because the side effects of the wrong medicines will kill

the patient. As we will elaborate below, unrestrained capacity competition can be lethal in the air transport business.

But first, with regard to the improvement in airline performance of the last nine months: Officials of the government involved with aviation policy make frequent reference to the current upturn in traffic and airline profits as proof of the benefits of the competitive changes of the past 18 months.

We have no dispute with the fact that overall traffic and profits are up, tremendously. But one must be very precise in determining the source of the benefits. Our view is that the data is still too new and unrefined for very firm conclusions to be reached. A strong case can be made in the opposite direction.

For instance, at a meeting of an air transport research symposium in Dublin in early June the TWA director of international passenger pricing reported an analysis of the impact of low fares on TWA's transatlantic revenues. The analysis was based upon a series of surveys conducted by the European Travel Commission in which TWA, Pan Am, British Airways, and Laker participated and also independent surveys by TWA. One of TWA's findings was that the new low fares help, but the underlying strength of the current surge is demand in the transatlantic market is not low fares but demand created by generally good economic conditions. Moreover, the low fares are not producing pure economic benefit either.

The following is excerpted from an article in the Aviation Daily of June 29, 1978:

TWA ATLANTIC FARE INCREASE BASED ON DECLINING YIELD

"TWA's filing of across-the-board increases for transatlantic fares ranging from 10% to 15% on deeply discounted fares to 5% on normal economy and first class, is based partially on a steadily increasing decline in the carrier's yield, according to the justification it filed with CAB.

"Impact of the deeply discounted fares was only now becoming apparent, TWA told the Board and pointed out that its yields in cents per mile had declined 0.3 percent in December, 2.4 percent in January, 3.1 percent in February, 3.9 percent in March, 6.5 percent in April, and according to preliminary figures, would be down 7.5 percent in May.

"*TWA said that the spectacular traffic increase between the U.S. and U.K., where most deeply discounted fares are being offered, appeared to be illusionary. When those discount passengers attracted to New York from other U.S. gateways and to London rather than other European gateways are subtracted, general traffic to the U.K. has not increased substantially over traffic to other European destinations, such as France, where deep discounts are not available.* (Emphasis supplied.)

"While admitting that it was currently enjoying record high load factors, TWA stressed that such increases could not continue at their current rate. 'TWA believes the average annual load factor of 65 percent projected for 1978 represents close to optimum which can be achieved in international scheduled service,' the carrier told the Board."

Confirmation of TWA's transatlantic traffic generation findings can be argued from European traffic statistics. This year the Association of European Airlines is reporting traffic increases averaging 8 to 9 percent. These increases are occurring on the intra-European schedules where airline fares are very high by U.S. standards and where there is not a new set of reduced fares to lure additional travel. Undoubtedly, some of the increase in transatlantic traffic, is attributable to the inducement of lower fares but the degree to which lower fares are responsible is an important element of fact that still must be determined. Moreover, the impact of the low fares on aggregate revenues must be considered as well.

Pan Am figures for the first quarter of 1978 show the airline in substantial profit overall, however, the Atlantic Division is operating in deficit despite record traffic and very high load factor.

Dr. Kahn has expressed the view that the industry must be financially healthy if it is to give good service. Declining yields must ultimately impair an airline viability. Over the long term if the new low fares produce lower aggregate net revenues our industry will be in mortal trouble. Obviously if TWA cannot remedy the transatlantic yield problem, domestic operation eventually must subsidize the foreign or the airline may have to suspend transatlantic service. If the revenue pattern of Pan Am's Atlantic Division spreads to its other divisions Pan Am cannot remain in business without subsidy.

We are all grateful that in 1978 overall industry net revenues are up. But this enhanced profitability must be carefully analyzed to determine whether it is predictable and repeatable or whether transitory, uncontrollable factors may have had a role. The data available also demonstrates that very significant increases in load factor have accompanied the increase in net revenues. This is in perfect accordance with theory. Airlines are highly profit leveraged with increasing load factor, i.e., the cost of transporting the marginal passenger is always well below average costs, therefore, the revenues from incremental passengers contribute substantially to profit. However, it is important to note that the increase in load factor was not the result of conscious decision making by airline managements to exploit high load factor leverage. The increase in load factor was a direct function of the fact that the airlines were unable to offer additional capacity as traffic surged upward.

The facts are that after nearly a decade of depressed air transport production we have a scarcity of transport aircraft today. In other words, the increase in airline profitability today is as much a result of an inadvertently imposed capacity restriction as it is a function of increased travel due to incentive fares. If scarcity was not a constraint of today's market, in other words, if moth-balled aircraft could have been rolled out over the last several months to carry the additional traffic, entering the market due to the low fare inducement, then the load factors and profits would not have increased.

Because the scenario just described is clearly counter-productive it appears unrealistic. Why would airline managements add capacity and drive their load factors and therefore their profits down in a rising market? The answer is that they would not add capacity if they had monopoly routes; but a paradox of airline competition forces them to add capacity on competitive routes because capacity is a critical element in route competition between airlines. Capacity competition is the Achilles heel of rational airline management. It is a structural imperfection that destroys the theoretical effectiveness of the free market in air transportation.

The core of the problem is a phenomenon known as "S" factor. In the airline business a carrier able to schedule a substantial frequency of service advantage over its competitors on a given route will come to enjoy a more than proportionate share of the market, i.e., the carrier with the highest frequency will realize an above average load factor and therefore greater net revenue. The failure of a carrier to match a service increase of a competitor inevitably leads to its suffering a loss in proportionate share of market which translates directly into lower load factor and reduced net revenue. Of course, a carrier might fight to hold market share by reducing fares but, because such action is so easily countered by the other competitor, fare slashing is generally resorted to only as a desperation tactic. In the long run even the consumer loses from uneconomic fares.

The propensity of the industry to enmesh itself in overcapacity has been noted by officials of DOT and CAB. Dr. Kahn at the Hearing on June 27 asked of an industry witness whether there were indications of a new wave of excessive investment. Dr. Kahn was reassured that at least on the domestic scene such a prospect was not in sight.

We believe that this question requires much deeper probing. We believe that DOT and CAB are discounting overcapacity as a potential problem based on a rational that runs something like this:

"The industry learned its lesson in the early 1970s and will not repeat the mistake. Proof that the lesson was learned is evidenced by the fact that today there is no surge toward excessive investment. The carriers are adding capacity at rates well below traffic growth and are in return realizing improved revenues as load factors climb. Why should they turn away from rational, prudent management?"

The problem with the formulation above is that it attributes the restraint of industry today to rational management rather than to the real cause which is an inability of most of the carriers to finance large scale purchases.

We are unlikely to see a capacity surge among U.S. carriers while the industry remains financially weak. But given a return to more robust balance sheets it would not take long for a new wave of investment to start. Particularly in view of the loosened restrictions on freedom of entry, even the most conservative carrier will need to build a capacity reserve to meet potential market invasions. And once aircraft are on hand they will be flown to cover their fixed charges. We believe

that a long term effect of the new policy will be to insure the loss to the consumer and the shareholder of the benefits to be gained if the air transport system operated at the high end of load factor.

As far as the domestic situation is concerned perhaps the carriers are too weak to engage each other in destructive capacity war for still several years and therefore there is time to come to grips with the problem. Internationally, however, the situation is much different.

In Europe, Lufthansa, Air France, British Airways, and Swissair among others have ordered or are about to place orders for massive numbers of additional aircraft.

In Southeast Asia, the island state of Singapore has ordered sufficient aircraft to nearly double its international passenger carryng ability. In a few years Singapore will have the capacity to fly half of its population around the world every year.

Our international airlines will not be able to meet the capacity competition of a Singapore Airline, a KLM, a Lufthansa or SAS unless our government negotiates for a fair share of the economic benefits our travel produces.

Unless our negotiating objectives reflect our government's determination to insure that American carriers will not be squeezed out of the air lanes, in a few years our international air carrier industry may be in the same condition as our merchant marine and our long haul railroads; a victim of well intentioned policy that failed to accommodate to realities. We must have protection against foreign state supported carriers bent on exploiting their self advantage.

Question 3. How do we get from here to where we want to be?

There is no precise answer to this question until the conflict is resolved over priorities of the policy as noted in our comment on its preamble.

Labor's first priority is the preservation and enhancement of our employment opportunities and our working conditions without disruption. This priority can only be achieved if the paramount negotiating guideline is maintenance of our existing U.S. carriers as strong competitors on the international routes to which they have authority.

Our international negotiators will have to abandon the fiction that free market rules can apply in international transportation markets for otherwise we will be faced with competition from state supported airlines too strong for us to survive. We are highly vulnerable and it is whimsy to talk of the competitive strength of private air carriers in an international market dominated by instruments of powerful sovereign states.

Our recommendation we can make today is that the policy of gradualism originally embraced by Dr. Kahn and articulated in his address to the Aero Club of Washington on October 25, 1977, is still the most appropriate course of action. In his colloquy, Dr. Kahn discussed an inclination toward gradualism in reshaping the structure of aviation regulation in the United States. He said that the problem associated with gradualism was that there was no blueprint for a gradual approach. "No organized body or theory by which to plan or monitor a movement." Last winter Dr. Kahn abandoned his preference for gradualism because of the "distortions" it introduced.

We do not believe, however, that the absence of a blueprint and the presence of distortions justifies, therefore, a precipitous leap into the unknown of open, unrestrained competition. It is a leap that requires an Act of Faith we are not prepared to make. There is no instant corrective for the imperfect product of forty years of regulatory control—but gradualism permits experimentation and wisdom to come into play.

Moreover, nothing fundamental has changed in international conditions to support the impatient rhetoric now heard for quick movement toward free market competition. The problem that gradualism is imperfect and results in distortions or that it is difficult to manage is not a sound reason to scrap an ordered approach. Certainly the recent improvement in airline fortunes, this mini-bonanza, does not mean that the industry can afford more bad mistakes. The fact that the airlines are temporarily operating across the Atlantic with high loads does not eliminate the need of caution in changing the established order.

The aviation policy of our leading international competitors is calculated to maximize their economic advantage. Their list of priorities is different from ours. Our negotiators must be realistic and attuned to the national opportunism that molds the position their opposing negotiators take. If we choose a set of policies that will result in a weakening of our international carriers, why should foreign governments object.

The vague generalities of our draft policy must be replaced by a coherent statement that makes it clear that we will not trade away our fair share of the benefits that will flow from the positive aspects of change in international aviation agreements that we are negotiating for.

The CHAIRMAN. That concludes the hearings today. The committee will stand in recess until 9:30 tomorrow morning.

[Whereupon, at 12 noon, the hearing recessed, to reconvene at 9:30 a.m. on Thursday, August 24, 1978.]

INTERNATIONAL AIR TRANSPORTATION COMPETITION ACT OF 1978

THURSDAY, AUGUST 24, 1978

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, D.C.

The subcommittee met at 9:40 a.m. in room 235, Russell Senate Office Building, Hon. Howard W. Cannon (chairman of the committee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. The hearings will come to order.

Today is the final day of hearings by the Aviation Subcommittee on S. 3363, the International Air Transportation Competition Act of 1978.

Before we begin today's hearing I want to set the record straight on some press reports, most notably, an article in yesterday's Washington Star which incorrectly represented my position and misquoted me on the current administration's strategy with respect to international aviation bilaterals.

The first correction I would like to make for the record on the Star's article is to let them know that my name is Howard W. Cannon and not Wayne Cannon. My middle name is Walter and not Wayne.

Of considerable more concern is the general message of the article that I am opposed to what this administration is doing in international aviation negotiations, that I was quoted as saying we were giving more than we were getting through "open skies," that I suggested the administration not implement its new international aviation policy until Congres makes a contribution, and that "open skies" would be trading temporary low fares for a permanent market.

Accurate reporting, on the other hand, would have noted: (1), that I complimented this administration on their accomplishments and general direction in international aviation negotiations; (2), that I asked Secretary Adams to respond to the criticism that we are giving more than we are getting from "open skies"; (3), that I complimented Secretary Adams on a clear, procompetitive policy statement which he introduced Monday and did not ask that they wait to implement it; the only delay I asked for was that the administration not send an "open skies" proposal to Germany prior to these hearings; and (4), I asked how the administration responded to air carrier criticism that we are trading permanent rights for temporary low

fare policies. And again in my opening statement I specifically said that I have an open mind on these new proposals.

If the Star wanted something more than their usual confrontation, they could have reported that the administration witnesses and I strongly disagree over what the President's 801 authority should be and how that authority has been used in the past, but they did not.

I have purposely been asking provocative questions of many of the witnesses. I've found that is the best way to get the information the committee needs.

I am also aware that many of these issues are complex and somewhat technical, and I hope that any members of the press covering such important hearings when I am involved will call on me or my staff when intentions, conclusions, or just the issues are not clear to them.

I would learn little in the future if every time I asked a question in committee I had to worry about that question being turned into my position by some members of the press.

Our first witness is Mr. William T. Seawell, chairman of Pan American World Airways, Inc.

And Mr. Seawell, I think perhaps you should explain what "T" stands for in case we have another Star representative present.

STATEMENT OF WILLIAM T. SEAWELL, CHAIRMAN, PAN AMERICAN WORLD AIRWAYS, INC.

Mr. SEAWELL. The T is for Thomas, Mr. Chairman.

Mr. Chairman, I thank you for your invitation to comment on S. 3363. In particular I welcome your statement that "in the interest of balance, we must recognize the need of our basic international airline, Pan Am, to weave into its system a domestic structure as we open the competitive opportunities on competitive routes."

That statement supports the proposed policy declaration that there is "the need to provide domestic route authority to air carriers with extensive international operations in order to provide a better integrated air transportation system, prevent waste of available capacity, and strengthen the competitive position of U.S. international carriers."

Two modifications in the bill are needed to give impetus to implementing that policy. Section 4 mandates international certificate awards to each of a number of supplementals in five international city pairs. We would support the suggestion of the Air Transport Association that it would be preferable for the bill to provide simply that scheduled and supplemental air carriers have the opportunity to operate all forms of domestic and international authority. However, if section 4 is retained in its present form, we believe there is an equal need to mandate domestic authority for Pan Am.

In addition, we would urge that in the interest of assuring efficient use of capacity and conserving fuel, air carriers, both scheduled and supplementals, should be specifically permitted to carry charter passengers on scheduled flights without restriction.

Section 6 establishes a presumption that merger between a supplemental carrier and a scheduled carrier will facilitate the entry of the supplementals into the mainstream of the trunklines, because circumstances have changed competitive relationships and opportunities.

Pan Am's competitive relationships and opportunities have also changed drastically, and if section 6 is retained in its present form, clearly a similar presumption should apply to merger between Pan Am and an essentially domestic carrier.

Domestic fill-up rights are useful, as far as they go, but cannot by themselves provide the needed domestic structure. Nor can the required structure be as effectively obtained on a case-by-case basis as by directed certification or by merger.

Under the general trend of deregulation, which Pan Am has supported, we foresaw that additional competition would be established on international routes. Quite frankly, we did not foresee the extent to which new entry would be authorized, both in absolute terms and relative to the exceedingly limited entry we have been permitted on domestic routes.

The bill establishes statutory goals for international aviation policy, including specifically the principle of reciprocity in access to air transport markets and the elimination of discriminatory unfair competitive practices against U.S. airlines abroad.

These provisions are both desirable and necessary. The competitive problems to which they are addressed are acute and worsening. The concepts of reciprocity of economic benefits in U.S. trade relationships generally and of equality of competitive opportunity in international air transportation specifically are already established as congressional policy, as evidenced by the Trade Act of 1974 and the Fair Competitive Practices Act. But an explicit congressional directive that the U.S. position in air transport negotiations recognize the importance of assuring U.S.-flag airlines equal treatment and equal competitive opportunity with foreign-flag rivals can be and I believe must be done to provide a highly constructive step toward ending the intolerable inequities to which U.S.-flag carriers are currently subjected. Such a directive would encourage firmness and determination by the executive branch which are essential if long overdue remedies are to be achieved.

The deprivation of equal competitive opportunity is most easily perceivable in a country like the U.S.S.R. But the problem of controlled markets exists even in a relatively liberal country like West Germany.

The German Government owns the airline and the railroad. They in turn own a major segment of the travel agents and freight forwarders. Furthermore, with the airline operating all of the domestic services the airline can exercise as much control as it wishes over all agents to feed traffic to its international services to the United States. The entire marketing apparatus is so completely controlled through interlocking relationships that U.S.-flag airlines are effectively kept in a subordinate position.

Nevertheless, in connection with bilateral negotiations with Germany in the offing, our Government plans to propose what amounts to a giveaway position on access of Lufthansa to the U.S. market—the so-called open skies approach. That position simply cannot be squared with any realistic evaluation of the relevant facts. I attach a memorandum, attachment A, on the German market, which I think explains it a little bit more in detail but succinctly the situation there, and

memorandum B, which I submit for the record, deals with a broad range of competitive problems faced by U.S.-flat airlines in their operations overseas, which I would submit for your consideration.

There is ample documentation as to the position of the U.S.–flag system abroad: the hearings that led to the passage of the Fair Competitive Practices Act and to the Trade Act of 1974; past research by the CAB; reports from U.S. Embassies; and the recent report by the GAO.

Italy's Umberto Nordio, Alitalia's chief, said earlier this year, "In the international air transport market there are all kinds of airlines, private, semiprivate, subsidized, or outright Government owned. They will not all respond in the same way to competitive pressures. The free market game rules will not be observed simply because this is not a free market, and no persuasive talk or forceful action * * * will transform it into one."

Pan Am, and I believe the U.S.-flag industry as a whole, would welcome an international aviation regime in which there is true equality of competitive opportunity with market success primarily reflecting efficiency of operations. Until such a regime actually exists, however, it is counterproductive and self-defeating for U.S. air negotiations to be conducted on the theory that it does, in fact, exist.

Time does not permit extended comment on the effects upon the public interest of ignoring in air transport negotiations the country's basic trade policy with respect to reciprocity of opportunities and benefits. Suffice it to say that ignoring that basic policy is adverse to the balance of payments, the value of the dollar, and the interests of the American investor, the American consumer, and perhaps most of all to the American worker.

A fact of life about which the U.S. Government can do nothing is that most foreign-flag airlines are directly or indirectly subsidized by their governments. Knut Hagrup, retiring president of SAS, put a pithy perspective on the facts recently. Speaking of the situation that would exist should a price war occur between U.S.-flag airlines and foreign-flag systems, he said, "You do not go into a bleeding contest with a blood bank."

I can assure you, Mr. Chairman, that he was not qualifying the U.S. Government as that blood bank.

The practical results of subsidy were dramatically evident during the fuel crisis and economic recession of recent years, as shown by the chart from the DOT data

The steady growth of the foreign-flag systems during the fuel crisis and recession occurred because they were sustained by cash and other concrete assistance from their governments. The decline of the U.S.-flag system occurred because similar assistance was not available. It will not escape you that one of the results was, in effect, a transfer of jobs.

KLM, with net losses of well over $100 million from 1971 to 1976, was bolstered by capital funds provided by the Dutch Government. By virtue of that assistance, KLM was able to increase capacity every year from 1971 to 1976, and to maintain virtually constant employment.

KLM, as you well know, is not an isolated instance. Other foreign-flag airlines, major and minor—lines like Air France, Alitalia, British

Airways, Iran Air, Sabena—receive direct financial aid, for capital investment as well as for operating subsidy. Air France and British Airways, with Concorde as a loss leader, are just the most prominent example. I attach a memorandum on financial assistance given by foreign governments to their airlines, prepared by the well-known consultant, Selig Altschul.[2]

Mr. Chairman, I submit these for the record, which is dealing in more depth with the types and forms of assistance provided to various international carriers.

Dr. Herbert Culmann, chairman of Lufthansa, recently commented publicly on what he perceives as the inferior position of U.S.-flag airlines with respect to financing adequate fleets of new airplanes. "Acquisition of new aircraft had to be postponed" because of insufficient earnings, he said, and added that "an aged U.S. fleet is the result."

We at Pan Am recently took an important initial step to replace some of our "aged fleet." But the number of L1011's which we have arranged to acquire will not meet our future needs. When you contrast the disadvantageous financing posture of U.S.-flag airlines with the foreign-flag airlines, the significance of the financing provisions of S. 3279 becomes painfully clear.

If you are a U.S.-flag airline that possesses a domestic system, you have a cushion against the effects of inequitable market access and discriminatory treatment abroad. You also have a broader base and a higher frequency of service over which to spread your costs and the means of deploying expensive aircraft more efficiently.

Pan Am's position, in contrast, has become bizarre. By the customary standards of measuring airline efficiency, we are the most efficient of the airlines devoted primarily to international operation, and among all U.S. trunklines we rank No. 2. Also, the success of our marketing and service programs in such that in 1977 we gained in shares of markets almost everywhere we operate. We operate the largest fleets of the world's premier intercontinental airplanes, the 747 and the 747SP. Through a combination of effective merchandising and rather stern self-help measures, we have turned the company around to profit from loss. We even made money on highly competitive routes like New York-London and a low-yield route like New York-Frankfurt, although there are some underlying problems.

Yet the cumulative effect of our unique situation among the U.S.-flag airlines and the uncertainty of the environment are such that as we look to the rest of 1978 and 1979, we conclude that we have some more disagreeable decisions to make. In order to be businesslike and profitable, we must prune our service pattern once again. We are even now making a final evaluation, and perhaps in early September will announce reluctantly another series of suspensions.

The other major decision we had to make was on how to develop a major domestic traffic base which would place us on equal footing with other domestic and foreign carriers. As I announced yesterday, Pan Am has proposed a merger of National with Pan Am.

This merger will benefit both carriers, their employees, and stockholders, and will create a more vigorous carrier able to compete effectively both domestically and internationally, a goal advocated by this committee and the administration.

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[2] See p. 261.

The public will benefit from new single-plane and single-carrier services from points like Las Vegas to the Orient, and Latin America.

Mr. Chairman, I believe Las Vegas is out in the Sun Belt someplace in your area.

As a result of the efficiencies gained by this merger, such as smoothing our contra-seasonal traffic patterns, increased efficiency in the use of human and physical resources, we have between us 10 common cities at which we operate, and more effective sales and scheduled network, the combined carrier will be able to offer the low fares we have advocated and introduced internationally.

This combination, since it is an end-on-end integration of the two systems, will have no anticompetitive impact.

Mr. Chairman, thank you for this opportunity.

The CHAIRMAN. Well, thank you for a very good presentation.

As you know, I have long felt that it was a mistake to limit Pan Am as they have been limited to the international marketplace.

I want to ask a number of questions about your position on open skies with the Germans, but first, in light of your merger announcement, I want to ask a few informational questions.

During the domestic regulatory reform debate, one issue which almost every airline agreed upon was that the big guys would gobble up the little guys. Now, if you merge with National, is there any chance you will both be gobbled up by Texas International?

Mr. SEAWELL. I make a very important stipulation, Mr. Chairman. Assuming success—and we don't assume those things in our company—but for the moment, assuming success, hopefully this will have a tripartite happy ending. Certainly, Mr. Frank Lorenzo, whom I admire rather extravagantly, will also be extravagantly wealthy. That would put him in a position, incidentally, perhaps to gobble up United Airlines.

The CHAIRMAN. I now understand in your testimony why you asked for the same merger presumption in the bill that applies to the supplementals to be applied to you. I wonder, though, if you are not stretching comparisons a bit too far. Pan Am, by most measures, is three or more times the size of the entire supplemental airline industry. There certainly should be no prohibition or added hurdle for a Pan Am domestic carrier merger. But why do you feel you should not have to show that your merger would have public benefits that outweigh any anticompetitive effects?

Mr. SEAWELL. Well, I think we will. I think we clearly will show just exactly that, Mr. Chairman. Assuming we reach an agreement, and then are in a position to make a case. I don't have any doubt in my mind but what we will sustain the position that it is not only anticompetitive but that, indeed, it would strengthen us both domestically and at long last maybe put us on an even footing and certainly strengthen us against the foreign-flag carrier who, as you know, typically controls his own domestic market.

Our Government has already clearly demonstrated—Chairman Kahn admits it—that the record indicates that the active policy today of the United States is that whenever there is a question of an international route awarded from point A in the United States to point B abroad, it is not going to Pan American; it is going to a U.S. domestic airline with collection and distribution systems in place.

I am seeking to get in that exact position so I can remain competitive, and I'm getting a little bit tired, frankly, of the rule of the white queen in Mr. Carroll's book about Alice in Wonderland, and that rule, you will remember, is "Jam tomorrow, jam yesterday, but never jam today."

And I guess we in Pan America are in a mood that we think we deserve a little bit of jam today.

The CHAIRMAN. Of course, our bill has the reverse presumption, and that is why I asked you that question. But you do feel then that you can make that showing?

Mr. SEAWELL. Oh, absolutely.

I have had, though inadequate, some opportunity to glance at the Chairman's response to your very appropriate questioning on this subject, Mr. Chairman, if you will allow me to choose from his "on the one hand," and "on the other hand." I can choose the proper "on the other hand" that would support my case without question, because he says that he recognizes that some selected individual mergers might be more competitive rather than less competitive.

Obviously, we would have the burden of proving that, and I look forward to that opportunity, frankly, assuming we get there—and I don't assume that yet.

The CHAIRMAN. Turning to the potential open skies with the Germans, let me begin by saying I certainly understand Pan Am's dislike for any policy which throws open markets to you for competition with both U.S. domestic airlines that have greater feed possibilities than Pan Am and to increased market opportunities for foreign airlines, which you now dont' have, with which you now don't have to compete.

I would agree that that is bad for Pan Am; however, I'm not convinced as yet that it would be bad for the U.S. aviation industry and U.S. passengers. I am convinced that fairness would dictate that a concomitant to an open skies international policy be expanded domestic authority for Pan Am.

Do you disagree that carriers such as United, Braniff, and others, might well be formidable competitors for Lufthansa and possibly develop new United States-German markets?

Mr. SEAWELL. I would answer that this way, Mr. Chairman. As I indicated in the text, we have no doubt in our minds but what we will face over time an increasing, not decreasing, competition both from other U.S. airlines, supplemental and scheduled.

We anticipate that the nonscheds will become scheds. And we don't shy away from that. We think that in an equal competitive opportunity, assuming that we do get the other side of the coin available, as you have mentioned, we think that in an equal competitive opportunity, we will do well.

We are not going to hog the world's market. There is a large market there. Our basic difficulty centers around what we believe is a naive presumption by the U.S. negotiators that this is indeed an equal opportunity market. That is why I have this attachment just to describe the very few results so far, that there is going to be an equal market. And that is West Germany.

And I would call your attention to it, rather than take the time here.

We have a Fair Competitive Practices Act that recognizes the inequalities of the market and the U.S. Government is supposed to do something about that. There are continuing efforts, but very little results.

Now, I don't know why we should assume, since there have been very few results so far, that there is going to be an equal market. And Mr. Chairman, in my view, and very importantly it goes beyond even these little specifics of discriminatory practices, which cumulatively are quite important; even assuming you have those solved, the problem is a broad one of an institutional situation as well.

The institution, and perhaps Japan is even more appropriate than West Germany, by virtue of their institutions, the interlocking relationship, that is not going to change. You might meet with Japan, Inc. today, and you might be able to send a few more pounds of Texas beef, and you might send a few more State of Oregon cherries, but you do not basically change the attitudes of Japan, Inc., nor West Germany's interrelationships.

It is a broad institutional problem, and I don't know why we should be so naive as to think that by pressing goodies on them, which is a typical U.S. approach to solving any problem, it is going to solve this problem. It isn't.

That is my only concern, Mr. Chairman, but that happens to be a serious one. If someone could assure me that we have equal competitive opportunity, then I would be happy to compete, because I think my efficiencies are at least comparable to those that I'm going to compete with.

The CHAIRMAN. Well, you said in your testimony that Germany practices a good deal of market control through government and airline control of travel agencies. It seems to me that that was the same charge that was at issue in the DER travel agent case before the CAB, and the Board ruled that DER had not been shown to be discriminating in its German operations.

Mr. SEAWELL. Well, Mr. Chairman, that still doesn't change the fact, and I have it spelled out here as to what that relationship is, of all the agents, who owns them, and let me just say what the result is. As a result of that, the German airline carries three out of four German passengers to the United States.

What happens to the United States in Germany? We have an open market. We have less brand loyalty. And I'm not complaining about that. And typically Lufthansa would get half, and the U.S. carriers would get about half. That is about the way the U.S. public reacts.

So, I don't see that relationship changing, regardless of the findings, because the fact is that those bloody carriers do control those agencies.

The CHAIRMAN. Well, if that travel agent control exists by the German Government, why did the U.S. charter operators get 60 percent of the German originating charter business?

Mr. SEAWELL. Why do we do as well, Mr. Chairman? Because we hump. I'm surprised we all do as well as we do. I admire the supplementals for what they're doing, but it doesn't change my opinion as to what the marketplace is.

Let me give you one small example. It is in the paper. It has nothing to do with the agents. Going into Germany is a reservation system.

That reservation system is under the complete control of Lufthansa, and it is a combination of all of their tour operators and agencies.

Pan American has been trying, lo these many months, and finally without very much negotiating leverage, seems to be in a position where perhaps we're going to get our schedules shown to the German agent, hopefully not in too inferior a position, along with Lufthansa.

But the starting position of Lufthansa is they will show their schedules. They will show their pool partner's schedules, and to hell with the rest of you. And if you don't think that controls the market in some substantial way, then I would invite the U.S. Government representatives to come and live with the airline industry, rather than going back to their law schools at Yale when they finish this tour of duty.

The CHAIRMAN. You note KLM as an example of an airline which received government subsidies in the early 1970's and was able to maintain constant employment, yet as you also note, the airline lost over $100 million. Now, that is certainly no predatious, bleeding bloodbank.

There was a government keeping its national airline stable, and as I recall, Pan Am asked for similar help from the U.S. Government during that same period.

Mr. SEAWELL. Oh, absolutely. We interpreted the law as making provisions for that. Unfortunately, no one paid any attention to the law. We never even got to the question of testing the legality of it. As a practical we had to survive, so we started about trying to survive on our own.

Let me make it clear, Mr. Chairman, I'm not here to have a bitch session about KLM or Lufthansa or anybody else. As far as I'm concerned they run very good, effective airlines. I think one of the basic bottom line distinctions I would make, because I would think and agree that today in general, even government owned airlines have some pressures from their government to be "profitable."

Their measure of what is profitability is not the same as the U.S. measurement of profitability, but push that aside.

I do believe that there are pressures, because even government owned airlines have to compete with other national programs for the support of their people. But a complete and important distinction is that at the bottom line, that management of the government owned airlines does have a commercial safety net unlike me or Mr. Smart in TWA or Ed Daley in World. If we make a gross commercial mistake, we have to live with it.

And the correction is for the shareholders to kick us out. In their case, the safety net is that a gross commercial error is, in the end, corrected by government support.

Granted, he might also get kicked out. More than likely, he will be given a "Sir" on his title, however, before he gets kicked out.

The CHAIRMAN. Well, let me ask you Chairman Kahn's question of yesterday: Where is the predatory subsidizer outside the Communist bloc? In other words, these carriers may have to have some help from their government, but it doesn't get into the field of predatory action.

Mr. SEAWELL. I don't really think so, either, Mr. Chairman I don't look upon this as predatory. Quite the contrary, I think it reflects their national economic systems, and I don't complain about their national

economic systems. I do think it is rather naive of the United States to think that the other guy, if we press a few little goodies on him, is going to play by our rules.

He is not going to play by our rules. He demonstrates it day in and day out. Take Air France. We tried to reenter the Paris market. No question within the U.S. Government but what under the existing bilateral we had the chance to do that. No question about it.

Did that prevent the French from making their own independent interpretation that we did not have the right? Absolutely not. They did, and they stuck to it, and the United States who had the chance to correct that by applying a 213 action at the last minute, in light of the President's pending visit to a summit, the State Department recommended he crumble.

Why? I presume because the State Department thought its own three martini cocktail party was going to be upset with the French.

I will predict that if we had stuck to our guns, Air France would have been letting Pan Am operate all this past summer into France. It is just a demonstration that we think we reach an agreement. It is clear in our minds the French have no difficulty whatsoever interpreting that agreement in their favor, and what does the United States do about it?

Right at the moment they're working like hell in the State Department to get an arbitration in our favor; assuming we finally get it in our favor, we will have lost 1 year of operation.

As a matter of fact, we will now have to go through a reevaluation of that marketplace, because as I indicated, now that we have at long last reached a level of profitability by some slashing and tourniquets, we don't intend to get back into that trough if we can avoid it.

The CHAIRMAN. Well, now if these foreign carriers are beneficiaries of subsidies to the extent that you point out, why is it that they are consistently advocating higher fares?

Mr. SEAWELL. On the fare situation, if I think of Europe—and let me just think of that for the moment—I really think that the intra-Europe situation does need opening up. And maybe Mr. Laker will in time serve a useful function there as well, because the intra-European fares are exceedingly high and in my own personal view, I don't have proof, so therefore won't say it is without doubt, but in my personal view, the high intra-European fares are in part subsidizing the North Atlantic for some of those carriers.

The CHAIRMAN. Do you think that the IATA rate structure ought to be maintained?

Mr. SEAWELL. My view on IATA is this, Mr. Chairman. We have advocated rather strongly within IATA circles that the time is long overdue for some major change, and I am happy to report that a very good committee chaired by Mr. Claude Taylor of Air Canada and Mr. Smart of TWA on it and others—I was not a member—proposed, I think, some very constructive improvements to the IATA structure.

It did not go as far as we in Pan Am would advocate. We advocated that within the fare and traffic area that we have the complete flexibility not only to opt in and out as to whether we would be in all of the passenger and all of the cargo. That is a choice. But within any area, we could opt out, and we clearly would opt out of some of them,

so we may have to make a choice at some point as to whether to get out of the IATA traffic conferences completely or not.

We don't have to face that one yet. I think IATA is long overdue for some correction. I think the correction is in process. Hopefully it will be sufficient. We would like to see more correction than is proposed at the moment.

The CHAIRMAN. Yesterday I suggested to Chairman Kahn that the open skies proposal include a provision requiring increased data from and access to the books of the foreign airlines; would this kind of reporting and access requirement ease your concern over the foreign subsidy issue?

Mr. SEAWELL. It certainly would. Once again, I have not had the benefit of being able to read a lot of the testimony as given, but as I recall, I think Mr. Driscoll answered a question in this area, if I understand it correctly, along the line that there is a need for the development and the presentation on the table for a cross-examination and testing by the carriers of the case.

What are the facts? What are the figures? What is the cost benefit? What will be the traffic situation in Germany as between Germany and the United States 5 years from now under various assumptions? And let us test that.

I would frankly be more at ease, because at the moment there is no pretense to make such a case before the carriers.

The CHAIRMAN. What is your position on the United States-Israeli fare mechanism?

Mr. SEAWELL. Mr. Chairman, among the options that are available, the Dutch kind of agreement, the other one, where you file and the other carrier tries to influence his government to approve or disapprove or the Israeli where there must be an agreement by both to disapprove, frankly we would opt for the Israeli type agreement on fares with hopefully an assumption that the governments don't play games.

Now, there are some games that could be played. We needn't go into that, but I will be optimistic for a moment and say that they won't, and if that is the case, then our company would opt for the Israeli kind of agreement.

The CHAIRMAN. Do you think that that kind of agreement could work in all the bilaterals or would you have to be very selective with the countries?

Mr. SEAWELL. I think at the moment, until we have reached some additional plateaus of understanding and experience, I would be selective.

But as you always know, Mr. Chairman, you reach levels of experience as you change, and we clearly are going through massive change in the industry and for the most part I think it is going in a favorable direction, not a nonfavorable.

But as you reach certain levels of experience and understanding, then you can go over, but remember the Chairman himself has commented on the pace of this himself recently when he was quoted in one of the publications as saying:

> It is being scrambled so much, so that after the next 6 months, which incidentally is the termination of the period that he apparently is committed to stay in that job, that it cannot be unscrambled.

We may have to get Mr. Kahn back from wherever he is, Energy or upstate New York, to help unscramble some parts of it.

But on balance, I think that we have a very effective Chairman who is running one of the best shows in town, and on balance is going in the right direction. I think, as I've already indicated, I question some of the pace of what is going on, and I think we ought to have more facts out on the table, subject to cross-examination by the supplemental and scheduled carriers.

The CHAIRMAN. In light of your merger announcement, do you still plan to suspend some services in September, and are those plans due to the uncertain environment or your normal seasonal fluctuations?

Mr. SEAWELL. It has nothing to do with seasonal fluctuations. Let me answer in this way. I would like to remain a little nonspecific, because I'm dealing here with people, and that is very important. We are, frankly, going through another evaluation, Mr. Chairman, at the moment on an assumption that ultimately we do get an approval of the proposed national merger. It is quite clear that if we can contemplate going down that direction, we could undoubtedly retain some of the operations under question.

We are going through that, and I would hope that I can stay in some of those areas long enough to get the benefit of the domestic feed behind that would make it viable. If that falls apart, then I have no doubt but that what we will suspend more, not less.

That is the position we are in, and that's one of the reasons why I would like to remain nonspecific as to the cities involved—most of them are abroad, obviously—until we have gone through a careful evaluation. It is too important to our company to be frivolous about something like this.

The CHAIRMAN. Yesterday we heard from your flight engineers, and we were told that there were 510 men still on furlough as a result of your previous cutbacks. In light of this merger announcement, would this give these people some hope at the end of the tunnel?

Mr. SEAWELL. There's no doubt about it. Our position is: well, I would hope that there would be some light at the end of the tunnel. Period. But the length of the tunnel can change dramatically. It is true we have 510 pilots still on furlough. Some of those, a large number of those, since 1969, and we do have a very constructive agreement with our pilots union that allows us, hopefully, to give all of those people an opportunity to come back, regardless of the past contract with some standards that must be met. When you have been out of service that long, I think we have a very constructive relationship with our pilots in this regard.

We recalled 118 this past year, bringing it down to the 500 number. I was quite hopeful earlier that we would have another large recall this year. Quite frankly, that is in doubt now.

The CHAIRMAN. Senator Zorinsky.

Senator ZORINSKY. Thank you, Mr. Chairman. I just have one question I would like to ask. I don't know how deeply you have delved into this and maybe you haven't as yet, but to what extent has the value of the American dollar enabled you or disenabled you to compete with the other airlines?

Mr. SEAWELL. I has its pros and cons, sir. Our configuration as an airline is that we generate more than half our revenues broad. We have moved into that position, so in the sense that the value of the dollar has improved the attraction of the U.S. market for the overseas visitors, we obviously get some benefit out of that.

Although, as I indicated to the chairman, as in the case of Germany, the marketplace is configured such that about three out of four of the passengers normally are loyal to their own national carrier, but we get a healthy share of traffic and do reasonably well.

So, in that sense, we get an advantage. I have even been making speeches in Europe that the best buy in the world is the United States because of the situation. The other side of that coin, of course, is that it is less and less an attractive buy for the Americans. We have been very fortunate in my opinion this year as to the strength of the traffic.

I have been pleasantly surprised. I do not believe that it is entirely the result of the quote, "low fares," close quote. I don't know what the weighting is, but clearly a large weighting also has to be given to the pent-up demand for travel that has been released this year, because it was depressed for a time.

And also I think the psychological situation, where the Americans now accept that inflation is going to be with them, and they will travel now, spend the money now, because it is going to be less valuable next year.

In terms of our cost and revenues, therefore, we have increased costs abroad, and we have improved revenues in some areas as a result of selling in local currencies, such as marks and yen, and converting to dollars.

That comes out as a positive in those areas. The puts and takes of all of this is that so far we kind of hold our own.

Senator ZORINSKY. Have you noticed any efficiencies concerning the ability of travel agents to cope with this tradeoff? In other words, is your airline working very closely with these travel agencies?

Mr. SEAWELL. Yes, about 70 to 75 percent of our business is through travel agents.

Senator ZORINSKY. Has it gotten complicated to the point where they are having trouble providing their service or are having a hard time keeping up with the changes in rates?

Mr. SEAWELL. Well, there's no doubt about it. They do have difficulty keeping up with the changes in rates. We, the airlines, have difficulties. Our experienced agents have difficulties, and we have to keep working on systems of information to put that before them more effectively.

There is no doubt but what this is confusing. I think in the case of the international, perhaps it—well, the net of it has been that, in general, the agent has been getting in the international arena more commission as contrasted with the domestic market. His percentage of commission is larger. Therefore, it covers his cost better. And I think there has been an industry study by an outside auditing firm that confirms that.

So, I think the agent continues to do well in the international marketplace. There is no doubt but what this confusion increases his costs somewhat, but I think his net is still good.

I believe his principal problem with this situation is probably centered on the domestic more than the international, but it is a problem for all of us.

Senator ZORINSKY. Do you feel that preconditions on various rates are becoming excessively complicated?

Mr. SEAWELL. Well, I think we are complicated. On the other hand, those who suggest—who seem to suggest that there is a very simple little fare structure that could be laid out, I think are not entirely correct. There is a variation in the marketplace that ranges from the luxurious to the no frill, and there is a variation in time, and there is a marginal pricing that is economic.

Our budget fare and pricing, with proper controls, is clearly economic pricing in the economic syntax, but I think there is some more simplification that can be arrived at. I know in the domestic marketplace in particular, seemingly TWA and I believe American seems to be trying to accomplish some of this.

Senator ZORINSKY. Thank you. Mr. Seawell, thank you, Mr. Chairman.

The CHAIRMAN. I have just been reviewing these tables that you submitted, and I'm wondering if that information has been called to the attention of the Board? Because Mr. Kahn was explaining to us yesterday how difficult it is to get these figures and how people have had difficulty trying to come up with a precise subsidy that some of these airlines have enjoyed.

Now, here your consultant set forth quite clearly the computed subsidy of the various companies. I don't know whether he is right or not, but if he is it would seem to me that this would be a very important matter for the Board to have.

Mr. SEAWELL. I'm trying to clarify this with Mr. Schott. The clear answer—I believe the answer to your question is on the yes side, but I will take the precaution of making absolutely certain, because this is clearly public information, available publicly.

It was an effort to try to get more accurate information, and we felt that it would be more accurate and more credible if an acknowledged expert did it. And so it is clearly available, and we will make certain that it is posted to Chairman Kahn.

The CHAIRMAN. Well, if you don't make certain, we will make certain.

Mr. SEAWELL. Why don't we both make certain?

The CHAIRMAN. Now, getting back to the travel agents, do you use the same travel agents? That is, are you using airline controlled travel agents in Europe? In Germany?

Mr. SEAWELL. Absolutely; where else do you go?

The CHAIRMAN. Well, that's what I wanted to know.

Mr. SEAWELL. As I said earlier, Mr. Chairman, I don't feel like saying this is illegal, immoral or any other thing. This is the way their economic structure is.

The CHAIRMAN. Well, you were allowed to control a travel agent and had one, you would expect that they would naturally favor you by turning business to you.

Mr. SEAWELL. In the U.S. market there is no such assurance.

The CHAIRMAN. But I said, if you did, if you owned a travel agent——

Mr. SEAWELL. There is no brand loyalty in the U.S. market. They serve their customer, and I don't complain about that. If we don't give their customers good service they ought to turn elsewhere, but typically abroad, there is this built in structure that tends to give the predominant share. It ranges all the way up to 90 percent.

It is not that way in Germany. That is why I call it one of the more liberal situations. So, we worked and scrambled, but there's no doubt but what there is a structure that automatically will move a predominant share of the market to a Lufthansa, and if I were Herbert Culmann, I would make the most of that.

And I'm not complaining about Herbert Culmann making the most of it. I am complaining about the United States assumption that that is going to change.

The CHAIRMAN. You have consistently sought relaxed opportunities, both abroad and domestically, and yet you complain now about the Board giving relaxed opportunities in the fashion they are. What would you suggest ought to be done in getting a relaxation in some of these market areas, such as the Board is now seeking, for example, on the German agreement.

Mr. SEAWELL. I would first do what I understand Mr. Driscoll has already suggested. I would require the compilation and the laying out of facts and figures that make the case as to the cost benefit to the United States.

And I wouldn't go around submitting white papers that don't have any facts but have a lot of assertion that open skies is the best thing since sex. I would just try to do my homework first, and I don't think it has been done, and I think then there ought to be a fair opportunity for the Driscolls and the Seawells of the world to cross examine and see if we can work it out. I would welcome more competition, if you can get that marketplace a little more even steven.

But I really don't think you get that by a pressure campaign from State that says it is like a giveaway foreign aid program. If we just pour enough money on it, we're going to solve it. In this case, if we pour enough goodies out, we're going to solve this problem. It is not going to change Japan, Inc., and it is not going to change the structure of Italy, Germany, or any other of our principal markets.

The CHAIRMAN. Thank you very much, Mr. Seawell. We appreciate your presentation.

Mr. SEAWELL. Thank you, Mr. Chairman. Could I have the indulgence of just a brief comment?

The CHAIRMAN. Surely.

Mr. SEAWALL. If I understand the traditions of the Senate correctly—and I may not—your chairmanship of this subcommittee may pass to one of your colleagues in the next session. If that understanding be correct—and I am not advocating it—this therefore may be one of my last opportunities to appear before you.

The CHAIRMAN. I plan to be around a little longer.

Mr. SEAWELL. Of course, I'm already familiar by virtue of my own career with your deep understanding of the military side of aviation, but I would like to say that—and I'm sure this view is shared by the industry, that we certainly appreciate your equally deep understanding of commercial aviation.

So, I would just like to say thank you. And I would hope that and maybe we can treat it as one of your contributions if during this session of Congress both the regulatory reform and the noise bills were passed and not passed over.

I think it would be a great further contribution to your leadership. And we thank you for what you've done.

The CHAIRMAN. Well, thank you very much for your very complimentary statement. If you get that merger, make sure you repeat those words when you get out to Nevada.

[The attachments referred to earlier follow:]

[Attachment A]

THE GERMAN INTERNATIONAL MARKETPLACE AND THE OPEN SKIES PHILOSOPHY

The fact that the international air transport market is different from the U.S. domestic market has not deterred the United States government from seeking to apply the same regulatory philosophy in the international market that it is seeking domestically. The objective is to bring about the withdrawal of governments from control of the number of airlines that serve a given city pair, the capacity or frequency that each airline operates, the origin and destination of the traffic it carries and the price it charges. The theory is that by removing governments from a regulatory role, service and price decisions will be made in a free marketplace and that this will benefit the consumer. This effort has reached a new level in the "Open Skies" arrangement now under consideration for the bilateral agreement with Germany.

There is not, and the United States cannot create, a free market for U.S.-flag carriers in Germany.

OWNERSHIP OF TRAVEL AGENCIES AND FREIGHT FORWARDERS

A survey of German travel characteristics conducted for the United States Travel Service of the Department of Commerce showed that 52% of the air travel sold in Germany and destined to the United States is sold through travel agents. Of those passengers who used a travel agent, 92% said that they looked to the agent chiefly to arrange primary transportation.[1] The ownership of these travel agencies is, therefore, of great concern.

The following tabulation will indicate some of the ownership and interlocking relationships that exist in the German airline, travel agency and freight forwarder infrastructure:

1. The German government and government instrumentalities own: 86 percent of the capital stock of Lufthansa, 100 percent of the German railroad system.

2. The German railroad owns: 52 percent of the DET agency chain with over 40 offices in Germany. DET appoints agents for the German railroad, thus over 500 of the more than 800 IATA appointed German travel agents hold DET appointments, 55 percent of ABR agency chain with 120 offices, 100 percent of Schenker agency chain with 7 offices, 100 percent of Schenker Air Freight Forwarder, the largest air freight forwarder in Germany.

3. DET and ABR each own 12% of the stock of TUI. TUI is Europe's biggest tour operator and wholly owns the following:

TOUROPA—Features inclusive tours in the upper price range with 400,000 bookings per year.

SCHARNOW—Wide range of destinations, 700,000 bookings per year.

HUMMEL—Specialist in inclusive tours.

AIRTOURS INTL—Europe's biggest operator of individual air inclusive tours founded in 1967 by the three agency chains ABR/DER/Hapag Lloyd after prompting by Lufthansa. From the beginning, the head of Airtours has been a former Lufthansa management employee.

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[1] West Germany, A Study of the International Travel Market, U.S. Department of Commerce, May 1978.

TWEN TOURS INTL—Caters to young people, 100,000 bookings per year.
DR TIGGES—Inclusive tours for higher income bracket.
TRANSEUROPA—Mainly caters to lower income bracket.

4. Two Lufthansa Directors are members of the Supervisory Board of Global Touristik AG, a holding company established to acquire and manage tour operators and travel agencies in Germany and abroad. Global Touristik has financial ties with the agency chains Kuehue and Nagel (18 offices) and Euro Lloyd (6 offices).

Although there are at present no known direct financial ties between Lufthansa and travel agencies and tour wholesalers in Germany, there are indirect ties through their common owner, the German government, and there is an obvious favored working relationship.

Because of Lufthansa's monopoly of the domestic air services in Germany and the fact that there is no competing German flag scheduled international airline, German travel agents and freight forwarders are dependent on Lufthansa for a high percentage of their commission revenue from the sale of air transportation. Obviously this places Lufthansa in a position of great influence with all agents, including those that are not owned by the German government.

The situation confronting Lufthansa in marketing its services in the United States is in marked contrast to that which an American carrier finds in Germany. The United States laws assure the private ownership of agents, independent of any U.S. airline or government financial control or influence. The large number of airlines in the United States assure that no single American carrier has such a dominant financial relationship and influence with any agency or chain of agencies.

GERMAN DOMESTIC AIRLINE SYSTEM

Lufthansa operates all of the domestic air services in Germany. Arrival and departure times of domestic flights are coordinated with arrival and departure times of Lufthansa international flights and those of Lufthansa's pool partners; they are not coordinated with the arrival and departure times of the United States carriers. Pan Am has encountered difficulty in booking space on Lufthansa domestic flights, particularly in the case of group bookings, unless the international haul is shared with Lufthansa. Lufthansa has ticket offices throughout Germany. Every passenger who originates an international air journey at an interior German city must use the German international carrier to fly to the gateway city.

This too is in stark contrast to the situation in the United States where there are many United States domestic airlines who are eager to provide interline services with Lufthansa. In fact, there are economic considerations that prompt U.S. domestic airlines to be more anxious to route their traffic to Lufthansa than to Pan American, because they know that Lufthansa is in a favored position to route German originating traffic to them.

DISTRIBUTION OF TRAFFIC

U.S. Immigration and Naturalization Service data confirms what is to be expected, that of U.S. citizens (excluding U.S. military traffic) traveling directly between the United States and Germany, approximately half fly on the U.S.-flag carriers and half on German carriers, whereas three out of four alien passengers (predominately German citizens) arrive and depart the United States on a German carrier.

RESERVATIONS COMPUTER SYSTEM IN GERMAN TRAVEL AGENCIES

A reservations computer operations company, START, has been created to install electronic reservations equipment in the offices of German travel agencies. START is owned jointly by Lufthansa (25%), the German railroads (25%), and a combination of travel agency and tour wholesalers, virtually all of whom are partially owned by the German government. The computer terminals in the agencies will be tied to the reservations control centers of Lufthansa, the German Railroad, and the Hapag Lloyd Steamship Co.

The computer system will display Lufthansa schedules plus those of Lufthansa's pool partners. Because of Lufthansa's domination of the German travel market, the START system will probably be the only such electronic reservations system in the offices of German travel agents. U.S. carriers could not afford

to establish their own system and other foreign carriers pool with Lufthansa and thus have no reason to join the U.S. carriers. Pan Am has asked to have reservations information for its flights which serve Germany included in START's computers. Inclusion was at first refused. Pan Am insisted and negotiations are underway. While it cannot be predicted where these negotiations will come out, certain elements are already clear. The central issues from Pan Am's viewpoint will be price and the format of material displayed on the agent's screen. The initial price offering was very high, approximately two million dollars per year when the installation is fully in place. The second issue, whether Pan Am's services would be displayed on an equal basis with those of Lufthansa or in a secondary or "biased" position has not yet been addressed. However, Lufthansa has made it clear to Pan Am that favorable treatment will depend entirely on what quid pro quo Pan Am can produce for Lufthansa. Obviously, Pan Am is in no position to significantly influence (for better or worse) Lufthansa's access to U.S. travel agents and thus is in a very weak bargaining position.

GERMAN GOVERNMENT FINANCIAL PARTICIPATION IN LUFTHANSA

The Federal Republic owns 74.3% of the capital stock of Lufthansa. Other government instrumentalities own an additional 12%. To bolster the airline's capital structure, the Government invested $81 million in the capital stock account during 1975.

The German government, directly or through its instrumentalities such as the Deutsche Bundepact, has from the outset of Lufthansa's development pursued a consistent policy of advancing direct loans to the airline. The Government also guarantees repayment of loans extended to Lufthansa by the United States Export-Import Bank and by commercial banks.

INCOME FROM THE CARRIAGE OF MAIL

In 1976 Pan Am was paid 21.0¢ per ton kilometer by the U.S. Postal Service for the carriage of transatlantic mail. Lufthansa was paid 68.1¢ per ton kilometer by the German government for carrying German mail. A relatively small increase in the mail rates paid to Pan Am would have wiped out the losses accumulated during the period 1969 to 1976. During that time, Pan Am was forced to cut 12 thousand employees (30%) from its payroll and reduce or suspend numerous services. During this same time period, Lufthansa had a net increase in the number of employees in every year but one.

DEPRECIATION OF AIRCRAFT

The following excerpts are taken from an address presented by Dr. Herbert Culmann, Chairman of Lufthansa German Airlines, on March 16, 1978:

"And if you look at the Pan American annual report you will find, that they have to depreciate their aircraft over a period of 18 years! Lufthansa depreciates over 10 years . . .

"Lufthansa has managed to utilize the resulting business low of the aircraft manufacturers to renew practically its entire Jumbo fleet at quite favorable conditions. This renewal wave will be completed in 1979. With our DC–10s and Boeing 747s we then have a modern and young long-range fleet . . .

"The average age of the aircraft of the U.S. trunk-airlines, again including Pan American, was 8.4 years in 1976, 71% of the fleet (= 1250 aircraft) were older than 8 years. New aircraft types will not be available before 1982. At that time a fairly large number of aircraft will be in operation, which are 20 years old."

U.S. airlines, lacking government financial support, do not have the flexibility enjoyed by Lufthansa to maintain "a modern and young long-range fleet.' '

FOREIGN NATIONAL AVIATION POLICIES

There has been talk of spreading the "Open Skies" philosophy to other countries of Europe. A similar description could be drawn of the market control and airline support in many of those countries.

It is a fundamental tenet of the national aviation policies of most foreign governments that their airline must get at least fifty percent of the traffic between their country and each foreign country. (They will take more than fifty

percent if the other government will permit them to.) They have told this repeatedly to United States aviation delegations. It is basic in their acceptance of revenue pooling agreements which dominate the world's air routes except on sectors adjacent to the United States. It is not in accord with the aviation or trade philosophies or the national laws of foreign governments to establish free markets in their homelands.

An "Open Skies" approach by the United States would inevitably lead to the relative strengthening of foreign flag carriers and the relative weakening of the U.S.-flag system. With a lock on a larger market share, the foreign carriers will be able to schedule a greater number of frequencies than their American competitors can, particularly where there are several American carriers. With a larger number of frequencies the foreign carrier will attract a disapportionately larger share of the total market. The United States must not delude itself into thinking that any number of foreign governments will tolerate more than half of the market between their country and the United States going to U.S. carriers collectively. That is too contrary to their trade and their aviation policies. They have the means to see to it that it doesn't happen—even if they signed an "Open Skies" Agreement. American consumers, American labor and the American public at large will be the losers.

Restrictions on Competition in the International Aviation Marketplace

BACKGROUND

All nations have an interest in the development and strength of their commercial aviation industry insofar as the industry is tied directly to national interests. In addition to transportation objectives, such interests include concern for national prestige, employment opportunities, tourism, balance of payments, technological development, defense capabilities, and the like. The United States has always elected to achieve these objectives through a private, profit-seeking industry. Most foreign nations, however, have elected to own or control their national carriers in order to be able to assure the accomplishment of these national objectives. Many of these objectives are more essential to foreign economies than airline profitability and therefore foreign carriers are financially supported by their governments as necessary.

The purpose of this document is to describe some of the forms of intervention which Pan American confronts every day in the conduct of its business. The list is not intended to be exhaustive but illustrative of the types of practices that are designed to control the marketplace. With very limited exceptions, there are restrictions that Pan American is currently experiencing, and do not include the many more than Pan American has faced from time to time in the past. Further, these examples are taken from Pan American's experience—other U.S. international carriers have been subjected to similar and additional problems.

SPECIFIC EXAMPLES OF MARKETPLACE RESTRICTIONS

A. Refusal to approve schedules

1. France

During the spring of 1978, the French Government disapproved a Pan American schedule from Los Angeles to Paris with an intermediate stop at London which involved a change of guage from a B–747 to a B–727 for the London-Paris segment. The case has gone to arbitration, but, in the meantime, Pan American missed most of the peak eastbound summer season and the return portions of these trips, lost the impact of its advertising and promotion, the service lost credibility with travel agents, and the cost (and revenue) implications of a lower level of service than planned were adverse. This type of uncertainty and disruption in scheduling plans is seldom if ever encountered in the domestic marketplace.

2. Nigeria

In June 1978, the Nigerian Government informed Pan American that it would not be permitted to operate a fourth B–707 frequency despite the fact that a U.S./Nigeria bilateral agreement, which is based on Bermuda I principles, including a liberal capacity regime, was signed in April 1978. Therefore, despite the new agreement, Pan American continues to be constrained in its ability to strengthen its service pattern in Africa, which it has been seeking to accom-

plish for over ten years. In the meantime, it is now competing for traffic to the United States with Nigerian Airways.

3. Iran

In its most recent schedule submission to the Iranian Government (to become effective July 15, 1978), Pan American requested permission to operate its beyond Tehran service to Bombay, India instead of Calcutta, the point specified in the bilateral. Despite its being only a *substitution* of one Indian city for another, the Iranian Government refused to approve the Pan American schedule. Subsequently, it did grant approval, but without local traffic rights and without authority to cross connect on-line traffic at Tehran.

B. Restrictions on aircraft types

1. Italy

Italy has refused to permit the operation of B–747 freighters, which are the only freighters Pan American operates in the North Atlantic.

2. Argentina

Until a recent agreement, Pan American was completely precluded from operating B–747s to Argentina.

These exclusions obviously work to the disadvantage of Pan American, which has been converting to a B–747 fleet, and to the competitive advantage of the foreign carriers which, in both cases, were not operating comparable equipment.

C. Frequency restrictions

1. Philippines

In the Philippines, the U.S. flag carriers have been constrained for many years from operating additional frequencies to Manila, despite the fact that there is a clear demand and need for such frequencies. Since there is no U.S./Philippine bilateral agreement, there is no recourse from such arbitrary decisions by the Government, which are clearly motivated to protect Philippine Air Lines' position in the U.S. market.

2. Japan

Japan has maintained strict control over the frequency of aircraft operations by means of controlling "slots" at Japanese airports. The number of slots are allocated by means of a slot committee and a carrier is not permitted to exceed the number of slots it is allocated. While this allocation is theoretically justified as a means of coping with congestion at the airports, in fact, it is the Japanese method of controlling capacity into and out of Japan and restricting JAL's competition.

D. Monopoly ground handling requirements

At numerous airports, foreign governments or airport authorities have established ground handling operations which are either complete or partial monopolies. Usually the monopoly agent is owned or financed by the foreign government itself or the competing foreign airline. Such monopolies obviously disadvantage U.S. carriers insofar as there are no competitive pressures to keep prices or the quality of service under control. In addition, they close off the opportunity for a U.S. carrier to provide ground services to other carriers on a contractual basis, thereby limiting the ability to spread its costs over numerous users.

1. Italy

The Italian Government passed a law in June 1975 which established a quasi-governmental agency with all ground handling service rights at Fiumicino and Ciampino Airports in Rome. The range of services provided by Aeroporti di Roma is extremely broad, and includes all catering in addition to most passenger handling services. U.S. carriers are unable to negotiate either the desired quality of ground handling services, or to establish a fair price for the services being purchased. In addition, Alitalia still performs its own passenger check-in and interline handling at Fiumicino, advertises its name prominently in the terminal, and maintains full cargo self-handling rights in its own terminal.

While charges for the ground handling have not been excessively high for the types of services rendered, they are extremely high relative to the quality of

those services and have been increasing at a very rapid rate. Since July 1, 1975, charges for handling a B–747 have increased by approximately 150%. In addition, Pan American has been informed that the AR intends to raise these charges again in the near future by 50%. Such charge increases are totally unfounded, given the extremely low quality of service.

2. Singapore

All foreign carriers are currently required to use a monopoly ground handling agent at the Singapore airport. This agent, a wholly owned subsidiary of Singapore Airlines, is highly profitable. As a result of complaints about this monopoly arrangement, the Government of Singapore plans to establish two ground handling agents at a new airport which is to open in January 1980. However, one of these agents will again be owned and operated by Singapore Airlines and the other by the Port of Singapore Authority. Consequently, U.S. carriers will again be in the untenable position of having its major competitor, or an authority of the foreign government, provide all ground services.

3. Delhi

In Delhi, Air India has a monopoly on the provision of ground handling services to foreign carriers. This monopoly is inclusive of all services except the technical aspects of aircraft servicing. Pan American has been attempting to obtain contracts to provide such technical services at the airport for other carriers. However, we have recently been informed that income from such contracts will be taxed at the rate of 68.25%. Such an exhorbitant rate obviously hampers Pan American's efforts to use its personnel and resources more efficiently and productively at this location.

E. Barriers to equal access to foreign markets

1. Iran—Special fares

A special low fare is available for use only on Iran Air which is applicable to an extremely broadly defined group of citizens. It gives Iran Air sole access to students, government employees, and their families. Since the applicability of this fare is loosely monitored, Pan American is at a distinct and substantial competitive disadvantage as a result of it.

2. Iran, Italy, Germany—Group reservations

In a number of countries, Pan American has been consistently unable to obtain confirmed space for groups on a foreign carrier between two foreign points. The same group reservations often can be booked, however, if the related transatlantic or long-haul portion of the trip is on the foreign carrier. There are occasions when such group space is legitimately not available precisely at the time Pan American needs it, but there is also a strong motivation on the part of some foreign carriers to deny the requested space for purely competitive reasons. We run into this type of unfair action most often with Iran Air, where it is a consistent problem, and with Alitalia and Lufthansa.

3. Italy—Cargo airport rights

In Italy, U.S. carrier charter flights must use Ciampino airport whereas Alitalia charters have access to Fiumicino, the scheduled carrier airport. This means that Pan American must operate out of two locations in Rome whereas Alitalia is able to market and maintain its operations from a single competitively desirable airport. Alitalia is also able to offer more convenient connecting service.

F. Inability to remit foreign receipts

At any given time, about half of Pan American's overseas cash cannot be freely remitted to the United States. As of August 11, 1978, Pan American had over $25.4 million in accumulated bank balances despite intensive efforts in the last several years to expedite remittances.

We recognize that to the extent such conversion restrictions are the result of a shortage of foreign exchange, the U.S. Government is unable to negotiate them away. However, in some cases, the procedural requirements and delays are merely a form of harassment. Not only has Pan American experienced losses due to devaluation, but there are substantial costs associated with this unusable

capital and with the efforts to obtain remittance which are borne by U.S. international carriers. Foreign flag carriers operating to the United States do not have to bear similar costs here.

1. Zaire

Inability to convert local currency into dollars has caused Pan American to plan to suspend passenger service to Zaire at the end of this month. As of August 11, 1978, Pan American has accumulated bank balances of approximately $3.8 million in Zaire.[1] Despite repeated efforts, Pan American has been unable to extract this money out of the country, and faces the continuing uncertainly as to whether and when Pan American will ever be able to extricate its funds from Zaire.

2. Ghana, Nigeria

As of August 11, 1978, Pan American also had accumulated bank balances of $4.2 million in Nigeria and $2.5 million in Ghana.

G. Discriminatory and excessive user charges

Pan American must pay airport and air navigation user charges which are extraordinarily high when compared to the services needed and used. In addition, we face arbitrary increases in these charges at frequent intervals. Not only are airport charges often very much higher than in the United States, but no air navigation charges are imposed by the U.S. Government. Further although foreign government charges are theoretically uniform on all carriers, they are often skewed to favor local and regional services of the national airline.

1. Japan

The most recent example of unreasonable charge increases occurred in Japan. International carriers confront an increase in airport fees for a B–747 at Tokyo from the $3,000 paid at the old airport (Haneda) to over $4,600 at the new airport (Narita) during the first year of operations and over $5,000 in the second year. These increases will result in additional costs to Pan American for its operations at Tokyo of over $5 million per year. These charges must be paid despite no substantial increase in the quality or level of services received for the payment.

In addition to these airport costs, Pan American faces extraordinary increases in airways charges in Japan. Using April 1977 as a base, international carriers sustained and foresee increases of 66% in April 1978, 144% in April 1979, and 188% in April 1980. These increases will occur despite the fact that an IATA technical team has presented a convincing case that a large portion of the services being supported by these charges are not needed or used by aircraft on international routes.

2. United Kingdom

International air carriers have been negotiating for a number of years to change the structure of charges levied by the British Airport Authority (BAA) and to obtain reasonable charging levels. Initially, the objection was to the allocation of charges on the basis of distance flown. When even the shorthaul European carriers, which benefit from the formula, concurred, the BAA changed its formula. The major point of disagreement at the present time revolves around the BAA's policy of "peak period" surcharges. These hit transatlantic carriers hardest since transatlantic flights are limited by marketing and time zone considerations in ability to schedule arrivals and departures out of the designated peak periods. While the charge is justified by the BAA as a method of spreading the volume of operations, BAA controls the volume and spread of operations.

3. Eurocontrol

Eurocontrol (on behalf of ten European Governments) will charge Pan American $11.3 million in 1978—about 50% of its total worldwide airways cost burden. Eurocontrol plans substantial continuing increases. The rates charged are dis-

[1] Plus an additional $0.9 million is owed Pan American for technical assistance program fees.

proportionately high, and it has not been possible to obtain useful data or to initiate meaningful price negotiations.

H. Miscellaneous

1. Beirut—Civil strife

Many times in its history, Pan American has had to cancel its operations to a country because of internal strife or war. Beirut, for example, was a major traffic center for Pan American. Cancellation of services to Beirut meant that the money spent by Pan American on development and promotion of Beirut as a destination was simply lost. In addition, Pan American incurred the costs of closing its station, and relocating people. Such involuntary interruption of service and the costs related to it are not encountered in the U.S. domestic marketplace.

2. Worldwide pooling agreements

Most foreign airlines, with the knowledge and permission of their governments, operate under "pooling" agreements with their competitors. Such agreements permit carriers to agree upon a level of capacity in specific markets, how the capacity will be operated, and the share of the revenues derived from such traffic based upon a predetermined formula. As a result of these agreements, the pool partners obviously have an interest in directing traffic to each other in order to maximize revenue return.

3. Eastern European countries

Market restrictions in the Eastern European Countries are due primarily to entirely different political, economic and social systems. These countries typically do not share our concepts of free competition and regulate their markets accordingly. Specific examples of market restrictions are:

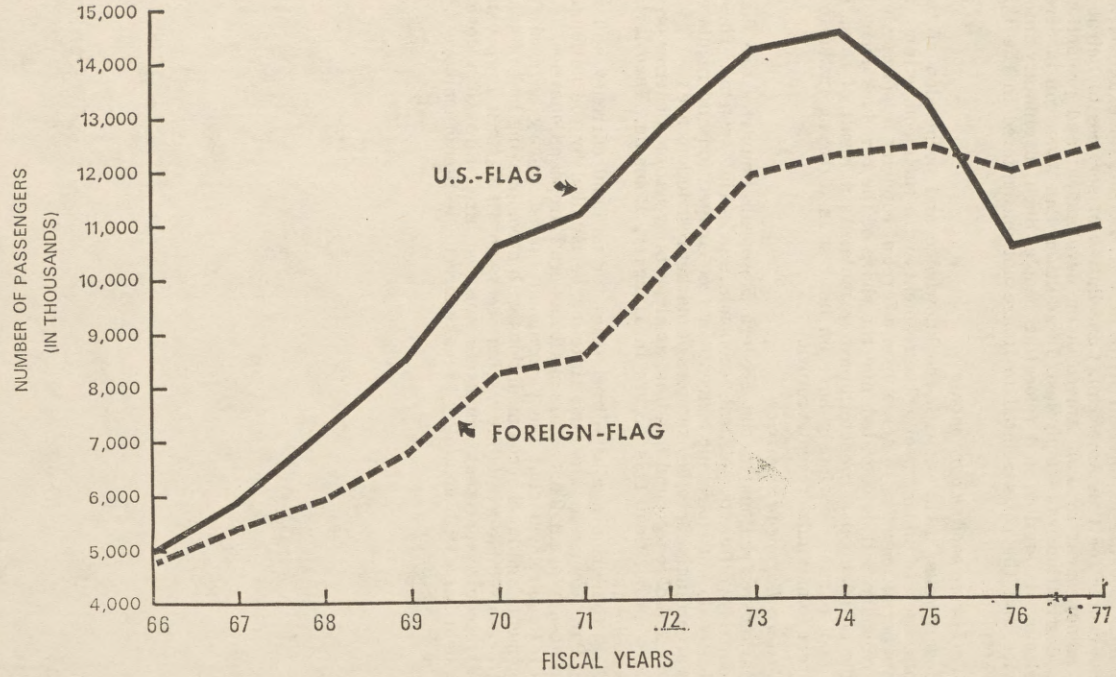
(*a*) Mandated ground handling at airports by national carrier or state-owned airport authorities. This occurs in Hungary, Romania, Yugoslavia, U.S.S.R., Czechoslovakia.

(*b*) Prohibition against direct sales for national currency and requirement that Pan American sales and ticketing be handled by the national carrier as general sales agent. This occurs in all Eastern European Countries.

(*c*) Requirement that the government tourist agency be used for tour arrangements and hotel accommodations with accompanying lack of quality control and/or unreliable availability. This occurs in all Eastern European Countries.

(*d*) Requirement that employees must be hired through a government employment bank with no ability to make direct selection of employees. This occurs in the U.S.S.R.

COMPARISON OF GROWTH OF U.S. AND FOREIGN-FLAG CARRIERS



SOURCE: IMMIGRATION AND NATURALIZATION SERVICE

EXHIBIT 1

The CHAIRMAN. The next witness is Mr. Lee Hydeman, vice chairman of the subcommittee on aviation, American Bar Association.

STATEMENT OF LEE M. HYDEMAN, VICE CHAIRMAN, SUBCOMMITTEE ON AVIATION, SECTION ON ADMINISTRATIVE LAW, AMERICAN BAR ASSOCIATION

Mr. HYDEMAN. Mr. Chairman, Senator Zorinsky, I very much appreciate the opportunity to appear before you once again in connection with section 801 of the Federal Aviation Act.

It is a matter in which I believe you are aware I have long held strong personal views.

My appearance today, as it was in June of 1976, is on behalf of the American Bar Association.

I would like to offer for the record, Mr. Chairman, my written testimony which has one appendix attached to it, and then separate are four other appendixes.

The CHAIRMAN. Your testimony will be made part of the record.

Mr. HYDEMAN. Thank you.

I will attempt now to summarize that testimony.

I appear today to support enthusiastically and emphatically section 8 of your S. 3363. That section would remove the President from reviewing CAB decisions involving international route awards to U.S. airlines.

This position is pursuant to very careful consideration given this matter over many years by the ABA.

In 1974 our House of Delegates for the second time in its history adopted a unanimous resolution urging modification of section 801. That resolution formed the basis of my earlier testimony, which is attached as appendix A,[1] and my testimony today.

For over 20 years the ABA has sought modification of section 801 in order to return integrity to this part of the administrative process by removing these international route decisions from politics and providing for judicial review.

Less than a week before I testified in 1976, President Ford adopted an Executive order seeking to bring greater integrity to this part of the administrative process, first by seeking to control and publicize communications between parties to CAB proceedings and those in the executive branch reviewing the decisions; second, by directing interested agencies in the executive branch to put their views on specific route matters before the CAB on the public record; and, third, by seeking judicial review of those Board decisions which do not and did not involve significant decisions of foreign policy or defense.

When I appeared before Senator Cannon at that time, I applauded the President's effort to clean up the process, but I warned that it was likely to prove ineffectual and in any event did not go far enough.

First, I did not think the efforts to control *ex parte* contacts would prevent political manipulation of the final decision.

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[1] Appendix A is in the committee files.

Second, I didn't believe that the efforts to limit the President to considerations of foreign policy and defense and to require interested agencies to put their views on the public record would prevent Presidential interference with the economic or carrier-selection aspects of the Board's decisions.

And finally, I was skeptical as to whether the Executive order would, in fact, cause the courts to review any 801 decisions.

Frankly, I would have been delighted had the Executive order proven effective. It gives me no particular satisfaction to be sitting here today and saying I told you so. However, the facts are that the serious reservations I expressed 2 years ago have proven to be correct in the short time since that testimony.

There are two events which have occurred which I think you ought to particularly take note of and which do underscore the importance of getting the President out of the review process, as proposed by your section 8.

The first event was President Carter's action in the *Transatlantic* case, directing the selection of Braniff in place of Pan Am for a Dallas-to-London route. This put politics right back into the process. It literally tore the heart out of the carefully delineated review process established by the Executive order.

I might note parenthetically that I agree substantively with the choice of Braniff, but I disagree violently with the President's right to interfere in the decision and the manner in which he did so.

The first respect in which the President eroded the very essence of the Executive order was his admitted receipt of congressional and gubernatorial submissions and visits regarding both the selections of Braniff and Delta.

One of the key aspects of the Executive order, as you recall, was to prevent any communication between parties to CAB proceedings and those in the Office of the President. The purpose was to remove political pressure and political manipulation from the review process.

The history of political abuse of section 801 was a major complaint of the ABA and other critics of the process. The President's Associate General Counsel was quoted by the press—and I have included that article as appendix B—as excusing this conduct on the basis that obviously the President could not be cut off from conferring with other political leaders. His counsel noted that the Executive order addressed only contact by air carriers or their representatives or their lobbyists.

The problem is that the document which the President received from a Texas congressional delegation was a document admittedly prepared by Braniff. It essentially was the same document that Braniff had presented to the executive departments and was a document which under the explicit terms of the Executive order would have been inappropriate for Braniff or its representatives to submit to the President or his staff directly under the Executive order.

Now, however, regardless of the merits of the position of the President's Counsel, it is obvious that the net result of the action in this case is to bring politics back into the international route-award process. The only difference between what transpired before the Executive order and the rules of the road now is simply who the airlines are encouraged to hire to affect the process. Prior to the order, the practice

was to hire what the press calls influence-peddlers who could get directly to the President or his staff. Now, the carriers are encouraged to seek assistance at the congressional or gubernatorial level.

The process is no different. The impact is no less devastating. Political manipulation becomes the name of the game once again, and the administrative process is once again seriously eroded and undermined.

The second respect in which the President's action in the *Transatlantic* case violated the essence of the Executive order was the area and manner in which he overruled the Board and the justification for his action.

The President interferred with the Board's selection of the specific carrier to serve the agreed-upon route, and for the first time in my recollection he designated the carrier to be selected.

It is commonly recognized that the question of which carrier is selected normally has little relevance to foreign policy or defense considerations, and even in past overturns, Mr. Chairman, you might recall that the President normally plays somewhat of a game and he sends it back with a new route description and says to the Board, pick another carrier.

You will recall that in the *Transatlantic* case he had to do it twice because the Board kept sending the same carrier back.

Moreover, the President directed the selection of one carrier in place of another based on economic considerations, not the kind of foreign policy or defense considerations which were contemplated by the Executive order and, I believe, the legislative history of section 801.

His rationale was effectuation of the administration's policy to encourage low fares.

While that policy is highly laudable, it is strictly a matter of economic policy and general regulatory goals, which are the very essence of the congressional authority delegated to the Board.

Moreover, the President cannot even complain that he was faced with an unsympathetic Board. Dr. Kahn was already in control of the Board and had voted for the selection of Pan Am. Dr. Kahn, much to his credit, in several public statements which are referred to in my written material, and I gather in his testimony before you, criticized the Presidential interference and stated how it undermined the integrity of the process.

Rumors abounded at the time that he was considering resignation, and certainly, in my view, the degree of Presidential interference was sufficient to justify such extreme action.

Directly on target was the comment by Reuben Robertson, then with the aviation consumer action project and now a key staff official of the Board, and I would like to quote:

> The trouble with this is it thrusts the entire review procedure right back into the political wheeling and dealing that characterized prior administrations * * *.

That was exactly what the Executive order issued by President Ford was meant to end.

The second event which has occurred since the Executive order was adopted and which makes clear the ineffectiveness of the order and the need for legislation is the decision of the U.S. Court of Appeals for the District of Columbia in *Braniff* v. *CAB* which was the Chicago-to-Montreal case, a copy of which is contained in appendix D.

A major purpose of the Executive order was to permit judicial review of those decisions not materially affecting foreign policy or defense. In that case, pursuant to the Executive order, the President stated in his letter approving the award that "no defense or foreign policy considerations underlie my decision."

Several carriers sought judicial review, asserting that the Board decision was arbitrary and lacked the reasoned decisionmaking required by the courts in CAB route decisions.

The court refused to review, stating that the right to review requires congressional action and cannot be created simply by Executive action.

The court noted that the *Waterman* doctrine, which as you know is a historic case which prohibited review in international route decisions, had been on the books for 30 years and has not been overturned by Congress, despite congressional consideration of the matter. The court specifically noted that the Senate bill on regulatory reform "does not affect section 801 in any fashion."

I might note parenthetically, Mr. Chairman, that I argued the case on the merits; the Department of Justice argued the *Waterman* issue, the review issue; and our colloquy in 1976 on the 801 issue turned out to be used against me in the sense that the court said that, having thought about this and considered this issue, it was really up to the Congress now to act.

So the problem now lies squarely back in your laps. Only Congress can return integrity to this part of the administrative process by preventing continued political manipulation and permitting judicial review.

Executive action to clean up the process has been ineffective. The approach to legislation on this matter taken in section 8 of S. 3363 is precisely the approach I recommended 2 years ago and continue to support. It is consistent with the unanimous resolution adopted by our House of Delegates.

I have discussed other approaches in my testimony. Certainly, the approach taken in the House bill on regulatory reform is wholly inadequate. It would not prevent the kind of Presidential interference which occurred in the *Transatlantic* case, and also it would not assure judicial review.

I have submitted as an appendix to my testimony—and it is attached to the first portion—an alternative which would be consistent with the objectives of the ABA but one that I think complicates the language and I don't think is necessary. I think your section 8 is more than adequate.

In conclusion, let me emphasize that the important element of legislative action on this matter is, first, to remove the President's review of Board decisions in international route matters involving U.S. air carriers and, second, to state in the legislative history that this would bring such cases explicitly under the judicial review section of the Federal Aviation Act.

It is high time for Congress to act to return integrity to this increasingly important aspect of the Board's decisionmaking process, and by that I mean—and I think it is relevant to the last witness's statement—the international routes. At least for the time being, they are more protected than the domestic routes or appear to be going in that

direction, and therefore the stakes may be even higher than they are today, relatively. But the stakes already are very, very high, as you know. The value of these routes is tremendous.

Fairness in the process is essential to protect both the airlines, which have a significant financial stake in the outcome of these proceedings, and more importantly, the public, whose interest in the outcome is of great importance.

Certainly, if we are, as this administration is witnessed to do, to insist on morality in domestic affairs from our neighbors abroad, we ought to be setting good examples at home.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Hydeman, for a very fine statement.

I well recall your appearance before this committee in the past, and as you know, at that time I thought that section 801 authority ought to be changed, and I am still of that same opinion, though we have not been able to make any changes at the present time.

Mr. HYDEMAN. Well, I think Chairman Kahn's support of it is a very candid admission by a member of any administration that it is desirable to change the process. That took a lot of guts, I think, and he displays it often.

Each administration wants not to give up this power because it provides substantial political leverage.

The CHAIRMAN. Paragraph B of your proposed alternative approach, what does that mean?

Mr. HYDEMAN. Well, you may recall, I had a fairly lengthy exchange last time with Senator Stevens. There were those in the bar association who felt that there ought to be some recognition—if you were going to get rid of the President in the 801 review process, that the President's legitimate foreign policy and defense powers—there are two aspects of that.

Section B is one, which essentially says, if the Board certificates a carrier or a route and a carrier, and the President feels that to implement that award would so complicate our foreign policy as to do it serious damage, he then does not have to take the necessary steps of implementing the award.

For example, if we would go back to the *Transpacific* case and the American award to Japan, the Japanese, as you know, at the time raised very, very serious problems. It was the only case in which President Johnson had ever interfered, and he did so based on the serious foreign policy concern. Well, he could do so under B, not by sending the matter back to the Board but merely by not going ahead and effectuating the award by sending the American name to the foreign government as a U.S. certificated carrier.

I think, however, in fairness, Senator Cannon, the reason I don't really think this is necessary, if you also go back over the history of the cases, is that where the departments of the executive agencies have come before the Board and stated their foreign policy or defense considerations, the Board has in every case heeded their views.

The problem today is that they don't come before the Board because they can do it in the confines of the executive review process.

So it really recognizes Presidential power, but the power is there

whether you recognize it or not, and therefore I think you ought not to complicate the legislation with this kind of provision. I think it is an academic issue, frankly.

The other side of the coin is C, and C says that if the President wants a carrier or a route and the Board won't certificate it, then the President can direct it.

Now, as you recall, the last time with Senator Stevens, I said the President has that power anyway to contract for the service. The President has contracted for services in the past with the executive branch.

Again, that is highly academic. I know of no case in the 40-year history of the Board where the President has either asked for or even suggested that a new route be certificated, that the Board has been unwilling to do so.

So I think both of these are academic issues. The President's power remains. You don't have to recognize the President's power. You certainly are not, I think, engaged in legislation of a questionable constitutional validity if you stick with your section 8 as drafted.

The CHAIRMAN. Well, thank you very much, Mr. Hydeman, for a very fine statement.

Mr. HYDEMAN. Thank you, sir. I appreciate it.

[The statement and attachments referred to follow:]

STATEMENT OF LEE M. HYDEMAN, VICE CHAIRMAN, TRANSPORTATION COMMITTEE, SECTION ON ADMINISTRATIVE LAW, AMERICAN BAR ASSOCIATION

Mr. Chairman, My name is Lee M. Hydeman. I am in private practice in Washington and have been specializing over the past twelve years in an airline regulatory practice. I am Vice Chairman of the Subcommittee on Aviation of the American Bar Association's Section of Administration Law.

I appear before your Subcommittee today as the designated representative of the American Bar Association to support prompt enactment of legislation to remove the President from reviewing CAB decisions relating to U.S. airline activities in foreign or overseas air transportation, while preserving the President's constitutional obligations for national defense and foreign relations. This is the second time I have appeared before this Subcommittee on this matter. On June 15, 1976, I testified on behalf of the American Bar Association, specifically urging "that Section 801 should be amended to remove from presidential review actions of the Civil Aeronautics Board involving the certification of U.S. air carriers." At that time I was also Vice Chairman of the Subcommittee on Aviation of the ABA's Section of Administrative Law. Our subcommittee had taken the initiative to raise with the full American Bar Association the matter of the urgent need to amend Section 801 of the Federal Aviation Act to return integrity to the administrative process. After two years of careful consideration, the House of Delegates of the ABA for the second time in its history adopted a resolution urging modification of Section 801. That resolution was the basis of my earlier testimony as it is today. Following is the text of that resolution, which was jointly submitted by the Section of Administrative Law and the Standing Committee on Aeronautical Law.

Be it resolved, That the American Bar Association supports the enactment of legislation to amend Section 801 of the Federal Aviation Act (49 U.S.C. § 1461) by withdrawing from the President the power of review or approval of Civil Aeronautics Board actions to the extent that such cases involve certificates of public convenience and necessity to U.S. Air Carriers for overseas and foreign air transportation, such withdrawal to be accomplished in a manner which will preserve the President's constitutional rights and obligations in the fields of national defense and foreign relations, while (1) removing economic and domestic political considerations from the decision-making process, and (2) assuring availability of judicial review; be it further

Resolved, That the President or his designee is authorized to represent the Association in the furtherance of this resolution.

It would serve no purpose to repeat the extensive testimony I submitted two years ago on behalf of the American Bar Association.

To clarify our position, the ABA strongly favors the need to reform Section 801 as detailed in our resolution. However, we have not determined any particular legislative language which is preferable. Any number of alternatives would be acceptable. The essence of the ABA's position is that Section 801 needs to be amended along the lines proposed in S. 3363, or similar, alternative language, to return integrity to this part of the administrative process by removing international route decisions relating to U.S. carriers from the political arena and by providing for judicial review of such decisions. Copies of my earlier statement are a part of the record.

Less than a week before I testified in 1976, President Ford adopted an Executive Order seeking to bring greater integrity to this part of the administrative process, first, by seeking to control and publicize communications between parties to international route proceedings and those in the Executive Branch reviewing the decisions; second, by directing interested agencies of the Executive Branch to put their views on international air route matters on the public record before the Civil Aeronautics Board; and, third, by seeking to create judicial review of those decisions approved by the President which do not in the President's judgment involve considerations of foreign policy or national defense.

While I applauded the President's effort to clean up the process, I warned in my testimony that it was likely to prove ineffectual and, in any event, that it did not go far enough. In the first place, I did not believe that efforts to control so-called ex parte contacts would prevent political manipulation of the decisional process. Secondly, I did not believe that the effort to limit presidential review to foreign policy and defense considerations would prevent presidential interference with the economic or carrier-selection aspects of the Board's decisions, since foreign policy had already been broadly interpreted by some within the Executive Branch to include the economic impact of the Board's decisions. Finally, I expressed skepticism as to whether the President by Executive Order could cause the courts to review Board decisions required to be submitted to the President under Section 801.

Frankly, I would have been delighted had Executive Order No. 11,920 (3 C.F.R. 121 (1977)) been effective in returning integrity to these international route decisions. It gives me no particular satisfaction now to be in a position to say, "It told you so." But, in fact, the serious reservations I and others had expressed as to the effectiveness of this approach to the matter have proven to be correct in the short span of two years since I last appeared before you on this issue. Two things have happened since then which underscore the importance of adopting remedial legislation.

PRESIDENTIAL INTERFERENCE IN THE TRANSATLANTIC ROUTE CASE

President Carter's action on April 22, 1977, in the Transatlantic case, overturning the selection of Pan American and directing the selection of Braniff for a route between Dallas and London, put politics right back into the process of international route awards. The President's action literally tore the heart out of the carefully delineated review process established in Executive Order 11,920. Indeed, his action makes a mockery of the Executive Order in the two principal respects in which the order was intended to clean up the process.

Before detailing this, I might note parenthetically that I agree substantively with the President's reasons for selecting Braniff over Pan American. But, by overturning the award, he was in effect usurping the very essence of the responsibility delegated by Congress to the Board, namely to make the economic and carrier selection decisions, and was pushing beyond reasonable limits his power in the area of foreign policy.

The first respect in which this action eroded the very objective of Executive Order 11,920 was in his admitted receipt of congressional and gubernatorial submissions favoring Braniff's selection. Executive Order 11,920 specifically prohibited representatives of air carriers or other parties from discussing pending international route cases with the President or his staff. Contacts were limited to the executive departments, and public records of all such contacts were required to be maintained. The obvious purpose of so limiting contacts was to try to remove political pressure and manipulation from the review process. The history of political abuse in the 801 review process was a major complaint of

the ABA and other critics of the process, as I detailed in my testimony two years ago.

The President, during his review of the Transatlantic case, admittedly received and considered a paper from the Texas congressional delegation urging the selection of Braniff in place of Pan American. Matters were made worse because that paper apparently was prepared by Braniff; it paralleled Braniff's written submission to the executive departments. The President in effect received indirectly from the air carrier precisely what the Executive Order prohibited the carrier from presenting directly to the President or his staff.

The President's associate general counsel is quoted by the press as excusing this conduct on the basis that obviously the President cannot be cut off from conferring with other political leaders. A copy of this article has been submitted to the committee. He asserted that such could not have been the intention of the Executive Order, which addressed only contacts by air carriers or their representatives or lobbyists. He also indicated that the Executive Order did not explicitly cover communications to the President, but only those in the President's offices. Without going into the questionable merits of the position taken by the President's counsel, it is obvious that the net result of the President's action is to bring politics back into the international route award process.

The only difference remaining between what transpired before Executive Order 11,920 and the rules of the road now is simply one of who the airlines are encouraged to hire to affect the process. Prior to the Executive Order, the practice was to hire Washington influence-peddlers who could get to the President or the White House staff. Now the carriers are encouraged to seek support at the congressional or gubernatorial level. The process is no different. The impact is no less devastating. Political manipulation becomes the name of the game once again. The administrative process is once again seriously undermined.

The second respect in which President Carter's action in the Transatlantic case eroded the basic objective of the Executive Order was the area and manner in which he overruled the Board and the justification for his action. The President interfered with the Board's selection of the carrier to serve a specific route. Carrier selection has always been regarded as the most sensitive area for potential abuse of the presidential review process. Normally, the question of which carrier is selected bears little relevance to any legitimate foreign policy or national defense consideration. It is true that in the past there have been a few cases where the selection of one carrier over another might create a foreign policy impediment to implementation of the award because of the peculiar nature of the carriers' route systems as they relate to legitimate concerns of a foreign government. But this is the one area of international route decisions which is generally believed to be within the almost exclusive province of the expert regulatory body. Yet that is the area in which President Carter overruled the Board. Moreover, he did not do what prior Presidents have done, namely to suggest to the Board that it choose another carrier which would avoid or aid in achieving the specific foreign policy considerations underlying his action. Rather, he specifically directed the carrier to be selected.

The rationale for President Carter's decision also went well beyond the boundaries intended in the Executive Order. He interfered with the Board's decision based on economic considerations, not the normal kind of foreign policy or national defense considerations which appear to have been contemplated by the Executive Order or Section 801. His rationale for this was effectuation of the Administration's policy to encourage price competition among air carriers. While that policy is highly laudable, it hardly qualfies as a serious consideration of foreign policy or national defense. It is strictly a matter of economic policy and general regulatory goals, which are the very essence of the Board's responsibility. Moreover, the President was dealing with a Board which generally agreed with his own economic policy views.

Dr. Kahn found the President's interference to be highly questionable. In a public statement issued right after the decision, he asserted that the Board's decision

". . . was the one that would in our view best serve the consumer interest . . . and I am disappointed that he [the President] nowhere alludes to our thorough explanation of why we thought our decision was the one that would best serve that end"

Later, in a television interview, Chairman Kahn spelled out why the President's action served to undermine the integrity of the administrative process. The

breach was so serious that rumors abounded at the time that Chairman Kahn was considering resigning, which report appeared in the Aviation Daily issue I have provided the committee. Certainly the degree of presidential interference was sufficient to justify such extreme action by the Chairman.

Even more to the point are the reported comments of Reuben Robertson, who was then with the Aviation Consumer Action Project and is now one of the key staff officials of the CAB. He made clear his view as to the receipt by the President of oral or written communications from governors or members of Congress. In summing up his view as to the impropriety of this kind of ex parte contact, Mr. Robertson is quoted as stating:

"The trouble with this is it thrusts the entire review procedures right back into the political wheeling and dealing that characterized prior administrations—especially the Johnson and Nixon administrations—and in which there were very strong overtones of scandal in some of these cases. That was exactly what the executive order issued by President Ford was meant to end" (Appendix B).

REJECTION OF JUDICIAL REVIEW IN THE CHICAGO-MONTREAL CASE

The second event which has occurred since Executive Order 11,920 was adopted, and which makes clear the ineffectiveness of the order, is the decision by the U.S. Court of Appeals for the District of Columbia in the Chicago-Montreal case (Nos. 76–2043 and –2176, and Nos. 77–1020, –1027, and –1166, decided July 10, 1978). A copy of that decision has also been provided to the committee and again I ask that it be incorporated into the record of this hearing.

As indicated, a principal objective of Executive Order 11,920 was to meet the criticism of the ABA over the lack of judicial review of cases required under Section 801 to be submitted to the President. Without judicial review, the administrative process is bound to have far less integrity or even meaning. Fairness to the parties and protection of the public require review to the maximum extent feasible. As the ABA recognized, judicial review is the essential element in providing a check on unreasonable, arbitrary, or capricious agency action. Without access to review, fairness and reasonableness of agency action are left to chance. This becomes an even more serious matter as we move into a less regulated environment. International route awards will become even more important, since international routes will constitute the one protected area of carrier route systems.

Under the Executive Order, the President was to indicate whether his action in approving Board decisions was based on foreign policy or national defense considerations. The stated purpose of this public statement was to enable the courts to review those decisions which did not involve foreign policy or national defense considerations.

In the landmark case of *Chicago & Southern Airlines, Inc.* v. *Waterman Steamship Corp.*, 333 U.S. 103 (1948), the Supreme Court refused by a vote of 5 to 4 to review a CAB decision relating to an international route matter involving a U.S. carrier, which decision had been reviewed by the President under Section 801. The Court held in that case that it simply could not separate out the foreign policy and defense considerations, which were within the exclusive province of the President, from the normal economic considerations delegated by Congress to the Civil Aeronautics Board. It was believed by some that if the President were to differentiate those cases in which his decision involved foreign policy or national defense considerations from those which did not, the *Waterman* impediment to review would be removed, at least as to the second category of cases. Others doubted that the courts would be willing to take review absent congressional action.

This matter has now been resolved. Congressional action is required if judicial review is to be available. In one of the first international route decisions after Executive Order 11920 was adopted, President Ford approved a Board order awarding a route between Chicago and Montreal to American Airlines. In his letter approving the award, President Ford stated that "no defense or foreign policy considerations underlie my decision." Several carriers sought judicial review, asserting that the Board decision was arbitrary and capricious and lacked the reasoned decision-making required by the appellate courts in CAB domestic route decisions. American Airlines moved to dismiss based on the non-reviewability of the order, relying on the *Waterman* doctrine. The Justice Department intervened in opposition to American's motion, relying on the Executive Order.

The D. C. Court of Appeals granted the motion to dismiss. The Court in effect

said that the right to judicial review requires congressional action; it cannot be created simply by executive action. The court noted that the *Waterman* doctrine has been on the books for thirty years and has not been overturned by Congress, despite congressional consideration of the matter. Indeed, the court made a point of the fact that the Senate bill on airline regulatory reform "does not affect section 801 in any fashion."

THE NEED FOR CONGRESSIONAL ACTION

So the problem now lies squarely back in your laps. Only Congress can return integrity to the administrative process by preventing continued political manipulation of the international route award proces and by permitting judicial review of Board orders in such proceedings. Executive action to clean up the process has proven ineffective and indeed counterproductive in both areas.

The inevitable question is, what kind of legislation? Two basic approaches have been suggested. One is the approach of S. 3363, namely to remove the President from international route decisions involving U.S. carriers. This approach would certainly accomplish the objectives of clearing up the Section 801 process.

Another approach which has been suggested is somehow to limit the President's role in reviewing CAB international route decisions. One form of this second approach is that contained in the pending House bill on regulatory reform, namely to limit presidential review to foreign policy and national defense considerations and specifically to preclude presidential consideration of carrier selection. That approach may be acceptable if the President's authority is limited to a veto right based exclusively, and in fact, on foreign policy and national defense grounds.

Under the approach taken in the House bill, the courts may still be unwilling to grant judicial review. Indeed, so long as the President remains in the review process, judicial review may be precluded no matter what Congress says. The D.C. Court of Appeals panel which rendered the recent decision in the Chicago-Montreal case made clear during the argument that they were offended by the concept that the President could turn on and off the faucet of judicial review simply by using magic words. The court went on to say that: ". . . we express some degree of skepticism concerning whether the award of an international air route could ever be entirely free of foreign policy and defense considerations" (See p. 14 of the decision, which is before the subcommittee). I am painfully aware of the court's concern, since I argued the case on its merits. A representative of the Department of Justice argued the *Waterman* review issue.

There is yet another alternative form of this second approach which would be generally consistent with the objectives of the ABA. That would be to eliminate presidential review of CAB international route awards, but at the same time to recognize explicitly in Section 801 the President's foreign policy and defense powers as they may legitimately relate to international air route matters.

The Appendix to my statement contains suggested language outlining this approach, although I would emphasize that this language is mine, and not necessarily suggested by the ABA. First, it recognizes the President's right under this foreign policy and defense powers to direct the Board to certificate air service in a specific market, if the Board refuses to do so after receiving a presidential request in this regard. The Board, of course, would have complete discretion as to which carrier to select. Although the need for such a reservation of executive power maybe academic, since I know of no instance in forty years of CAB regulation where the Board has refused a presidential request, or even a suggestion that a new international air route be opened for U.S. flag carrier certification.

Second, this approach provides that no certification action by the Board would be binding on the President if such action contravenes foreign policy or defense objectives. However, this suggestion should be viewed in an historical perspective. The Board has always heeded the views of executive departments where they have appeared on public record to oppose an award of authority based on foreign policy or defense considerations. Moreover, the President has the final say whether or not to effectuate an international route award made by the CAB.

I did not suggest such an explicit congressional reservation of executive power when I testified on behalf of the ABA in 1976. However, as noted in the Association's policy, that approach would be consistent with our stated objective of "withdrawal (of the President) to be accomplished in a manner which will preserve the President's constitutional rights and obligations in the fields of national defense and foreign relations."

In conclusion, the important element is to remove the President's review of Board decisions in international route matters involving U.S. carriers. It is high time for Congress to act to return integrity to this increasingly important aspect of the Board's decision-making process. This process has too long been highly politicized. The stakes are high, and fairness in the process is essential to protect both the airlines, which have a significant financial stake in the outcome of these proceedings, and the public, whose interest in these proceedings is of great importance. It is now crystal clear that the process cannot and will not be cleaned up by presidential action or restraint. Certainly, if we are to insist on morality from our neighbors abroad, we ought to set a good example at home.

AN ALTERNATIVE APPROACH TO AMENDING SECTION 801

"Presidential authority

"SEC. 8. Section 801 of the Federal Aviation Act of 1958 (49 U.S.C. 1461) is amended as follows:

"*President of the United States*

"SEC. 801 (a) The issuance, denial, transfer, amendment, cancellation, suspension, or revocation of, and the terms, conditions, and limitations contained in, any permit issuable to any foreign air carrier under section 402 shall be subject to the approval of the President.

"(b) No Board action involving a certificate authorizing any U.S. flag air carrier to engage in foreign air transportation shall be deemed to require the President to take any action regarding service to a foreign country deemed by the President contrary to national defense or foreign policy.

"(c) The President shall have authority to direct the Board to authorize U.S. flag service in foreign air transportation where such service is deemed by the President to be necessary to our national defense or foreign policy.

"(d) Any order of the Board pursuant to section 1002(j) of this Act suspending, rejecting, or canceling a rate, fare, or charge for foreign air transportation by a foreign air carrier, and any order rescinding the effectiveness of any such order, shall be submitted to the President before publication thereof. The President may disapprove any such order when he finds that disapproval is required for reasons of the national defense or the foreign policy of the United States not later than ten days following submission by the Board of any such order to the President."

(APPENDIX B)

[From the Washington Star, Dec. 23, 1977]

DID CARTER VIOLATE SPIRIT OF LOBBYING ORDER?

(By Stephen M. Aug)

President Carter may have violated the spirit of an executive order designed to end the practice of intensive behind-the-scenes lobbying at the White House to influence the outcome of international airline cases.

The executive order was issued in June by then-President Ford. It forbids anybody in the executive office of the president to discuss with any "interested private party, or any attorney or agent for any such party" the disposition of any international airline matter pending before the president.

The lobbying at issue in this case involves two visits Georgia Gov. Gerge Busbee paid to the president this week to discuss a trans-Atlantic airline route case on which Carter was to make a decision.

As it affected Georgia directly, the president's decision, announced Wednesday, simply ratified the Civil Aeronautic Board's decision to grant Atlanta-based Delta Airlines a new route between Atlanta and London.

But Carter reversed another CAB recommendation and gave the Dallas-London route to Dallas-based Braniff airways rather than to Pan American World Airways, as the CAB had suggested.

The President has been urged by a delegation of Texas congressmen and senators to substitute Braniff for Pan Am.

After the Braniff-Pan Am switch was announced, CAB Chairman Alfred E. Kahn said he was not pleased with Carter's decision to reverse the CAB.

Kahn said the board's decision "was the one that would in our view best serve the consumer interest . . . and I am disappointed that he (the president) nowhere alludes to our thorough explanation of why we thought our decision was the one that would best serve that end."

None of the agencies advising the president on the decision recommended any changes in the CAB recommendations on grounds of economics or foreign policy—the grounds Carter cited in reversing the board.

Pan Am Chairman William T. Seawell said Carter's ruling was "dictated by the kind of political manipulation that the president promised would not characterize his administration."

Regarding Carter's decision on Delta, the White House says there was no impropriety in the Busbee discussions because the executive order in question does not cover visits by elected officials—a view disputed by others. It also was implied that the president himself isn't covered by the order.

Duane Riner, Busbee's press secretary, said that indeed the governor visited with Carter earlier this week, but it was "to expedite White House approval." He said the governor's interest "has never been Delta per se. His interest has been enhancing Atlanta as an international city."

The executive order on lobbying was issued to end abuses that had existed for many years. Under federal law, international airline matters are first decided by the CAB, an independent regulatory agency, after public hearings. Then—largely for foreign policy and national security reasons—they are sent to the White House.

But in the past, the White House phase of these cases frequently was colored by extensive lobbying of White House staff members.

The lobbying became so distasteful that the American Bar Association recommended legislation that would have taken the White House entirely out of the international airline route selection process.

The executive order was an attempt to head off the legislation. Not only did it attempt to end the lobbying, it sought to limit the president's consideration of international airline route matters to national defense and foreign policy, leaving economic matters entirely to the CAB.

Thus, not only may Carter have violated the spirit of the order in seeing Busbee, but also in his decision to reverse the CAB's selection of Pan Am and to order the board to give a route to Braniff.

John E. Robson, chairman of the Civil Aeronautics Board at the time of the 1976 executive order—and one of those who sought such a restriction—said in a recent telephone interview that while its wording would indicate that it doesn't apply to the president directly, "I would think he would want to impose the same rule on himself as he would on others."

In the interview, Robson was not told of the Busbee visit.

Edward Schmults, who as a counsel to Ford drew up the order and who now is a lawyer in New York City, also said that while the wording did not apply to the president, he felt it probably ought to apply to governors who might be pushing international airline service for their states.

"The spirit of the executive order was designed not to permit the sort of ex parte (off-the-record, private) communications at the White House by lobbying the staff people who submit recommendations to the president," Schmults said, "but they should go lobby at the State Department, Transportation, Justice . . . and those departments were then encouraged to open up a file and put this in the record over there." These files were to be made public.

As to whether the order applies to governors, Schmults said, "We specifically left out members of Congress . . . but I think we intended to include everybody else. . . I don't think a governor could have talked to a person at (the Office of Management and Budget) who prepares a decision."

One persistent critic of the CAB, Reuben B. Robertson III, said that Busbee-Carter conversations "would not appear to be appropriate."

"The whole point of the executive order was to protect the public against anyone exercising behind-the-scenes influence at the presidential level," said Robertson, counsel to Ralph Nader's Aviation Consumer Action Project.

He indicated it should make no difference whether the influence was being exerted by an elected official or a corporate executive. "The State of Georgia's interest is perfectly clear in the matter . . . It's also apparent that a number of members of Congress have been beseiging the White House with their own views on how the case should be decided, particularly the Texas delegation.

"The trouble with this is it thrusts the entire review procedure right back into the political wheeling and dealing that characterized prior administrations—especially the Johnson and Nixon administrations—and in which there were very strong overtones of scandal in some of these cases. That was exactly what the executive order issued by President Ford was meant to end."

The view from the White House is a little different. Douglas Huron, associate general counsel who advises on executive orders, said, "We have interpreted the order . . . (as saying) that White House personnel and executive office personnel are not to talk to either the officials from the carriers under consideration or their representatives or lobbyists.

We have not interpreted it to mean that we can't talk to elected officials whether they be members of Congress or, in this case, a governor. And I think it would be . . . not only unrealistic but . . . just contrary to good government to try to put any impediments between communications between people in the White House and other elected officials."

Huron said that some time ago staff members in White House lobbyist Frank Moore's office asked about what to do in the event a congressman should want to discuss the matter. "We looked at that executive order and said, 'You can talk to a congressman . . . but not . . . an official of the airline.' "

As for Carter's decision reversing the CAB, Robertson pointed out that while he didn't necessarily disagree with Carter's evaluation of the economics of the matter, "what I am concerned about is the intrusion of his economic views into an area that I think is properly restricted to national security and foreign relations."

Robertson pointed out that the intent of the Ford executive order was "to get the economic decisions made for better or for worse by the CAB and . . . only for security reasons have the president intervene, the idea being to take the pressure off the White House to get the decisions made in the right place."

In fact, the Ford order says government departments and agencies responsible for advising the president on airline route should make all regulatory arguments before the CAB and raise only defense or foreign policy arguments in their recommendations to the president.

(Appendix C)

AVIATION DAILY, FRIDAY, DECEMBER 23, 1977

NEW TRANSATLANTIC ORDER WILL BE ISSUED

CAB Chairman Alfred Kahn not pleased

CAB Chairman Alfred Kahn said yesterday he is "not pleased" with President Carter's decision overturning the Board on two major issues in the Transatlantic Route Proceeding (DAILY, Dec. 22). Kahn indicated he was disappointed and frustrated by Carter's decision. He refused to discuss the legality of Carter's action and said he had "no knowledge" of political maneuvering. He added, "I have heard the rumors." During a press conference, Kahn admitted that he had fleetingly considered resigning, but said, "I am having too much fun here to quit." (*See President's letter to CAB on back of Page 298.*)

Kahn's statements were made after the Board held an open meeting during which the staff was given a two-week deadline to prepare a new order including the changes ordered by President Carter. In the transatlantic case, Carter overruled CAB on the Dallas/Fort Worth-London award and ordered the route to be given to Braniff rather than Pan Am. Kahn, along with Members Richard O'Melia, Lee West and G. Joseph Minetti, had voted for Pan Am, while Republican Elizabeth Bailey was the only member to vote for Braniff.

Bermuda II conflicts

At the open meeting, several questions left ambiguous by Wednesday's White House statements were resolved. Pan Am's Houston-Europe—not simply Houston-London—authority begins shortly after a revised order is issued, but under Bermuda II, the carrier will not be able to operate London nonstops until 1980. In addition, it was decided the President, in adding Amsterdam and Frankfurt to National's route system, had intended National would be able to provide nonstop service to those points from each of its U.S. coterminals, including New Orleans and Tampa. Finally, the Board read the President's decision to mean

that only one carrier will have any transatlantic authority from Dallas/Fort Worth, namely Braniff. Pan Am will be left out of both Dallas/Fort Worth-London and Dallas/Fort Worth-Europe markets. Braniff is not authorized to serve any beyond-London points.

All of the route awards in the proceeding will be reviewed in five years, with special attention paid to the carriers' record in providing low fares.

Thorough consideration ignored by Carter

At a press conference following the Board meeting, Chairman Alfred Kahn expressed CAB's pleasure that Carter approved most of the Board's recommendations, but said he was "not pleased" in the two reversals. The Board had based its decision on "very thorough consideraiton of the record," he said. He also said CAB is "no less dedicated than the President to promoting competition," sharply adding that the President's letter "nowhere alludes" to CAB's "thorough explanation" of why its decision was the best for meeting that goal.

Asked his opinion on the fact that the policy of promoting strong U.S. regional carriers for international routes apparently had been imposed upon the Board from above, Kahn said CAB also believed in allowing international competition from regional carriers such as Braniff. However, he said that, unlike the President, CAB had "balanced" that concern with the concern of travelers and shippers in the continued existence of a strong, central, around-the-world operation such as Pan Am's. Both elements are involved in international competition, he said.

Kahn said apparently there was no disagreement between CAB and the White House on the goal of U.S. foreign aviation policy—enhanced competition—only on the judgments for reaching that goal.

Asked whether the decision permits Braniff to get its foot in the door to more European routes, Kahn said, "I should think so." He pointed out that under Bermuda II the U.S. carrier to London will be under capacity restrictions—with Braniff possibly being limited to four Dallas/Fort Worth-London flights a week—which would create an obvious incentive for Braniff to seek beyond-London authority in the future.

Kahn said "officially" he was not privy to the various agency recommendations to the President on the case. Asked what he had known "unofficially," he refused to comment.

The chairman "very strongly" believes the decision provides stronger argument for making more domestic routes accessible to Pan Am. "If A has a right to compete with B, then B has the right to compete with A," he said.

He was asked whether he was "bothered" by the fact that Mary Schuman, who had marshalled all of the various materials for the decision, also had been the person responsible for Elizabeth Bailey's appointment to the Board. Bailey was the only Board advocate of Braniff for the Dallas/Fort Worth-London award. Kahn said, "She (Schuman) is less responsible than I am" for Bailey's appointment, adding that Bailey would not have been appointed without his enthusiastic support. (Docket 25908)

PRESIDENT CARTER LETTER TO CAB ON TRANSATLANTIC CASE

THE WHITE HOUSE,
Washington, December 21, 1977.

Hon. ALFRED E. KAHN,
Chairman, Civil Aeronautics Board,
Washington, D.C.

DEAR MR. CHAIRMAN: I have reviewed the Board's decision in the Tranatlantic Route Proceeding, Docket 25908. For reasons of foreign policy, I have decided to approve all aspects of the Board's decision except that I have determined (1) to award Dallas/Fort Worth-London route to Braniff Airways, and (2) to add the European points of Amsterdam and Frankfurt to the route system of National Airlines.

The decision to certificate Braniff Airways to serve the Dallas/Fort Worth-London route and National Airlines to serve Amsterdam and Frankfurt is based on my judgment that the certification of strong regional domestic carriers to serve international markets is important to my foreign policy of relying to the maximum extent possible on competitive forces in international aviation. To achieve this goal, my Administration, in close cooperation with the Civil Aeronautics Board, is seeking more competitive bilateral air agreements with foreign countries. I have also recently approved reduced fares on the North Atlantic and

have permitted carriers such as Laker Airways to enter the market and provide service at substantially reduced rates. My decision to permit competitive pricing, however, depends on authorizing additional new carriers to serve international markets, as new competitors are an important source of price innovation. My decision to certificate Braniff, Delta, National and Northwest—all of which are strong regional carriers—to serve new European markets is an important step in the pursuit of this overall foreign policy objective.

I therefore direct the Board to submit, as expeditiously as possible, a revised order which awards the Dallas/Fort Worth-London route to Braniff Airways and which adds Amsterdam and Frankfurt to National's route system. In all other material respects, the revised order should be identical to the order dated October 21, 1977.

Sincerely,

JIMMY CARTER.

(APPENDIX D)

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

UNITED STATES COURT OF APPEALS, FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 76–2043

BRANIFF AIRWAYS, INC., A CORPORATION, PETITIONER

v.

CIVIL AERONAUTICS BOARD, RESPONDENT [1]

AMERICAN AIRLINES, INC., INTERVENOR

No. 76–2176

CONTINENTAL AIR LINES, INC., PETITIONER

v.

CIVIL AERONAUTICS BOARD, RESPONDENT

AMERICAN AIRLINES, INC.

UNITED STATES OF AMERICA

DELTA AIR LINES, INC.

CITY OF KANSAS CITY, MISSOURI, AND

CHAMBER OF COMMERCE OF GREATER KANSAS CITY,

INTERVENORS

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

No. 77–1020

ALLEGHENY AIRLINES, INC., PETITIONER

v.

CIVIL AERONAUTICS BOARD, RESPONDENT

AMERICAN AIRLINES, INC.

DELTA AIRLINES, INC., INTERVENORS

No. 77–1027

TRANS WORLD AIRLINES, INC., PETITIONER

v.

CIVIL AERONAUTICS BOARD, RESPONDENT

AMERICAN AIRLINES, INC.

DELTA AIRLINES, INC.

[1] In order t distinguish this case from others of the same name, readers are encouraged to cite it os : *Braniff Airways, Inc. v. CAB* [*Chicago-Montreal*].

CITY OF KANSAS CITY, MISSOURI, *et al.*, INTERVENORS

No. 77–1166

OZARK AIR LINES, INC., a corporation, PETITIONER

v.

CIVIL AERONAUTICS BOARD, RESPONDENT

DELTA AIR LINES, INC.
AMERICAN AIR LINES, INC., INTERVENORS

Petitioners for Review of Orders of the Civil Aeronautics Board

Argued January 13, 1978

Decided July 10, 1978

Lee M. Hydeman argued for the petitioner Braniff Airways, Inc., in case No. 76–2043, Continental Air Lines, Inc., in case No. 76–2176, Trans World Airlines, Inc., in case No. 77–1027, and Ozark Air Lines, Inc., in case No. 77–1166.

O. D. Ozment argued for the petitioner Allegheny Airlines, Inc., in case No. 77–1020.

B. Howell Hill was on the brief for petitioner Braniff Airways, Inc.

Thomas J. McGrew also entered an appearance for petitioner Braniff Airways, Inc., in case No. 76–2043.

Thomas D. Finney, Jr., with whom *Lee M. Hydeman* and *James T. Lloyd* were on the brief, for petitioner Continental Air Lines, Inc.

Edmund E. Harvey and *Henry J. Oechler, Jr.*, were on the brief for petitioner Trans World Airlines, Inc.

Paul L. Bradshaw also entered an appearance for petitioner Ozark Air Lines, Inc.

Theodore I. Seamon, with whom *O. D. Ozment* was on the brief, for petitioner Allegheny Airlines, Inc.

David B. Armstrong also entered an appearance for petitioner Allegheny Airlines, Inc.

Jay L. Wilkin, with whom *James C. Schultz*, General Counsel, *Jerome Nelson*, Deputy General Counsel, *Glen M. Bendixsen*, Associate General Counsel, and *Robert L. Toomey*, Attorney, were on the brief, for respondent.

Robert B. Nicholson and *Susan J. Atkinson*, Attorneys, Department of Justice, were on the brief for intervenor United States of America.

Daniel J. Conway, *Barry Grossman*, and *Frederic Freilicher* also entered appearances for the Department of Justice.

Alfred V. J. Prather and *Ky P. Ewing, Jr.*, were on the brief for intervenor American Airlines, Inc.

J. William Doolittle also entered an appearance for intervenor American Airlines, Inc.

James W. Collison also entered an appearance for intervenor Delta Air Lines, Inc.

Nordhal E. Holte also entered an appearance for intervenor City of Kansas City, Missouri, *et al.*

Before: WRIGHT, *Chief Judge*, and TAMM and LEVENTHAL, *Circuit Judges*.

Opionion for the court filed by *Circuit Judge* TAMM.

TAMM, *Circuit Judge*: Petitioners[1] seek review, under 49 U.S.C. § 1486(a) (1970), of an order of the Civil Aeronautics Board (the Board) awarding intervenor American Airlines authority to operate between Chicago and Montreal. Because of the international nature of this route, the order was submitted to, and approved by, the President prior to its being served. *Id.* § 1461(a) (Supp. V 1975). American has moved to dismiss the petitions for review on the authority of *Chicago & Southern Air Lines, Inc.* v. *Waterman Steamship Corp.*, 333 U.S. 103 (1948). Because the nature of petitioners' challenges to the Board's order brings this case squarely within the holding of *Waterman*, we hold that the Board's order is nonreviewable, and thus grant the motion to dismiss.

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[1] Braniff Airways, Inc.; Continental Air Lines, Inc.; Allegheny Airlines, Inc.; Trans World Airlines, Inc.; and Ozark Air Lines, Inc.

I

On May 8, 1974, the United States and Canada entered into an amendment to their bilateral Air Transport Agreement.[2] The amendment provided for a number of new routes for the air carriers of each country, Canada agreeing, *inter alia*, that a United States carrier would have the right to operate between Chicago and Montreal beginning April 25, 1976.

On June 11, 1975, the Board instituted the *Chicago-Montreal Route Proceeding* to consider the need for United States air carrier service between these two cities, and, if such a need existed, to determine which carrier or carriers should be authorized to provide the service.[3] An administrative law judge (ALJ) found that the public interest required the designation of a U.S.-flag carrier to inaugurate service on the Chicago-Montreal route, and he recommended that Trans World Airlines be selected to provide the serivce.[4] On reivew, the Board affirmed the American to operate the Chicago-Montreal route.[5]

Because the route under consideration would involve "overseas or foreign air transportation" the Board's proposed decision was transmitted, to the President, pursuant to section 801 of the Federal Aviation Act of 1958, as amended, 49 U.S.C. 1461(a) (Supp. V 1975). On November 4, 1976, President Ford approved the Board's order, noting in his letter of approval that:

"The issues presented in this proceeding are not affected by any substantial defense or foreign policy considerations, and no defense or foreign policy considerations underlie my decision.[6] "

The Board's order was served on November 8, 1976, to be effective on January 7, 1977.[7] On January 6, 1977, the Board issued a second order, which denied requests for reconsideration and refused to stay the original order.[8] This appeal ensued.

II

In *Waterman*, the Supreme Court interpreted what is now section 1006 of the Federal Aviation Act[9] to preclude judicial review of orders, granting or denying international air route authority to citizen carriers, that must be submitted to the President for approval under section 801 of the Act.[10] 333 U.S. at 114. Since pre-

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[2] Agreement Amending Air Transport Agreement, May 8, 1974, United States-Canada, 25 U.S.T. 748, T.I.A.S. No. 7824; *see* Air Transport Agreement, Jan. 17, 1966, United States-Canada, 17 U.S.T. 201, T.I.A.S. No. 5972. For a discussion of how such agreements are negotiated, see Calkins, *The Role of the Civil Aeronautics Board in the Grant of Operating Rights in Foreign Air Carriage,* 22 J. Air L. & Com. 253 (1955). *See also* Brief of American Airlines, Inc. at 4–5.

[3] CAB Order 75–6–55, Docket 27932, Joint Appendix (J.A.) at 18, 21.

[4] Recommended Decision of Administrative Law Judge Frank M. Whiting, Docket 27932, Feb. 27, 1976, J.A. at 108, 130, 149.

ALJ's finding of a need for U.S.-flag service in the market, but it instead chose

[5] Chicago-Montreal Route Proceeding, [1976] 2 Av. L. Rep. (CCH) paragraph 22,224.

[6] J.A. at 50.

[7] *Id.* at 30, 47.

[8] *Id.* at 51, 70.

[9] 49 U.S.C. § 1486(a) (1970), formerly 49 U.S.C. § 646(a) (1952), provides (emphasis added):

Any order, affirmative or negative, issued by the Board or Administrator under this chapter, *except any order in respect of any foreign air carrier subject to the approval of the President as provided in section 1461 of this title,* shall be subject to review by the courts of appeals of the United States or the United States Court of Appeals for the District of Columbia upon petition, filed within sixty days after the entry of such order, by any person disclosing a substantial interest in such order. After the expiration of said sixty days a petition may be filed only by leave of court upon a showing of reasonable grounds for failure to file the petition theretofore.

[10] Section 801(a) of the Act, as amended, 49 U.S.C. § 1461(a) (Supp. V 1975), provides:

The issuance, denial, transfer, amendment, cancellation, suspension, or revocation of, and the terms, conditions, and limitations contained in, any certificate authorizing an air carrier to engage in overseas or foreign air transportation, or air transportation between places in the same Territory or possession, or any permit issuable to any foreign air carrier under section 1372 of this title, shall be subject to the approval of the President. Copies of all applications in respect of such certificates and permits shall be transmitted to the President by the Board before hearing thereon, and all decisions thereon by the Board shall be submitted to the President before publication thereof.

cisely that type of order is now before us, and since the thirty-year-old *Waterman* doctrine has not been overturned by the Court [11] or the Congress, [12] the doctrine of *stare decisis* would appear to render unnecessary any further discussion in this case. However, certain contentions advanced by the petitioners require further analysis.

Petitioners first point out that the 5-4 decision in *Waterman* has been criticized virtually since its issuance.[13] A fair measure of the criticism has been directed at the expansive language used to describe presidential prerogatives in the conduct of foreign affairs, and, in indeed, the Supreme Court has subsequently emphasized, in an oblique reference to *Waterman*, that not all questions touching up foreign relations lie beyond judicial cognizance. *Baker v. Carr*, 369 U.S. 186, 211–13 (1962); *see Zweibon v. Mitchell*, 516 F.2d 594, 622–23 (D.C. Cir. 1975) (en banc) (principal opinion) (Wright, J.), *cert. denied*, 425 U.S. 944 (1976).

Secondly, *Waterman* has often been limited and distinguished, most notably in cases decided by this court. In *American Airlines, Inc. v. CAB*, 348 F.2d 349 (D.C. Cir. 1965), which questioned the Board's authority to permit supplemental carriers to engage in "split charter" flights to foreign countries, then-Judge Burger stated that the *Waterman* doctrine did not preclude judicial review of challenges asserting that the Board had acted outside its statutory authority regarding domestic carriers applying for international routes. *Id.* at 352; *see Pan American World Airways, Inc. v. CAB*, 392 F.2d. 483, 492–93 & nn.11 & 13–15 (D.C. Cir. 1968) However, he also noted specifically that the *Waterman* bar to judicial review *did* apply to challenges attacking the substantiality of evidence undergirding presidentially approved Board orders, and challenges alleging procedural due process deficiencies in the proceedings leading to the order. *American Airlines, Inc. v. CAB*, 348 F.2d at 352; *see Pan American World Airways, Inc. v. CAB*, 392 F.2d at 493, 496 n.26. *See also British Overseas Airways Corp. v. CAB*, 304 F.2d 952, 953 (D.C. Cir. 1962); *United States Overseas Airlines, Inc.* v. *CAB*, 222 F.2d 303, 304 (D.C. Cir. 1955).[14] Echoing *Waterman*, Judge Burger supported this latter statement by noting that "the President must be free to consider broad 'evidentiary' policy factors not involved, and indeed not relevant, in Board proceedings and that the President must be free to exercise unreviewable discretion as to the weight to be given to such extrajudicial factors." *American Airlines, Inc. v. CAB*, 348 F.2d at 352. *See also Pan American-Grace Airways, Inc. v. CAB*, 342 F.2d 905, 909–10 (D.C. Cir. 1964) (Wright, J., concurring), *cert. denied*, 380 U.S. 934 (1965).

Petitioners, however, joined by the United States of America as intervenor, argue that this case is distinguishable from *Waterman* because of the President's

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[11] Indeed, *Waterman* has been cited by the Court as recently as 1974. United States v. Nixon, 418 U.S. 683, 710 (1974); California Bankers Ass'n v. Schultz, 416 U.S. 21, 59 (1974). *See also* Pan American World Airways, Inc. v. United States, 371 U.S. 296, 310 (1963); Puget Sound Traffic Ass'n v. CAB, 536 F. 2d 437, 439 (D.C. Cir. 1976).

[12] There have been many congressional attempts to limit or overrule *Waterman*, but to date none has been successful. In 1957, the Senate passed a bill that sought to limit *Waterman* so as to permit judicial review of all elements of international route decisions except those elements specifically grounded upon national defense or foreign policy bases; the House of Representatives did not act on the bill. S. 1423, 85th Cong., 1st sess. (1957); *see* S. Rep. No. 119, 85th Cong., 1st sess. 1–5 (1957); 103 Cong. Rec. 5137 (1957). In 1972, however, an amendment to section 801 of the Federal Aviation Act was enacted, adding a new subsection to that provision. *See* Pub. L. No. 92–259, § 2, 86 Stat. 95, 96 (1972). The new subsection, 49 U.S.C. § 1486(b) (Supp. V 1975), provides that the President may disapprove certain actions regarding rates, fares, and charges in "foreign transportation" only for reasons of national defense or foreign policy; this amendment left untouched the original language of section 801, the statutory basis for *Waterman*. In 1977, two bills affecting section 801, S. 292 and S. 689, were introduced, the latter proposing a repeal of section 801 in its entirety; neither bill was passed by the Senate. *See* S. 689, 95th Cong., 1st sess. § 20 (1977); *Hearings on S. 292 & S. 689 Before the Subcomm. on Aviation of the Senate Comm. on Commerce, Science, & Transportation* 95th Cong., 1st sess. (1977). In early 1978, the sponsors of S. 689 introduced a new bill, which passed the Senate on April 19, 1978. S. 2493, 95th Cong., 2d sess. (1978); *see* 124 Cong. Rec. S5900 (daily ed. Apr. 19, 1978). Significantly, this most current bill does not affect section 801 in any fashion.

[13] *See* Brief for Petitioner Braniff Airways, Inc. at 22–25; Miller, *The* Waterman *Doctrine Revisted*, 54 Geo. L.J. 5 (1965); Hochman, *Judicial Review of Administrative Processes in Which the President Participates*, 74 Harv. L. Rev. 684 (1961).

[14] Commentators generally have agreed with the distinction drawn by the *American Airlines* case, although some have indicated that perhaps procedural due process claims should also be subject to judicial review. *See, e.g.*, Miller, *supra* note 13, at 22.

statement in his approval of the Board's order that "no defense or foreign policy considerations underlie my decision." [15] Briefly put, their contention is that this statement removes any impediment to judicial review arisng from application of the *Waterman* doctrine, since that doctrine applies only to "final orders [that] embody Presidential discretion as to political matters beyond the competence of the courts to adjudicate," 333 U.S. at 114.

The President's statement derives from Executive Order No. 11,920, 3 C.F.R. 121 (1977), which establishes executive branch procedures to facilitate presidential review of Board decisions submitted under 14 U.S.C. § 1461. Specifically, agencies are required to forward to the White House reports that "identify with particularity the defense or foreign policy implications," if any, of the Board decision under review, in order that the President might consider including in his letter of approval a disclaimer such as is presented here. 3 C.F.R. at 122. Insertion of such a disclaimer is "[f]or the purpose of assuring whatever opportunity is available under the law for judicial review." *Id.* at 123.

The executive order apparently was issued in response to growing criticism of the manner in which international route decisions were reviewed in the Executive Office of the President. Principally, critics charged that economic and political considerations of a domestic nature, often advanced in ex parte communications with members of the White House staff, had supplanted national defense and foreign policy considerations as the dominant factor in most route selection approvals, and yet application of the *Waterman* doctrine insulated the former considerations from any form of judicial review.[16]

While this court's commitment to integrity in the administrative decision-making process is unwavering,[17] we cannot endorse a remedial measure, no matter how well intentioned, that fails to give due consideration to basic constitutional principles. The procedure established in this executive order attempts to give the President power to decide which Board orders are subject to judicial review. The President, however, cannot create judicial review authority. *American Airlines, Inc. v. CAB*, 348 F.2d at 351; *accord*, *Ludecke v. Watkins*, 335 U.S. 160, 166 (1948); *see Hayburn's Case*, 2 U.S. 409, 411–12, 2 Dall. 409, 410–13 1792). As recently reemphasized by Mr. Justice Marshall in an analogous

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[15] *See* note 6 *supra*, and accompanying text. The Board has expressed no view on this contention. *See* Brief for Respondent at 15–16 n.19.

[16] Whitney, *Integrity of Agency Judicial Process Under the Federal Aviation Act: The Special Problem Posed by International Airlines Route Awards*, 14 Wm. & Mary L. Rev. 787, 796–801 & n.62 (1973); Note, *Section 801 of the Federal Aviation Act—The President & the Award of International Air Routes to Domestic Carriers: A Proposal for Change*, 45 N.Y.U.L. Rev. 517, 523, 527–33 (1970); *see* Aviation Consumer Action Project v. CAB, 412 F. Supp. 1028 1031 & n.4 (D.D.C. 1976).

[17] We have previously noted the obvious contribution toward this goal of other provisions of Executive Order No. 11,920, which should mollify, to a considerable degree, those critics concerned about improper ex parte communications:

Sec. 4. Individuals within the Executive Office of the President shall follow a policy of (a) refusing to discuss matters relating to the disposition of a case subject to the approval of the President under section 801 with any interested private party, or an attorney or agent for any such party, prior to the President's decision, and (b) referring any written communication from an interested private party, or an attorney or agent for any such party, to the appropriate department or agency outside of the Executive Office of the President. Exceptions to this policy may only be made when the head of an appropriate department or agency outside of the Executive Office of the President personally finds that direct written or oral communication between a private party and a person within the Executive Office of the President is needed for reasons of defense or foreign policy.

Sec. 5. Departments and agencies outside of the Executive Office of the President which regularly make recommendations to the President in connection with the Presidential review pursuant to section 801 shall . . .

(a) establish public dockets for all written communications (other than those requiring confidential treatment for defense or foreign policy reasons) between their officers and employees and private parties in connection with the preparation of such recommendations; and

(b) prescribe such other procedures governing oral and written communications as they deem appropriate.

3 C.F.R. 121, 123 (1977); *see* Home Box Office, Inc. v. FCC, 567 F.2d 9, 56–57 (D.C. Cir.) (per curiam), *cert. denied*, 434 U.S. 829 (1977).

setting,[18] "the task of defining the role of the Judiciary is for this Court, and not the Executive Branch." *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 683, 725 (1976) (Marshall, J., dissenting). If we were to permit the President to determine the appropriateness of judicial review, we would abdicate our constitutional function, and contribute to politicization of the Judiciary. *See First National City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 790 (1972) (Brennan, Jr., dissenting). Further, because any judicial decision on the merits that resulted in a remand to the Board for further proceedings would, in course, be presented once again to the President for approval, the initial decision by the court of appeals would be impermissibly advisory in nature. *Hayburn's Case*, 2 U.S. at 411, 2 Dall. at 411; *accord*, *McGrath v. Kristensen*, 340 P.S. 162, 167–68 & n.6 (1950) *see Glidden Co. v. Zdanok*, 370 U.S. 530, 582 (1962) (principal opinion) (Harlan, J.)[19]

J.A. at 961, 962 (emphasis added). Thus, because he is not required to include a disclaimer in all cases not involving foreign policy considerations, the President has not bound himself to adhere to the spirit of the procedure. As a result, whatever potential now exists for political abuse of the *Waterman* doctrine would appear to remain.

Similarly, we express some degree of skepticism concerning whether the award of an international air route could ever be entirely free of foreign policy and defense considerations. Indeed, after stating in his letter of approval that such considerations were not present in this case, President Ford continued:

I note that by the terms of the May 8, 1974, air services agreement with Canada, United States flag service in the Chicago-Montreal market could have begun on April 25, 1976. Yet the Board did not complete its carrier selection until this month.

The United States' public interests are not served when foreign governments gain valuable traffic rights for their carriers in exchange for rights for United States carriers that either are not operated or are uneconomic. I appreciate the Boad's responsibility to weigh the public service and economic viability considerations in its proceedings. At the same time, the public deserves the benefits that warranted new routes can provide, and United States carriers deserve timely hearing of their route applications.

Foreign governments evidence no reluctance to designate their carriers to serve new routes. As a result, foreign carriers often enjoy negotiated route benefits before United States carriers, even though our international agreements are drawn to provide a balance of competitive opportunity.

Accordingly, I request that the Board act promptly on the further route cases implementing the May 8, 1974, agreement with Canada. *Id.* at 50.

Implicit in these sentiments is the notion that general foreign policy considerations, including balance of both payments and competitive opportunity, are at play to at least some degree during each of the stages leading to the ultimate award: negotiations with the foreign country; proceedings before the Board; and consideration by the President. A variation of this theme was echoed by President Carter in a letter to the Board Chairman, dated April 22, 1977, concerning cargo rate proposals by domestic and foreign carriers:

> As you know, one of this Administration's key objectives in the field of aviation is the encouragement of price competition among carriers, a policy which will yield substantial benefit to consumers. While special circumstances sometimes exist with respect to the international aviation environment, encouraging such competition is also an important element of our foreign economic policy.

Id. at 968; *see* Washington Post, May 22, 1978, § D, at 10, col. 6.

Finally, one must not lose sight of the fact that the President's special authority in the award of international air routes is "exercised pursuant to statute; i.e.

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[18] In his dissenting opinion in Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 724–25 (1976), Justice Marshall called attention to the fact that the applicability of the so-called *Bernstein* exception to the act of state doctrine, a doctrine that immunizes foreign governments from suits based on public acts performed in their own territory, had been rejected by six members of the Court in First Nat'l City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 772–73, 776–77 (1972). The *Bernstein* exception, which stems from the case of Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij, 210 F.2d 375 (2d Cir. 1954) (per curiam), would allow the Executive to advise a court whether declining to apply the act of state doctrine in a particular case would adversely affect the conduct of foreign policy. If no such adverse effect or embarrassment would result, the theory goes, then the court would be free to review the case.

[19] *But see* Hochman, *supra* note 13, at 706–07 & n.76; 3 K. Davis, Administrative Law Treatise § 20.05, at 84–85 (1958).

by the will of Congress," *United States v. American Telephone & Telegraph Co.*, 551 F.2d 384, 392 (D.C. Cir. 1976). Thus, even though the President may believe that no defense or foreign policy considerations are present, then Congress may have exactly the opposite view.

III

We hold, therefore, that because these petitions challenge only the merits of the decision underlying the order of the Board that was approved by the President, and not the Board's authority to issue such an order, judicial review is precluded by application of the *Waterman* doctrine.[20] The motion to dismiss is granted, and the petitions for review are dismissed.

So ordered.

The CHAIRMAN. Mr. Arthur Frommer, president, Arthur Frommer International, on behalf of the U.S. Tour Operators.

STATEMENT OF ARTHUR FROMMER, MEMBER, LEGAL AND GOVERNMENTAL AFFAIRS COMMITTEE, U.S. TOUR OPERATORS ASSOCIATION; ACCOMPANIED BY CHARLES MORIN; AND RICHARD LITTELL, COUNSEL

Mr. MORIN. Mr. Chairman, with your permission, if I might make a brief statement.

I'm Charles Morin, and I'm here with the U.S. Tour Operators Association. I appeare dhere with Mr. Frommer, Mr. Chairman, something more than a year ago. We appeared for the first time. Mr. Frommer, I think, can be directly described as one of the pioneers in the United States for low-cost air transportation.

I pointed out last year that he was the author of the famous book, "Europe on $5 a Day," which was amended last year to "$10 a Day." He now has his own publishing company.

The CHAIRMAN. What is the latest amendment to that?

Mr. MORIN. Europe on $15 a day, with a table in the back for conversion as the dollar moves upward and downward.

Last year I think that we were helpful in persuading the committee that the independent tour operator was a vital force in providing affordable air travel vacations for millions of Americans, and I think the committee and the U.S. Senate agree.

This bill and its provisions demonstrate to us what is an alarming change in this policy, and Mr. Frommer, who is also perhaps the dean of tour operators in the United States, is here to explain to the committee why, Mr. Chairman.

Mr. FROMMER. Thank you, Mr. Chairman.

Mr. Chairman, the members of the U.S. Tour Operators Association consist of 25 large and well-established tour operators who each year account for many hundreds of thousands of international tour passengers.

I don't think it immodest of me if I were to say that many of the major innovations in tour packaging and most of the breakthroughs in the reduction of the cost of international holidays have come about as a result of our efforts.

We were operating low-cost tours internationally and especially low-cost charter tours long before the airlines began emulating our policies

[20] Although American's pleading was styled as a motion to dismiss for lack of jurisdiction, we base our holding on the fact that the orders are nonreviewable. *See* Barlow v. Collins, 397 U.S. 159, 171 n.3 (1970).

this year. And I do not think it is in the public interest that we be eliminated and replaced by large airline bureaucracies, as we think section 3 of the proposed bill would most assuredly do—as I shall now try to demonstrate.

In doing so, because I only have 10 minutes, I shall try to extemporize largely the highlights of the written testimony that we would like to file with this committee.

We begin with the fact that the number of planes available for charter use internationally has already been sharply reduced by developments in scheduled transportation and will be even further reduced when the supplemental carriers receive schedule rights. To reduce that dwindling supply by a further 40 percent, as section 3 of the proposed bill would do, is literally to sound a death knell for 300 small and medium, independent charter tour operators.

Already many of these operators have found it is extremely difficult to find charter equipment nowadays for viable low-cost programs of the sort that is so eagerly sought by the public.

This bill, or section 3 of this bill, would inevitably freeze out hundreds of such low-cost programs and assign the limited charter capacity to a few standard tours operating by the airlines themselves or by a few large tour-operating giants such as American Express, and thus the bill ironically would wipe out the only real competition that exists today in the holiday tour industry, for it is the existence of several hundred independent tour operators who are mainly small- and medium-sized companies in violent competition with one another that provides an almost classic form of free competition in travel today.

Section 3 of the bill, as I have said, would replace 300 companies with a dozen airlines, but it would do even worse.

Since most airlines, even charter airlines, tend to specialize in certain destinations, it would mean that most international destinations would now be serviced by only one or two charter programs in place of the many competitive programs now available. We would thus reach the sorry state which I described in my testimony last year, the state already attained in several European countries in which the consumer finds as he enters the travel agency one catalog of airline-sponsored charter tours, one only from which to make his or her vacation choice.

Mr. Seawell this morning described the policies of KLM in Holland. KLM now owns what is, for all intents and purposes, the only major tour operator, and when a Dutch consumer walks into a charter—into a travel agency, he finds one catalog providing him with his vacation choices.

Even with respect to the fortunate tour operators who might attain the remaining 60 percent of small charter capacity available to them under this act, I, for one, do not see how they would be able to compete against the 40 percent of airline-sponsored tours.

Inevitably, these tour operators will be consigned to the droppings from the airlines tables. The airlines themselves will inevitably assign to themselves the best departure dates and the best equipment. They will be entitled, as I am sure they are entitled legally under the law, to give themselves preferential charter rates by filing with the CAB special tariff filings for their own programs of the sort that they now file for certain large charter programs.

Even if the operators of the remaining 60 percent share receive the good weekend dates, the freedom from cancellation penalties, or the preferential charter prices that the airlines will assign to themselves, they could not hope to match the lavish marketing expenditures of the airlines in promoting tours.

All experience has shown that in the operation of in-house airline tours using scheduled transportation, normal business considerations are thrown to the wind, and the large organizations take over. Millions of dollars are spent by the airlines on tour programs that could not possibly provide the same millions of dollars of income. The brochures as lavish as a Christmas gift book, sometimes costing $2 a copy, are produced, overwhelming the product of independent tour operators, even if the independent product is a superior product.

This is not, in our view, competition. It is the purchase of tour markets by airlines and by airline bureaucracies who are not seeking to follow the most viable business course but to expand the scope of their own responsibilities and to increase their own career opportunities.

And when the independent tour operator is destroyed by such policies, competition ends, and the public suffers.

Mr. Chairman, section 3 of this bill thus achieves the exact opposite of the goals for which the bill was designed. In the preamble to the bill the bill states that its goal is to avoid undue industry concentration, excessive market domination, monopoly power, and other conditions that allow one or more carriers to increase prices, reduce services, or exclude competition. And by eliminating the one truly free market of competition that now exists in international travel, section 3 defeats the purposes for which the many other excellent sections of the bill have been drafted.

It also achieves the exact opposite of what this subcommittee attempted to achieve just a few months ago when it inserted a provision into the Aviation Reform Act of 1978 that would prevent the vertical integration of airlines into tours, and if I may read from that provision—just 6 or 7 months ago the subcommittee drafted a bill which contains a section reading:

"It shall be unlawful for any air carrier or foreign air carrier directly engaged in the operation of aircraft to be engaged in or be controlled by or be under common control with any person engaged in selling or organizing charter trips in interstate or overseas air transportation."

We are unaware of any new arguments that have been advanced to justify such a sharp reversal of policy.

Now, all of us have heard the arguments educed by the several airlines who wish to vertically integrate. Many of them talk about controlling their own destiny. They complain about creating a product and then not being able to sell it. They express unhappiness about having to deal in the hurly-burly world of several hundred tour operators. They complain about us, that we run from one to another, that we set one of them against another, that we negotiate and bargain, that we seek the lower price. What they are describing, of course, is the free enterprise system. They are unhappy about having to deal with the free marketplace of buyers that tour operators presently represent.

Mr. Chairman, all would-be monopolists want to control their own destiny or market their own product, but when there are industries that are inherently monopolistic or oligopolistic—and I would point out that in a recent speech Dr. Kahn even admitted that the airline industry is inherently oligopolistic—in such industries we respectfully submit that it is wise policy to maintain a free market by prohibiting vertical integration.

We respectfully further submit that section 3 therefore, is foreign to an otherwise excellent bill.

Mr. Chairman, you may also recall that in previous testimony about a year ago several of the supplemental airlines stated that dealing with tour operators in the United States was not a great problem and that they were more concerned with the necessity to vertically integrate in their foreign-originating tour product.

When the U.S. tour operators said at that time that we had no objection to their imitating what we considered to be the evil and monopolistic practices, especially of the European countries' carriers, rather, in their own countries where such vertical integration has become a standard thing—but we do not believe that any of us should import these practices into the United States. The prohibition of vertical integration by airlines into tours has created one of the most classically free marketplaces of competitive companies that exist in any industry in the United States today.

We believe that the public has benefited from this competition by enjoying the finest values and the most innovative and exciting products of any that are now being marketed by any travel industry.

We also believe that the intercontinental charter products that are not being offered to American consumers are far superior in value and variety to the intercontinental products offered to European consumers in their own countries where a sharply different philosophy prevails.

Mr. Chairman, we are very grateful for this opportunity to present these views again to you.

The CHAIRMAN. Thank you very much, Mr. Frommer and Mr. Morin.

Yesterday we heard much the same thing from the Air Charter Tour Operators of America. As I told them, we certainly have no vendetta against charter tour operators or anyone else. Ironically, we have been criticized by others for having created special interest legislation, not for the supplementals, but for the charter tour operators by guaranteeing them 60 percent of the charter business.

Now at the outset, I want to correct one misinterpretation of this bill. It is not my intent that the authority to sell charter trips directly to the public extend beyond the air transportation portion of the trip. And if an inclusive tour is involved, the tour operator would have to be used for the land portion of that trip.

So your worry about the low cost prices, I would think, should be alleviated. If we maintain that section, we would certainly make that perfectly clear.

And secondly, I would like to point out that many of your arguments against section 3 seem to me to be good arguments as to why it would not make any difference if we allowed 100 percent direct ticketing, if you are correct that in truth, that the proposed rule would threaten the financial stability of the supplemental airlines and they

would certainly be foolish to do anything differently than they are doing today; namely, the using of the tour operators exclusively.

We heard Mr. Boros speak yesterday of the charter bus companies that use indirect carriers almost exclusively rather than organizing their own charter tours. That leads me to believe that the supplementals would probably choose to continue to operate as wholesalers rather than retailers.

Furthermore, even if this doesn't happen, the direct carriers have a very large stake in maintaining a viable tour operator industry, since, at a bare minimum, 60 percent of their business would have to be conducted with the indirect operators.

Now let me make a few points here for the record. You state that tour operators are the aviation industry's only true bastion of free enterprise. I think that is maybe a little overstated. I'm sure that the air freight forwarders, the travel agents, and especially, the commuter airlines, would challenge that assertion. And apparently, you have not heard of Fred Smith of Federal Express, either. So I think that that is maybe a little bit of an overstatement.

I'm curious about one discrepancy between your testimony and that of Mr. Boros.

He indicated that there are 800 independent tour operators and you've indicated there are 300. Is there some dispute as to how you calculate these numbers?

Mr. FROMMER. I was referring to the companies that frequently and habitually operate tours. There are a great many people who do it on an ad hoc basis.

The CHAIRMAN. So the 800 people would be people who may, on occasion, organize a tour.

Mr. FROMMER. Yes.

The CHAIRMAN. Why is there a difference? There are two organizations here. It seems to me their interests are almost identical.

Mr. FROMMER. We don't think they are identical. The Air Charter Tour Operators Association consists of companies who are only engaged in the chartering of aircraft. Our organization operates tours using scheduled flights as well as charter flights and has, we believe, broader interest than those of the charter industry.

Mr. Chairman, you made several points in your statement that I would like an opportunity to comment on.

The CHAIRMAN. Certainly.

Mr. FROMMER. First, I don't find the language of this provision of section 3 limiting the effect of this bill simply to the sale of seats on charter flights and continuing the prohibition against the sale of inclusive tours.

The CHAIRMAN. Well, if that is not clear and we develop this legislation, we would certainly clarify that point.

Mr. FROMMER. Even if it were to be limited to the sale of seats on inclusive tours, I still don't think it would meet the problem, because all of the scheduled airlines in the United States, or most of them, maintain in-house airline tour operations or controlled tour operators whom they could easily use to create land tours in association with their own sale of charter seats.

Their ability to sell charter seats directly to the public to assign to themselves preferential dates, preferential prices, and to give them-

selves preferential rates for those charter seats permit them, in association with their own in-house tour operation or with affiliated tour operators, to gain a major advantage over the truly independent tour operator that our association represents.

The situation prior to this bill is that 100 percent of all charters must be sold by independent touring operators. Because of Federal legislation and because of CAB regulations, no charters may now be sold directly to the public by direct air carrier. And we feel that by permitting the airlines to come in with 40 percent is to reduce dangerously the remaining equipment and the remaining planes available to the rest of us.

We feel also that normal business considerations will not govern the operation of these 40 percent of flights because if the airlines were to operate logically, they would today not be operating in-house.

Airline after airline today loses millions and millions of dollars, and we foresee the inevitable appearance of these airlines before you in a few years as to take over the remaining 60 percent.

We do not see how any tour operators can compete against the large and massive organizations that airlines represent, and we believe that the airlines will be able simply to sell off that remaining 60 percent for the standard, stable tours that are operated, whatever the price situation or regulatory situation is, but that they will take to themselves the 40 percent of tours that would have otherwise been operated under conditions of intense competition and innovatively, by the independent tour operators.

We have taken the lead in every progressive step that has occurred in this vacation industry, and we have then only been imitated belatedly by the airlines.

We think it is a terribly dangerous step and not in the public interest to give to them this 40-percent share, which we believe will immensely cut down the travel opportunities available to the American public.

The CHAIRMAN. I know of no other industry where the Federal Government prohibits by law that industry from selling its own product.

Can you tell me why this industry is so completely unique in the entire U.S. economy?

Mr. FRAMMER. We feel it should be unique because of the fact that it is inherently a monopolistic industry. We feel that regardless of the deregulation that now comes about, that eventually, the situation will settle down in such a way that, to most international destinations, there will only be two or three carriers at the most; even today, with the Government of Holland permitting free entry into their country, with various supplementals having received the right to operate schedule transportation into Holland, there is no one who plans this winter to operate flights into Amsterdam.

And that means that for all intents and purposes, the American public has one means of flying to a city such as Amsterdam, which is to go on KLM.

Imagine if, in addition, KLM had then the right to sell directly 40 percent of its own charter capacity in the United States directly to the public.

Competition to that gateway would be eliminated.

We feel that this will then happen to every gateway in Europe to which, at best, there will be a foreign-flag carrier controlling 70 or 80 percent of the capacity and a very small competitive response by other airlines.

National, or rather Northwest Orient, which was given the right to service Scandinavia, has announced that it is not going to start its service until next April. We now have available to the American public this year one carrier on which you can fly in wintertime to Scandinavia.

I am making this point to underline our feeling that the airline industry is a unique industry, and that it is inherently oligopolistic, and therefore, that to permit these airlines to vertically integrate to create a monopoly to their destinations.

Mr. MORIN. Mr. Chairman, may I add something?

The CHAIRMAN. Counsel has a question.

Mr. BARCLAY. Mr. Frommer, your analogy would belie the fact that we have a very successful freight forwarder business and travel agent business in this country, and yet, air carriers can sell directly to the public for scheduled services.

Why do you believe that charter air transportation is so much different from the scheduled air transportation business?

Mr. FROMMER. The charter is different in many ways. It has a totally different history and it serves a totally different economic function.

The charter is a plane taken over by a risktaking entrepreneur who lowers his prices drastically because he seeks to enjoy a load factor radically different from what is normally enjoyed on scheduled services.

The moment airlines begin operating charters like scheduled flights, they must necessarily anticipate that they will enjoy a much lower load factor, and the price of those flights will go up.

Now, you have in the United States today hundreds of people who, wisely or foolishly, are willing to take the risk of chartering, and to go out to the public based on prices that require 89 percent load factors, 92 percent load factors, load factors that scheduled airlines would never dream of tolerating.

The result of those entrepreneurs taking those risks, intensively marketing their products to the public, independent of the imperatives of large organizations, has been that the public has enjoyed the advantages of the airplane.

The charter represents the single most rational use that can be made of an airplane.

The scheduled airlines have never been able to offer prices as low as charter prices. The deeply discounted fares across the Atlantic this summer, which have destroyed so many hundreds of thousands of charter opportunities for Americans, have been priced at $50 or $60 a seat more than the charter seats that they eliminated.

So I simply want to make the point that the charter is a different animal. It is an enclave in the travel industry, and it is one that has provided low-cost transportation to the public in a way that scheduled carriers, by their very nature, cannot provide.

And we have had a price war that has broken out in the last year that seems to have cast doubt on the validity of the charter mode.

All of us feel that that price war is a temporary phenomenon.

Already Pan Am, TWA, and British Airways are asking to increase their rates starting this winter.

We feel that it is a good thing that the charters should be treated separately, that it should be to a certain extent, protected, but that most importantly, it should be sold by hundreds and hundreds of small- and medium-sized independent business and not by one or two airlines.

Mr. MORIN. I would like to add to your earlier question. I think the airlines product is air travel. And with the coming into existence of large-scale air travel, a whole new industry was developed by these entrepreneurs, the small businessmen, private businessmen who bought other products, hotel products, ground transportation products, entertainment products, and added them to the airlines products.

And the CAB and the Congress of the United States, I think, has, up until now, at least, found it to be in the public interest to foster that industry. And I think it goes beyond the airline selling its own product if the airlines now get into the business of selling those other products, which this industry has traditionally sold.

The CHAIRMAN. I think one of the problems most recently has been that airlines in some instances have not been able to find someone willing to take the risk.

Now, do you think that they should be required to keep the airplane on the ground if they can't find an operator that is willing to assume that risk?

Mr. FROMMER. Mr. Chairman, I've heard that stated by them and, very frankly, I question their ability to sell seats on the plane to the public if we tour operators cannot sell the same seats to the public.

If we have to cancel our flights this summer because scheduled fares came on to the market, undercutting the attractiveness of a charter, there is no supplemental airline in existence that is going to be able to succeed where we failed.

Now, if you say that they will then proceed to operate at under cost and at a loss where we would not do so, well, that very well may be, but that is not an attractive goal to be pursued.

And I would also point out that we are talking now not only about supplemental carriers, but this bill gives this right to sell to the public to scheduled carriers as well.

There are many industries in which method of sale is through wholesalers and where one does not bypass——

The CHAIRMAN. Not by Government fiat, though.

Mr. FROMMER. No; not by Government fiat, but here we're dealing with an industry that hitherto has been regulated and where a major charter industry has grown up as a result. But we don't cancel flights because we want to. We don't fail to accept charter equipment for frivolous reasons.

If tour operators are unwilling to take the risk of chartering a particular plane, it is because they have a reason for doing so. And none of the supplementals would have done any better than we did this summer.

You will hear testimony later today from foreign carriers who are now operating scheduled flights in the guise of charters.

They are saying that they are taking the risk, that they're transferring the risk from the charter operator to themselves. And so they

schedule a charter flight every Friday, Saturday, and Sunday, and then they sell individual seats on those charters to affiliated tour operators.

The moment that becomes the pattern of transportation, where the risk is transferred from the entrepreneur to the airline, the cost of air transportation will inevitably increase.

There is no airline that can consistently operate at the same high-load factors that independent tour operators use as the basis for their pricing.

The CHAIRMAN. Well, thank you very much, Mr. Frommer and Mr. Morin.

[The full statement follows:]

STATEMENT OF ARTHUR FROMMER, MEMBER, LEGAL AND GOVERNMENTAL AFFAIRS COMMITTEE, U.S. TOUR OPERATORS ASSOCIATION

Mr. Chairman and members of the subcommittee, my name is Arthur Frommer. I am representing the United States Tour Operators Association. The Association's active membership consists of 25 independent tour wholesalers who sell charters and other tour-based forms of air transportation. The Association's aviation counsel, Charles Morin and Richard Littell, are accompanying me.

A. SUMMARY

I am here today in order to express our opposition to Section 3 of Senate Bill 3363. That provision would enable airlines, for the first time, to organize and sell charters directly to individual passengers.

This change would have very anticompetitive consequences. It would sound the death knell for many of the nearly 300 independent tour operators who comprise the aviation industry's purest and most innovative competitive force. That a bill entitled as a "Competition Act" should contain such an anticompetitive provision is ironic.

Senate Bill 3363 proposes a giant step backward from the Aviation Reform Act which the Senate passed by an 83–9 vote last April. In drafting that bill, this Committee overrode the airlines' arguments and made it unlawful for airlines to control a tour operator which markets charters originating in the United States. The bill before you now would overrule the Senate Reform Bill, with tragic results.

Mr. Chairman, USTOA recognizes that you and Senator Pearson have contributed greatly to the growth of charter and other low-cost air tours. We don't doubt that Section 3 of Senate Bill 3363 was motivated by the best of intentions. If this Subcommittee wants to aid supplemental airlines, it can do so in many ways. But there is no need to destroy independent tour operators. And, although we assume that the bill's 40 per cent limitation on airline sales was designed to help protect tour operators, it is not a practical solution.

B. INDEPENDENT TOUR OPERATORS ARE INSTRUMENTAL IN PROMOTING LOW-COST, INNOVATIVE AIR TRAVEL

I cannot emphasize too strongly that I favor more competition, not less. Today, nearly 300 independent tour operators throughout the United States provide charter and other air tours, many to foreign destinations. Most tour operators are medium-sized or small businessmen.

These tour operators are the aviation industry's only true bastion of free enterprise. They compete with each other as to both price and the composition of holiday packages.

So long as this competition continues, tour operators and airlines must offer charters and tours at the lowest possible prices. The consumer gets the best bargain that competition can provide.

This competitive system is among the great glories of American commerce. Our industry today is providing values to the traveling public that no other industry in the United States can rival. Consumers win because independent tour operators have achieved a level of efficiency and frugality that no airlines can match.

C. IF THE AIRLINES ARE ALLOWED TO OVERTURN PRESENT LAW, THEIR PREDATORY TACTICS WILL SQUEEZE OUT INDEPENDENT TOUR OPERATORS

Under current rules, only independent tour operators can sell charters to the public. But the airlines yearn to encroach on the tour operators' share of charter vacation packaging and merchandising. Thus, they want to set up their own "in-house" tour subsidiaries or, as Senate Bill 3363 would permit, sell directly to the public. The airlines' goal is to replace the many with the few, to substitute airline-controlled tour operations for the present marketplace of competition.

I have attached to my testimony our lawyers' memorandum explaining how current legal rules forbid airlines from selling charters to the public. Earlier this year this Committee codified these pro-competitive rules in the Cannon-Kennedy-Pearson Air Transportation Act of 1978 (S. 2493).

These rules against vertical integration protect competition, not competitors. There is simply no way that independent tour operators can compete with airline "inhouse" tours. One reason is that airlines can price their tours at below-cost prices. Once airlines begin selling air charters and land tours combined, they have carte blanche to use air fares to subsidize the land arrangements.

The airlines would probably try to tell you that they can make a profit on their "in-house" tour operations. This claim is disproved by the scheduled airlines' experience in selling land tours in connection with individually-ticketed flights. Actually, when an airline sells both air tickets and land arrangements, whether it shows a profit depends upon how it allocates costs between the two businesses—or whether it fairly allocates costs at all.

The unpleasant fact is that, for non-charter tours, airlines already slough off many of their tour costs without charging a penny to their "in-house" tour departments. Instead, these airlines use general corporate budgets to conceal massive T.V. and magazine promotion of tour packages. Tour operations are never charged for the expense of tour brochures which are as lavish as a Christmas gift book—brochures which cost up to $2 a copy and are given away by the hundreds of thousands.

Other examples abound. In all, the airlines' noncharter tour marketing programs are a story of expenditures that would stagger a Middle Eastern sheikdom. Now the airlines want to extend these pernicious practices to charters. No independent tour operator can dream of matching the huge subsidies with which airlines will finance their "in-house" charter tour departments.

In addition, airlines have a host of unfair advantages in marketing tours. For example, as the CAB has found, airlines can prefer their "in-house" tour units in providing aircraft capacity which might be in short supply. The CAB also found that airlines can gear their schedules specifically to accommodate tours organized by an affiliated tour operation. Both these anti-competitive practices are likely where airlines operate, and can favor, their "in-house" tours.

The Senate Aviation Reform bill recognized that the best way to prevent these predatory tactics is to prohibit "in-house" airline charters entirely.

D. ALTHOUGH ALLOWING AIRLINES TO SELL CHARTERS WILL NOT AID SUPPLEMENTAL AIRLINES, THE BILL'S PERCENTAGE LIMITATIONS ARE INEFFECTIVE TO PROTECT TOUR OPERATORS

I am skeptical about any claim that airlines will be better off if they can package and market their own charter tours. During hearings before this Subcommittee last year. World Airlines' counsel acknowledged that his airline's greatest problem was with European-originating tours, and that World's problem in the United States "is not great".[1] Knowing World's position, USTOA and I advocated legislation which would prohibit vertical integration only for U.S.—originating tours.[2] In the Aviation Reform Bill, the Subcommittee followed this approach. The CAB has since authorized World and others to organize and market their own European-originating tours.

Time has proved that the supplemental airlines were overly optimistic about the benefits of vertical integration in Europe. Their proposals for vertical integration of United States-originating charters are even less credible.

In truth, the supplemental airlines' present proposals for vertical integration

[1] Hearings Before the Senate Aviation Subcommittee, on S. 292 and S. 689, Part III, 95th Cong., 1st sess., page 1551 (April 6, 1977).
[2] Hearings cited in note 1, at page 1605.

threaten their own financial stability. Under present rules the independent tour operator guarantees the airlines' plane-load revenues. If airlines are allowed to acquire tour operators, they will inherit risks of load-factor which have made scheduled services financially vulnerable. They thus expose themselves to the threat of business failures which, in the 1960's, plagued British charter airlines with tour operator affiliates.

Indeed, Northwest Airlines vehemently opposes "in-house" airline tours, stressing that they permit airlines to sell below cost. Northwest's view is that "no legitimate independent tour operatour could survive against the many advantages available to an air carrier in-house tour, or carrier controlled, subsidiary tour operation." [3]

Nor will Senate Bill 3363's percentage limitation of airline-operated charter tours protect most independent tour operators. Once airlines begin to organize and market their own tours, there is no practical way that smaller, independent tour operators can survive in order to claim a 90 percent, 75 percent, or even 40 percent market share. Earlier, I mentioned how airlines can overwhelm smaller tour operators by means of lavish advertising, below-cost pricing, and other predatory practices. Only a few large tour operators, if any, could weather these tactics and operate the non-airline-marketed tours which Senate Bill 3363 contemplates will continue.

In sum, if the Senate forsakes the Aviation Reform Bill's approach in favor of that contained in Senate Bill 3363, the independent tour operator industry will cease to exist as we know it now.

Mr. Chairman, I recall this Subcommittee's marvelous record of encouraging charter competition. During the 90th Congress this Subcommittee led the fight to preserve low-cost charters against the scheduled airlines' attempts to dominate the fledgling inclusive tour industry. That legislative struggle created the very statutory prohibition against vertical integration which Senate Bill 3363 is designed to change. Although the gladiators have changed somewhat, the battle is still over the same basic issue: Competition in the charter industry. This Subcommittee has always favored the solution which produces lower air fares for consumers. I am confident that you will be guided by the same objectives in this instance.

Thank you.

LEGAL MEMORANDUM ON RULES WHICH PROHIBIT AIRLINES FROM ORGANIZING AND SELLING CHARTERS DIRECTLY TO THE PUBLIC

Section 101(36) of the Federal Aviation Act now provides that supplemental airlines may not sell inclusive tour charters to the public directly, or indirectly through an affiliate. Although the statute speaks only about supplemental airlines, the CAB extends the prohibition to scheduled airlines, as well. Thus, in 1966, when the CAB inaugurated the Inclusive Tour Charters, the CAB expressly banned any airline-marketed or airline-controlled tour operations:

"As originally adopted, part 378 would preclude supplemental air carriers from acting as tour operators. We are expanding this provision to cover all direct air carriers (see Sec. 378.2(d)). It should also be noted that control relationships between air carriers and tour operators are prohibited by Section 408 of the Act in the absence of Board approval" (*see Sec. 378.3*). *Supplemental Air Service Proceeding*, 44 C.A.B. 396, 400, n. 12 (1966).

In later decisions, the CAB explained that its policy was designed to prevent unfair competition and discrimination. *Reopened Transamerica Corp. and Trans-International Airlines*, Order 71–7–119 (July 21, 1971). *aff'd sub nom. Foreign Study League* v. *CAB*, 475 F.2d 865 (10 Cir. 1973).

More recently, in 1977, the CAB reiterated that it follows a uniform "policy of precluding affiliation relationships between charter tour organizers and U.S. direct air carriers . . ." *Kuoni Travel Limited (Switzerland)*, Order 77–2–53, page 2. Indeed, the CAB had said earlier, if airlines acquire their own "in-house" charter tour operators:

"[T]he charter organizing industry in the United States would probably become dominated by tour operators affiliated with direct air carriers. Independent tour operators, to the extent that they might be able to survive at all, would be operating at a severe competitive disadvantage. The public would, as a re-

[3] Hearings cited in note 1, at pages 1605–1606.

sult, be practically restricted to tour organizers whose primary interest would be directed toward facilitating the operations of their direct air carrier affiliate, rather than providing charter tours which best meet the needs and convenience of the public. Such a threat to the independence of the tour organizing industry in the United States could not be considered to be consistent with the public interest." *Kuoni Travel Limited (Switzerland)*, Order 76–6–135 (p. 5)

The CAB explained in *Kuoni* that it opposed vertical integration because of its anti-competitive consequences. Thus, the CAB pointed out, airlines can prefer their "in-house" tour units in providing aircraft capacity which might be in short supply. The CAB also was concerned that airlines can gear their schedules specifically to accommodate tours organized by an affiliated tour operation. Other tribunals have also found that an airline can use air fares to subsidize the land arrangements. See *Foremost Int. Tours* v. *Qantas Airways Ltd.*, 379 F. Supp. 88 (D. Hawaii 1974), *aff'd.* 525 F.2d 281 (9 Cir. 1975). These anti-competitive practices are likely where airlines operate, and can favor, their "in-house" tours.

The CHAIRMAN. Mr. Cornish Hitchcock, counsel, Aviation Consumer Action Project.

STATEMENT OF CORNISH F. HITCHCOCK, ATTORNEY, AVIATION CONSUMER ACTION PROJECT; ACCOMPANIED BY JOHN SIMS, LEGAL DIRECTOR

Mr. HITCHCOCK. Good morning, Mr. Chairman.

On behalf of the Aviation Consumer Action Project, we appreciate the opportunity to be here and to testify this morning. Let me introduce at the outset Mr. John Sims, who is our legal director.

We have submitted already our prepared statement, which we request be included in the record, and we will briefly summarize some of the major points we are making on S. 3363.

In addition, we will comment on the open skies policy which you requested the witnesses to address in your opening remarks on Tuesday.

S. 3363 contains a number of provisions that we think would be beneficial to consumers and would make international air travel more available to more people from more cities with more options and at lower cost.

Turning to the particular provisions of the bill, we agree with section 2's emphasis on safety, the reaffirmation on competition as the best way of meeting consumer needs, and the necessity of protecting travelers from unfair and deceptive practices.

We think it's important that these be spelled out up front in section 102 of the bill.

The last two policy points, subsections 4 and 5, we think should be modified to emphasize evenhanded treatment of all carriers in Board proceedings, not preference for a certain type of foreign carrier in obtaining a permit, nor a preference for one single type of airline which is seeking new domestic route authority, but an equal opportunity for all carriers to compete for international authority as well as domestic trips.

Section 7 of your bill contains a very useful proposal. We wholeheartedly endorse the suggestion of ringing down the curtain on IATA pricefixing, which we think has victimized consumers with exorbitant prices and an absurdly complex structure of discount fares.

The global aviation network that exists today is far different than the circumstances of 1946, when the CAB said it would rubberstamp IATA agreements because it had no alternative.

Consumers don't really need to be as subjected to pricefixing, which keeps fares artificially high, or any capacity agreements which are useful in filling up planes but don't give passengers a break on the price.

As you are aware, the CAB has begun an intensive re-examination of this whole IATA system, and IATA itself has been doing some soul searching on the question of its future.

We think, however, the committee should press forward with legislation such as section 7, which is a good piece of antitrust law, a pro-consumer bill, and also a useful sunset provision, all wrapped up in one.

As for the charter provisions, we agree with the basic thrust in those sections. We question the legislative formulation, however.

With respect to secton 3, we think that charter carriers should be able to sell directly to the public, but why stop at 40 percent, and what happens after 3 years?

Why not just untie the hands of the supplementals and let them sell all of their charters directly to the public?

This is an issue which we think Congress should look at more closely, as well as the attendant consumer protections that would be necessary and would have to be available if there were to be this kind of direct marketing.

With respect to section 4, we note that the Board may well have achieved this goal by the time S. 3363 would be signed into law. There are a number of cases pending, such as the United States-Benelux Proceeding and the Transpacific case, where supplemental carriers have applied for authority, and even domestically, I would just note from today's paper that in the *Transcontinental Case*, one supplemental carrier may now be able to fly from coast to coast with scheduled service.

That is quite a breakthrough, which we think will benefit consumers. In effect, if the CAB is going to act more quickly and let the current supplementals break into this scheduled market, we would question the need for legislation.

Section 6 we are opposed to, however. We don't think that there should be a provision saying that all schedules and all supplemental mergers are presumptively good.

Each merger ought to be taken on its own basis and the question should be, how will this merger affect competition? Will it improve the overall situation?

The question of the Presidential authority under section 801 has been touched on by a number of witnesses. We agree that the President's direct and unchecked power should be taken away, that there should be revisions which would remove this power of shuffling around carriers after the CAB has acted in its quasi-judicial role and made route awards, which are supposed to be economically justified on the basis of substantial evidence.

The abuses which this system has produced are well known. The President has other ways of making these foreign policy and national defense concerns, which are legitimate concerns of the President, known to the CAB in a particular route case. But in many instances, as President Ford pointed out in the *Chicago-Montreal* case, there are no

foreign policy considerations in who gets to fly from Chicago to Montreal.

Section 9 of the bill is a section which we think should be looked at closely, and we don't think it goes far enough to meet the real needs for protecting consumers from anticompetitive and anticonsumer agreements.

There are two key needs. On the one hand, there must be a coordinated effort by executive agencies and the CAB; guidelines must be clearly spelled out for negotiators in the Federal Aviation Act, and the leadership role of which agency is in charge should be clearly defined.

But the more important point is making these policymakers accountable to the Congress and the American public for the agreements which they sign.

The current policymaking apparatus over the last year has shown that it can work properly, according to the system which appears to be envisioned by section 802 of the current act. We really question the need for shuffling the bureaucratic functions and creating a powerful new aviation czar in the White House.

We think the State Department, which is responsible for conducting foreign policy and has negotiators and facilities around the world, is best suited for taking the lead. But it also has to work for the other agencies and the nongovernmental parties in formulating negotiating strategy.

The real issue is not who should captain the negotiating team, but how that team should be held accountable. We deal in the international aviation area with mixed issues of foreign policy as well as interstate and foreign commerce. And in the latter area, Congress has power under the Constitution.

The current practice, which has gone on for over 30 years, of concluding executive agreements which totally usurp Congress role in this area has, as then—Senator Walter Mondale wrote in 1975, "subverted the significance of the treaty ratification powers of the Constitution and "dramatically shifted" the power to the President.

This practice has gone on for a number of years. The Bermuda II agreement last year just brought the whole problem to a head in a very dramatic way.

The problem with that agreement is that Congress as an institution was totally left out of the picture. Mr. Boyd was appointed as a special negotiator on a short-term basis. There were no consultations, apparently. There were no confirmation hearings. There was no confirmation by the Senate, despite the obvious importance of his mission in negotiating a new agreement with the United Kingdom.

After Bermuda II was signed, a number of local communities and consumers around the country felt the direct impact of Bermuda II in terms of lost service, and they sought to challenge that action, saying Congress was illegally left out of the process.

Well, in response, the State Department and the Transportation Department said, "Bermuda II was the subject of appropriate consultation with Congress." And further, that the "Congress has thus far taken no formal action, demonstrating its dissatisfaction with the terms of Bermuda II or the manner of its implementation." And they said the silence is "highly significant."

Now what is the basis for this sweeping conclusion and this assertion that Congress was appropriately consulted on Bermuda II?

Well, in the papers that State and DOT filed, they stated that there were few phone calls and a few meetings with key members of Congress, including yourself, Senator. Your name was prominently mentioned in this connection.

This assertion that there was proper consultation and that there was proper review by Congress flies clearly in the face of Mr. Boyd's testimony before this subcommittee last year, where he admitted that he did not make a sufficient effort to consult Congress. He said he should have briefed you on a more timely basis and then he went ahead and signed Bermuda II, even though a number of key Members of Congress requested a delay so they could take a look at the particular pact and study its provisions.

The way to prevent this sort of thing from happening again is not to create a new bureaucracy which is just as unaccountable as the old one.

Negotiators have to be given firm statutory guidelines, but that is a first step, albeit an important one.

The real need is for Congress to reassert its authority to be consulted early on in the negotiations, have staff observers sit in on particular negotiating sessions—and I note that in the Israeli talks, there was such a staff member present, Senator—to have oversight hearings, and most importantly, ratification and full public airing of agreements which appear to be unlawful.

Oversight and review by the Congress is the best way of restoring constitutional balance, and we don't believe that the system will function smoothly or that the public will really benefit until both branches of Government perform the duties that are assigned to them in the Constitution.

Briefly, with respect to the open skies concept—let me comment on it as a package, as I think it has to be dealt with.

The concept of open skies, in terms of all the territory of the United States and all the territory of the other country being opened up to the carriers in both countries, should be accompanied by a provision which allows freedom to compete on fares, so that U.S. carriers can fly to the other country and be able to take passengers from that country back to this country, and vice versa.

That is a necessary ingredient. The other aspect of the package is multiple designation, which can really be exercised.

As a practical matter, multiple designation exists now in a number of agreements, although the language has worked better in theory than in reality. Multiple designation would provide entry for carriers when prices get too high, and this is our concern here. Once all this commotion dies down and once the current interest in international aviation drops off, the carriers may revert to their IATA heritage and raise prices again to the previous exorbitant levels. And what is the alternative if a new carrier cannot come into the market? This is an area where legislation may be needed to provide sort of an international equivalent of automatic market entry to make sure that multiple designation works in those countries.

With respect to this open skies idea, the whole thing really has to stand together as a whole. Countries may otherwise say, well, we like

the part where we get to fly to any point in the United States. We don't like the part, however, where we have to compete on price, we regard as predatory anything that hurts our carriers, and that is why we think the country of origin-type veto on pricing is essential.

If a foreign country is not ready to accept the whole concept as a package, then perhaps the negotiation ought to be approached in terms of the Dutch-type agreement.

From a consumer standpoint, an open skies policy could be beneficial if there is the dynamic of competition and the possibility for new entry, which your bill or regulatory reform would inject into the domestic market.

That is about it. Basically, consumers should have options and the availability of new service, should the demand arise.

The CHAIRMAN. Well, thank you very much for a fine statement. I am sympathetic to your proposal that would require congressional approval of bilateral agreements, especially in the wake of Bermuda II. As you know, that was one of the proposals placed before the witnesses last year in our first round of international aviation hearings.

Chairman Kahn's testimony before the subcommittee made a good point of the fact that the shear number of bilaterals that the Congress would be required to examine and approve or reject would create an excessively cumbersome process.

One of the recommendations we heard was to establish a special counsel or a special office to handle these bilaterals and set out the guidelines for negotiations, which must be followed by the interagency office. Now this is exactly what S. 3363 does, and very few of the witnesses we heard now support the Office of International Aviation and Negotiations created by section 9 of the bill.

In light of your opposition to section 9 and the realities of the limits of congressional review, do you have any other suggestions as to how the bilateral negotiations process should be handled?

Mr. HITCHCOCK. Well, Senator, the problem of concentrating power in the special counsel's office over in the executive branch is that Congress is still left out.

Perhaps there could be internal reforms in Senate committees to provide for hiring special counsel for the Foreign Relations Committee, say, to consider agreements. If, as the executive branch says, many of these agreements are routine and are fully within the realm of powers which have been delegated to the President, and they don't conflict with statutes or with anything else, then maybe the argument has been made, there is no need for ratification.

What we are dealing here with in the Bermuda II situation is a clear case of an agreement violating the law, by this I mean the clear mandate of the Federal Aviation Act, which favors competition to the extent practicable. And when, as the CAB found in a number of cases, where there can be competitive service, it ought to be certificated, and additional service should be provided.

From a policy standpoint, though, going back to the Constitution, the Constitution doesn't recognize that such a thing as an executive agreement exists. It talks in terms of treaties. On one extreme you could say, well, everything that is signed ought to be ratified by the Senate. A limited proposal would be anything that seems to violate the act should require ratification.

Basically, we think the review mechanism of the special counsel should exist in Congress and not the executive branch. Why is it, for example, that the Department of State and the President can have to come up here and say to the Senate and the American people, well, it's a good thing for foreign policy reasons to give away the Panama Canal, and on the other hand, they don't explain to the people in Tampa and Cleveland and Boston and Philadelphia and San Francisco and a number of other cities, why they must be denied air service, which the CAB says that they are entitled to.

That, basically, summarizes our concerns in this area. Any special counsel should more probably reside in Congress than the executive branch.

[The statement follows:]

STATEMENT OF CORNISH F. HITCHCOCK, ATTORNEY, AVIATION CONSUMER ACTION PROJECT, ACCOMPANIED BY JOHN CARY SIMS, LEGAL DIRECTOR.

COMPETITION, THE CONSUMER AND THE CONSTITUTION IN UNITED STATES INTERNATIONAL AVIATION POLICY

Mr. Chairman, on behalf of the Aviation Consumer Action Project, we are pleased to testify before the Subcommittee on the need for a new legislative charter to govern international aviation policy, one which emphasizes lower fares and innovative service options as the best ways of meeting consumer needs.

International aviation is now in a time of transition. For the past 30 years, the U.S. Government has paid lip service to competition as the cornerstone of international aviation policy, but from the consumer standpoint, the result has not been a dynamic system offering a wide range of price and service alternatives. Instead, the consumer has been confronted with high standard fares, a complex structure of discount fares, severe restrictions on low-cost charter service, and agreements and private side letters with other countries which have sharply curtailed travel options.

The need for a break from this tarnished history was graphically illustrated by last year's Bermuda II agreement, which had a disastrous impact on American consumers. Among other things, that agreement prohibited nonstop service from a number of U.S. cities, eliminated competitive service between U.S. carriers from other cities, predetermined the number of flights which could be offered from U.S. gateways, cut back air service available beyond London, and restricted the ability of carriers to change schedules to meet public demand.

Bermuda II clearly showed that U.S. negotiators must trade only expanded opportunities, consistent with a firm and detailed set of pro-competitive negotiating objectives. Recently, the Administration formally adopted a new policy statement containing a number of pro-consumer negotiating stands which ACAP supports. It is important to emphasize, however, that a policy statement—even one filled with stirring words we endorse—is not enough. A policy statement does not have the binding effect of a statute, and it can be bent or ignored in the give and take of negotiating sessions. That is why legislation is essential. The Federal Aviation Act presently puts a premium on competition as the "best means of effectuating the other public interest goals contained in § 102." [1] While this expression of Congressional intent is clear, it has not, however, deterred the executive branch from entering into a number of anti-competitive agreements over the years. Thus, there is a need for legislation which spells out with greater precision what U.S. negotiators can accept and what they must reject, so that when we speak of "competition," we are all talking about the same specific elements.

Before turning to the specific provisions of S. 3363, we would like to note that reducing the cost of foreign air travel, expanding service options and reducing barriers to efficient carrier operations have been among ACAP's principal con-

[1] Continental Air Lines v. CAB, 519 F.2d 944, 954 (D.C. Cir. 1975), cert. denied, 424 U.S. 958 (1976).

cerns since its inception in 1971. We have advocated these positions in various CAB and court proceedings and recently as a member of U.S. delegations. Last October, U.S. negotiating teams were expanded to include consumer and labor representatives, in addition to industry spokesmen who traditionally took part in the closed door negotiating sessions. ACAP was given the privilege of serving on a number of U.S. delegations since then, including the ones which negotiated pro-competitive agreements recently signed with the Netherlands and Israel.

On the basis of our work in this area, there are a number of provisions in S. 3363 which we think would benefit consumers, although there are also some provisions we oppose. On balance, though, this bill does a useful job of raising and focusing, attention on the important questions which must be debated and resolved during this crucial transitional era.

We now turn to the specific sections of S. 3363, which fall roughly into five categories.

DECLARATION OF POLICY

ACAP endorses the basic thrust of section 2 of S. 3363, which would spell out U.S. policy up-front in section 102 of the Federal Aviation Act. We agree wholeheartedly with the primary emphasis on safety and on competition which brings about price and service alternatives that are responsive to consumer needs. The practical experience we have all gained with the recent spate of discount fares, both in the domestic and foreign markets, demonstrates beyond question that genuine price competition stimulates lower fares and more efficient carrier operations.

The validity of this principle can be seen when we compare standard domestic fares—which certainly are not low—with international fares, which are devised in IATA traffic conferences and geared not to consumer needs but to the financial health of the least efficient participant.

For example, the standard round trip coach fare from Miami to Lima, Peru is $582, despite an average load factor of 67 percent. The coach fare in the Boston to Los Angeles domestic market—which is also a distance of just over 2600 miles—the coach fare is $460. Thus, the IATA rate is over 25 percent above the CAB-approved domestic fare, which assumes only a 55 percent load factor.

In 1977, Freddie Laker's cartel-busting Skytrain provided a glimpse of what a little price competition could do to improve international service. Even though Laker flights were limited in number and reservations were not permitted on his daily New York-London service, passengers flocked to this spartan service, which cost 65 percent less than the average price of a regular coach seat. Incumbent carriers rushed into the breach with their own low-priced alternatives. After the U.S. and U.K. negotiated a relaxation of Bermuda II tariff restrictions earlier this year, a wide range of price and service options blossomed in the North Atlantic market.

The Laker experience was clearly a boon for passengers, not only in the U.S.-U.K. market, but in the whole Transatlantic market as well. Especially notable is the fact that the Laker-inspired boom did not cause a loss in frequencies of service available to passengers for whom the availability of service is more important than price.

While we applaud S. 3363's re-affirmation of the need for competition, we are glad to see that it is accomplished by an emphasis on protection of the consumer from unfair, deceptive, predatory and monopolistic practices. A vital ingredient in a system of healthy competition is a sensitivity to the potenial for such abuses and a declaration by the Congress of its opposition to such tactics.

With respect to the fourth and fifth policy points, ACAP agrees with the underlying purposes, but thinks it is bad practice for a declaration of policy to single out one carrier or one class of carriers for special preference from the Civil Aeronautics Board. We think that if these sections are to be included in final legislation, they should be restated to emphasize evenhandedness as well as expeditious treatment for all carriers.

Turning to proposed section 102(b) (4), it is perhaps an unfortunate comment on CAB procedures generally that a provision favoring expedited treatment of foreign carriers should even be necessary. Nonetheless, any particular problems of CAB delay should be handled by reforming Board procedures (for example, as section 5 of S. 3363 proposes), instead of redrafting the policy statement of the Act. In addition, we note that the "most favored nation" status this section would create could itself become a bargaining point in individual negotiations.

Similarly, ACAP has no quarrel with the intention of proposed section 102 (b) (5), which is designed to assist Pan American complement its international

routes with new domestic authority. While there are obvious consumer benefits in letting Pan Am or any fit, willing and able carrier link up international routes with domestic segments, the Board should not be required by section 102 to look more favorably on one application over another. Instead, we think that the Board should, in each proceeding, consider every application for new route authority on an equal basis.

In addition, this provision should go further and urge removal of existing restrictions which keep consumers off half-empty flights. In this connection, we note that the CAB has recently begun granting fill-up rights on domestic segments of existing international routes and that CAB reform legislation already passed by the Senate would eliminate most closed-door restrictions, effective January 1, 1979.[2] Such a broader statement of policy would favor expanding consumer choice and improving efficient carrier operations.

CAB APPROVAL OF IATA PRICEFIXING

Consistent with our preference for healthy competition as the preferred means for meeting consumer needs, we wholeheartedly support section 7 of S. 3363, which would ring down the curtain on CAB approval of pricefixing agreements by the International Air Transport Association (IATA) cartel. ACAP has long been an opponent of this arrangement which, since the end of World War II, has victimized consumers with inefficient, inflexible and overpriced service.

Early in its history, ACAP challenged the process whereby the CAB rubberstamped price agreements reached in IATA traffic conferences; the CAB first adopted such agreements on a "temporary" basis in 1946 and has continued to approve them on a permanent basis since then.[3] In filings before the CAB, ACAP has contested a number of across-the-board price hikes by IATA carriers in Atlantic and Pacific markets, and in 1973, ACAP won an important court suit which established the precedent that vague and unsubstantiated CAB fears about the "chaos" of an open rate situation were insufficient to warrant automatic approval of unjustified IATA price hikes.[4]

One of the principal justifications for CAB reliance on IATA ratemaking since 1946 has been that the Board had no alternative. This rationale crumbled in 1972, when Congress gave the Board the power to suspend and reject international fares,[5] thereby filling a statutory lacuna that existed in 1946 when the CAB first accepted IATA mechanism as "the only opportunity available to it under existing legislation."[6] Although Congress in 1972 declined to add the complementary power to prescribe international fares, these amendments were crucial in chipping away at the need for continued participation in this scheme.

The CAB recently launched a long-overdue appraisal of this whole process when it issued an Order to Show Cause why it should continue to approve IATA carrier agreements.[7] Such a course of action was urged upon the Board last fall by the U.S. Department of Justice,[8] and even IATA has begun the process of self-examination of this subject. While we hope the CAB will ultimately end its approval of IATA ratemaking machinery, there is still the need for legislation to protect consumers from pricefixing, which keeps fares artificially high, and from capacity restrictions which are profitable to carriers because they fill up planes, but are harmful to consumers, who do not get a corresponding reduction in the price of their ticket.

The anti-competitive and anti-consumer effects of this traditional reliance on IATA was well-summarized by one court as follows:

"This whole IATA concept as the most desirable and so far inevitable outcome of negotiations is definitely contrary to the philosophy of our antitrust laws, contrary to our usual view of the public having the benefit of either competitive rates or rates set by a regulatory body in the public interest."[9]

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[2] S. 2493, 95th Cong., 2d sess., sec. 5 (1976), adding a new sec. 401(j) to the act.
[3] IATA Traffic Conference Resolution, 6 C.A.B. 639 (1946); IATA Traffic Conference Resolution, 9 C.A.B. 221 (1948); IATA North Atlantic Fares, 25 C.A.B. 792 (1957).
[4] *Pillai* v. *CAB*, 485 F.2d 1018 (D.C. Cir. 1973).
[5] Public Law 92–259, adding sec. 1002(j) to the Federal Aviation Act.
[6] 6 C.A.B. at 645.
[7] CAB Docket 32851, Order 78–6–78 (June 9, 1978).
[8] Preliminary comments of the U.S. Department of Justice, North Atlantic Fares Investigation, CAB Docket 27918 (Oct. 31, 1977).
[9] *Pillai* v. *CAB, supra* note 4, at 1029 (emphasis in original).

Whatever relevance this system may have had in the war-ravaged world of 1946, is clearly has no benefit to consumers today. Section 7 of S. 3363 is a useful piece of both antitrust and sunset legislation.

CHARTER OPERATIONS

For many years, charter carriers were the only competitive goad to IATA carriers to offer low-fare alternatives. Unfortunately, charter operations have traditionally been burdened with CAB rules designed to make this form of travel inconvenient for consumers. In addition, many countries, fearful of the competitive impact of charter service, have insisted on further restrictions which made charters even harder to use.

For these reasons, a top negotiating objective has been and must continue to be achieving bilateral agreements which permit the country where the charter originates to set the conditions and terms under which the charter will operate. Such "country of origin" rules have been accepted in a number of recent agreements, and under the Public Charter rules[10] adopted by the Board, the public should benefit from the removal of many artificial restrictions which have severely limited the availability of this low-cost travel option.

With respect to the proposals in S. 3363, ACAP is in favor of removing artificial distinctions between scheduled and supplemental carriers, as well as permitting supplementals to offer low-cost scheduled and charter service to foreign points. We have reservations, however, about the approaches to these goals which are taken in sections 3 and 4 of this bill.

Section 3 would permit charter carriers to sell a fixed percentage of their foreign charter trips directly to the public. While direct marketing would be beneficial to the consumer, we think that the Committee should not just set aside a certain amount of foreign charter trips for direct sales, but should instead explore the broader questions of whether the restriction on direct sales should be maintained at all and if not, what consumer rights and protections should be guaranteed to passengers on these charter trips.

Section 4 would require the CAB to permit each of the five largest supplementals to perform nonstop, scheduled service in five international city-pair markets of each carrier's choosing. The Board would have to issue a final decision within seven months after this legislation is enacted and could deny an application only if opponents meet an impossible burden of showing that a grant would "cause irreparable harm to the travelling public" and that "denial is required by the public convenience and necessity." While ACAP favors new entry and new low-cost service in international markets, we question the practice of singling out a select number of a certain class of carriers for expedited and preferential treatment. In making route awards, the Board should focus on the type of service being offered rather than then type of carrier offering it.

In addition, it is important to note that pending legislation and CAB proceedings could permit supplemental carriers to compete effectively in foreign markets, and thus the need for section 4 may soon be eliminated.

CAB reform legislation already passed by the Senate would not permit the CAB to certificate scheduled carriers to engage in new foreign charter air transportation, thus leaving that market open for supplemental carriers.[11] In addition, each of the five supplementals eligible for new authority under this section has alheady filed applications to serve at least five city-pair markets between the United States and the Netherlands, Belgium and Luxembourg.[12] Two of these carriers have also applied for authority to provide low-fare scheduled service from the United States to several points across the Pacific.[13] If the Board grants these applications consumers would benefit from this new low-fare scheduled service abroad, and the supplemental carriers would have established a place for themselves in that market.

Finally, the Board initiated a major proceeding in March of this year to consider a number of applications for new supplemental certificates.[14] Some of these applicants, if successful, would no doubt like to begin foreign transportation as quickly as possible.

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[10] Regulation SPR–149, 43 Fed. Reg. 33604, adopted Aug. 14, 1978.
[11] S. 2493, 95th Cong., 2d sess., sec. 5 (1976), creating a new sec. 401(c) to the Federal Aviation Act.
[12] U.S. Benelux Low-Fare Route Proceeding, Docket 30790.
[13] Transpacific Low-Fare Route Investigation, Docket 33068.
[14] Former Large Irregular Air Service Investigation, CAB Docket 32327.

In that proceeding, the Board has tentatively concluded that "there is a continuing need for additional entry into supplemental air transportation in domestic overseas and foreign markets," [15] and the Board declined to impose any restrictions on the number of applicants or the markets to be served in foreign areas.[16]

While we think that the current supplementals should be given the chance to compete effectively against the scheduled carriers, we think that the Congress should also consider the need for maintaining the possibility of entry into the supplemental market as well.

There is one proposal pertaining to charters in S. 3363 which we strongly oppose. Section 6 of S. 3363 would create a "rebuttable presumption that any consolidation or merger of the properties of an air carrier and supplemental air carrier is in the public interest." This provision runs contrary to the entire thrust of U.S. antitrust laws. It invites takeover attempts by scheduled carriers and could lead to the extinction of supplemental carriers. It makes no distinction between friendly mergers, unfriendly mergers, financial health of the carrier or anything else. It merely states that mergers are presumptively good, regardless of the circumstances of the individual case. Section 6 is a bad provision which could increase concentration in the industry, thereby limiting consumer options.

PRESIDENTIAL POWER AND FOREIGN CARRIER PERMITS

Two sections of this legislation would improve the process whereby carriers are certificated to provide international service. One contains a major reform which is long overdue; the other expedites the processing of permit applications by foreign carriers.

Section 8 of the bill would sharply curtail the President's absolute power over selection of U.S. carriers to perform international service. At present, section 801(a) of the Act gives the President carte blanche to overturn any CAB determination involving international routes and carriers, without any justification. There is no check on this unfettered power. Section 1006(a) of the Act, which bars only judicial review of foreign service permit decisions, was expanded by the Supreme Court to prohibit review of decisions on U.S. carriers' certificates in the case of *Chicago & Southern Air Lines, Inc.* v. *Waterman Steamship Corp.*, 333 U.S. 103 (1948). Over the past 30 years, the Waterman doctrine has been eroded a bit around the edges to permit judicial review when the CAB is alleged to have exceeded its statutory powers, but aside from that, judicial review is still foreclosed.[17]

As with IATA ratemaking, this broad grant of power to the President is another vestige of the early days of international aviation and has lost its relevance with the rise of today's global air network. Written in 1948, *Waterman* describes international air commerce as "revolutionary" and explains section 801's "unparalleled" Presidential control in a context of his role as commander-in-chief, his responsibility in foreign affairs, "commercial strategic and diplomatic interests," "intelligence services" and "executive confidences." Even though *Waterman* was decided at the height of the Cold War and immediately prior to the Berlin Airlift, the observation of commentator is still pertinent:

"What does any of this have to do with the question of whether Waterman or Chicago & Southern gets to fly from New Orleans to the Caribbean?" [18]

In today's environment, the question answers itself. Any foreign policy or national defense issues—which are proper concerns of the President—can be handled by the President in a bilateral negotiation or a CAB proceeding. There is no need for the President to be shuffling routes and carriers after the Board has acted in its quasi-judicial capacity—weighing evidence on the public record and relying on its expertise to make an informed economic decision. Section 801(a) shortcircuits this whole process. The result is what former CAB Chairman John Robson termed "intense, surreptitious lobbying campaigns in the Executive Branch and Congress." [19] Board decisions on carriers and routes, which are sup-

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[15] Order 78–7–106 at 8 (July 21, 1978).
[16] Id. at 15.
[17] *See generally Braniff Airways* v. *CAB* (Chicago-Montreal), No. 76–2043 (D.C. Cir., July 10, 1978) (slip. op. at 8–9).
[18] A Lowenfeld, Aviation Law IV–106 (1972).
[19] *Aviation Consumer Action Project* v. *CAB*, 412 F. Supp. 1028, 1031 n. 4 (D.D.C. 1976).

posed to be made on the basis of substantial evidence, can be overturned for reasons which are wholly unrelated to foreign policy or national defense and which flatly contradict the Board's economic analysis of the public convenience and necessity.

Several examples will suffice to show how this unchecked Presidential power has been abused in the past.

In the mammoth Transpacific Route Investigation in the late 1960s, the Board's decision was based on 86 volumes of testimony from 72 parties over 115 days of hearings. The Board's international route recommendations were changed by President Johnson in the waning days of his Presidency amidst charges of cronyism and improper influence, and President Nixon announced early in his new administration that he would review the international route awards. Two months later, he drastically modified the Board's order on the basis of a private DOT memorandum which took issue with the Board's traffic estimates.[20]

Also illustrative are two merger cases which required not only CAB approval but also Presidential approval because carriers served foreign points. A merger between Eastern and Caribbean-Atlantic airlines was eventually consummated upon Presidential order, even though the proposal had been twice rejected by the CAB.[21] A proposed merger between American and Western was marked by extensive industry lobbying on high-level executive branch officials, even though the merger was ultimately rejected by the Board and the President.[22]

An Executive Order issued in June of 1976 [23] attempted to end ex parte lobbying of White House officials and to limit Presidential review solely to national defense and foreign policy issues. Despite the adoption of this Order, however, President Carter last December switched Braniff for Pan American as the monopoly carrier in the lucrative Dallas/Fort Worth-London market, amidst charges of Congressional pressure and vote trading on an unrelated political issue.

It is doubtful that a halfway measure would restore integrity to this process. For these reasons, ACAP believes that unchecked Presidential control over U.S. carrier selection in foreign markets should be ended.

One proposal we do find constructive is section 5 of S. 3363. That section would remove the requirement of a public hearing in proceedings concerning a foreign carrier's application for a permit under section 402 of the Act. In addition, this proposal makes optional the necessity of a Board finding that issuance of the permit "will be in the public interest." So long as a foreign carrier is certificated by its own government and will provide service safely, reliably and in compliance with U.S. law, we see little purpose in retaining rigid statutory requirements which can delay issuance of a permit.

MAKING POLICY

Once there are clear statutory guidelines, the principal question is: Who should be responsible for making, carrying out and reviewing international aviation policy? To answer this question, ACAP suggests there are two criteria which should be considered:

(1) A coordinated effort between the executive departments, CAB and other interested parties, with leadership clearly assigned to one party; and

(2) Accountability of the policy makers for their decisions and actions. The best assurance of this is a requirement of Senate ratification of any agreement which appears to be inconsistent with the Federal Aviation Act.

We are skeptical, on the basis of the Bermuda II experience, of relying on short-term special negotiators brought in to handle negotiations with a single country. CAB Chairman Alfred E. Kahn testified before this Subcommittee last year that use of special ambassadors was "not a good idea," [24] and Alan S. Boyd, the special ambassador in charge of the Bermuda II negotiations, also testified that the practice "is an aberration and should be seen as such." [25] Even if the individual is skilled in international aviation diplomacy, current procedures

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[20] CAB Docket 16242; see also Note, Section 801 of the Federal Aviation Act—The President and the Award of International Air Routes to Domestic Carriers: A Proposal for Change, 45 N.Y.U.L. REV. 517, 527–533 (1970).

[21] Eastern-Caribair Acquisition Case, CAB Docket 22690.

[22] American-Western Merger Case, CAB Docket 22916.

[23] Exec. Order No. 11,920, 3 C.F.R. 121 (1977).

[24] Hearings on International Aviation Before the Subcomm. on Aviation of the Senate Comm. on Commerce, Science and Technology, 95th Cong., 1st sess., ser. 95–50, at 12 (1977) (hereinafter "Senate Hearings").

[25] Id. at 74.

do not permit Senate confirmation or an opportunity for Congress to have its say before the negotiating team is sent to the table. A special negotiator's task is a short-term assignment, limited not only in time but also in responsibility to the particular country in question. Since this procedure can lead to agreements at odds with overall U.S. policy, we think that the leadership role should be placed within a department in the executive branch.

The question, then, is which agency. Section 9 of the bill would create an Office of International Aviation Negotiations in the Executive Office of the President, headed by a Director and Chief Negotiator who would lead international aviation negotiations. Assisting the Director would be three Special Counsels who would act as liaisons with the Departments of State, Transportation, and the Civil Aeronautics Board. Policy would be formulated by a standing Aviation Policy Committee consisting of the Director, the Special Counsels, and representatives from other government agencies and the private sector; policy would be established consistent with guidelines set out in the proposed section 1102(h) of the Act, as well as the policy declared in proposed section 102(b). In addition, Congressional observers would be permitted to attend negotiating sessions.

Obviously, there is a need for executive branch coordination when it comes to making policy, but we question the need for shuffling bureaucratic functions and creating a powerful, new aviation czar in the White House. The inter-agency policy group is showing that it can prepare negotiating strategy along the lines section 9 envisages, and from an organizational standpoint, we would suggest that primary responsibility be left with the State Department which would consult and act in concert with DOT, the CAB and other interested parties, as section 802 of the Act envisages. There are a number of policy and practical reasons for this selection.

The Secretary of State, appointed by the President and confirmed by the Senate, is responsible by statute for the conduct of foreign policy.[26] In the exercise of his duties, the Secretary must submit executive agreements to the Congress,[27] as well as periodically report to the Congress on international affairs generally. In addition, the State Department, with its many negotiators and its facilities around the world, is well situated to take the lead not only when it comes to negotiating a new agreement, but also when minor disputes crop up.

Obviously, the State Department must work closely with the other responsible agencies. In a nutshell, we think a section 802 structure can be effective if statutory guidelines are clear, leadership is defined, and, most important of all, Congress fulfills its constitutional obligations to consider agreements signed by the executive.

International aviation involves mixed questions of foreign policy and interstate and foreign commerce. These are areas in which the President and the Congress share responsibility, and Congress cannot delegate its duties lock, stock and barrel to the executive. Under the Constitution, the President may have broad powers with respect to such things as his position as commander-in-chief or his power to see that the laws are faithfully executed; nevertheless, "the power to regulate interstate and foreign commerce is not among the powers incident to the Presidential office, but is expressly vested by the Constitution in the Congress." [28]

Even though Congress may have deliberately delegated a limited number of powers to the President in the area of international agreements, the executive branch has over the years usurped total control by its practice of entering into executive agreements instead of treaties which must be ratified by the Senate under article II, section 2 of the Constitution.

This problem is not confined to international aviation. As then-Senator Walter F. Mondale observed:

"Presidents have largely subverted the significance of the treaty ratification powers of the Constitution through use of the so-called executive agreement, often entered into secretly and not requiring ratification by the Senate. This dramatically shifted the power to make agreements with foreign nations from Congress to the executive. Treaty ratification contemplates agreements with

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[26] 22 U.S.C. secs. 2651, 2653, 2656.

[27] 1 U.S.C. sec. 112b.

[28] *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655, 659 (4th Cir. 1953), aff'd on other grounds, 348 U.S. 296 (1955). See U.S. Const. Art. I, sec. 8.

foreign governments mutually consented to by President and Congress; executive agreements are entered into by Presidents without Congressional assent." [29]

The potential for abuse in the arena of international aviation was pointed out by one perceptive commentator in 1945, even before the first Bermuda agreement was negotiated:

"Under the existing statutory law as set forth above, it is apparent that the conclusion of executive agreements to effect an exchange of operating rights is without legal basis in our statute law. Such executive agreements, to have legal validity, would require the adoption and ratification of a treaty between the governments concerned. This is not to say that it would be impossible to provide by new legislation for the delegation of power to the President or to the Civil Aeronautics Board to negotiate international operating rights, but such legislative delegation of authority would have to be surrounded with appropriate safeguards and would require a promulgation of suitably specific criteria by the Congress. In the absence of new legislation legalizing this procedure, government action to procure international operating rights must, if the agreements are to be safe from constitutional challenge, be accomplished through the treaty machinery." [30]

Unfortunately, Presidents have not followed this sound advice, but have acted in a manner which has indicated a lack of consistency in practice. In the immediately post-war era, the International Air Service Transit Agreement, 59 Stat. 1693 (1945), which grants overflight and landing rights in scheduled service for non-traffic purposes, was submitted a treaty and ratified by the Senate. Shortly after that, the Senate also ratified the Convention on International Civil Aviation (the Chicago Convention), 61 Stat. 1180 (1947), which grants rights of nonscheduled flights for both traffic and non-traffic purposes. Both before and after this period, a number of aviation agreements have been submitted to the Senate.[31]

When President Truman submitted the Chicago Convention to the Senate for ratification, his accompanying message acknowledged that other civil aviation agreements—including Bermuda I—had been consummated "under authority vested in me" but without submission to the Senate for ratification.[32] A contemporaneous opinion of the Attorney General sought to justify this distinction by arguing that bilateral agreements were signed pursuant to existing legislation, citing sections 801, 802, and 1102 of the Federal Aviation Act.[33] In the 30 years since then, the United States has entered into a number of bilateral air transport agreements, none of which has been ratified by the Senate, even though some contain capacity limitation clauses.[34] Despite this clear violation of the competitive goals of the Federal Aviation Act, these arguments became effective when signed, and the Senate was given no opportunity to consider them.

This 30-year policy finally bubbled over in the Bermuda II agreement of last year, and S. 3363 is clearly intended to prevent that sort of thing from happening again.

In the middle of those negotiations, Alan Boyd was named as a special negotiator on a short-term basis without Senate consultation, and no hearings were held on this appointment or confirmation for the post, despite the obvious importance of his mission. Although Congress as a whole was clearly left out during this process, the Departments of State and Transportation contend that Mr. Boyd contacted individual Members of Congress both "prior to and during negotiations for Bermuda 2," including telephone calls to key Members of Congress immediately before the signing in Bermuda. They note that Mr. Boyd testified before this Subcommittee and the House Aviation Subcommittee late last

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[29] W. Mondale, the Accountability of Power: Toward a Responsible Presidency 113 (1975).

[30] Wiprud, Some Aspects of Public International Air Law, 13 Geo. Wash. L. Rev. 247, 275 (1945).

[31] See Warsaw Convention, 49 Stat. 3000, Hijacking Convention, 22 U.S.T. 1641, Sabotage Convention, 24 U.S.T. 564, Convention on the International Recognition of Rights in Aircraft (the Mortgage Agreement), 4 U.S.T. 1830. Pending in the Senate Foreign Relations Committee now are Montreal Protocols 3 and 4 of 1975, which would incorporate the Guatemala City Protocol to the Warsaw Convention pertaining to liability of carrier for damages to international passengers.

[32] International Civil Aviation Conference, Message from the President, Ex. G, 92 Cong. Rec. 6661–62 (1946).

[33] Validity of Commercial Aviation Agreements, 40 Op. Att'y Gen. 451 (1946).

[34] Lissitzyn, Bilateral Arguments on Air Transport, 30 J. Air L. & Com. 248 (1964).

year, and that "The Congress has thus far taken no formal action demonstrating dissatisfaction with the terms of Bermuda 2 or the manner of its implementation." They term this silence "highly significant." [35] From this scanty record—a few private meetings, a few phone calls and a few days of Subcommittee hearings after the fact—State and DOT draw the sweeping conclusion that "Bermuda 2 was the subject of appropriate consultation with Congress," [36] even though Mr. Boyd stated to this Subcommittee last year that he did not delay the signing, as several Members of Congress had requested.[37]

Whatever power Congress may have delegated to the President, it did not delegate power to predetermine rigid capacity limitations which ignore public demand; eliminate necessary competition between U.S. carriers from U.S. gateways; forbid nonstop service from a number of cities to the U.K.; suspend a carrier's certificate to provide scheduled service without a finding that such was required by the public convenience and necessity; or set up a "tariff working group" to evaluate rates, fares and service, whose findings shall be considered by the CAB in its deliberations. Those provisions are contrary to the Federal Aviation Act and should not be effective unless Bermuda II is ratified by two-thirds of the Senate.

In short, Mr. Chairman, writing clearer legislation to guide executive branch negotiators is a first step, albeit an important one. There is an equally compelling need for Congress to re-assert itself throughout the stages at which international aviation agreements are negotiated. Congress should be consulted before negotiations begin, and staff members should be permitted to attend negotiating sessions as observers. Congress should conduct oversight hearings on a more regular basis, and above all, the Senate should be required to ratify as a treaty any executive agreement which does not conform to the dictates of the Federal Aviation Act. Consultation is no substitute for ratification; Congressional oversight and review is the best way of restoring the balance intended in the Constitution between the President and the Congress. The system will not function smoothly nor will the public interest be well served until branches of government perform the duties assigned to them in the Constitution.

The CHAIRMAN. Well, thank you very much for your presentation.

The next witness is Mr. Robert Beckman, counsel, Laker Airways Limited.

STATEMENT OF ROBERT M. BECKMAN, COUNSEL, LAKER AIRWAYS LIMITED, ON BEHALF OF SIR FREDDIE LAKER, MANAGING DIRECTOR

Mr. BECKMAN. Thank you, Mr. Chairman. Sir Freddie asked me to apologize for his not being able to be here because he would have very much liked to have been here, since he is such a supporter and admirer of your views on competition.

The comments which he would give—and I respectfully request that they be included in the record—are directed to the subject of charter operations.

Laker Airways, because of its skytrain service, has gotten much attention for these scheduled route operations that it performs. But Laker is principally a charter operator.

It carries about 1 million charter passengers a year. Laker is the No. 1 charter carrier in the United Kingdom for charter passengers to North America. It carries more than 50 percent of the total charter traffic uplifted in the United Kingdom.

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[35] Statement of Points and Authorities in Support of Defendants' Motion to Dismiss or, in the Alternative, for Summary Judgment at 43–44, *Greater Tampa Chamber of Commerce v. Adams*, Civ. No. 78–517 (D.D.C. 1978).

[36] Id. at 43.

[37] Senate Hearings, supra note 24, at 74.

It is also interestingly the No. 1 charter carrier in the United States for charter traffic to the United Kingdom.

In the peak season of this year, Mr. Chairman, Laker is operating 48 weekly charter flights between the United Kingdom and North America. That is almost seven flights a day. Now, recently released Immigration and Naturalization Service statistics show a 36-percent decrease in United States-United Kingdom traffic in the first 6 months of 1978 compared to the same period in 1977.

We saw a recent CAB survey which showed that U.S. supplemental carriers suffered a 42-percent cancellation rate in 1978. Laker's charter traffic between the United States and the United Kingdom increased in 1978 over 1977—Laker carried over 200,000 passengers in 1978 between the United States and the United Kingdom.

Why? Well, it is not Sir Freddie's shining brown eyes and snaggly toothed grin. The reason, Mr. Chairman, is because in operating from the United Kingdom, Laker is able to use affiliated charter and tour operators: Laker Air Travel and Arrowsmith Holidays.

And here's the way it works. The affiliated charter or tour operator takes the lead in chartering aircraft, and that way the charter airline can plan, promulgate, and operate a stable program. The affiliated tour operator of the carrier, however, does not take the entire capacity of the aircraft.

The independent tour operators buy into those airplanes. The independent tour operators have that way a very wide selection of flights to choose from, and they have the assurance that the flights will operate.

What you really have, Mr. Chairman, is competition. You have competition that benefits the charter airlines, that benefits the independent tour operator, and that most importantly benefits the public.

Now, Mr. Frommer was represening independent tour operators who complained that permitting affiliated charter operators in the United States will be the death knell of independent charter tour operators. The evidence, sir, does not support that statement.

In the United States the independent tour operators compete with carrier-affiliated tour operators on scheduled service and they do very well indeed. They have the largest share of the market. Independent tour operators compete with carrier-affiliated operators in the United Kingdom, in Canada, in Europe, and in every market where independent charter operators compete with carrier-affiliated tour operators, you have healthy competition. The independent tour operators do very well. They do better, in fact, because the carrier-affiliated tour operator provides a stable base.

The CHAIRMAN. We received a request several weeks ago that Mr. Laker wished to present his own testimony. What happened? Where is he?

Mr. BECKMAN. Mr. Chairman, I got a call from him, and he could not make it, and asked me if he thought that the committee would permit me to come in and have this statement presented for the record. He would have very much liked to be here.

The CHAIRMAN. Well, we heard press reports that Laker's skytrain was selected by the CAB to serve Los Angeles-London. Is that a final decision, or are there other procedural steps required by the British Government?

Mr. BECKMAN. There was an appeal by British Caledonian, and the appeal was rejected by the Secretary of State for Trade, so that the decision is final.

Laker was designated by the United Kingdom, an application has been submitted to the CAB, and we have every reason to believe that the CAB is expeditiously processing the foreign carrier permit application.

The CHAIRMAN. When do you propose to start service?

Mr. BECKMAN. September 26, 1978, the first anniversary of the New York service.

The CHAIRMAN. What is the experience on the New York service?

Mr. BECKMAN. The average load factor since the beginning of service on September 26, 1977, is 82 percent. The profit has been on the order of several million dollars. The flights have operated with excellent reliability. Most days the passengers who want to go on that day get fully accommodated.

We have had a few peak periods around holidays, but in the main it has worked like a charm, Mr. Chairman.

The CHAIRMAN. Now, is that all individually ticketed, or does that include some of your so-called part charters?

Mr. BECKMAN. No, sir. It is all individually ticketed. You can buy the ticket only on the day of the flight.

The CHAIRMAN. You indicate quite a high flow of charter traffic. What is the destination of that traffic?

Mr. BECKMAN. All over the United States and Canada. New York, Detroit, Chicago, Los Angeles, San Francisco, Seattle, Vancouver, Toronto, all over the North American Continent.

The CHAIRMAN. Well, thank you very much for your testimony. We appreciate your being here today. That concludes the hearings at this time.

[The statement follows:]

STATEMENT OF SIR FREDDIE LAKER[1]

The purpose of S. 3363, as expressed in its preamble, is "to promote competition in international air transportation." I have spent my professional life and a good deal of my money fighting for competition. I, therefore, believe I am among friends.

First, let me establish my credentials with you in the charter field. Many people tend to think of Laker Airways solely in terms of our Skytrain scheduled service. In fact, Skytrain service is only a small part of our business. We are primarily a charter carrier. We carry approximately a million passengers a year on our charter flights in Europe and between the United Kingdom and North America. We are the leading U.K. carrier in transatlantic charters. We carry more than 50% of all charter passengers uplifted by U.K. carriers destined for the U.S. and Canada. In the U.S., we are the leading operator of U.S.-originating charters to the U.K. and Europe and the sixth ranking carrier in total U.S.-originating international charters after TIA, Capitol, World, Pan American, and ONA.

In 1977, Laker carried approximately 200,000 charter passengers between the U.S. and the U.K. and a similar number between the U.K. and Canada. This sum-

[1] This material is prepared, edited, issued and circulated by Robert M. Beckman, 1001 Connecticut Ave. NW., Washington, D.C., on behalf of Sir Freddie Laker, Gatwick Airport, Horley, Surrey, England, who is registered with the Department of Justice, Washington, D.C., under the Foreign Agents Registration Act as an agent of Laker Airways Limited, Gatwick Airport, Horley, Surrey, England. This material is filed with the Department of Justice where the required registration statement is available for public inspection. Registration does not indicate approval of the contents of the material by the U.S. Government.

mer we are operating 48 weekly one-way charter flights between the U.K. and North America. While our U.K.-Canada charter traffic in 1978 is less than 1977, our U.K.–U.S. charter traffic has increased in 1978 over 1977.

Our charter operations are financially successful. We are obviously doing something right.

I congratulate Senators Cannon and Pearson for perceiving the importance of permitting direct carrier participation in charter sales. The charter industry in the United States is in serious trouble. ONA the fifth largest operator of U.S.-originating international charters is going into liquidation. Nationwide Leisure, the largest U.S. international charter and tour operator closed its doors this summer as did Elkin Tours, the fifth largest U.S. international charter and tour operator. The entire charter industry in the U.S. took a beating this summer which the carriers, the charter operators and the public will long remember.

Something must be done. In my submission, the most important and constructive step toward stabilizing U.S. charter operations would be the authorization for carriers to sell charters to carrier-affiliated charter operators.

I am sure that the Committee is aware that every country in the world which has a vigorous charter industry permits carrier-affiliated charter operators to compete with independent charter operators. The C.A.B. has authorized U.S. and foreign carriers to sell foreign-originating charters through carrier-affiliated charter operators in Great Britain and in Europe. Canada recognizes and permits carrier-affiliated charter operators. The only market in the world which does not have the benefit of carrier-affiliated charter operators is the U.S.-originating market.

Why has Laker been able to mount such a large charter program with success when others have failed or have sharply reduced operations? I will tell you the key to our program: we are able to sell in the U.K. through our own charter affiliates, Laker Air Travel and Arrowsmith Holidays. Let me explain. Our affiliated charter operators take the lead in chartering our aircraft. This enables us to publish a charter program which is subject to our own control. We can offer a certain number of flights to certain destinations and we know we will operate those flights because our own charter companies take the risk of empty seats.

The independent charter operators are then able to buy blocks of seats on Laker flights with the assurance that the flights will operate. The independent charter operators do not have to take the risk of the entire aircraft. The independent charter operators can thus offer an extensive program to their clients by buying blocks of seats on a wide range of flights—much, much more extensive than they could afford to offer if they had to take the risk of the entire planeload.

The ability of a charter carrier to sell through an affiliated charter operator thus benefits the charter carrier and the independent charter operators. The benefits are stability of operations and greater variety of charter offerings. Charter carriers who must rely solely on independent charter operators are restricted in their programs and run the risk of the destruction of their programs through cancellation or failure of an independent charter operator. We saw enough of that this summer. Cancellation rates as high as 42% for the U.S. Supplementals.

The principal and ultimate beneficiary of stable and varied charter operations is, of course, the public. Today, the charter passenger in the U.S. is subject to greater uncertainty than his counterpart in England, Canada, or Europe as to whether his planned charter flight will operate. With carrier-affiliated charter operators providing the underlying support for a program, the public will get better service.

Carrier-affiliated charter operators will benefit not harm U.S. independent charter operators. The experience in Great Britain, Canada and other countries with extensive charter operations confirms that the growth and vitality of independent charter operators is not restricted by the competition of carrier-affiliated charter operators, rather it is augmented. Since the purpose of S. 3363 is to promote competition in international air transportation, I respectfully submit that the bill include full authorization for sales in the U.S. by charter operators affiliated with U.S. and foreign carriers.

The CHAIRMAN. The committee will adjourn, subject to the call of the Chair.

[Whereupon, at 11:50 a.m., the hearing was adjourned, subject to the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF JAMES A. MILLER, PRESIDENT AND CHAIRMAN OF THE BOARD, AMERICAN SOCIETY OF TRAVEL AGENTS. (ASTA)

Mr. Chairman and Members of the Subcommittee:

My name is James A. Miller. I am a travel agent from East Lansing, Michigan, and also President and Chairman of the Board of the American Society of Travel Agents, Inc. (ASTA), the world's largest professional travel association, which is comprised of 8,600 travel agent members throughout the United States, and over 16,000 members in more than 120 countries representing all facets of the travel and tourism industry. ASTA's purpose is the promotion and advancement of the interests of the travel agency industry and the safeguarding of the traveling public against fraud, misrepresentation and other unethical practices. Members of ASTA ararnge the travel plans of over 40 million American consumers annually who spend approximately $12 billion each year, in business and pleasure travel.

In behalf of ASTA, I am grateful to have this opportunity to submit our views on S. 3363, the International Air Transportation Competition Act of 1978.

The ever-increasing reliance of the traveling public on travel agents for advice and service, especially for international journeys, makes the bill before this subcommittee of vital importance to travel agents and our clients. I know that both travel agents and the members of this panel share the same ultimate objective in the current undertaking: establishment of an international aviation policy that best serves the needs of U.S. travelers and those of other nations.

The Administration, the Congress and the Civil Aeronautics Board have determined that this goal is best achieved through competition—competition between and among U.S. and foreign flag carriers, as well as between scheduled and supplemental airlines. S. 3363 attempts to statutorily add a new form of competition to this policy: competition between direct air carriers and independent tour operators for charter sales. It is this aspect of S. 3363—Section 3 of the bill—to which I will direct these remarks.

Competition is one of the basic foundations of our country's economic policy. Our laws encourage, foster and often insist upon it. Generally speaking, competition breeds innovation; innovation breeds choice. This theory has certainly borne fruit within the last year in the commercial aviation field. Domestic and international travelers alike have been presented with such an impressive array of air travel alternatives that it has become an almost impossible task to keep up with new schedules, fares, carrier choices, trip duration options and service selections.

I know our Government wants to maintain this momentum in order to keep airline fares low while keeping travelers' options open. ASTA shares this desire. It is for this reason that we oppose Section 3 of S. 3363. That provision, which would permit direct air carriers to market up to 40 percent of their foreign charter trips directly to the public, will eventually result in limiting travelers' options and make those options that remain more expensive to acquire.

Mr. Chairman, I would like to describe just why ASTA is convinced that vertical integration in the air charter industry can and will disserve commercial aviation.

CURRENT LAW AND PRACTICE

At present, only an independent tour operator acting as an indirect air carrier having no common ownership or control relationship with a direct air carrier may sell charter trips directly to the public. This practice is grounded on Section 101(36) of the Federat Aviation Act as interpreted and enforced by the CAB. The Act specifically forbids supplemental air carriers to control or be controlled by tour operators, and, further, prohibits supplementals from selling tours directly to the public. Although the Act contains no comparable specific

restrictions applicable to scheduled carriers, the CAB has effectively extended these proscriptions to all direct air carriers through orders [1] and regulations.[2]

Thus, both Congress and the CAB recognized the procompetitive benefits of requiring that charters be marketed only by tour operators independent of direct air carriers. The competition for charter sales then, has been between autonomous tour operators, not between such operators and large airlines or airline-controlled operators. We were hopeful that full legislative recognition would soon be given to this pro-competitive policy as a result of this, the fine work done by this subcommittee and the Senate on the Air Transportation Regulatory Refrom Act of 1978 (S. 2493). That bill, as passed by the Senate in April, would prohibit any direct air carrier or foreign air carrier from entering into any interlocking relationship with any U.S. tour operator who sells domestic charters or U.S.-originating foreign air charters.[3]

Mr. Chairman, we are at a loss to understand why, less than four months after the Senate passage of S. 2493, you and Senator Pearson would support a proposal which totally contravenes the recent action of this panel and the Senate.

We are equally mystified that CAB Chairman Kahn, in testimony before this subcommittee on August 23, 1978, endorsed Section 3 as "an important liberalization, and it would help equalize competitive opportunities between supplemental carriers and scheduled carriers." [4] This statement is puzzling because the Board has consistently held the position that charter trips containing an air component must be sold through independent tour operators only. In fact, as recently as eleven days before the Chairman's testimony the Board, with Dr. Kahn's affirmative vote, adopted its new Public Charter rules, replacing several different charter forms with one simplified format. One of the keystones of the Public Charter is that it must be sold by an independent tour operator. The Board took great pains to describe the importance of the tour operator's role:

"The requirement that Public Charters must be arranged and sold by an independent tour operator is of paramount importance in evaluating their legal sufficiency. This is not just one distinction, but a whole complex of them. The essence of the charter concept is a bilateral contract, and at the center of the contractual relationships is the tour operator. Unlike scheduled service, sold either directly by the route carrier or through a travel agent, the charter operator bears the risk of operating a financially successful flight. His estimate of the potential of a particular market, and his willingness to risk his capital in charter contracts with direct air carriers, generally months before sale to the public, is the essential element in the charter industry today. Before he can sell to the public, however, he must have submitted to the Board a detailed prospectus covering each flight, including his charter contract with the carrier and the contract that will be entered into with participants. The operator must also arrange a surety bond or similar agreement with a financial institution to insure his financial viabiliy, and in most cases a depository escrow to protect participants' funds.

"These important distinctions are not limited to behind-the-scenes arrangements; they are of real significance to the traveling public. A person planning to travel by charter flight must deal (either directly or through a travel agent) with flight plans and payment arrangements set up by the tour operator, not an airline. He will have to sign a contract with many detailed provisions con-

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[1] *See, e.g., Reopened Transamerica Corp. and Trans-International Airlines,* CAB Order 71–7–119 (July 21, 1971). *aff'd sub nom. Foreign Study League* v. *CAB,* 475 F.2d 865 (10th Cir. 1973); *Kuoni Travel Limited (Switzerland), d/b/a Kuoni Travel Inc.,* CAB Order 76–6–135 (May 24, 1976).

[2] *See* 14 C.F.R. Parts 371 (Advance Booking Charters); 372a (Travel Group Charters); 373 (Study Group Charters); 378 (Inclusive Tour Charters); 378a (One-Stop-Inclusive Tour Charters); and 380 (Public Charters). The Public Charter regulations became effective on August 15, 1978 and will eventually replace the other five charter formats. The

[3] *See* Section 16 of S. 2493 which would add a new Section 422(e) to the Federal Aviation Act of 1958.

[4] It should be noted that the coverage of Section 3 is not entirely clear. Although Chairman Cannon's remarks upon introducing S. 3363 indicated that "charter carriers" would be permitted to sell directly to the public a portion of their foreign charter trips, the present language does not so restrict coverage.

As presently worded, this section applies to "air carriers directly engaged in the operation of aircraft", thus, encompassing both scheduled and charter carriers. Should S. 2493 become law in its present form, U.S. scheduled carriers will become eligible for charter certificates within five years. At that time, these scheduled airlines, under Section 3 of S. 3363, would be able to sell 40 percent of their previous year's foreign charters directly to the public.

cerning the itinerary, conditions, and libilities associated with the trip. His rights are governed by a special set of Board rules concerning such matters as flight delays, as well as the special rules of foreign countries. These factors may be much more important, in fact, to the individual deciding between charter and scheduled service than restrictions such as advance booking, minimum stay and/or ground package that have characterized charters in the past. The typical vacationer, after all, makes his arrangements in advance, stays for at least a week, and spends money on ground accommodations, regardless of his mode of travel." CAB Reg. SPR–149 (Aug. 14, 1978), at 8 (footnotes omitted).

THE PROBLEM WITH VERTICAL INTEGRATION IN THE AIR CHARTER INDUSTRY

Vertical integration in the air charter industry—that is, common control relationships between airlines and tour operators or direct public sale of charters by air carriers—will retard competition in the industry because affiliated operators and airlines will enjoy unfair advantages over their independent tour operator counterparts. At present vigorous competition exists for the dollars more and more Americans are spending on pleasure travel, especially on charter tour packages containing an air component. This competition has consistently produced a wide variety of innovative and economical options for the vacationing traveler. This variety and economy cannot be maintained, however, if a sizable portion of the air charter market becomes dominated by the carriers who control the essential element of charters : aircraft availability.

The importance of the ability to control aircraft space and use cannot be overstated. Presently, lively competition exists among tour operators for aircraft space, because greater numbers of seats are being used to accommodate scheduled passengers flying at a variety of deeply-discounted scheduled fares. Should tour operators be faced with additional competition for space from the carriers' own charters, it is the tour operators whose needs will go unmet. This problem will, of course, become especially acute during peak travel seasons, particularly in already well-developed markets. As carrier eligibility for a share of the charter market increases, tour operators' share of aircraft space will correspondingly decline.

It is also important to recognize that the traveler stands to suffer from the effects of the airlines' direct control over aircraft space. Under the present system, a tour operator must contract to purchase the desired number of seats from the supplying carrier far in advance of departure. Should the tour program fail to sell to a sufficient number of participants, forcing the operator to cancel a flight or series of flights, the carrier can assess a stiff financial penalty against the sponsoring tour operator. Obviously, the cancellation fee presents a strong incentive to the operator to vigorously market his offering through effective promotional efforts and attractive fares. Thus the consumer has a built-in measure of protection against last minute cancellations.

This consumer protection mechanism will not be available to prospective participants in carrier-sponsored tours. Since an airline will not penalize itself for aborting a program that it fails to sell, the traveler who has booked his passage and made his vacation plans may well see his tour cancelled at the last minute.

Aircraft space is not the only tour ingredient at the disposal of the direct air carriers. Many airlines own and operate hotels. Thus, they would not only have "first crack" at desirable rooms for charter packages that include ground components, but would also be in a position to obtain these accmmodations at reduced rates through advance bulk buying. Furthermore, it is not unreasonable to fear that more subtle forms of discrimination could occur, such as assigning the more choice rooms and affording VIP treatment to those persons who purchased their tours directly from the carriers.

In order to fully appreciate the manner in which carriers can prey upon the unwitting independent tour operator, one need only examine the case of *Foremost International Tours, Inc.* v. *Qantas Airways Ltd.*[5] In that case, the District Court found that Qantas had failed to properly allocate its general business expenses as costs when establishing the price for the land portion of its individually-

[5] 379 F. Supp. 88 (D. Hawaii 1974), *aff'd.*, 525 F.2d 28 (9th Cir. 1975) *cert. denied*, 429 U.S. 816 (1976).

ticketed tours,[6] and thus was able to sell the tours below cost. The Court enjoined Qantas from continuing its tour sales until the carrier convinced the Court that all appropriate costs were factored into its pricing structure.

One aspect of the air charter industry that appears to have been overlooked by the supporters of Section 3 of this bill is the role independent tour operators have played in the discovery and development of new markets. Such efforts require constant attention to the changing interests of travelers, a sensitivity to the needs of persons visiting foreign lands, on-site investigation and discovery, and the willingness and financial ability to devote resources to all facets of packaging an attractive tour. Tour operators have been both willing and eager to undertake the task of innovation because the keenly competitive nature of the industry encourages it. Thus an almost limitless supply of well-planned, attractive vacation options have been available to pleasure travelers.

It is doubtful that this competition-spurred innovation will continue in a vertically integrated charter industry. As the air carriers advance toward the acquisition of 40 percent of the charter market, they will quickly achieve dominance in the consistently profitable destinations (*e.g.*, Western Europe) through their ability to control aircraft space. Little if any competition for such destinations will be forthcoming from tour operators. Thus these operators will be forced to compete against one another for the remaining 60 percent of charter trips. This sharply curtailed market availability will cause substantial numbers of operators to cease doing business.

Those who manage to stay afloat will have to look to less popular destinations around which to build their tours. However, without access to proven money-making markets to provide the profit margin necessary for investment in new market development, innovative efforts will, by necessity, sharply decline. Air carriers will have no incentive to assume the role of innovation: they will already have their 40 percent trip allowance tied up in the most lucrative markets.

Of course, one might argue that since the number of charter trips a carrier can sell directly to the public in a given year is dependent upon the total trips it performed in the prior year (the carrier's own plus those sponsored by tour operators), airlines will have an incentive to keep tour operators financially healthy and productive. What mechanism might they employ to achieve this? Surely carriers will not refrain from entering lucrative markets. Possibly, however, they may favor select tour operators with limited access to the proven money-makers. Such preferential treatment given to select tour operators is indeed undesirable and certainly not conducive to healthy competition.

Alternatively, the carriers may opt to let the available charter market decline—through the attrition of independent operators—and be content with a lower market share yielding a high profit margin. Eventually, with fewer charters available to travelers, airlines can be expected to charge more for the carriage they do offer. Thus, the traveler loses in two ways: his vacation choices are restricted, but yet he pays more for those that are available.

CONCLUSION

Mr. Chairman, ASTA endorses the primary thrust of this legislation, as expressed in Section 2(b)(2), to infuse the maximum degree of competition into the international air transportation system. But we firmly believe the foreseeable results of Section 3 will contravene the laudable policy set out in Section 2(b)(3). That section calls for

"The prevention of unfair, deceptive, predatory, or anticompetitive practices in foreign air transportation, and the avoidance of undue industry concentration, excessive market domination, monopoly power, and other conditions that would tend to allow one or more air carriers or foreign air carriers unreasonably to increase prices, reduce services, or exclude competition in foreign air transportation."

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[6] Airlines *are* permitted to sell directly to the public inclusive package tours that include round-trip air transportation on scheduled flights and ground arrangements. These airline-sponsored inclusive package tours were inspired by the success of charter tours organized by independent operators. They represent the airlines' first step into the tourism industry, and have supplied additional competition for the discretionary travel dollar by providing another option to the traveling consumer. However, in the sale of individual inclusive package tours as in the sale of charters, independent operators cannot be expected to long survive in competition against the powerful airlines. Many of the arguments raised against direct air carrier sale of charters (as catalogued herein) apply with equal force against the continued authority for carrier sale of inclusive package tours.

In our view, Section 3 would encourage "undue industry concentration," "excessive market domination," and "monopoly power," and result in increased prices, reduced services, and exclusion of competition in foreign air transportation. ASTA strongly recommends that the subcommittee strike Section 3 from S. 3363 and in so doing forcefully reaffirm its support for the maintenance of the independent tour operator industry. The risks of experimenting with a new form of charter sales system as outlined in Section 3 are just too high.

Thank you for affording ASTA the opportunity to present its views on this significant legislation.

STATEMENT OF JOHN J. O'DONNELL, PRESIDENT, AIR LINE PILOTS ASSOCIATION, INTERNATIONAL

I am Captain John J. O'Donnell, President of the Air Line Pilots Association, International (ALPA), which represents the interests of more than 30,000 professional pilots. We are pleased to have this opportunity to present our views on legislation to develop policies and a structure for international aviation negotiations and to improve opportunities for U.S. international airlines.

ALPA believes the policy statements and organizational structure set forth in S. 3363 are long overdue, Mr. Chairman, and we commend you and Senator Pearson for your leadership in moving to fill this void. In particular, we applaud the provisions of the bill that establish a new organization in the federal government to conduct bilateral air transport negotiations. Such an organization is the only way we see to end the inter-agency bickering that has characterized our approach and limited our success in international air negotiations for too long.

International aviation matters have been something of a neglected stepchild in the Executive Branch for many years. Too often, the U.S. has traded away aviation advantages it held for what it thought would be gains in other areas to avoid offending another nation. If these trades were not to our advantage, the losers were not the government but the airlines, their passengers and their employees.

You have long recognized this problem. Mr. Chairman, and have expressed your concern before, particularly in hearings last fall. Unfortunately, the Executive Branch has not shared your concern. We hope that this bill will encourage it to do so.

This legislation is needed not because of deficiencies with Bermuda II—most of these have been corrected—or because U.S. policy is basically wrong. Rather, the need arises from our repeated experience that the various government agencies involved in negotiating bilateral air agreements seldom consider them as business contracts. But these agreements serve not only the national interests of the U.S.; they also should have a positive economic effect on our international airlines. One benefit of a financially healthy airline is that its employees do not fear temporary or permanent loss of their jobs. Another is that the carrier is in a better position to provide safe, reliable, comfortable transportation for its passengers, most of whom are Americans.

This year, however, our negotiations have focused mainly on obtaining lower fares for travelers and have often overlooked or neglected the interests of airlines and their employees. They, too, are part of the public interest and are deserving of consideration during bilateral negotiations.

Some have quickly forgotten that many U.S. international airlines have cut back on routes and flights and laid off thousands of employees in response to heavy losses. Today almost 500 ALPA members at Pan American alone are on furlough and have been for several years.

U.S. flag airlines and their employees deserve some assurance that their interests will not be exchanged merely for possible or temporary lower passenger fares. Many passengers may not care if they fly on an American airlines or not, but the airlines and their employees do. At the least, we want passengers to be able to choose a U.S. carrier.

What we need is a realization on the part of our negotiators that there are many elements making up the national interest in aviation. A better balancing of these diverse elements is needed if the U.S. is to be successful in future negotiations. This bill will provide the structure and help ensure that all elements are fully considered in the negotiating process.

Looking at the agreements signed in the 13 months since Bermuda II, we are impressed with two: the Mexican and Dutch accords.

The agreement signed with Mexico in January is a good example of the approach we would like the U.S. to follow in all negotiations. The entire delegation—airlines, labor and consumers, as well as the relevant federal agencies—participated in the hard bargaining. Time has confirmed our initial assessment

that we got our money's worth. U.S. airlines now have routes to all tourist and business destinations in Mexico from points throughout the U.S. The agreement also includes liberal charter provisions and a flexible pricing arrangement. Braniff and Pan American achieved important flexibility in transferring passengers arriving in Mexico City to flights for beyond points in Central and South America.

The Dutch agreement is important primarily because of its strategic value in dealing with other European nations. At the time it was being negotiated, the British were refusing to approve low fares from U.S. points other than New York, where standby and budget fares already were in effect. The Dutch agreement induced the British to agree to low fares from other U.S. points because they were suddenly faced with the prospect of a major diversion of traffic from London to Amsterdam. We can use the Dutch agreement in the same way when negotiating with other European countries.

Except for these two agreements, there have been no significant permanent developments. We recently signed an agreement with Israel, but it is difficult to consider it to be a model for future negotiations. One reason is that the U.S. has a rather unique relationship with Israel and another is that the volume of traffic betwen the two countries is small compared with that between the U.S. and Britain or the Continent.

Of these three agreements, then, one was a situation where talks were well under way before the current U.S. negotiators took office, another was a response to the weaknesses of Bermuda II and British reluctance to approve low fares, and the third was a special situation.

Thus, this Administration has yet to sign with a major traffic-generating nation an agreement negotiated entirely under its new international aviation policy. We believe in the principles set forth in the Administration policy, but like any statement of policy, it is open to varying interpretations. We are concerned that some U.S. negotiators may place more emphasis on low fares than on other policy objectives such an elimination of capacity controls and unfair competitive practices in important future negotiations.

One issue that produced some apprehension for us arose during the negotiations with Germany. That is "open skies," allowing another country's carrier to fly to any point in the U.S. in exchange for U.S. airlines having the same authority in the other country. An underlying assumption of some proponents of "open skies" is that a free market could be created in international aviation. Also, they overlook the fact that any other country offers far fewer cities with traffic to support international air service than does the U.S.; thus, a foreign airline would benefit far more from "open skies" than U.S. carriers would.

Our apprehension about "open skies" has subsided somewhat after hearing Administration officials testify before this subcommittee. We now see a more realistic approach to negotiations by the State Department and the Civil Aeronautics Board and a growing comprehension that there are many restrictions and much discrimination against U.S. airlines throughout the world.

The attitude of our negotiators to important upcoming talks appears to be more prudent and businesslike now than it was in late spring.

While our attitude and ability in negotiations have improved and we now have a policy, we still need an organization to carry out that policy. The bill before the subcommittee, S. 3363, will do that.

It would establish the Office of International Aviation Negotiations in the White House. The Director and Chief Negotiator would have the rank of ambassador and would have three assistants—one each from the State and Transportation Departments and the CAB.

We wholly support establishment of this office. A permanent organization is needed to end the continuous bureaucratic squabbles and jurisdictional fights that federal agencies in international aviation have engaged in for too long. Just recently, we saw one department publicly trying to grab jurisdiction from another department whose role in this area was reaffirmed by President Ford less than two years ago.

Establishment of the Office of International Aviation Negotiations should put a stop to such sorry spectacles. It should also put a stop to the recent practice of some members of the U.S. negotiating team to conduct negotiations themselves without the coordination of the group or konwledge of other team members. Unfortunately, some of our negotiators have been unable to resist such independent, fragmented negotiations or premature public discussion of unresolved issues. Such actions can only have an adverse effect on our performance at the negotiating table.

Everyone acknowledges the principle that the U.S. must speak with one voice in aviation negotiations. The Director of the Office would do so. He would also have the responsibility and authority to see that our international aviation policy is carried out. The Director should be able to move international aviation from being lost in the pack to its rightful place in the economic interests of this nation.

Opponents of Section 9 of your bill, Mr. Chairman, argue that the Office would automatically require a large staff. We think not. We view the Office of International Aviation Negotiations as being patterned after the Office of the Special Representative for Trade Negotiations. The latter has a staff of about 40 in Washington, hardly a large bureaucracy. The aviation office would draw largely on the existing staffs of the three agencies involved in international aviation negotiations and could obtain personnel and information from other agencies as needed.

Regarding other aspects of your bill, Mr. Chairman, we offer the following specific comments:

1. We suggest you consider adding enforcement of the International Fair Competitive Practices Act to the responsibilities of this Office. Combating restrictive and discriminatory practices against U.S. airlines will become an increasingly important element of many bilateral negotiations. Putting this responsibility in the new Office makes sense and should provide more enforcement for the Act than it has received so far in the Transportation Department.

2. We also note that S. 3363 provides for an International Aviation Advisory Council, whose membership would include a representative of labor. However, the current version of the bill does not state explicitly that the U.S. negotiating team will include a representative of labor. Currently, a representative of labor is an advisory member of the U.S. delegation, and we would not want the bill to alter that.

3. The Declaration of Policy in the bill, Section 2(b)(1), calls for "maintenance and furtherance of a high degree of safety in foreign air commerce." We suggest adding "and security" so that it would read "maintenance and furtherance of a high degree of safety *and security* in foreign air commerce."

This addition would provide a way to add language on security to bilateral agreements. When S. 2236, An Act to Combat International Terrorism, becomes law—as we hope it will this year—we will be in a better position to include relevant provisions in new bilateral agreements if our proposed change is made.

4. We note that Section 1102(c) requires the Director to report directly to Congress and that Section 1102(i) allows representatives of Congress to observe international negotiations. These provisions are needed because Congress too often in the past has exercised oversight only after a poor agreement such as Bermuda II was signed.

5. Congress also may wish to include in S. 3363 a provision authorizing a resolution of disapproval within a fixed period of time after a bilateral agreement is signed. Such a legislative veto could preclude another Bermuda II.

In conclusion, Mr. Chairman, APA commends you and Senator Pearson for your initiative and leadership in developing this legislation. It is sorely needed. We are grateful for your interest in international aviation and your concerns for U.S. airlines and their employees. We support your efforts and your bill, and we look forward to working with you toward passage of this needed legislation.

That completes my testimony, Mr. Chairman, and APA is grateful for the opportunity to present our remarks on this important legislation.

STATEMENT OF TRANS WORLD AIRLINES, INC.

TWA appreciates the opportunity to comment on S. 3363 and other issues of current importance arising from our international aviation policy and bilateral negotiations pursuant thereto. The interest and expertise of the Chairman and Members of this Committee in these important matters provide an important forum for timely and serious consideration of numerous changes in the conduct our our international aviation relations. Some of these changes are so drastic and so sudden that continuing oversight by the Subcommittee is essential to an orderly process of deliberation.

Before commenting directly on S. 3363, we do wish to address some specific questions raised by recent bilateral negotiations. Chairman Cannon adverted to two of these items in his remarks opening the hearings on August 22, 1978. These concerned the fare and rate article of the new U.S.-Israeli Agreement,

and the "open skies" philosophy advocated for negotiations with Germany in September 1978. In addition, of great importance and concern is the apparent shift in U.S. policy which abandons the long established rule that capacity be premised on the demands of traffic moving between the countries of bilateral partners. The result would be international route patterns designed to use the U.S. travel market to support fifth and sixth freedom operations by foreign flag carriers.

TWA shares Senator Cannon's expressed concern that the fare/rate article in the U.S.-Israel Agreement "abolishes a needed safeguard against potential predation by a foreign carrier and its government". The adverse balance of payments implications of this new tariff article, particularly when combined with an "open skies" philosophy, warrants much more serious concern than has been evidenced thus far by those formulating U.S. policy.

We recognize the advantages to the consumer of free competition, but we also recognize the dangers inherent in providing foreign flag carriers with a potentially dominant position in international aviation. The U.S. maritime, steel and textile industries and their employees and shareholders have found themselves damaged by foreign competition which was supported by some form of governmental assistance. Therefore, we believe great care must be taken to insure certain aspects of the new U.S. International Aviation Policy do not create more problems than they may resolve for the United States.

We also associate ourselves with the positions advanced so emphatically by Mr. Seawell of Pan American and Mr. Daniellan of the International Economic Policy Association with respect to "open skies". TWA's fundamental reservation regarding our new international aviation policy is based on the view that a fair competitive market does not, can not and will not exist in international air transportation. As the new policies rely entirely on the assumption that there is a free competitive market (or that our government can see to it such a market exists), the premise is faulty as are the conclusions derived from it. Attachments A and B submitted to the Subcommittee with Pan American's testimony provide overwhelming evidence on these points. They clearly establish the difference between textbook and real world economics. The fact that foreign flag carriers are generally active and direct participants in the actual bilateral negotiations serves to underscore their unique position vis-a-vis their governments.

In a letter dated March 13, 1978 to Secretary Adams TWA urged that our government conduct appropriate research to establish the facts relating to international competition in the aviation area. To our knowledge, no such review has been conducted by the various agencies and departments directly concerned with establishing the new International Aviation Policy. We believe it is essential that our government review the international competitive environment in depth before major policy conclusions are reached.

In recent negotiations with the Netherlands, the United States gave away valuable new routes to the Dutch and obtained nothing in the way of equally valuable benefits for our country. In addition, the U.S. negotiators specifically abandoned the long established policy which generally requires that capacity be premised on demands of traffic moving between the countries of the bilateral partners. This tenent has been a fundamental and critical element of U.S. policy for thirty years.

The Dutch have long ignored this feature of the bilateral agreements and have built a system based on fifth and sixth freedom traffic. Our negotiators sprinkled retroactive holy water on Dutch violations of the agreement and eliminated the relevent clause of the bilateral. There is no reasonable explanation for this action and TWA respectfully urges the Subcommittee to call for a re-examination of this change.

The Dutch bilateral not only legitimizes, but in effect promises assistance to, the siphoning of traffic away from the U.S. and bilateral partner flag carriers, to sixth freedom operators. This was done by guaranteeing, in the bilateral, that the U.S. would insure that restrictions were not placed on fares between the U.S. and other countries, such that the Dutch could not match that fare. For example, if a low, cost-based gateway-to-gateway, non-stop fare were introduced between New York and Athens, the Dutch would be allowed to match the fare via Amsterdam. Since KLM does not schedule aircraft for the New York-Athens market, their incremental cost of carrying a passenger on their existing New York-Amsterdam and Amsterdam-Athens flights is very low, and KLM can thus afford to pay travel agents very high commissions, and engage in other similar giveaways, to redirect this traffic from the U.S. and Greek flag airlines.

The foregoing observations are offered in response to Senator Cannon's invitation that he would welcome constructive suggestions regarding all aspects of our international aviation policy. We now turn to the specifics of S. 3363.

TWA welcomes this effort to establish objectives for U.S. negotiators that are intended to bring the benefits of competition to the international air travel market. In addition, the bill's focus on our government's organizational structure is timely and constructive. These are the two primary thrusts of the proposed legislation.

As regards the increased emphasis on competition, we have always indicated our support for this concept subject to a reservation that the policy be applied evenhandedly and without any discrimination. Whether the issue arises under domestic "regulatory reform" or in the context of international aviation policy, TWA strongly urges that no carrier, class of carriers or group of carriers receives preferential treatment. Equity requires that new competitive opportunities be made available for all carriers that meet the test of public convenience and necessity.

On this basis we would support the amended declarations of policy in Section 2, with certain reservations on Subsection 4 (see below), but urge that Subsection 5 be re-written to eliminate the obvious discrimination. The language submitted by the ATA on August 22 accomplishes the necessary change in focus.

We also support the request for continued confidentiality of international traffic data set forth in the attachment to Mr. Paul Ignatius' testimony. The competitive nature of this industry clearly warrants such action.

We also believe it is important that the international policy statement include language calling for a viable and profitable, privately owned, U.S. flag air transport system.

If the declarations of policy were re-drafted to incorporate the foregoing considerations, we believe Sections 3 and 4 of the bill are redundant and unnecessary. Section 3 would allow airlines to sell charter trips directly to the general public. Section 4 mandates extensive new international route authority for certain supplemental air carriers. The competitive benefits sought in these sections can be achieved, we submit, without specific legislation favoring supplementals in such discriminatory fashion.

Section 5, dealing with foreign air carrier permits, prompts two comments. The first is our reservation regarding Subsection (4) of the policy statement. The Subsection offers speedier regulatory action to carriers whose countries have less restrictive agreements with the United States. This is not discriminatory on its face but the absence of standards as to what is or is not restrictive would make the law difficult to administer.

Section 5 of the bill would also eliminate the requirement for a foreign airline to meet the public interest test under certain circumstances. We believe a hearing in regard to the public benefits of foreign flag entry into new markets is an essential forum for inquiry into whether any unfair competitive practices exist which could be rectified. For this reason we believe that an evidentiary hearing should be retained.

Section 6 establishes a rebuttable presumption that mergers between supplemental and scheduled carriers are in the public interest. TWA suggests that the type or class of carriers seeking consolidation should not enter into a determination of public benefits or adverse effect on the public.

Section 7 prohibits any fare, rate or capacity agreement affecting foreign air transportation. A legislative bar to any such agreement at any time under any circumstance that may arise in the future appears to be unnecessary. There may be another situation similar to or worse than the fuel crisis of 1973. If a government approved, term-limited capacity agreement offered the best solution, it would be unfortunate to have such a prohibition on the books.

As to fare or rate agreements, we prefer this question be dealt with under existing law. There will be times when agreements must be reached on fare disputes if only because we are dealing with sovereign states. Imposing a legal bar to carrier resolution of such issues, subject always to government approval, may well foreclose an option which governments themselves would like to leave open.

Section 8 limits the authority of the President to apply only to CAB decisions affecting foreign as opposed to U.S. air carriers. Certification of U.S. carriers between the United States and foreign countries plainly bears upon foreign policy, international relations and other areas uniquely falling within the jurisdiction of the President. It would appear to be inappropriate, therefore, to exclude the President from the process of certifying United States air carriers in foreign air transportation. Therefore, the present Section 801 should be continued.

Section 9 creates a new Office of International Aviation Negotiations in the Executive Office of the President and sets forth "Goals for International Aviation Policy".

It is our position that the recent review of responsibilities of the various agencies and departments of government involved in bilateral negotiations has been salutary. There seems to be a much clearer understanding as to who is on the team, who plays what position and who is the captian. We see no need to impose a new layer of authority over the recently evolved structure. We would rather see aviation up-graded within the Department of State than to create a new office at the White House. Specifically, we have long advocated an Assistant Secretary for Aviation at State both to assure more attention and authority in that Department and to equate the rank of our principal negotiator more evenly with his foreign counterparts.

In conclusion, addressing the "Goals" for our negotiator, we note again the omission of any reference to a financially viable and privately owned U.S. flag international air transport system. However ,it is our view that the Policy Declarations of S. 3363, if rewritten as indicated above, take care of the objectives sought in this legislation. Therefore, there should be no need for the degree of specificity detailed in Section 9.

We look forward to continued participation in the efforts of the Subcommittee to establish policy direction in international aviation matters and an effective, responsive government organization to implement the policy.

STATEMENT OF HAMILTON, MILLER, HUDSON & FAYNE TRAVEL CORPORATION

Hamilton, Miller, Hudson & Fayne Travel Corporation, a tour operator with headquarters in Southfield, Michigan, submits this statement for the consideration of the Subcommittee. HMHF is engaged primarily in selling charters[1] in the Las Vegas, California and Caribbean markets.

HMHF's principal concern is with section 3 of S. 3363, which would permit direct air carriers to sell charter trips directly to the public in progressively larger percentages up to forty percent. HMHF strongly opposes enactment of section 3 or any similar measure which would authorize direct carriers to sell charter seats directly to the public.

The rationale for section 3 presumably is the oft-repeated desire of the supplemental carriers for authority to sell all or a portion of their capacity to the public without participation by independent tour operators, a desire based upon the alleged need to overcome predatory pricing by scheduled carriers which has led to underutilization of supplemental carrier fleets. The claim has also been made that direct sales will produce operating efficiencies for the carriers.

HMHF believes that authorization of direct charter sales will be fundamentally anticompetitive and will not in fact improve the position of the supplemental carriers. The Civil Aeronautics Board has already found that it would be contrary to the public interest to permit direct carriers to acquire control of tour operators for the purpose of direct sales. CAB Order 76–6–135, served June 21, 1976.

One of the alleged "operating efficiencies" often claimed to result from direct sales is the presence of an "assured customer" for the carrier's aircraft. What this really means is that the selection of markets in which to commit aircraft, and the timing and terms of such commitments, will be based primarily upon the carrier's need to utilize its aircraft and not upon an independent evaluation of the demand and the level of capacity needed to satisfy it.[2]

The impact of such decisions upon independent tour operators will be devastating if the carriers elect to commit too much capacity at extremely low rates merely to keep aircraft flying. It would likely also result in further concentration of capacity at gateway points, thus restricting the supply of charter lift in secondary markets. The carriers can effectively mount a scheduled service with respect to air-only charter seats. A direct carrier with the ability to sell its seats

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[1] Historically, most of HMHF's programs have been of the One-Stop Inclusive Tour type, with some Advance Booking Charters as well. Effective August 15, 1978, these charters have been designated Public Charters under new Civil Aeronautics Board regulations.

[2] In addition to excessive aircraft capacity, this could also result in selling seats to more passengers than there are hotel rooms to accommodate. Direct carriers would, of course, compete directly with independent tour operators for the limited supply of hotel rooms. This may well force prices of ground accommodations up.

individually to the public can divert traffic from independent tour operators by offering excessive commissions to retailers, while covering these additional costs through higher seat cost charges to independent tour operators. There is no way that the Civil Aeronautics Board can effectively police this type of activity. Nor can it realistically prevent agents from independently packaging land programs to be offered in conjunction with low-rated air-only charter seats sold by the carrier.

It is no answer that the direct carrier may sell only a portion of each aircraft on an air-only basis, thereby reducing the seat commitment required by the tour operator. The difficulties with this approach are manifest. If World Airways offers, for example, a B–747 aircraft in a market where the tour operator would not undertake to sell such a large aircraft due to perceived lack of demand, the tour operator's position would not be materially improved by accepting the offer on the basis that World would itself sell a portion of the seats on an air-only basis. The tour operator would in effect be arranging for the sale of capacity in a market which by hypothesis could not support it. The carrier and the tour operator would be competing with each other for the same traffic. One outcome could be that the carrier, with vastly superior resources, would fill its seats while leaving the tour operator to pay for unsold capacity to which it had committed.

And this would be true even if the tour operator were selling only package tours. Common myths notwithstanding, many potential purchasers of package tours are also potential purchasers of very low cost air-only programs. The direct carrier would have every incentive to sell the air-only seats at or below its cost in order to fill its portion of the plane, thereby making it more difficult for the tour operator to attract passengers to higher cost packages which are predicated on the carrier's higher seat cost to the operator. This type of competition would also preclude the tour operator from offering air-only seats as a portion of its total program. While we have not thought of all of the possibilities, we believe that the same problems will arise in any scheme which allows direct carriers to sell seats on their own behalf.

Similarly, there is no substance to other alleged "operating efficiencies." Direct carriers can monitor charter bookings by working cooperatively with independent tour operators—they do not need to be the tour operator to achieve this goal. Joint advertising is also possible under the present industry structure. See CAB Notice SPDR–36A, December 5, 1975. And there is no evidence that passengers are today paying discriminatory or noncompetitive prices and thus no demonstrated need for the direct carriers to control the retail price of charters. The tour operator segment is the most competitive portion of the aviation industry today, with virtually free entry, free exit and free pricing.

Authority for direct sales by carriers will deter independent tour operators from aggressively developing new markets, since any success in that direction will likely be met by preemptive direct participation from the direct air carriers. The direct air carriers could readily restrict capacity available to tour operators who have developed new markets and thereby eliminate the principal reward for such development.

The real problem posed by the new deep discount fares approved by the CAB is that they have escalated the risk of a large commitment of charter capacity by both the tour operator and the carrier in the major charter markets, particularly in the non-peak season. The tour operator who undertakes a major program only to be met by Super Saver, Super Jackpot or their equivalents, at prices only nominally higher than the charter seat price and without the necessity for a planeload seat commitment, is taking a tremendous gamble.

The Public Charter liberalization of the charter rules, made effective just last week, will offset some of these increased risks by enabling tour operators to offer a more competitive product. This ability hopefully will compensate for the loss of the price advantage which charters once enjoyed. This will in turn lead to a reduction in the carrier's risk of premature cancellation by a tour operator which becomes uncertain of its marketing position in the face of deep discount scheduled fares and substantial charter cancellation penalties. In this way the need of the charter carriers for additional competitive opportunities can be met without gutting the vitality of the tour operator segment of the industry.

We have attached hereto a copy of the comments filed by HMHF with the CAB on the subject of granting fill-up rights to supplemental carriers which comments further elaborate on the problems created by direct sale of charter capacity by direct air carriers. The fallacy of section 3 of S. 3363 is that there is no demonstrable connection between the authority to be conferred and any

specific benefits to the travelling public. The immediate consequence of abandoning the historic role of charter carriers will be the substantial curtailment of investment in the tour operator industry by responsible businessmen. As the direct carriers expand their scheduled services (authority for which will be conferred upon the supplementals by S. 3363), the quantity and variety of charter services will diminish and the competitive pressure which charters have long exerted will be dissipated. The combined effect of sections 3 and 4 of S. 3363 will therefore be a substantial diminution in the supply of charter seats, an increase in the cost of charter transportation and a clear detriment to the travelling public.

BEFORE THE CIVIL AERONAUTICS BOARD, WASHINGTON, D.C.

SUPPLEMENTAL CARRIER FILL-UP CASE

(Docket 32398)

BRIEF OF HAMILTON, MILLER, HUDSON & FAYNE TRAVEL CORPORATION TO THE BOARD

Hamilton, Miller, Hudson & Fayne Travel Corporation (HMHF) submits this brief to the Board in response to Order 78–4–50 which instituted this proceeding. HMHF is a tour operator with headquarters is Southfield, Michigan. It is engaged primarily in selling ABC and OTC charters in the Las Vegas, California and Caribbean markets.

HMHF is opposed to the grant of fill-up authority. The *World Airways* case[1] does not require, or support by implication, the conclusion that the Board may lawfully permit a carrier to combine section 401(d)(3) authority with section 401(d)(1) authority on the same flight.

Fill-up authority, however conditioned, would not constitute scheduled route service in any sense previously conceived under section 401(d)(1). Fill-up authority likewise is not "charter" and does fall within the broad discretion conferred upon the Board to define "charter". Fill-up authority is simply not contemplated by the Federal Aviation Act.

But even if the Board has the legal authority to grant fill-up authority to supplemental carriers, the question remains whether it is sound policy to do so. There is no way that the Board can answer that question without a full hearing. The Board does not have before it any substantive evidence of the implications of granting this authority and will not have such evidence at the conclusion of this round of briefs. Yet the Board must have evidence to support its action in granting the authority.

The Board cannot find, without evidentiary procedures, that the benefits and goals about which it speculates at page 1 of Order 78–4–50 will come to pass or even that there is a reasonable chance that they will materialize. HMHF does not believe that they will, a position based upon many years of operating experience in the industry, an experience which the Board cannot claim. Fill-up authority will not, for example, "improve the marketability of charters" because it is not "charter" authority. The scheduled carriers will match the prices and terms of any fill-up seats dumped on the market by the supplementals. This authority will not "reduce the potential for charter flight cancelations or . . . consolidations." Passengers will be diverted from charter seats to the fill-up seats and these risks will probably increase. It must be remembered that one supplemental will be dumping fill-up seats at bargain basement prices while tour operators on another supplemental, or scheduled carrier charter, are still trying to sell charter seats for the same dates/markets or competitive dates/markets. The Board also asserts that fill-up authority will "expand the market". It is hard to see how the sell-off of individually-ticketed seats will expand the market for charter seats.

HMHF further submits that the sharing of the risk of empty seats with tour operators will be harmful to both supplemental carriers and tour operators. If a tour operator cannot market ABC seats even at its cost, it should follow that the carrier will do not better unless it reduces the price of the fill-up seats below the yield that it was getting from the tour operator. The carrier must recoup these revenues somewhere. It will do so by increasing prices to tour operators for chartered seats, offsetting any "eventual reduction in the per seat cost of the charter flight" to tour operators and making charters even more difficult to sell. The ability to sell below-cost services cannot be regarded as beneficial to the long-term health of the charter industry.

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[1] *World Airways, Inc.* v. *CAB*, 547 F.2d 695 (D.C. Cir. 1976).

The ability to sell fill-up seats will lead to wholesaling of fill-up seats to agents who will make bloc-seat commitments. Since the availability of fill-up seats will not be known until very late, only high risk takers will participate.[2] Passenger payments will not be protected by the depository regulations imposed upon tour operators.

The Board must collect evidence on these points if it is to conduct its statutory functions in a responsible manner. It cannot claim that it is acting to benefit the charter industry, or a portion of it, without having a reasoned basis for so concluding. HMHF submits that fill-up authority will be catastrophic to the tour operator segment of the industry and cannot benefit the supplementals under any credible set of circumstances.

Fill-up authority is a major step in a fundamental restructuring of the industry which includes elimination of the business opportunities enjoyed by a major portion of it. We do not believe that the Board can lawfully do this by exemption or show cause order. We believe that the law is that the Board in its long-term licensing actions must act by certification following full adversary hearings in which an evidentiary record is developed and tested. The Board has the burden of justifying its action and cannot lawfully place the burden upon the industry to prevent arbitrary action by proving that the propsed actions are wrong. The Board's staff presumably believes that fill-up authority will not injure the tour operator industry. If so, the staff should be required to submit the factual basis for its views to the test of an adversary hearing in which affected industry members have a chance to press a few pertinent questions rather than merely filing papers and waiting for the outcome.

Respectfully submitted,

PAUL M. RUDEN,
Attorney for Hamilton, Miller, Hudson & Fayne Travel Corporation.

INTERNATIONAL AIR TRANSPORT ASSOCIATION,
Montreal/Geneva, August 25, 1978.

Hon. HOWARD W. CANNON,
Chairman, Senate Subcommittee on Aviation,
Russell Senate Office Building,
Washington, D.C.

DEAR CHAIRMAN CANNON: The International Air Transport Association (IATA) wishes to take this opportunity to express certain views to you and members of the subcommittee concerning S. 3363, the "International Air Transportation Competition Act of 1978". We understand that you have introduced this bill to stimulate discussion on the development of U.S. international aviation policy and that preliminary public hearings have been held before your subcommittee on August 22–24, 1978.

IATA is a cooperative, democratic association of the world's airlines, having its roots in the International Air Traffic Association established in 1919. Its objectives are:

To promote safe, regular and economic air transport for the benefit of the peoples of the world, to foster air commerce and to study the problems connected therewith;

To provide means for collaboration among the air transport enterprise engaged directly or indirectly in international air transport service;

To cooperate with the International Civil Aviation Organization and other international organizations.

IATA at present is composed of 107 member airlines—large and small, government owned, those with mixed ownership and private enterprises; airlines who fly the flags of 85 States, developed and developing; airlines operating public scheduled services and charters.

Airlines in IATA have, over the years, devoted worldwide common effort and millions of man-hours to the task of building an integrated global air transport network and system. This work, which provides a vital link between users, air-

[2] If the Board expects that the number of fill-up seats will be determined when the charter contract is signed, but with sale delayed until shortly before departure, it will invite impossible enforcement problems in controlling the premature sale of the seats. If the sale of fill-up seats is to be allowed concurrently with the sale of charter seats on the same flight, the tour operator will be cutting his own throat. It is also impossible to distinguish the latter arrangement from part-charters which the Board has thus far wisely resisted.

lines and governments, includes developing safety standards, ensuring adequate airport facilities, exchanging information on engineering problems and operational experience, training of crews, reducing operating costs including fuel consumption, development of complex interlocked reservations systems, so that anyone can go anywhere in the world by virtually any routing on one ticket paid for in one currency, formulating processes for efficient passenger, baggage and mail handling, and speeding their progress through the system, and from the outset actively assisting in the establishment of security standards and anti-hijacking procedures. As one integral part of these activities, with the approval of governments, IATA provides member airlines with a multilateral forum in which their individual tariff proposals are developed and blended for subsequent presentation and consideration by governments around the world.

We hope that our perspective as a democratic and apolitical international organization, serving all world governments, will be of assistance to you and the subcommittee in considering S. 3363 and related issues.

Many provisions of S. 3363 address the goals of U.S. international policy in aviation. This is a subject which other U.S. Government organs, including the CAB and the Executive Branch, are currently exploring as well. IATA appreciates the need for governments to undertake such reviews and would not deem it appropriate to intervene in any domestic process to review national goals.

There is, however, an important difference between the goals of a nation's international aviation policy, and the actions through which policy is implemented or presented to the other nations of the world. We believe it vital that any air transport legislation not overlook the importance of the latter in its concern for the former.

The actions by which the U.S. seeks to implement its international aviation policy directly affect the sovereignty of other governments.

It should be recognised that aviation worldwide is different from most business involving services or commodities. In addition to economic considerations, it directly engages the national interest and sovereignty and the 'prestige' of almost all countries of the world.

International aviation cannot be divorced from this wider world of international political and economic interrelationships of which it is a dynamic and vitally necessary part—a world in which nation states attempt to co-exist and must, therefore, step cautiously, in concern. This interdependence implies the need for a common approach toward international relationships rather than confrontation provoked by unilateral action.

In this context, IATA urges, regardless of the U.S. aviation policy goals selected, that they be exported in a manner consistent with the maintenance of world harmony and an enhanced travel and communications system. We urge the United States to reaffirm explicitly its commitment to a policy of advancing its economic philosophy through consultation, negotiation and agreement rather than through unilateral action or confrontation.

A renewal of this commitment would provide a reassuring signal to the other nations of the world at a time when the United States is contemplating major changes in the substance of its aviation philosophy. Many of these nations already view with alarm a number of actions recently undertaken by the Civil Aeronautics Board in areas which impact directly on the orderly development of their own air transportation system. To them, the U.S. appears to be trying to impose its goals through the sheer might of its civil aviation resources.

Against this background, we would like to comment on that aspect of Section 7 of S. 3363 which would amend Section 412 of the Federal Aviation Act to prohibit the Civil Aeronautics Board from approving fares and rates proposals negotiated between air carriers under the terms of bilateral government accords, or, in the terms of the bill, 'any contract or agreement affecting foreign air transportation . . . which fixes rates, fares, or charges between or among air carriers and foreign air carriers'.

The inclusion of such blanket prohibitions in Section 412, in light of the knowledge that virtually all nations view agreed prices as essential to a fair economic environment, certainly appears to sow the seeds of confrontation.

Specifically, while the United States may conclude that it favours an economic philosophy under which governments rarely intervene in rate questions, we believe that it should recognise that other nations, including many with which the U.S. has important air commerce relations, may not share this view. We hope that the United States would also recognise that it may not be able to achieve all of its economic objectives in negotiating inter-governmental air transport agree-

ments, and that the particular issues on which accommodation may be reached with other sovereign States should not be foreclosed by mandatory legislation.

If the proposed amendment to Section 412, together with the U.S. anti-trust laws, operated to foreclose negotiated rates proposals at the carrier level, then only two alternatives would remain where U.S. bilateral partners sought to exercise rate powers:

(1) direct negotiation of rates at the diplomatic or bureaucratic levels; and

(2) open confrontation, with governments refusing to implement unilateral rate filings by U.S. carriers.

The first alternative would likely burden the development of air commerce by additional administrative delay and might further complicate the development of a rational fare structure by the intrusion of political factors not directly connected with aviation, and hardly could be said to contribute to deregulation and reduction of government involvement and bureaucracy in international air commerce. The second alternative is even more undesirable, since it offers nothing but the prospect of destructive actions which ultimately could lead to rate inertia or to temporary or permanent disruptions in service between the nations involved.

For these reasons, we believe that provisions such as the proposed amendment to Section 412 (concerning carrier negotiated rates proposals) would be overly restrictive in limiting the ability of U.S. negotiators to move toward U.S. goals in a constructive international atmosphere. The United States always remains free to negotiate agreements providing for pro-competitive conditions and restrictions on rate intervention and the CAB can weigh these agreements in passing on specific Section 412 issues. To leave anti-trust enforcement, public and private, as the sole means by which the U.S. can respond to other nations' desires for a commercially co-ordinated rate regime seems to invite unnecessary confrontation in the international aviation community.

In raising questions about S. 3363's restriction on the discretion of the CAB and U.S. aviation negotiators, IATA takes no position on U.S. competitive philosophy, nor on the U.S. efforts to liberalise international competitive conditions. As you have noted in introducing S. 3363, the U.S. has made progress in recent bilateral negotiations. Perhaps more important, the U.S. has caused a large number of carriers and governments to begin reviewing their own regulatory attitudes. Consequently, new government and carrier thinking has been reflected within IATA. For almost a year, steps have been in hand—a more important follow-up to earlier constant review and change—to restructure the Traffic Conferences to provide further competition and innovative rate-making options to member carriers and to introduce increased accessibility, flexibility and openness into the processes. We believe that this evolution will enable the IATA forum to accommodate the contrasting policy goals of various sovereign governments, by facilitating the development of commercially meaningful tariff proposals in a form generally acceptable to governments.

We respectfully suggest that, in view of the points raised in the statement above, Section 7 be eliminated from the bill or at least postponed until experience has been gained from the presently evolving IATA structure and Traffic Conference Provisions.

In addition to the specific comments made concerning Section 7 of the proposed S. 3363 and in line with the stated aims of the bill, I would like to take the opportunity of drawing your attention to one area closely related to increased competition—its impact on airport facilitation and security arrangements. It is already the case that at all major U.S. international airports, existing facilities are overburdened as a result of current traffic volumes and obsolete border crossing procedures which require not only adjustment to the legislation but also substantial procedural improvement. In April 1977, IATA and the ATA testified to Senator Inouye's Sub-Committee on Merchant Marine and Tourism Concerning International Visitor Facilitation containing the details of the problems already then encountered by international carriers at U.S. international airports. These problems are now obviously accentuated by the increased flow of traffic experienced in the summer of 1978 and have reached disastrous proportions at some gateway airports. In the interests of the travelling public, we would urge your Sub-Committee to take these problems into account and to give them a high priority when developing new international air transport legislation,[1] thereby ensuring a parallel development of international traffic expansion due to greater competition and a significant improvement in facilities available and procedures implemented

[1] The situation regarding cargo facilitation is similarly in great need of improvement in the United States.

for processing this traffic. In this way the quality of air transport can be maintained and even enhanced in the public interest. A copy of IATA's submission to the Sub-Committee on Merchant Marine and Tourism Concerning International Visitor Facilitation is attached for your easy reference.[2]

In closing, the International Air Transport Association wishes to emphasize its conviction that you and the Aviation Sub-Committee are making an important contribution to the development of U.S. international aviation policy through your consideration of S. 3363. We hope that the views expressed herein will facilitate your deliberations.

Yours sincerely,

KNUT HAMMARSKJÖLD.

[The following information was referred to on p. 141:]

SERVICES IN AMERICA'S INTERNATIONAL TRADE: THE AIR TRAVEL AND TOURISM SECTOR

(By the International Economic Policy Association Washington, D.C.)

FOREWORD

The International Economic Policy Association has long advocated a greater recognition of the role of services in international trade because of its potential for balance of payments earnings and for stimulation of employment. For the first time Congress recognized the increasing role of services in the Trade Act of 1974 (PL 93–618). That Act, in particular Title III, Chapter 1, Section 301, and the House Ways and Means Committee report on the Trade Act, clearly show this recognition and the congressional concern about the problems facing U.S. service industries.

Service industries encompass a broad range and include such activities as construction and engineering, shipping and insurance, financial and accounting services, and air travel and tourism. The latter two were specifically discussed in the Ways and Means Committee report. The executive branch, however, has done little to carry out the expressed mandate of Congress, and the exhaustive study done in 1976 by the Commerce Department, "U.S. Service Industries in World Markets," has not been followed up.

In the changing mix of international transactions, and with the problems encountered by direct investment in many countries, the petrodollar and world financial crises plus general currency uncertainties, service-industry investment and foreign exchange earnings around the world have become more important for the United States. These subjects are examined in the first part of this paper. The paper then turns to the tourism and the air travel sector of the international service industry to illustrate the specific types of problems confronting U.S. industry in this regard. This is especially relevant in light of the current controversy over the Carter administration policy of stressing international competition per se, as opposed to seeking an international "balance" in the concessions and agreements involved in that competition.

This paper is the work of the IEPA staff, particularly Ronald L. Danielian, who has had governmental experience with tourism matters in the past while occupying the post of Director, Office of Research and Analysis of the U.S. Department of Commerce United States Travel Service. It has been discussed with members of the IEPA Committee on Trade but it does not necessarily reflect the corporate views of any individual member company.

INTRODUCTION

Over the last 20 to 30 years, services have provided the major ingredient of U.S. economic and employment growth.[1] Shortly after World War II, services, broadly defined, comprised slightly over half of the value of goods and services produced in the country. Today they account for two-thirds of U.S. economic output and consumption and about two out of every three Americans in the work force are employed in the service sector. The Bureau of Labor Statistics has

[2] The statement is printed in the hearing record Serial No. 95–23 p. 172.

[1] See U.S. Service Industries in World Markets, U.S. Department of Commerce, December 1976.

estimated that the rapid growth in the labor force was facilitated by strong employment gains in service and trade industries, and believes that this growth reflects a long-term trend.[2]

The evolution and rapid growth of service industries in the United States and other industrial nations are not the result of any erosion in manufacturing ability or competitiveness. They are the natural result of an increasing economic wealth, that creates increased demand for services relative to goods, and of increasing economic specialization.[3]

I. Services in the Balance of Payments

Service receipts in the U.S. balance of payments have become a large component of the country's total international economic picture. Table 1 shows the annual U.S. receipts for goods and services in selected years from 1960 through the first three quarters of 1977. As can be seen, all private service receipts (excluding exports of goods and military equipment and U.S. Government receipts) rose from a level of $7 billion in 1960 to $17.2 billion in 1970, and finally to $46.3 billion in 1977. These service receipts, which now represent 26.3 percent of U.S. international exports of goods and services, have grown rapidly in the immediate past and are likely to continue to grow rapidly in the future.

The dollar amount of exports required to create or maintain a job in the United States has been variously estimated over the last several years. The latest Commerce and Labor Department findings are that approximately $35,000 in exported goods supports one job. Service industries by their nature are more labor-intensive than the all-industry average, and therefore the amount of receipts required to produce a job in the service sector would be less than the overall figure cited. The Commerce Department's United States Travel Service has estimated that for every $25,000 of tourist spending, one job is created.[4]

If that figure is used as a broad gauge for all service industries, up to two million jobs were supported by the gross export receipts of U.S. service industries. If you net out service earnings against the U.S. payments for foreign services received in 1977, there is still a surplus of $12.9 billion in our total private service account which would have netted over one-half million new jobs.

One-third of the $46.3 billion in service export receipts for 1977 came from U.S. direct investments abroad (either royalties and fees from affiliated foreigners, or income receipts on direct investments); another third came from transportation services, including both air and sea; and the remaining third derived from other private services and receipts, mainly in the banking sector and in fees and royalties from unaffiliated foreigners.

The largest contribution to our returns in the service sector has been generated by U.S. direct investments—$15.8 billion in gross receipts in 1977. This is closely followed, however, by service sector receipts in transportation and tourism, at $14.8 billion. Approximately half of that amount represents travel and air transportation to the United States by foreigners.

Table 2 shows U.S. avel and transportation expenditures and receipts in the balance of payments from 1974-through 1977. Prior to 1973, the U.S. deficit on a balance of payments basis for airfare and other travel and transportation expenditures was above $3 billion. More recently, the United States has been able to reduce this deficit to levels below $3 billion.

All the service sector accounts have become extremely important to the ability of the United States to finance its expenditures abroad. According to the Morgan Guaranty Trust Company, "A major favorable factor [in the balance of payments] which has partly offset the growing trade deficit has been the rapidly rising net revenues on services. Only a few years ago net income from services was close to balance with payments to foreigners largely offsetting income from abroad. However, in 1974, and particularly in 1976, and again in the first half of this year [1977] the net services income has climbed sharply."[5] This trend continued throughout 1977 to the present time.

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[2] Statement of Julius Shiskin, Commissioner of Labor Statistics, before the Joint Economic Committee, January 12, 1977.

[3] Ibid., 1.

[4] *Highlights, International and Domestic Tourism 1976,* U.S. Department of Commerce, U.S. Travel Service, April 1977. Also see: *Travel: An Engine of Employment,* Discover America Travel Organizations, 1977.

[5] *World Financial Markets,* Morgan Guaranty Trust Company, September 1977.

CONGRESSIONAL CONCERN

Tourism is the third largest U.S. industry in terms of consumer spending, and its average annual growth rate in the last five years has exceeded that of the GNP.[6] Despite this fact, the Congress paid little direct attention to services in 1974. The House Committee on Ways and Means in its report on that statute explains that, "It is the intent of the Committee that 'commerce' as it is used in Section 301(a) is to include the services as well as goods. Although the Committee understands that the trade agreements of the type authorized under Title I of the bill do not usually extend to the treatment of services, it is much concerned over present practices of discrimination against U.S. service industries including, but not limited to, transportation, tourist, banking, insurance and other services in foreign countries. It is the Committee's intent that the President give special attention to the practical elimination of this discrimination by the use of authority under this provision, to the extent feasible, as well as steps he may take under other authority.

This intent in further indicated in the Section 163 requirement that he report to the Congress on the results of action taken to remove this discrimination in international commerce against U.S. service industries." [7] The sections of the Act which cover services or service industries include Title I, Chapter 1, Section 102; Title I, Chapter 3, Section 135(b)(1); Title I, Chapter 6, Section 163; Title IV, Section 405; Title VI, Section 601(10). However, the most important section dealing with services including tourism services, is Title III, including Sections 301 and 302.

Specifically Section 301 empowers the President to withdraw trade agreement concessions, impose duties or other import restrictions on imported products, or impose fees or restrictions on the services of any foreign country which burdens, restricts, or discriminates against U.S. commerce or engages in discriminatory or other acts or policies which are unjustifiable or unreasonable and which burden or restrict U.S. commerce.[8] For the purposes of this section, commerce is specifically defined to include services associated with international trade. This section of the Act has been used in several cases when service industry barriers have arisen, principally against U.S. shipping companies. The best example is in a Delta Steamship case against Guatemala. That country imposed restrictions on the carrier and became subject to review under Section 301. Ultimately, the case was settled out of court, but the pressure of a U.S. investigation under Section 301 was responsible for moving the issue to settlement between the parties concerned.

In 1974 the Congress also passed the Fair Competitive Practices Act, which allows U.S. Government action against discriminatory and unfair competitive practices against U.S. air carriers in providing foreign air transportation services. The coverage of the Act includes unreasonable international user charges and unfair rates for transportation of international mail. It also mandates that transportation of government-financed passengers and property be on U.S. carriers as certificated under Section 401 of the Federal Aviation Act of 1958, as amended. The law further prohibits solicitation or acceptance of rebates by shippers of air freight; it mandates observance of tariffs by ticket agents; and it amends the International Travel Act of 1961 to provide for the promotion of travel on U.S. carriers in foreign air transportation.

The hearings accompanying the Act describe some of the nature and extent of the problem of discriminatory practices followed by foreign countries as related in the CAB's 1974 report entitled "Restrictive Practices Used by Foreign Countries to Favor Their National Carriers." [9] In supplementary information provided for those hearings before the Senate Subcommittee on Aviation, the Department of State indicated some of the problems faced by U.S. carriers in foreign countries. For example, Air France, through its ownership of tourist agencies and air freight forwarders, controls a significant portion of the French market; and the French Government, through its ownership of the major domestic carriers

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[6] U.S. Department of Commerce, United States Travel Service Fact Sheet, 1977.

our international trading relationships until the passage of the Trade Act of

[7] House Committee on Ways and Means, Report on the Trade Reform Act of 1973 (H.R. 10710) which was passed as the Trade Act of 1974. House Report #93–571, October 10, 1973, p. 66.

[8] See, Trade Act of 1974, Public Law 93–618, 19 U.S.C. 2101.

[9] See *International Air Transportation Fair Competitive Practices Act of 1974*, hearings before the Senate Committee on Commerce, Subcommittee on Aviation, July 16 and 17, 1974.

as well as Air France, has virtually a monopoly position on traffic originating in France.[10] It is no wonder that roughly two-thirds of the foreign visitor arrivals in the United States from France flew on foreign carriers (most notably those of French registry).

EXECUTIVE CONCERN

In December 1976 the Department of Commerce issued a 418-page study entitled "U.S. Service Industries in World Markets: Current Problems and Future Policy Development." It outlined some of the problems faced by all U.S. service industries. Among those specifically facing U.S. air transportation—especially in international markets—it cited such factors as the following: (1) foreign government subsidization which allows the operation of national air carriers on a non-economic basis; (2) foreign currency controls that restrict the availability of foreign exchange for purchasing air transportation services and interfere with the remittance of profits back to the United States; (3) excessive and discriminatory charges for the use of airport and airway facilities; (4) discriminatory application of income, fuel, and other taxes between foreign and national carriers; (5) illegal ticket discounting and rebating; (6) ground handling monopolies by foreign governments for carriers; (7) government procurement practices.

The study highlighted the fact that the international receipts of U.S. scheduled airlines accounted for some 27.8 percent of their total operating revenues in 1975. It also pointed out that of the 60 foreign carriers providing service to the U.S. market, 46 are either wholly government-owned or receive substantial subsidies. In the North Atlantic markets, where U.S. financial losses during that year were the largest, every major foreign carrier was either government-owned or supported.

Thus, up to 1976 at least, Congress and the executive branch expressed deep concern for the discriminatory practices that sometimes beset our international service industries; and tourism and travel are key components of that group. As mentioned above, international and domestic tourism for the United States was estimated in 1976 at $105 billion or 6 percent of the American GNP. In 1976 again, tourism ranked fourth among U.S. exports of goods. Only machinery, transport equipment, and grain and cereal preparations ranked above tourism in the export categories. U.S. tourism receipts in 1977 are estimated to have supported some 270,000 U.S. jobs and contributed approximately $975 million in Federal, state, and local tax receipts, according to the U.S. Travel Service Fact Sheet.

II. Competition for the Transportation and Travel Dollar

With tourism becoming such an important feature in the American economic landscape, and with international tourism so full of potential economic benefits to the United States, it is no wonder that the competition for the international travel and transportation market is fierce. Foreign governments are organized to attract international tourism receipts and the transportation portion of these expenditures is viewed as an integral part of the total package. Generally the European countries, especially our OECD trading partners, have viewed tourism and transportation services as one commodity in the aggregate of money spent by travelers. Their policies have been generally directed toward getting the traveler to their countries to spend foreign currencies. The fact that the air transportation portion of the trip may be at break-even cost is not important so long as the total expenditure of foreign exchange by the tourist, for both transportation and expenses within the country, is increased. The national tourist offices of 35 countries spent approximately $420 million in 1975 to attract foreign tourists to their shores. The competition for tourist dollars has centered on the key factors of market access and share of the potential travel earnings.

For example, a special survey done in collaboration with the European Travel Commission on the occasion of the Commission's Zurich conference on European Tourism Prospects in the 1980's, elicited several responses to a question about the scope and emphasis in the marketing policy of government tourist organizations. In the reply from The Netherlands, the government's involvement in tourism and tourism receipts was described as devoted to "more emphasis on employment-foreign exchange maximization, (and) environmental protection."[11]

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[10] Ibid., p. 54.

[11] See *Tourism International Policy*, Tourism International Press, London, England, 4th quarter 1977.

In pursuit of market share and access, the European governments will not willingly let their carriers suffer losses from market dilution or overcapacity. European officials, representing both government and private business, have indicated to this author in private discussions during the spring of 1978 that foreign governments will use any available means of subsidy to maintain the presence of their carriers in the market. One such spokesman noted that "Dilution of routes will simply hurt U.S. private carriers, and some of them will go out of business; but we will still be here to market our product. We are convinced that European carriers will be subsidized by their governments."

Even in Germany, the largest European travel market, the U.S. drive to dilute the market may cause numerous foreign policy problems. This market is composed of large tour organizations that are involved in routing almost 80 percent of the travel of Germans.[12] A move to dilute routes and offer cut-rate transportation by the United States will bring strong German financial interests forward to put pressure on the German Government not to give in to the American desires.

This is because a plethora of carriers offering services will probably alter the basic nature of the German travel business, in which ground arrangements including tours and hotels traditionally have been purchased along with air transportation through travel agencies. Chart 1 shows the interrelationship between the major travel agencies in Germany and other business interests. It is also noteworthy that the *Deutsches Reisebüro*, one of the largest tour operators, is directlly owned by the Georman Government through the federal railroads. Since Germans alone spent $8.1 billion in 1977 on travel, it is safe to assume that any perceived jeopardy to that market would be resisted.

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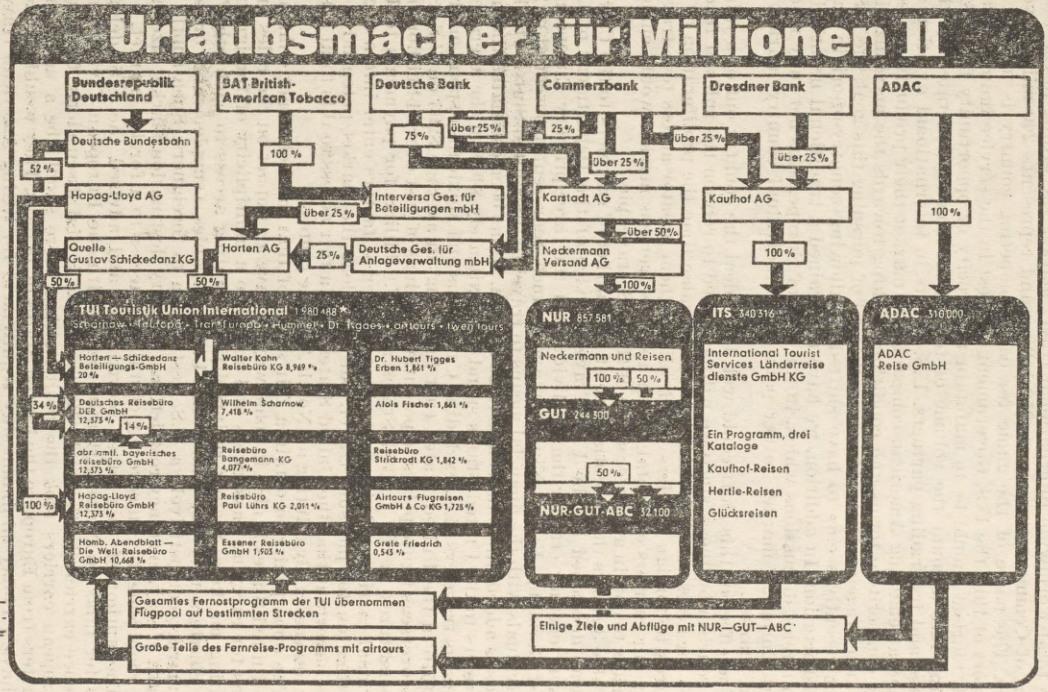
[12] About 52 percent of the German international travelers coming to the United States in 1976 used travel agencies in booking their trips. See: *West Germany, A Study of the International Travel Market,* May 1978, United States Travel Service, U.S. Department of Commerce.

CHART 1

TRAVEL AGENT
FOR MILLIONS



* Gästezahlen Saison 1976/77

% = ownership

WELT am SONNTAG -

Sonntag, 12. März 1978

The foreign competition for the travel dollar is surely understandable when you consider that U.S. citizens spent $6.4 billion in 1975, $6.9 billion in 1976, and $7.6 billion (estimated) in 1977 on world travel. The 1977 figure excludes the estimated $2.8 billion spent by U.S. tourists on foreign air carriers (see Table 2). The total worldwide international travel market (according to the U.S. Department of Commerce) is worth $50 billion and represents 240 million world travelers. The name of the game for each competing country is market share. In support of this, the U.S. Government interest in the service industries associated with tourism should be to maintain reciprocity of opportunity for U.S. carriers, taking into account the volume of tourist movements generated by the United States and its trading partners. U.S. efforts in international aviation should be aimed at enabling American companies to market their products overseas under very competitive terms and conditions looking towards the maximization of foreign exchange earnings. However, instead of pursuing this goal, the U.S. Government recently seems to have shifted to allowing country-of-origin rules in air transportation. In addition, we have maintained a traditional negotiating stance of bilateral discussions which, in the case of Europe, does not fully recognize the total European market rather pairs each individual country market with our total market.

The effect of this shift could well be to deal the country out of a fair share of the tourism business, since we will be forced to rely on the rules of foreign countries for access to their markets. At the same time the proliferation of American awards to foreign carriers which allows them greater access to a travel market than our carriers can obtain from a single overseas market would enable foreign carriers to obtain a greater share of the U.S. travel pie.

Table 3 shows the potential size of the market of travelers to the United States. It was developed by the U.S. Travel Service of the Department of Commerce. Taken together (rather than individually) the three primary European markets, West Germany, United Kingdom, and France, represent a potential of 24 million individuals with the financial means to travel to the United States. If The Netherlands is added, the total comes to 26 million. It has been estimated that all foreign travelers to the United States spend approximately $400 on the average, and that overseas travelers (i.e., excluding Canadians and Mexicans) spend on the average of $576 in the United States (not including an average $293 on U.S. carriers).[13] The overseas figure points to potential earnings of just over $14 billion for tourism expenditures in the United States and $7.6 billion for payments to U.S. international carriers. Obviously a great number of factors enter into a decision on a destination for pleasure travel, but it is clear the market potential is large and it is important that the United States have a fair access to this total market without unnecessarily diluting all North Atlantic routes.

The opportunity to obtain a fair share of that market is not enhanced unless the United States is able in some way to have an impact on the rules and regulations for carrying passengers and access to a multiplicity of foreign travel generating markets. Simply reciprocity in granting access to each other's markets for charters may not enable the U.S. companies (supplemental or scheduled) to market competitively a U.S. destination to foreigners. Such subtle factors as length of stay, currency restrictions, primary destination market size, and ticketing requirements can severely curtail our access to a foreign market.

The author of this paper served with and advised the U.S. delegation for charter talks on North Atlantic routes with the European Civil Aviation Conference carriers in the early 1970's. In the initial discussions, for instance, the European carriers took the position that there should be a minimum stay on charters from Europe to the United States of 14 days. They would also be satisfied to have a 14-day minimum stay requirement for lifting American travelers from the United States to Europe. That this is a most subtle form of discrimination is evident to those who know the facts on travel between Europe and the United States. Figures supplied by the Department of Commerce to that conference showed that the median length of stay for Europeans (especially charter passengers) in the United States was 7 days. If the United States had agreed to a minimum stay requirement of 14 days we would have been effectively cut out of 50 percent of the market. On the other hand, the average American's length of stay overseas, especially in Europe and the Mediterranean area, was 24 days. A 14-day rule would have opened up our markets and closed theirs!

[13] *Survey of Current Business*, U.S. Department of Commerce, June 1978, pp. 64–67.

THE PROBLEMS FOR INTERNATIONAL TRANSPORTATION EARNINGS

Competition in the international travel market can benefit both U.S. citizens and foreign nations. But there should be a differentiation in terms of the capacity (i.e., the number of carriers or absolute seats) on any route or group of routes. The latter can have the effect of reducing the profitability of those carriers operating without official subsidies (such as the U.S. international airlines) while giving an unfair competitive advantage to other airlines with increased access to our total market. It is possible to have price competition with more limited access to the U.S. market on the part of foreign carriers as long as the total capacity in any market is more than enough to satisfy the demand of that market. On the North Atlantic, for instance, over the last three years, there has never been a shortage of seats except during extraordinary peak-demand periods as noted below. Market demand and its yearly increases can be satisfied with today's level of reciprocal route awards. Placing more carriers on these routes will not insure the lowest possible price to the consumer in the long run consistent with sound business management. Such pricing is not solely dependent upon adding present or future capacity between the United States and Europe. Most foreign carriers competing with the U.S. private carriers are government-supported, government-subsidized, government-run, or government-directed. Their main objective is to obtain a requisite market share, taking into account not just the transportation revenues but also the tourist spending involved. Foreign carriers that are government influenced are more concerned with their total earnings and not whether the revenues in the transportation sector alone cover the costs of the service.

Furthermore, there is an interwoven relationship between U.S. transportation earnings and U.S. exports and employment. The social returns to the United States in the form of exports and employment reinforces a need to maintain a healthy U.S. international flag system. A policy that looks only to the consumer benefits and acquiesces in foreign subsidization of passengers and cargo transportation can only place our returns in jeopardy and adversely affect our balance of payments.

For example, on a census basis in 1976, the United States exported $6.2 billion worth of civilian aircraft engines and parts. Netting out imports gave us a surplus of $5.8 billion in that year, and in the first three quarters of 1977 our net account in aircraft sales to foreigners was plus $3.6 billion. There is a "pull" effect from U.S. international airlines. Furthermore, a cause and effect relation appears between U.S. orders and overseas sales, for the ability of U.S. manufacturers to profitably produce a new generation aircraft depends on the total foreign and U.S. market demand for the plane. "U.S. international air carrier purchases oftentimes determine the 'go or no go' decision on the production of new generation aircraft. If an aircraft manufacturer cannot obtain enough commitments to buy before production starts, the aircraft will not be produced."[14] In the past, foreign sales oftentimes have been a key to aircraft manufacturing profitability. It is clear that these sales would be in jeopardy if it were not for the strong U.S. international flag system.

According to 1976 figures, the five major U.S. air carriers with authority to fly on the North Atlantic routes employed 109,000 persons.[15] Weighted for the passenger kilometer-miles flown in the same year, the international operations of those carriers accounted for 36,681 jobs. These figures reflect information from the scheduled airline industry and probably would be several thousand more if they included the employees related to nonscheduled charter services across the Atlantic. Certainly some 36-40,000 employees depend upon the viability of U.S. international aviation for their livelihood. A dilution or overcapacity in the market well beyond that necessary to carry the total traffic could jeopardize these jobs. In addition, the health of our airline industry and its profitability are key ingredients in our continued predominance in the aircraft manufacturing industry. In the early 1970's we still provided approximately 85 percent of the world's civilian commercial aircraft. Today our share is about 80 percent and as foreign consortia continue to make inroads in the aircraft manufacturing field, that share will be more difficult to maintain.

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[14] See *The United States Flag System in International Air Commerce: An Analysis of Public Policy Implications*, International Economic Policy Association, 1974. Also see *National Interest Aspects of the Private International Air Carrier System of the United States*, Office of Policy Development, U.S. Department of Commerce, September 1974.

[15] See *World Air Transport Statistics*, No. 21, International Air Transport Association, 1976.

A diminution of U.S. earnings in tourism receipts for travel or transportation, or a decline in our earnings under aircraft sales would mean a corresponding reduction in gross receipts for the U.S. balance of payments. Our deficit in current account in 1978 is running, on an annual basis, in the neighborhood of $18–$20 billion, and the deficit in our trade account is over the $31 billion registered in 1977. Since the only major surplus factor in our balance of payments seems to be in service sector earnings, the United States should be doing everything it can to maintain our income from this all-important source.

III. U.S. International Aviation Policy

U.S. international aviation policy has been guided by the comprehensive statement of U.S. policy developed by the Economic Policy Board Task Force on International Air Transportation Policy that reported to the President in the fall of 1976.[16] The policy calls for our aviation to contribute to our objectives in national defense, foreign policy, and international commerce. It recognizes that the governments of other nations may share our objective of efficient transportation services, but many differ sharply as to how such transportation should be organized, financed, regulated, or promoted. The statement also stresses that often we cannot pursue our international policy goals with the same means by which we conduct our domestic transportation system. The substantial differences between the international and domestic operating environments are set out as follows:

1. Private U.S. companies must compete with state enterprises in most markets. Competition in international transportation is limited by government policy in most other countries, and in some instances restraints are imposed against efficient competitive practices.

2. Some foreign states underwrite their national carriers' losses in order to maintain large capacity to the United States for a number of reasons (e.g., tourist revenues). Similarly, foreign carriers sometimes seek below-cost cargo rates as a means of promoting their nations exports.

3. The problem of tailoring supply to meet demand is more difficult on international routes than on usually denser domestic routes. The ratio of daily flights to the number of competing carriers is generally much lower than domestically; international aircraft are larger on average; and carriers have less flexibility in arranging continental schedules.

Present international aviation policy can be viewed through the speeches and appearances of members of the Administration. It appears that a new policy focus has developed that does not take into consideration some of the differentiation between domestic and international air service. On October 6, 1977 President Carter's letter to Secretary of Transportation Adams set down the basic Administration goals for international aviation in discussing the bilateral negotiations with the Japanese over air agreements. The letter states, in part:

"Our central goal in international aviation should be to move toward a truly competitive system. Market forces should be the main determiner of the variety, quality, and price of air service.

"We should seek international aviation agreements that permit low fare innovations and scheduled service, expanded and liberalized charter operations, nonstop international service, and competition among multiple U.S. carriers and markets of sufficient size. We should also avoid government restrictions on airline capacity. For keeping in mind the importance of a healthy U.S. flag carrier industry, we should be bold in granting liberal and expanded access to foreign carriesr in the United States in exchange for equally valuable benefits we receive from those countries. Our policy should be to trade opportunities rather than restrictions."

The problem remains, however, that we may be in a position of trading aviation rights for nonequal returns to the United States, for there is no attention to total market access and size in the policy statements of the present Administration. A 1975 report by the Civil Aeronautics Board noted that of 55 airlines examined, 25 were wholly state-owned and 22 were partly state-owned.[17] Only eight were owned totally by the private sector. The government-owned airlines sometimes receive direct subsidies; one case involved cancellation

[16] See, *International Air Transportation Policy of the United States*, The White House, September 1976.

[17] *Government Ownership, Subsidy and Economic Assistance in International Commercial Aviation*, Civil Aeronautics Board, 1975.

of debt as well as low-interest government loans and guarantees and other special treatment. Considering that in 1977, 71 foreign airlines were operating scheduled passenger service to the United States (with several other nonscheduled charter operators), it is safe to assume that in terms of flights (and seating capacities) there is, indeed, competition.[18] However, competition for the airline industry is not just the number of airline flights or capacity, but also the amount or market share of business accruing to each carrier, both in the United States and overseas. Since it appears that U.S. international aviation policy is relying upon country-of-origin rules for airline service to the United States, especially charter operations, our ability to increase our market share of foreign travelers will be dependent upon foreign rules for flights from other countries. In addition, the threat of reduced profitability of our carriers in the face of foreign government subsidies can hinder the extent to which our airline industry aggressively markets its services. This is truly a noncompetitive environment which is not in keeping with maintaining a strong international service sector with an ability to earn a far share of service receipts.

As evidenced by the statement of the Dutch quoted earlier in this paper, it seems that foreign countries view their own interests in this important foreign exchange earnings sector as critical. The United States should view its interests in no less terms, especially with the plight of our balance of payments and its effect on the dollar.

CONFLICT OF AVIATION POLICY WITH TRADE POLICY

The evident change in U.S. international aviation policy also appears to be in conflict with policy previously set by the Congress for other trade-related negotiations.

The House Ways and Means report on the Trade Act of 1974 states, "In the opinion of the Committee the negotiating authority granted by the bill is fully adequate for such negotiations and recognizes at the same time that the best negotiating tool the United States has in seeking an open and nondiscriminatory trading world is access to the U.S. market." [19] The key here is that the Congress viewed the Trade Act as a tool for negotiations with foreign countries and the muscle behind the tool is control of access to U.S. markets. In international aviation, however, it appears that we have given up our negotiating tool with foreign countries, i.e., by granting access to our markets and our citizens, but we may not have gained commensurate rights of access to the foreign markets. The country-of-origin operating rules of foreign countries may, indeed, be nontariff barriers which are classified "to encompass all private and governmental policies and practices that serve to distort the volume, commodity composition, or *direction* of trade in goods and services." [20] (emphasis added)

It should be remembered that at the close of the Kennedy Round negotiations under the Trade Expansion Act of 1962, dissatisfaction developed in the United States over the ultimate agreement because, while we lowered tariff barriers for industrial products in general, we did not settle agricultural commodity issues or the broader question of conditions of access to commercial markets.[21] In large measure, it is because of this background that the Trade Act of 1974 contains numerous congressional safeguards and requires that the Administration keep in close contact with the Congress during the negotiation process. In fact, with regard to nontariff barriers and other distortions of trade the Congress must specifically be consulted and may overrule any agreements made. The Congress also established sector negotiating guidelines indicating that the principal objective of the United States in negotiating under Sections 101 and 102 of the Act shall be "to obtain to the maximum extent feasible, with respect to

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[18] The fact that at most times, there are load factors on flights of 50–60 percent and that even Skytrain price-competitive service usually has load factors of 80–90 percent means that additional capacity is generally available to the traveling public. This must be viewed over a year's time because peak demands could be made which the international air system would be temporarily unable to handle. Opportunity costs are such that no airline could incur the capital costs of more equipment to meet peak demands.

[19] *Ibid.*, 8.

[20] *Studies in Business Technology and Economics, Commercial Policy Options in An Age of Controls.* Prepared under the auspices of The Center for International Studies, New York University, Robert G. Hawkins, Ingo Walter, editors, Lexington Books, D.C. Health Company, 1972, p. 64.

[21] See "Traders and Diplomats" by Ernest H. Preeg, *An Analysis of the Kennedy Round of Negotiations Under the GATT,* Brookings Institution, Washington, D.C., 1970 Chapter 16.

appropriate product sectors of manufacturing and with respect to the agricultural sector, competitive opportunities for U.S. exports to the developed countries of the world equivalent to the competitive opportunities afforded in U.S. markets to the importation of like or similar products, taking into account all barriers (including tariffs) to and other distortions of international trade affecting that sector." [22] The Trade Act emphasizes sectors, so that any trade agreement that is consummated contained a balanced result without trading one major group for another. Yet in international aviation we seem to be deviating from the objective of balance.

IV. The Security Aspects

This paper is not intended to deal with the international military significance of U.S. service industries. However, the American foreign and security policy context of maintaining a viable Civil Reserve Air Fleet (CRAF) is important in addressing the returns to U.S. industry and the national interest from a healthy U.S. international service industry base.[23] With the development of detente with the Soviet Union and China, and the unwillingness of the U.S. Congress to retain the primary guarantees of our sweeping range of post-World War II military defense commitments with lower levels of on-scene American participation. The political and economic factors of the 1970's has forced the United States towards a strategic concept of a central reserve of Army, Navy and Air Force elements, located in the United States but able to defend U.S. interests and carry out U.S. commitments abroad, including logistic support of UN peacekeeping forces and other international obligations.

The key strategy in our defense posture has been one of mobility. Our defense and national security posture in the seventies depends on the ability to rapidly respond to contingencies ranging from political tension to the support of our allies, all the way to actual military operations should they become necessary to defend our treaty commitments. Various cost factors make it too expensive for the U.S. military to maintain the total required transportation on its own account. The Civil Reserve Air Fleet is designed to fulfill the need for mobility during a crisis by rapidly augmenting military forces with supplementary transportation from commercial airlift and sealift resources.

Established after World War II, the program entails the commitment on the part of U.S. domestic and international air carriers to allocate specific aircraft services to military procurement in several stages for emergencies as provided in a memorandum of understanding between the Secretaries of Defense and Commerce. While both domestic and international U.S. carriers provide passenger and cargo aircraft for the CRAF, there is an extra utility from having U.S. international carriers involved in this program. The overseas repair and refueling facilities and ground personnel of U.S. international carriers enable these airlines to enter military service with less problems than strictly domestic carriers. The two largest U.S. international flag carriers—Trans World Airlines and Pan American World Airways—make up a large portion of the international long-range capability. Together they provide approximately two-thirds of the passenger capability and almost one-third of the cargo capability of our CRAF system. We understand that in the continuing reassessment of our defense and national security commitments there has been a reemphasis on maximum mobility of U.S. forces and support personnel from the United States to trouble spots around the world. Thus, the health of the U.S. carrier system, including the maintenance of retaining the U.S. flag on overseas routes is extremely important in this national security context. This is in addition, of course, to the intangible benefits of "showing the flag" through U.S. international carriers.

V. Conclusion

We have seen that the international service earnings in the U.S. balance of payments are important for helping to offset the deficit in our overall relations with other countries. Specifically, the travel and transportation sector of service industries has been viewed as an important and growing dollar earner for the

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[22] The Trade Act of 1974, PL 93–618. Also see, House Committee on Ways and Means report on the Trade Reform Act of 1973 (enacted as the Trade Act of 1974) No. 93–571.

[23] See: *The United States Flag System in International Air Commerce, An Analysis of Public Policy Implications,* August 1974, International Economic Policy Association, Washington.

United States. Service industries, however, are beset by a series of nontariff-type barriers that various nations have developed over the years to protect their own industries.[24] The General Agreement on Tariffs and Trade (GATT) establishes, in a sense, the rules of the road for international trade in goods and commodities, but there are no such rules or safeguards for service industries. In fact, nowhere in the GATT is the service sector addressed. But the importance of U.S. service earnings has been highlighted and the Congress has directed its attention to them in the 1970's. For the first time there are laws on the books to begin to cope with some of our international service-sector problems. However, it appears that in the airlines area, which encompasses the tourism sector, we have not differentiated between the consumer need for lower and more competitive fare structures and the proliferation or dilution of the market which can have adverse effects on U.S. market shares and the balance of payments. Unrestrained and open competition is an efficient way of insuring the best possible fare structure for the consumer, but in an international industry structure dominated by government-linked corporations, truly private, profit-oriented industries can find the international competitive process noneconomic. The extreme example of this effect, in transportation service industries, can be seen in the predilection of the Soviet Union to undercut shipping rates in the Pacific, for instance, in order to gain market share, which damages the profitability of U.S. private shipping companies.

The level of service provided on any route should be commensurate with the present traffic and the immediate market potential for its growth, and it need not be set at a level that dilutes overall market shares. This would be consistent with a desire to provide the lowest possible transportation cost to the consumer. More importantly, it would be consistent with the objective of maintaining our foreign exchange earnings in this important service sector. A negotiating process that concentrates mainly on U.S. domestic objectives without taking into account our foreign economic or security interests, and a negotiating stance that defers to country-of-origin rules can be detrimental to the U.S. international economic posture. We must maintain a balance in our negotiation process that trades commensurate benefits instead of apples and oranges. The Congress has dictated this policy in the goods trade area after observing in the 1930's what it considered unequal trade-offs in certain areas. Equal access is critical, but so is insurance against noncompetitive factors that can be used by foreign governments to increase their market shares to the detriment of our own international aviation industry. In order to maintain the viability of our international service sector in transportation and tourism and to insure the health of the private competitive U.S. industries, our negotiating process must stress the following:

1. We must maintain a balance of concessions with our international trading partners involving access to their markets. They must not be granted access to the U.S. market on any more favorable terms than those governing our access to their markets.

2. We must support a private U.S. international air transportation and surface shipping industry that is economically viable and efficient and that will generate sufficient earnings to attract private capital and provide job opportunities.

3. We must rely primarily on competitive market forces to provide the lowest-priced, economically justified transportation for U.S. consumers. At the same time, we must recognize that the views of other nations differ, especially as regards the use of nontariff barriers for furthering their policies. Our policies must be modified accordingly, in order to reach bilateral and multilateral accommodations.

4. The international transportation market must be viewed in its totality and the level of service provided must be related to the present market and its projected growth. This means that market dilution through the provision of excess service must not be allowed to harm the international earnings of U.S. transportation companies.

5. In negotiations, trading access to our total market through a multiplicity of city routes in exchange for access to a single country market is not dealing from strength. In the European Community, for instance, member nations want to be viewed as one market when dealing with other countries in goods trade. However, in airline matters they consider themselves individual countries, just as if we were to consider the 50 American states as single entities for the certification

[24] *U.S. Service Industries in World Markets,* U.S. Department of Commerce, December 1976.

of a plethora of airlines. Our objectives in the negotiating process must be aimed at the total European market and at denying the Community members the advantage of individual bargaining which restricts our access to their total market.

6. We cannot rely on country-of-origin rules in this service sector, for to do so would limit our ability to influence our access to foreign markets. If we acceded to our trading partners' rules for such access we would be sanctioning foreign country restrictions. This is something we are not willing to do, for instance, in our goods trade with countries such as Japan and the members of the European Common Market.

TABLE 1.—U.S. BALANCE-OF-PAYMENTS RECEIPTS OF GOODS AND SERVICES 1960–77 (I–III) FOR SELECTED YEARS

[In millions of dollars]

	1960	1965	1970	1975	1976	1977 QI–III at annual rate
Exports of goods and services [1]	27,510	39,502	62,424	147,600	163,265	175,736
Merchandise, adjusted, excluding military agency sales contracts	19,650	26,461	[3] 42,469	107,088	114,694	120,212
Transfers under U.S. military agency sales contracts	335	830	1,501	3,919	5,213	7,376
Travel	919	1,380	2,331	4,839	5,806	6,164
Passenger fares	175	271	544	1,039	1,225	[4] 1,325
Other transportation	1,607	2,175	3,113	5,785	6,529	6,973
Fees and royalties from affiliated foreigners	590	1,199	1,758	3,543	3,522	3,533
Fees and royalties from unaffiliated foreigners	247	335	573	757	844	910
Other private services	486	668	1,228	2,868	3,586	4,339
U.S. Government miscellaneous services	153	285	332	432	478	500
Receipts of income on U.S. assets abroad:						
Direct investments [5]	2,355	3,963	4,992	8,567	11,127	12,308
Other private receipts	646	1,421	2,671	7,644	8,955	10,428
U.S. Government receipts	349	515	912	1,119	1,287	1,341

[1] Excludes transfers of goods and services under U.S. military grant programs.
[2] Excludes exports of goods under U.S. military agency sales contracts and imports of goods under direct defense expenditures identified in census import documents.
[3] Denotes break in series.
[4] Estimated from first 3 quarters with 4th quarter at 1976 rate. Traditionally, tourism receipts and expenditures drop sharply in the 4th quarter and it would exaggerate the figures to annualize these on a 3-quarters basis.
[5] Consists of interest, dividends, and branch earnings; excludes reinvested earnings of foreign incorporated affiliates of U.S. firms or of U.S. incorporated affiliates of foreign firms.

Source: "Survey of Current Business," U.S. Department of Commerce, June 1975, December 1977.

TABLE 2.—U.S. TRAVEL AND TRANSPORTATION EXPENDITURES AND RECEIPTS IN THE BALANCE OF PAYMENTS, 1974–77

[In millions of dollars]

	1974	1975	1976	1977
Passenger fares receipts	+1,104	+1,039	+1,225	[2] +1,325
Travel receipts	+4,032	+4,839	+5,806	+6,164
Total	5,136	+5,878	+7,031	+7,489
Passenger fare expenditures	−2,095	−2,263	−2,568	−2,843
Travel expenditures	−5,980	−6,417	−6,856	−7,451
Total	−8,075	−8,680	−9,424	−10,294
Balance	−2,939	−2,802	−2,393	−2,805

[1] Includes passenger fares paid by foreigners to U.S. carriers for travel outside of the United States as appears in U.S. balance-of-payments accounts. The deficit on the "travel account" for tourism is sometimes quoted without these receipts. Since our study concerns total U.S. dollar earnings in the balance of payments from international service activities in travel and passenger transportation, they are included here.
[2] Estimated on 1st 3 quarters with 4th quarter at 1976 rate. See note 5, table I.

Source: "Survey of Current Business," U.S. Department of Commerce, June 1977, December 1977, June 1978.

TABLE 3.—BASE POTENTIAL FOR TRAVEL TO THE UNITED STATES

Country of residence	Number of individual W/I financial means for travel to the United States		
	Individuals (millions)	Percent	Rank
Canada	12		1
Mexico	10		2
West Germany	9		3
Japan	8		4
United Kingdom	8		5
France	7		6
Subtotal 6 USTS primary markets	54	63	
Italy	5		7
Brazil	4		8
Australia	2		9
Netherlands	2		9
Switzerland	1		12
Belgium	1		12
Venezuela	1		12
Subtotal 7 USTS secondary Markets	16	19	
Total, USTS markets	70	81	
Other areas	16		
Total, world	86	100	

Source: Speech by Beverly Shipka, Director, Research and Analysis Division, U.S. Travel Service, U.S. Department of Commerce at the 1978 Travel Outlook Forum, Washington, D.C., Dec, 1, 1977.

[The following information was referred to on p. 165.]

AVIATION ADVISORY SERVICE, INC.,
New York, N.Y., August 1, 1978.

MR. ELIHU SCHOTT,
Senior Vice President,
International and Regulatory Services,
Pan American World Airways, Inc.,
New York, N.Y.

DEAR MR. SCHOTT: As requested, we are pleased to submit reports on the various forms of support received by foreign national airlines from their respective governments.

Of the total of eleven foreign airlines surveyed, detailed reports have been prepared for the following:

Alitala (Italy).
British Airways (Great Britain).
Iran Air (Iran).
KLM-Royal Dutch Airlines (The Netherlands).
Sabena (Belgium).

Within prevailing constraints it was not feasible to detail reports on the other carriers examined and which included:

Air France (France).
Aerolineas Argentina (Argentina).
Iberia (Spain).
JAL (Japan).
Lufthansa (Germany).
Qantas (Australia).

As indicated in the detailed reports submitted, in addition to other forms of assistance, there is a strong pattern of government support in providing necessary equity capital, loans and loan guarantees to permit the respective national air carriers to maintain and even expand their operations. Moreover, this included the financing of the acquisition of modern aircraft and related properties and facilities.

This same pervasiveness of direct government financial support is present for the national airlines surveyed and for which no detailed reports are submitted.

In addition, an analysis has been made of the mail payments received by twelve foreign international air lines as compared with that received by Pan American World Airways and TWA. Such studies show that a form of embedded subsidy being paid these foreign national air lines by their respective governments. The basis and calculations of these payments with the imputed subsidies for each of the individual foreign air lines examined are shown for the years 1975 and 1976, respectively.

We shall be pleased to pursue further developments as your requirements may dictate.

Thank you for inviting us to undertake this challenging assignment.

Respectfully submitted.

SELIG ALTSCHUL,
President.

ALITALA

The company

Alitala—Linee Aeree Italina—is the national airline of Italy. It operates through the government-owned Instituto per la Ricostruzione Industriale (IRI). IRI is financed by government funds and by issues of its own bonds; it has generally operated at a loss. Alitala maintains that it is not a subsidized government airline and is expected to be operated as a profit-oriented business. The record is clear, however, that the Italian government, regardless of the administration in power, is committed to support Alitala.

Ownership

The ownership in the capital stock of Alitala by IRI has varied over the years and, at last reports, has indicated to be around 95 percent. The balance is in private hands.

IRI is a vast industrial complex with a curious mixture of socialism and free enterprise. Among other entities, it controls banking institutions which has facilitated borrowing power and loan guarantees to be made available to Alitala.

The capital structure of Alitala has submitted to a series of adjustments as various infusions of additional capital have been made over the years. (The most recent are detailed in this review).

As of December 31, 1956, Alitala's paid-up capital was stated at 100 billion lira ($119 million) comprised of 200 million shares of 500 lira par value each represented by 190 million shares of common stock and 10 million shares of preferred stock.

Government support

The government has consistently and aggressively supported Alitala's operations. Direct grants of subsidy are in evidence but not always identified as such. The greatest measure of government assistance has been made available through direct capital investments, loans and guarantees of loans.

Since 1957, Alitala noted that it has been the "instrument for pursuing aims of general interest to the country in the field of air transport". The legal basis for this arrangement is identified as being derived from the D.I.C.P.S. No. 88 of September 4, 1946 which remains in effect. This provides for a service concession to be granted only to companies with participation from the State or IRI. The relations between the Company and the government authority were further regulated by convention No. 181 of September 8, 1962 with the "concession consequent thereupon" approved by D.P.R. of June 4, 1963. The convention and concession lapsed in June 1973. Despite this expiration of the formal concession, the Company managed under a "simple authorization to continue to operate provisionally the routes exercised hitherto. . . ."

Substantial relief, however, was soon forthcoming from the government through the enactment of Law No. 576 of December 2, 1975. As will be noted, this measure provided for an extensive recapitalization of the airline plus a substantial infusion of new funds.

Management has repeatedly acknowledged its gratitude for the government assistance received. For example, its 1976 annual report today ". . . we have pleasure in recording our gratitude to the Ministry of Transport and to the IRI for the valuable assistance they extended to us".

Mail compensation

Mail revenues while not bulking very large in Alitala's total income accounts, may be viewed as containing an element of subsidy as received from the Government of Italy. The government pays Alitala the UPU rate for outgoing international mail. The average revenue per mail ton-kilometer performed is at the higher end of the range among the major international airlines reviewed.

Pertinent elements of mail revenue for Alitala in recent years may be summarized as follows:

	Total mail revenues (millions)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer (cents)	Mail percent total revenues
Year ended Dec. 31:				
1972	$10.5	18,964	55.2	2.2
1973	10.6	19,299	55.1	1.9
1974	9.7	23,041	42.1	1.5
1975	9.8	23,240	42.2	1.3
1976	8.7	NA	NA	1.3

Note: U.S. dollar conversions at prevailing rates of exchange for years shown.

Payments from public funds

While not indicated in the Company's published annual reports, statements filed with the International Civil Aviation Organization and as published by that agency, show Alitala as receiving Payments From Public Funds as follows:

Direct subsidies

	U.S. millions
1972	$1.2
1973	1.2
1974	.615
1975	2.7

The purpose or utilization of such identified direct subsidies are not indicated.

Subsidiary support

Alitala has a 49-percent interest in Somalia Airlines–Mogadishu, the national airline of the Government of Somali. Starting in 1969, Alitala entered into a "collaboration agreement with the Somali Government to manage its airline. Early in 1974, this agreement was renewed for a further five-year period to December 31, 1978.

Somalia Airlines has consistently operated at a substantial loss; the actual amounts not being revealed. Alitala's interest in this airline is stated as ". . . part of Italy's aid to Somalia and (our) economic responsibilities are limited to the contribution of the Italian Government". In short, Alitala receives a subsidy to support this satellite service. Such subsidy presumably also includes absorption of some part of Alitalas' administrative and overhead expenses.

Operating results

Alitala has sustained substantial operating losses for the five years through 1976 as follows:

Calendar year	Net losses		U.S. dollar exchange rate [1]
	In lira (billions)	In U.S. dollars [1] (millions)	
1972	6.2	$10.7	$0.001714
1973	6.6	11.4	.001716
1974	37.1	57.1	.001538
1975	49.7	76.0	.001528
1976	40.1	47.7	.001190
Total	139.7	202.9	

[1] U.S. dollar conversions at prevailing rates of exchange for years shown.

However, large as the above reported losses are, they are substantially understated. For 1974 the Company did not provide any depreciation whatsoever for its flight equipment. Management decision for this action was attributed to ". . . the negative results of operations and partly due to the net statement of property and equipment in the books at a fair value in respect to the remaining useful life". Applying depreciation rates for 1973, consistent accounting treatment for 1974 would have increased reported losses by at least 28 billion ($43 million). (During 1974, the airline added two DC 10/30's to its fleet.)

Again for 1975, management considered it "unnecessary to provide for depreciation on the newly acquired fleet (DC 9's, DC 10/30's, B 747) in consideration of the fair carrying net value in respect to their market value and above all because of the extended useful lives of new aircraft due to the slackening of production by the aeronautical industry." However, depreciation of 19.5 billion lira ($29.8 million) including 9.66 billion on first generation aircraft was charged to 1975 accounts. With two new DC 10/30's added that year, full depreciation allowance for new generation aircraft would have incurred an impost of at least $40 million.

The pattern of understating losses by failing to properly depreciate aircraft on the books was repeated for 1976. The same reasons used in 1975 were again stated in 1976 to justify the action taken. With five 747's, eight DC 10/30's and thirty-five DC 9/32's in service during 1976, annual depreciation charges on this collection of aircraft may be conservatively estimated at about $30 million. Management, however, in following its stated principles, provided depreciation at a "reduced rate" for the "new generation aircraft" and which amounted to 12.2 billion lira ($14.5 million).

Government financial infusions

The intent and facilities of government support to Alitala is demonstrated by the actions taken. Following Alitala's losses of 1972 and 1973, management in its 1973 annual report advanced a dire forecast of the Company's outlook and called for immediate government assistance. Management's plea and the government's response was stated as follows:

". . . taking account of the provisions of Article 3 of the Agreement in force between the concessionary Administration and your company, which envisages the intervention of the competent government departments when the trend of the concessionaire's undertaking appears prejudicial to the regular carrying out of the services conceded, it was considered a duty to bring the gravity and consequences of the above-mentioned situation to the attention of the Minister of Transport and Civil Aviation, who was asked to make adequate provisions. The Minister replied to your company's request affirming the belief that "the present situation must be overcome with the maximum commitment at private and public level" and *giving assurance of having "in this connection requested from the competent bodies urgent exceptional provisions in the public interest"*. [Emphasis supplied.]

Setting the stage for the requested government assistance, Alitala, at an Extraordinary General Meeting of Stockholders, held on December 6, 1974, authorized sweeping changes in its capital structure. This permitted the reduction in the company's capital stock from 50 billion lira to 2.5 billion lira by cancelling the 2.5 million common shares of lira of 10,000 par value each and the reduction in the par value of the 2.5 million preferred shares from lira 10,000 to lira 1,000 per share and the simultaneous "reintegration" of the capital stock to 50 billion lira by the issuance of 47.5 million common shares of lira 1,000 par value each.

Subsequently, as the operating deficit continued to mount in 1975, shareholders at the annual meeting held on May 26, 1976, reaffirmed the amount of the reduction to be effected in the capitalization as the first stage but boosted the amount of "reintegration" in the proposed increase in capital from 25 billion lira to 100 billion lira. This would be accomplished by the issuance of 142.5 million common shares and 7.5 million preferred shares, all of 500 lira par value each. This would bring the authorized capital stock up to 100 billion lira to be represented by 200 million shares of 500 lira par value each and consisting of 190 million common shares and 10 million preferred shares. This authorization was made retroactive to January 1, 1976.

Moving almost in tandem, the government enacted Law No. 576 of December 2, 1975. This measure enabled Alitala to adjust its accounts so as to liquidate past deficits—a prerequisite to prepare for the infusion of new funds from the government.

To accomplish the first objective (i.e., liquidate past deficits) Alitala at the 1975 year-end revalued upwards its property and equipment accounts by 24.9 billion lira ($38 million). To support this move, "two appraisals have been produced to confirm the adequacy of this revaluation". The "benefit" of this revaluation was concurrently transferred to a special reserve account and labeled, "Monetary Revaluation, Law 576, December 2, 1975". The accumulated deficit balance of 49.9 billion lira ($76.2 million) remaining on the books at December 31, 1975 was liquidated by applying 24.9 billion lira of the special "Monetary Revaluation Reserve" and a 25 billion lira reduction in the capital account—all in accordance with the authorization contained in Law No. 576 of December 2, 1975 and with the resolution of stockholders on May 26, 1976.

The infusion of new funds during 1976 and as provided by IRI was effected through "reintegration" of the capital stock account from the reduced 25 billion lira level to 100 billion lira. This provided Alitala with 75 billion lira ($89.25 million) in fresh capital.

A repeat of ths two prong exercise was effected following the substantial loss of 40.1 billion lira ($47.7 million) experienced in 1976.

Management proposed and stockholders (IRI) approved at the annual meeting held on June 4, 1977 the following measures:

1. Partially offset the 1976 losses by the utilization of the ordinary reserve of 27.1 million lira and the balance of 33.1 million lira remaining in the "Monetary Revaluation Reserve". This reduced the reported 1976 deficit to 40 billion lira.

2. Reduced the capital stock from 100 million lira to 60 million lira reducing the par value of the 190 million shares of common stock and the 10 million shares of preferred stock to 300 lira par value per share from 500 lira. This served to offset the deficit of the year by 40 billion lira, leaving a carry-over of around 29 million lira into 1977.

3. New funds were again provided through the "reintegration" process. Capital stock was increased from the reduced level of 60 billion lira to 120 billion lira by the issuance of 200 million new shares of common stock of 300 lira par value each. This provided a fresh infusion of 60 billion lira ($71.4 million) to Alitala.

Hence, in the space of two years, a total of 135 billion lira in new capital funds were made available by IRI to Alitala. As such funds made whole write-offs of past losses, they may be regarded as direct grants by the government to Alitala. Interestingly enough such grants approximated the cumulative losses experienced by the Company for the five year period through 1976.

Loans and guaranteed loans

Despite the huge losses incurred over an extended period, Alitala nevertheless was able to move aggressively in making substantial capital expenditures, primarily in acquiring new generation aircraft.

The necessary financing was provided through "Financial Institutes" of the government. Such agencies are represented by the IRI and another instrumentality, Instituto Mobiliare Italiano (IMI). Alitala has received loans from both agencies as well as having a number of loans received in the external market guaranteed by these government instrumentalities.

A measure of the funds required to finance Alitala's expenditures for aircraft and plant and facilities may be seen from the following summary of major capital outlays made in these main categories:

[In billions of lira]

	Aircraft	Plant and facilities	Total	Total[1] (U.S., millions)
Calendar year:				
1972	17.1	2.1	19.2	$32.9
1973	58.9	9.1	68.0	116.7
1974	33.7	16.7	50.4	77.5
1975	25.8	10.0	35.8	54.7
1976	63.6	3.9	67.5	80.3
Total			240.9	362.1

[1] U.S. dollar conversions at prevailing rates of exchange for years shown.

While some funds were generated from internal sources, (i.e. through depreciation charges, sale of surplus aircraft and etc.), the bulk of required capital was obtained through loans or advances made directly by or guranteed by the IRI or IMI.

As of December 31, 1976, Alitala reported as outstanding a total of 134.1 billion lira in secured loans and 125.2 billion lira in unsecured loans, aggregating 259.2 billion lira ($308.5 million) in obligations. A portion of such loans, such as those made by the United States Export-Import Bank to finance equipment purchases, were obtained from external sources but were possible only because of the guarantee provided by the IRI or IMI.

In substance, the viability of Alitalais being underwritten by the Government of Italy.

BRITISH AIRWAYS

The company

British Airways (BA) emerged officially on April 1, 1974 through the consolidation of Britain's two state-owned airlines, British Overseas Airways Corp. (BOAC) and British European Airways (BEA).

This was a major consequence flowing from the "Report of the Committee of Inquiry Into Civil Air Transport" (known as the 'Edwards Committee') on British Air Transport in the Seventies", issued in 1969.

The British Airways Board (BAB) acted on the White paper subsequently approved by the government and, on April 1, 1972, set the consolidation process in motion for the two carriers and their subsidiaries. For this purpose, the British Airways Group (BAG) was created and during a transition period of two years organized a divisional structure combining the two airlines into one organization.

The BAG was given a mandate to operate as a commercial enterprise but "subject to the national interest." Upon completion of this consolidation stage, dissolution of BOAC and BEA aws officially effected on March 31, 1974 and there were no longer any individual balance sheet and income accounts issued for these component entities.

Government support has been manifest in BOAC from the outset of its creation in 1939 (and even earlier in its predecessor units) and has continued to the successor BA.

Continued government support was re-affirmed in the Civil Aviation Act of 1971 (part III, Par. 43–(1)) with the declaration: "The Secretary of State may pay to the Board out of money provided by Parliament such sums as the Secretary of State thinks fit."

In this review, the measure of government support will be established only from 1965 when BOAC submitted to a major financial reorganization and the present pattern of assistance was established.

The 1965 "financial reconstruction"

While operations for BOAC for the fiscal year ended March 31, 1965 were profitable, the company had experienced a sustained series of losses during the preceding period. This left the airline with a huge accumulated deficit and without the means to pursue a required equipment acquisition program. Its marginal financial position further endangered the viability of its operations. The company's capital structure was over-burdened with loans and advances from the government.

As of March 31, 1965, BOAC's accumulated deficit aggregated £82.5 million ($231 million). The "Financial Reconstruction" simply "extinguished" this deficit along with eliminating the outstanding indebtedness of £176 million ($492.8 million) due the government. BOAC was given a fresh start with a capital structure consisting of equity in the form of Public Dividend Capital (PDC) in the amount of £35 million ($98 million) and a £31 million ($86.8 million) loan. (As will be noted, PDC and loans made available by the government were to grow in amounts in subsequent years).

An immediate consequence was the reduction of BOAC's interest bearing debt due the government by £110 million ($308 million) and the establishment of a positive equity base. Remission of the accumulated deficit represented subsidization retroactively of past losses. Additionally, the substantial debt reduction con-

stituted a further subsidy in the amount of interest charges eliminated. Applying even a low interest rate of 4 percent, the "savings" in annual interest charges amounted to more than $12.3 million.

A low interest rate of 4 percent was established on the reduced debt. This contrasted with United Kingdom government bonds yielding around 6.5 percent at the time.

The flexibility of the PDC as a financing instrument and its advantages were duly observed in the Edwards report:

"Public dividend capital was an experiment for BOAC for a provisional period of five years. BOAC was selected for the experiment because after the reconstruction, it would be in a position to operate on a fully commercial basis, and because as an airline it was and is subject to fluctuating conditions of international competition. The payments on the public dividend capital can be varied just like any other dividend on ordinary shares according to each year's financial results. *The Minister has power how much of BOAC's annual profits should be put into reserve and how much paid to the Exchequer as dividends.*" [Emphasis supplied.]

The discretion pertaining to the payment of dividends is noteworthy. Various capital reserve funds could be augmented in transfers from earnings before dividend payments could be declared and paid to the government. In other words, there is no firm compulsion to assure the government of a return on capital as is the requirement for companies seeking funds in the private sector. The availability of PDC and the attendant flexible servicing terms has relieved the company from paying higher financing service charges for capital, be it in the form of interest on debt or dividends on equity. To this extent, hidden subsidy support from the government may be said to exist. This is highlighted in the review of earnings.

Operating results

Subsequent government support—beyond the 1965 Financial Reconstruction—must be viewed in the perspective of the operating results reported by the airline.

The consolidation processes of the state-owned airlines and the re-statement of accounts have led to differing versions of reported operating results of British Airways and its predecessor units. Further, profits are stated before and after various adjustments pertaining to cost of capital from borrowings, taxation and extraordinary items. However, interest costs, tax charges and extraordinary items have been subjected to arbitrary adjustments which are not always clearly stated. To the extent earnings are masked through such accounting devices a measure of government subsidy may be said to exist.

The "provisional" period of five years following the 1965 Financial Reconstruction and during which the PDC "experiment" was to be conducted turned out to be one of the most profitable in international airline operations. For the five years ended March 31, 1970, BOAC reported group profits (after interest on borrowings, taxation and other provisions) of more than £99 million. Of this amount, a total of £44.25 million was paid in dividends on the PDC to the government. (PDC has been increased from £35 million at March 31, 1965 to £65 million by March 31, 1970. Dividends paid on PDC ranged from a rate of 10 percent in fiscal 1966 to 25 percent for 1969 and dropping ot 20 percent in the following year).

The reported residual earnings (after dividend payments) bolstered various capital reserves and unappropriated retained earnings to an aggregate of around £75 million at March 31, 1970 as contrasted to the £35 million reconstituted on March 31, 1965.

The British were not immune to the economic and competitive pressures which beset the industry during the early 1970's. Reported earnings dropped sharply and deficit results were shown in a number of years.

For purposes of uniformity, earnings for this subsequent period are taken from data as filed by BOAC and British Airways with the International Civil Aviation Organization and as published in that agency's annual Financial Data Series. This data varies with that appearing in the public annual reports issued by the carrier. On this basis, reported earnings along with dividend payments are summarized in the following table.

BOAC AND BRITISH AIRWAYS NET PROFITS AND DIVIDENDS PAID, 1970–77

	Net profits (losses) (after all charges, in millions)		Dividends paid, lira (millions)	U.S. dollar exchange rate
	Lira	U.S. dollars		
Years ended Mar. 31:				
1970	19.3	$46.4	13,000	$2,400
1971	3.4	8.3	4,875	2,400
1972	(1.4)	(3.7)	3,250	2,614
1973	8.2	19.9	7,500	2,444
1974	35.2	85.1	6,100	2,420
1975	(9.4)	(22.4)	0	2,371
1976	(16.0)	(33.6)	0	2,097
1977	35.1	60.5	11,000	1,725

These reported net earnings are after all charges, including transfers to various capital reserves including fleet renewal, development, insurance and other funds, have been made. Dividends are paid only after the financial requirements of the company have been accommodated.

It is clear that the financial facility available to the British carrier in the form of government-supplied PDC and the attendant borrowing capability endows the company with a strategic advantage. In short, despite an erratic earnings record, including periodic heavy deficits, the company is largely shielded from the pressures of the market place. It is not subject to the conventional restraints in the pursuit of capital funds and their servicing requirements.

Public dividend capital

PDC, as noted, was originally granted to BOAC as part of its restructuring in 1965. The principle was continued for the British Airways Board through the Civil Aviation Act of 1971. As provided by this Act, the entire PDC concept was reviewed by Parliament before the specified deadline of March 1977. Parliament, at its discretion, could either convert the PDC to loans from the National Loans Fund or it could continue (PDC) as a permanent aspect of British Airways funding. In March, 1977, both Houses of Parliament through the Consolidation Act (British Airways Board Act 1977) chose to make PDC a permanent feature of the British Airways capital structure.

The only restraint placed upon the amount of PDC that British Airways may receive from the government is controlled by the debt/equity ratio, i.e., the ratio of capital borrowings to the total of PDC plus reserves. Here, too, considerable latitude is present as this ratio was agreed as ranging between 35/65 and 50/50.

The almost open-ended access to capital by British Airways is evidenced by the sharp increase in the amount of PDC outstanding since 1965. From the initial base of £35 million in 1965, gradual infusions over the years boosted PDC to a current peak of £290 million as of March 31, 1977.

The relative position of PDC and borrowings and the return paid on these capital funds are summarized in the attached Table A.

Borrowings

The British state-owned airlines have consistently had access to loans from the government either directly or through its agencies. Further, government guarantees were provided where necessary to secure credits in the private sector.

As shown in Table A, during the five year "experimental" period following the 1965 Financial Reconstruction, the Board of Trade was the government instrumentality advancing funds to the airline. Additionally, bank credits, guaranteed by the government, in increasing amounts were made available.

Loans were increased to meet the carrier's financial requirements, mainly for equipment acquisitions. The Civil Aviation Act of 1971 assumed borrowing authorization and loans were subsequently advanced under this mandate from the National Loan Funds. Peak borrowings, from all sources, reached a total of £225.7 million ($546.2 million) at March 31, 1974. The British Airways Act, 1977, assumed borrowing authority and continued the pattern established in earlier periods.

At March 31, 1977 total borrowings by the British Airways Group aggregated £222.6 million ($385.1 million). As of that date, the debt/equity ratio was 36.4/64.6—bordering the highest end of the prescribed range.

The authorized limit of borrowing powers of the British Airways Board at March 31, 1977 was £ 700 million. Applying the formula in effect, there remained the capability of obtaining an additional £ 222.2 million ($383.3 million) in loans.

Interest savings

Access to PDC, supplied by the government, has achieved substantial savings for the British Airway Group in interest charges. For example, the infusion of £ 80 million ($189.7 million) in additional PDC during the fiscal year 1975 and upon which no dividend was paid, obviated the need to borrow such funds. With an assumed interest rate of 9 percent, an annual saving in interest charges of £ 7.2 million ($17.1 million) is indicated. This contrasted with actual interest payments of £ 14.2 million made that year. Similarly, PDC was increased by £ 63.7 million in fiscal 1976 and upon which no interest was paid. On the same basis, the savings in annual interest charges on this increment alone can be calculated to be £ 5.7 million ($12 million) for fiscal 1976.

Loans obtained directly from the government or guaranteed by it find reflection in the relatively low effective interest rates prevailing for the British Airways Group. The imputed average effective interest rates for the airline in recent years have been as follows:

Imputed interest rate

Fiscal year:	*Percent*
1973	6.5
1974	6.7
1975	7.6
1976	6.4
1977	8.5

Loans obtained in the private sector—without any government endorsement—would command interest rates during this period ranging from 8½ percent to 11 percent, assuming such credits would be forthcoming at all given the financial condition of many air carriers at the time.

The savings in interest charges, regardless how effected, under government aegis and supported by the British taxpayers, represent a significant subsidy to the British Airways Group.

Concorde support

Of the substantial boost in PDC during the 1974–1976 fiscal period, approximately £ 115 million was indicated as earmarked for the acquisition of 5 Concordes and spares by British Airways. Investment in this program reached a total of £ 133 million at March 31, 1977.

The British government further appears to be supporting the Concorde program by underwriting the operating losses it incurs in the service of British Airways. For fiscal 1977, the £ 8.5 million ($14.7 million) stated operating deficit for the Concorde was deducted from the amount initially calculated as the recommended dividend—£ 25.5 million—on PDC. Moreover, the dividend as initially computed was premised at a rate of 13½ percent on "non-Concorde PDC". This is still another facet of subsidy support for the Concorde as it represents a capital-free loan in the financing of this aircraft.

Mail compensation

Mail rates are negotiated between the British Airways Group and the United Kingdom postal authorities. On a comparative basis they are lower than UPU rates. Certainly, on a relative scale, they are lower than the international mail rates being received by most European carriers.

The British Airways mail revenue experience for recent years are summarized as follows:

	Total mail revenues (millions)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer (U.S. cents)	Mail percent total revenues
Fiscal year ended Mar. 31:				
1972	$46.2	81,986	56.4	8.3
1973	39.6	90,479	43.8	5.9
1974	41.1	93,667	60.6	5.1
1975	52.9	116,212	45.5	3.3
1976	48.3	127,095	38.0	2.8
1977	56.4	137,981	40.9	3.1

While in the lower range of mail compensation for all European international air carriers, the British Airways Group receives a rate averaging almost twice that obtained by United States airlines in the same service.

TABLE A.—BOAC (1966–72) BRITISH AIRWAYS GROUP (1973–77)—CAPITAL POSITIONS AND RETURN

[Totals in millions of British pounds]

	Pub. dividends to capital	Capital reserves	Borrowings from—				Dividends paid	Interest paid
			Banks	Board of trade	Per CAA 1971	Others		
Years ended Mar. 31:								
1966	35.0	41.8	0.08	28.2			3.50	1.25
1967	35.0	64.1	.97	25.4			5.25	1.10
1968	50.0	61.0	7.20	22.5			10.00	1.14
1969	50.0	69.8	20.90	19.7			12.50	2.04
1970	65.0	73.6	37.70	16.9			13.00	2.87
1971	65.0	77.8	75.20				4.87	4.45
1972	65.0	74.7	103.60		187.7	5.9	3.25	4.90
1973	125.0	89.8	95.50		151.9	6.1	4.40	19.32
1974	136.3	100.3	103.30		116.0	6.4	6.10	17.10
1975	216.3	91.1	100.80		80.1	4.8	0	14.20
1976	280.0	74.8	104.20		[1] 108.2	5.8	0	14.00
1977	290.0	98.9	134.20		[1] 83.6	4.8	11.00	18.90

[1] Sec. 6(1), British Airways Board Act 1977.

Source: Company annual reports.

IRAN AIR

The company

Iran Air, officially known as Iran National Airlines Corp., was formed in 1962 when it absorbed the properties and franchises of the then existing two Iranian air carriers. Iranian Airways and Persian Air Services.

The entire issued capital stock of Iran Air ($56.5 million as of March 20, 1977) is owned by the government. Additionally, the Iranian government has provided substantial financial assistance to its national airline in the form of direct and government guaranteed loans. Other forms of government aid have also been made available to the airline. In fact, Iran Air, through its government, has brought into play a wide range of subsidized support measures to a far greater extent then that found for most any other airline.

Starting from a small base, largely centered in domestic operations, the restructured airline enjoyed rapid growth as it expanded operations into European markets in 1965. Two years later, international flights were extended from Bombay to London with a schedule pattern including Frankfurt, Geneva, Hamburg, Paris and Rome. This was in addition to the various points served in the Middle East. Major extensions were achieved in late 1974 with a weekly flight to Moscow, and shortly thereafter with twice weekly service to Peking and Tokyo.

In May 1975, the latest expansion was launched with five flights weekly from Tehran to New York via London. Further expansion plans envision extension of operations from London to Los Angeles, with a hint of an ultimate round-the-world service by continuing flights from Tokyo to Los Angeles.

Operating results

The expansion of Iran Air's international services is reflected in the company's operating revenues and profits. This is summarized in Table 1. As can be seen, following the airline's major route expansion to New York, its revenues for the fiscal year ended March 20, 1976 skyrocketed to $258.5 million, almost five times the level prevailing for fiscal 1971 and 1972. Net profits, as reported, also rose sharply from $5.2 million in fiscal 1971 to a peak of $60.9 million for fiscal 1976. While revenues increased to $300.2 million for fiscal 1977, net profits declined to $37.8 million, due largely to charges associated with continued expansion of operations.

Iran Air, through special government exemptions, pays no income taxes on its profits.

TABLE 1.—IRAN AIR SUMMARY—REPORTED REVENUES AND PROFITS

	Total operating revenues	Total expenses	Net profit [1]
Fiscal year ended Mar. 20:			
1971	50.6	45.4	5.2
1972	53.8	49.6	4.2
1973	62.8	56.3	6.5
1974	103.5	90.0	13.5
1975	151.4	129.0	22.4
1976	258.5	197.6	60.9
1977	300.2	262.4	37.8

[1] No provision in accounts for income tax.

Source: Company reports, IATA annual financial data.

Financial support

One of the more overt forms of government support to Iran Air is present in the financial assistance granted. In addition to providing the equity capital, the government, through its agencies, has facilitated debt financing by the airline by the guarantee of its various loans.

Interestingly enough, Iran Air has leaned heavily on the U.S. Export-Import Bank to finance its fleets of Boeing aircraft. In January 1974, Eximbank granted Iran Air a direct loan of $45.4 million to finance 45 percent of the total U.S. costs of two wide-body Boeing 747 SP's and three 727–200's and related spares, equipment and services. The loan was at the annual interest rate of 6 percent, repayable in 20 semiannual installments on two schedules starting February 15, 1975 and October 15, 1976.

Five other Eximbank loans, aggregating $40 mililon, on virtually the same terms, were extended to Iran Air from 1967 through 1972. All of these credits were guaranteed by the government of Iran.

In December 1977, Iran Air obtained $72 million through a seven year floating rate loan placed with a consortium of international banks led by the Iran Overseas Investment Bank Limited. This loan was guaranteed by the government of Iran and the proceeds applied toward the airline's equipment acquisition program.

Financial position

As shown in Table 2, Iran Air, given its government sponsorship, has maintained a strong financial position as it continued to expand its operations. As of March 20, 1977, coupling reserves with capital stock and retained earnings, the company could boast a most comfortable debt/equity ratio of .50 to 1, very low for an airline. As of that date, net working capital was at a low level of $1.2 million. Presumably, the December 1977 financing helped to boost the working capital position.

TABLE 2.—IRAN AIR SUMMARY—FINANCIAL POSITION

[In millions of U.S. dollars]

	Capital stock and retained earnings	Reserves	Long-term debt	Net equipment and retained deposits	Net working capital
Fiscal year ended Mar. 20:					
1972	17.3	20.9	34.9	57.2	9.8
1973	34.8	14.8	30.8	58.9	15.8
1974	60.8	21.1	51.5	82.1	27.0
1975	82.3	24.8	62.2	136.8	13.8
1976	118.4	43.0	59.0	202.7	(6.1)
1977	94.3	103.9	100.2	302.7	1.2

Source: Company reports, IATA annual financial data.

Flight equipment

With financing readily available, Iran Air has acquired a modern aircraft fleet which has made the carrier fully competitive. As of the 1977 year-end, the airline

owned and operated a total of three 747 SP's and two 747 Combis and which are primarily dedicated to its long-range international services. Additionally, a total of six 707–320's are owned and operated. For largely domestic services, four 737–200's, six 727–200's and five 727–100's fill the operating pattern.

Late in 1977, Iran Air placed an order for six A 300B2K (Airbuses) with an option for three additional planes. These aircraft are to be powered by General Electric CF6—50C2 turbofan engines. Two of these aircraft were placed in service in March 1978, with the remaining four on firm order to be delivered by the end of this year. Trade sources report that Iran Air obtained attractive financing terms for these aircraft from the builder.

Government support measures

The Iranian government has been aggressive in a series of support measures which have been of direct benefit to its national airline while at the same time in some cases imposing additional burdens on competing airlines from other countries.

An outstanding example is present in the policies imposed in the services provided by Iran Air at the Tehran airport. As is common in most countries, the "host" carrier handles the landing and other ground servicing requirements of competitive airlines. This applies to Mehrabad airport at Tehran where Iran Air enjoys a monopoly on servicing all incoming and outgoing airline schedules, regardless of the carrier's nationality. Some years ago, Mehrabad completed an extensive modernization program, including a new international terminal building and other ground facilities. Mehrabad allegedly could handle 32 aircraft, including three wide-bodied jets, at the same time. Nevertheless, non-Iranian airlines coming into Iran normally experience landing delays on the pretext that authorities claim that the required gate space is not immediately available. Frequently, too, this is coupled with other delays and inconveniences attributed to the sudden unavailability of ground equipment, ramps and the like to handle the deplaning passengers and the unloading of baggage and cargo. Remedies are at hand upon payment of added handling charges and which yield the gate space and the required ground support equipment.

Yet another stimulus to Iran Air's traffic and revenues is generated through the direct subsidy granted by the Minister of Education of the fares for all students traveling abroad on the national airline. This traffic, for which no precise data is available, is believed to be of a sustained nature and representing considerable volume to and from the United States. Similarly, military personnel training in the United States are directed to fly on Iran Air with their fares paid out of the military budget.

Iran Air is also the beneficiary of practices which are illegal in the United States and in most of the countries in the Western world. For example, under its air transport agreements with the various countries whose airlines serve Tehran, Iran's air carrier has reciprocal rights to fly to the same countries. However, from those countries which it has elected not to serve directly, Iran Air exacts an "effective reciprocity" fee from national airlines with landing rights in Iran.

A major competitive advantage accrued to Iran Air through its fare discounting practices. With the inauguration of service to New York in May 1975, at the direction of the government of Iran, Iran Air established a 40-percent discount on all fares between points in the United States and Iran for all "active and retired personnel of the Iranian government and Iranian students, including immediate family members of such persons. . . ." These are very broad categories, tapping a wide market spectrum.

The CAB is known to have strongly objected to this discriminating fare structure. The Iranian government has indicated that this practice would be phased out. Nevertheless, considerable traffic, according to trade sources, continues to be generated for the airline from this discount fare policy.

In addition to being exempt from all income taxes, the law which established Iran Air exempts the carrier from "all other taxes, duties and registration fees pertinent to aircraft technical equipment and relevant transportation facilities." Further, the airline is also exempted from the payment of customs duties and charges as well as the commercial tax applicable to facilities, equipment, tools, and supplies needed for its operations.

Mail compensation

Iran Air's mail rates are negotiated with its government's postal unit. As a large volume of domestic mail is included in the total, it is difficult to establish

the specific rate being paid Iran Air for its international mail movements. However, averaging the airline's total volume, the mail revenue per ton-kilometer (47.4 cents in fiscal 1977) is lower than the established U.P.U. rate but in the upper middle range when compared with the average mail rates being received by most European carriers.

The mail revenue experience for Iran Air for the last five years are summarized as follows:

	Total mail revenue (thousands)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer (U.S. cents)
Fiscal year ended Mar. 20:			
1973	$317	1	47.9
1974	438	19	55.5
1975	624	984	63.5
1976	1,451	2,862	50.7
1977	2,060	4,348	47.4

The Iran Air mail rate has been from two to three times greater than that paid Pan American World Airways and TWA by the United States in recent years. Applying the U.S. rate level as being non-subsidized, the imputed subsidy to Iran Air averaged around $1 million annually for fiscal 1976 and 1977.

Blunted government support

Another government measure supporting Iran Air was in effect until recently. However, under United States pressure, this practice which was found objectionable, was removed as far as it pertained to U.S. carriers.

This had to do with the government of Iran granting Iran Air the right of first refusal over certain charters from the U.S. to Iran. This developed shortly after Iran Air received its foreign air carrier permit in May 1974 to serve New York and co-terminal points Detroit and Los Angeles. This authority carried the right to perform an unlimited number of on-route charters with no requirement for advance approval.

Armed with this broad authorization, Iran Air required a "No Objection Certificate" before a charter flight could operate from non-designated U.S. carriers. (Pan American is the only U.S. carrier certificated to serve Iran.) For charter passenger flights, the fee was either 10 percent of the normal economy class fare or 15 percent of the charter price, whichever was higher. A fee schedule also pertained to charter cargo flights. This policy was imposed even in cases where Iran Air or Pan American was unable to perform the charter flight.

The "No Objection Certificate" fee requirement drew a sharp protest from the CAB in September 1975 through a show cause order directing Iran Air to desist from this practice under the threat of forcing that carrier to obtain advance authorization from the Board for all individual charters in the U.S. Under this threat of reprisal and as a result of extensive negotiations the Iranians through a "memo of understanding" agreed to desist from requiring a "No Objection Certificate" for U.S. carriers. This practice as it pertains to U.S. airlines appears to have ended. However, trade reports indicate that other Western air carriers remain subject to this impost.

KLM-ROYAL DUTCH AIRLINES

The company

KLM-Royal Dutch Airlines, the national flag carrier of The Netherlands, is a limited liability stock company in which The Netherlands Government owns a majority of the equity interests.

Company officials have publicly stated that "we enjoy excellent relations with the Government, but its majority ownership has never inhibited the operation of the Company in the best traditions of private enterprise."

Ownership

Of the total 3,105,380 common shares outstanding, 49 percent or 1,537,163, are publicly held in the United States and Europe. These shares are traded on six separate stock exchanges, including the New York Stock Exchange, where KLM, since 1957, enjoys the distinction of being the first and only non-American airline

listed. The majority common stock interest, 50.5 percent or 1,568,217 shares, are owned by the Government.

Additionally, the Government has paid for or subscribed to an aggregate of 400 million guilder ($160 million at the dollar exchange rate as of March 31, 1977) 5 percent Preference shares. (The nature of these Preference shares will be detailed later in this review.) Including these Preference shares, the Government may be said to own 78 percent of the Company's capital stock.

It is the stated objective of the Government ultimately to reduce its holdings in KLM to a "lower majority" presumably back to the 50.5 percent level prevailing in the common stock.

There are also 350 Priority shares outstanding of which 270 are held by the Government and the rest by various Dutch financial institutions. These Priority shares carry with them special voting rights.

Government support

There is a long history of Government support, in various forms, to KLM. In recent years, probably from around 1951, it does not appear that direct grants in the form of subsidies have been received by the Company. The Netherlands Government has been of substantial assistance, however, in making investments and guaranteeing loans so as to provide sufficient capital to permit KLM to expand its operations and acquire new equipment.

Mail compensation

Mail payments, one of the more common avenues through which government support their national airlines, has not been a significant factor to KLM's operations.

The Netherlands Government is believed to have negotiated an arrangement to pay KLM around 80 percent of the UPU mail rates on outgoing international mail movements. The average mail revenue per ton-kilometer performed by KLM is at the lowest end of the scale among all of the major foreign international air carriers.

Nor have mail revenues bulked very large in KLM's operations in recent years. This can be seen from the following:

	Total mail revenues (millions)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer performed (cents)	Mail percent total revenues
Fiscal year ended Mar. 31:				
1975	$11.9	27,252	43.4	1.5
1976	12.3	30,181	40.8	1.8
1977	13.8	[1] 31,725	[1] 43.5	1.7

[1] Estimated.

Infusion of new capital funds

The Netherlands Government, since its direct ownership in KLM in 1927, has, from time to time, made a number of direct capital investments and guaranteed various loans of the airline.

The intention of the Government to assure the viability of the airline is reflected in the various acts adopted over the years by the Netherlands States General (Parliament). A significant measure was the Act of August 21, 1950 (Netherlands Statute No. K 366). This authorized the Government to acquire the Company's capital stock, make loans, give guaranties, or pay subsidies. In return, the Company obligated itself to "provide adequate social welfare and pension plans for its employees, to maintain and operate airworthy aircraft . . ." The basic interest and provisions of this Act, with the exception of granting direct subsidies, have been continued in subsequent measures enacted by the Government.

The Government has repeatedly demonstrated its determination to come to the rescue of KLM when conditions so required.

New equity funds

After a substantial period of heavy deficit operations extending from 1960 through 1965 and which severely eroded the Company's capital position, the

Government, by taking up one-half of the issue, assured the success of a subscription offering to KLM's shareholders of 499,875 common shares in November 1966, raising $26.2 million in the process. This also maintained unchanged the Government's ownership in the equity. Further, in 1968, the Government purchased $20.4 million of the $40.4 million of the principal amount in 5¾% convertible subordinated debentures issued. Soon thereafter, in June 1969, KLM sold 300,000 shares of common stock in the U.S. market, with the Netherlands Government concurrently purchasing an additional 305,000 shares. In this instance, a total of around $40 million in new capital was provided.

Again, in 1971, faced with continuing deficit operations and the requirement to meet various amendments, KLM looked to the Government for a capital infusion. Under date of October 30, 1971, the Dutch Parliament authorized the Government to increase its investment in the airline to 200 million guilders ($62.5 million). Further, the State was empowered to extend guarantees for KLM on loans as to principal and interest up to $62.5 million. As a first step in this program, the Government, in January 1972, purchased a new 5% Preference stock issue in the amount of 200 million guilders ($62.5 million). This issue, as of November 1, 1976, became convertible into common stock.

To further bolster its capital position which was adversely impacted through the heavy losses experienced from fiscal 1972 on, KLM obtained additional equity funds from the Government on September 30, 1975. This time, it sold 200 million guilders ($74 million) in a new 5 percent preference, non-profit sharing stock issue to the Netherlands Government. However, of this issue, only one-half of the total was paid for upon issuance. The portion remaining unissued was included in the asset side of the balance sheet as a receivable. As far as can be ascertained, this balance has not been taken up by the Government. This new (1975 series) Preference share is convertible into common stock at par. Dividends on this series of Preference stock are non-cumulative.

Guarantee of loans

Concurrent with the bolstering of KLM's equity position, the Government provided support through its guarantee of loans to the airline over an extended period of time.

Other than the purchase of subordinated debentures (which was a form of equity), the Government is not believed to have made any direct loans to KLM. Its assistance in providing funds through debt appears to have been limited to loan guarantees.

As previously noted, the Government in its action of October 30, 1971, in addition to increasing its investment in the equity of KLM through the purchase of 200 million guilders ($62.5 million) in 5 percent preference shares, also empowered the State to extend guarantees for the airline in respect to the repayment of principal and interest on loans that may be obtained by the Company in an amount not to exceed 200 million guilders ($62.5 million). This guarantee provision was not implemented.

Subsequently, in view of the continuing losses, further infusion of equity capital by the Government through a new issue of 5 percent preference non-profit sharing stock was accomplished through legislation enacted on August 29, 1975. By virtue of this legislation, the amount for which the Ministers of Transportation and Public Works and of Finance were able to grant a State guarantee for KLM's loans was increased from $200 million guilders to 400 million guilders (then valued at $148.1 million). Despite the increase in the amount of the available government guarantee, it was never invoked. However, the existence of this "call" on a government greatly facilitated the Company's ability to obtain financing in the private sector.

KLM, in its 1972 annual report, acknowledged this assistance by noting: "We are deeply grateful to the Dutch authorities for their co-operation in a number of areas, and particularly in the field of financing".

Financing

Subsequent to the authorization of the availability of the recent Government loan guarantee facility, KLM accomplished a series of financial arrangements for the acquisition of new aircraft and which may be summarized as follows:

Fiscal 1973.—Delivery of four DC 10–30 aircraft under a sale and lease-back agreement was concluded and 75 million guilders ($25.7 million) 7 per guilder notes at an annual interest rate of 6 percent were issued by a KLM finance subsidiary. The U.S. Export-Import Bank also assisted in this financing.

Fiscal 1974.—Financing was arranged for the acquisition of three DC 10–30 aircraft through American and Canadian export credits, The value of this financing was estimated at around $75 million.

Fiscal 1975.—Two Boeing 747–206B Combi aircraft ordered in mid-1974 were delivered late in 1975. The financing was provided through bank credits and export financing. This involved an investment of $65.2 million. An additional investment of $15 million was committed for spare parts and ground equipment. Further, an export credit of $10.3 million towards the financing of a DC 10–30 aircraft delivered in February, 1975 was available but not utilized at the time. This aircraft represented an investment of $28 million.

The only outstanding loans under a Government guarantee as of March 31, 1977 were as follows:

	Guilders
4¼-percent debentures, 1972–83	5,250,000
3¼-percent loan, 1972–80	1,125,000

The Act of August 21, 1950 (Statute Book K 366) pertains to these loans obtained under the same Government guarantee provision have since been retired.

Tax position

KLM is not the beneficiary of any tax legislation which has been specifically fashioned for its benefit. It does benefit from the various tax incentives available to all corporate enterprises in The Netherlands. In this environment, KLM's corporate tax position is favorable. It has the benefit of an "investment allowance" which permits the deduction from pre-tax earnings of 8 percent of the purchase price on aircraft and spares during two years. Tax losses incurred in previous years permitted on a carry-forward basis for the succeeding six years, together with available investment allowances arising from aircraft orders, cushion the Company against corporate tax liabilities. As of March 31, 1977, the Company reported that "fiscal compensation possibilities for future profits of a minimum amount of 150 million guilders ($60 million) are available."

Operating results

The financing measures utilized by KLM are significant when viewed in the perspective of operating results reported in recent years and which may be summarized as follows:

Profit (loss) U.S. dollars	
Fiscal year ended Mar. 31:	*Millions*
1971	$19
1972	(39)
1973	(19)
1974	(22)
1975	(26)
1976	(7)
1977	31

NOTE.—U.S. dollars stated at prevailing exchange rates for the years shown.

SABENA BELGIAN WORLD AIRWAYS

The company

Societe Anonyme Belge d'Exploitation de la Navigation Aerienne (SABENA), the chosen instrument of Belgian air transport policy, was organized in 1923. In form, it is a private corporation, but the Belgian government has always had a controlling influence in it through an absolute majority of the voting stock and in the support provided. The government now holds 90 percent of the Company's capital stock, the remaining 10 percent appearing in the names of Belgian financial institutions.

Capital investment

The capitalization of the Company has been increased over the years through infusion of additional funds by the State in order to finance acquisition of new equipment and, most importantly, to sustain the viability of the airline in the face of mounting losses.

There has been a consistent pattern of providing additional funds to augment and sustain the Company's equity position which made for a stronger base to support a never-increasing level of borrowings. The State has been the source for the required equity as well as facilitating the bulk of borrowings obtained.

Capital stock

In addition to direct purchase of capital stock, the State in years past converted its loans to SABENA into equity.

As of December 31, 1976, the capital stock of the airline consisted of 1,500,000 shares of preferred stock of a par value of 500 Belgian francs each or 750 million B.F. ($19.5 million[1]). Common dividend stock (52,000 shares initially issued in return for intangibles are also outstanding but are not carried at any specified book value in the balance sheet.

The Belgian government has stepped up its commitments in SABENA'S equity as requirements dictated. For example, in recent years additional equity "anticipated" from the State was increased from 850 million B.F. ($22.98 million) in 1975 to 2.25 million B.F. ($58.46 million) in 1976. Steps were taken in 1977 to again increase the capital stock account, this time to 5 billion B.F. ($124.9 million). This "anticipated" equity capital to the extent not paid in represents a call on the State and is included as part of SABENA'S capital structure. Hence, at December 31, 1976, the Company reported its capital to be "equivalent" to 3,048.7 million B.F. ($79.2 million).

The authorization and provisions for the preferred stock find their basis in the Law of April 9, 1958. Among other things, the preferred stockholders are entitled to a fixed 5 percent return which is entered as an expense in the profit and loss statement. The charge for this dividend requirement has appeared annually in the amount of 37.5 million B.F. in recent years. ($974,400 in 1976). The State as the principal stockholder is thus presumed to obtain a return on its capital stock investment. This is an illusion as the funds to make such a presumed payment must be provided by the government in direct grants to cover the airline's operating deficits.

Long-term debt

SABENA has borrowed money from the Belgian government (and in the past from the colony of the Belgian Congo), as well as from certain government financial institutions. The most important form of government aid with respect to borrowings, however, has been the extension of State guarantees to loans obtained from other sources.

In addition to guaranteeing borrowings from other sources, the State, by the Law of August 18, 1955, is authorized to pay one-half of the interest on such loans. For example, the State undertook to pay 2⅜ percent interest (out of the total interest of 4¾ percent) on an issue of 20-year bonds Belgian government guaranteed, in the amount of 22 million Dutch guilders ($6 million) placed by SABENA on the Dutch market in September 1961.

There has been an upward trend in the borrowings by SABENA throughout the years.

As of December 31, 1976, after giving effect to transactions on additional loans and repayments, net long-term debt guaranteed by the State may be summarized as follows:

	Billion francs	U.S. dollars (millions)
From bondholders	2,920.2	$75.9
From other borrowings	5,765.3	149.8
To be funded	900.0	23.4
Total	9,585.5	249.1

Other loans not guaranteed by the State aggregated but 429.6 million B.F. ($11.2 million).

Thus 95.7 percent of SABENA's long-term debt was guaranteed by the State.

The Company's indebtedness bears varying rates of interest with the earlier obligations carrying yields ranging from 3.5 percent to 5.75 percent due to the government guarantee. Further, as previously noted, one-half of the interest on loans so guaranteed is paid by the State.

[1] U.S. dollar conversions throughout this report are shown at the rates of exchange prevailing for the specific year shown.

Operating results

SABENA has the unusual distinction of having an almost endless record of deficit operations for more than a decade. Losses were unusually heavy in recent years.

Reported results for this rcent period are summarized as follows:

	Net losses		U.S. dollars exchange rate
	Billion francs	U.S. dollars (millions)	
Calendar year:			
1972	239	$5.4	$0.022740
1973	174	4.5	.025725
1974	1,173	30.4	.025876
1975	2,495	67.5	.027039
1976	1,480	38.5	.025981
1977		[1] 6.0	

[1] Estimated.

As will be noted, SABENA's losses have largely been offset by government direct subsidy payments.

Direct subsidy support

Subsidies received directly from the State have been firmly established in the on-going support of the Company's operations. Such subsidy grants have been present from the airline's inception and have continued at ever-mounting levels to the present.

Under the Law of April 6, 1949, SABENA was entitled to receive a subsidy in the full amount required for the amortization of the flight equipment not covered by its own revenues. (This subsidy was recapturable without interest out of one-half of future profits under certain provisions. The recovery feature proved to be academic).

Subsequently, the basis for subsidy grants was broadened to include reimbursement for loan interest and "other charges". Under the Law of April 9, 1953 and as specified in Article 33 of the Statutes, reimbursement of these operating expenses and charges were identified as being made through annual government "Interventions".

Such payments made to SABENA by the government through "Interventions" have been as follows:

PAYMENTS FROM PUBLIC FUNDS UNDER GOVERNMENT INTERVENTION ART. 33 OF STATUTES

	Billion francs	U.S. dollars
Calendar year:		
1967	230.1	4.6
1968	314.6	6.3
1969	509.8	10.2
1970	602.5	12.1
1971	454.8	10.2
1972	966.8	22.2
1973	825.0	21.2
1974	[1] 858.0	[1] 22.2
1975	[1] 1,212.3	[1] 31.1
1976	1,181.3	30.7

[1] Estimated.

Hence, during the past ten years, more than 7.15 billion B.F. in government "interventions" as subsidies have been received by SABENA.

Mail compensation

Mail volume and revenues while relatively of limited significance to SABENA's total operating revenues are of considerable importance in terms of support to that carrier. The Belgian government pays SABENA the UPU rate for outgoing international mail. In terms of average revenue received per mail ton-kilometer performed, SABENA is among the top of all the European international carriers surveyed.

Mail volume, revenues and yields for SABENA in recent years have been as follows:

	Total mail revenues (U.S. millions)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer (U.S. cents)	Mail percent total revenues
Calendar year:				
1970	$4.4	8,131	54.1	2.4
1971	5.0	8,893	56.6	2.2
1972	4.6	8,616	53.1	2.0
1973	5.4	8,972	60.4	1.9
1974	5.5	8,590	63.6	1.6
1975	5.2	7,953	65.9	1.2
1976	5.8	7,950	73.2	1.2

It is noteworthy that in terms of yield per ton-kilometer performed, the return to SABENA in transporting mail has consistently averaged much higher than that received in its passenger service. In the period under review, average yields from passengers have ranged from 10 to 20 cents per ton-kilometer performed less than that received from transporting the mail. This disparity supports the belief that an element of subsidy is present in the mail revenues received by SABENA.

Company acknowledgement

Management has regularly acknowledged the government aid received. In its recent annual report, the company notes: "The Board is happy to express gratitude to the Ministers who are Trustees (guardians?) for the important contributions that they made to the company's recovery."

EMBEDDED SUBSIDIES FOR FOREIGN INTERNATIONAL AIRLINES

A form of embedded subsidy to foreign international air carriers may be found in the mail pay received from their respective governments. Such payments are largely based on the rates established by the Universal Postal Union (UPU)—a world facility established by the postal authorities of the various countries to govern the conditions and terms of international mail movements. These UPU rates are substantially higher than those established by the United States Civil Aeronautics Board (CAB) for U.S. carriers operating in the same international route channels.

Thus, an anomaly is present in that the CAB-decreed mail rates paid by the U.S. Post Office Department to U.S. air carriers are materially lower than those paid to competing foreign international air carriers. The U.S. Post Office Department, however, will tend to favor the U.S. carriers.

Most importantly, it is the governments of the national airlines who apply the UPU rates to compensate and support their respective air carriers in their international services. United States carriers, more often than not, offer to fly this mail at rates lower than that prescribed by the UPU. Nevertheless, it is the national carrier which is favored by their respective governments, at the higher rates, as established in the UPU.

The sharp contrast in mail payments as established by the CAB for its carriers and that made to foreign international airlines by their respective governments under the UPU schedule is illustrated by a comparison in two selected markets: New York-London, and New York-Frankfurt.

MAIL PAYMENT PER KILOMETER

	CAB rate	UPU rate [1]	
		Gold francs	In U.S. dollars
New York-London	$1.46	17.40	$6.86
New York-Frankfurt	1.63	19.50	7.68

[1] UPU rate based on postal gold francs. 1 postal franc equals 39.41 cents.

The CAB-decreed mail rates for U.S. carriers in international mail carriage are deemed by that agency to be fully compensatory, i.e. without any elements of subsidy.

On that premise, comparisons of the mail volume and revenues of twelve leading foreign international airlines for the fiscal year 1975 (the latest for which data is available) has been set forth in Table A.

On the basis of mail revenues per ton-kilometer performed, the foreign international airlines have received mail payments at a rate ranging from a minimum of around two to about four times that received by the U.S. international carriers operating in the same general market.

Applying a base averaging around 22 cents per revenue ton-kilometer, the U.S. carrier experience, as being the compensatory level, mail revenues in excess of that standard may be construed as a subsidy. This subsidy has, for the most part, been paid by the governments to their respective national airlines.

On this premise, as shown in Table A, subsidies received from this source for 1975 amounted to $25.3 million for Lufthansa, $20.8 million for British Airways, $15.8 million for JAL (Japan Air Lines), $15.3 million for Air France, $12.6 million for SAS, and $11.6 million for Swissair.

Moreover, it is likely that the level of subsidies will rise in the period ahead. Determination of UPU payments are made on the basis of postal gold francs. Currently, the exchange rate for one postal gold franc is 39.41 U.S. cents. With the weakness of the U.S. dollar, it is probable that at the next Congress of the UPU (scheduled for next year), exchange rate for the postal gold franc will be adjusted upward relative to the U.S. currency.

TABLE A.—COMPARATIVE MAIL REVENUE YIELDS SELECTED INTERNATIONAL AIR CARRIERS, FISCAL YEAR 1975

	Total mail revenues (U.S. millions)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer performed (cents)	Imputed subsidy (U.S. millions)
Air France	$31.6	74,918	42.2	$15.3
Aerolineas Argentina	5.1	5,831	80.8	3.4
Alitalia	9.8	23.240	42.2	4.7
British Airways	48.3	127,095	38.0	20.3
Iran Air	1.5	2,959	50.7	.9
JAL	29.3	61,524	47.7	15.8
Lufthansa	37.0	52,849	69.9	25.3
KLM	12.3	30,181	40.8	5.7
SAS	20.7	34,444	55.3	12.5
Sabena	5.2	7,953	65.9	3.5
Swissair	16.8	22,667	73.1	11.6
Qantas	14.2	25,620	55.5	8.6
Pan American (Atlantic)	30.7	140,835	21.8	----------
TWA (Atlantic)	17.0	76,443	22.3	----------

Source: Individual company reports and ICAO financial data, 1975.

ADDENDUM—EMBEDDED SUBSIDIES FOR FOREIGN INTERNATIONAL AIRLINES

With the availability of data for fiscal year 1976, an analysis of mail payments to foreign international airlines has been made for that year. This analysis is summarized in the accompanying Table B and follows the format presented in Table A and which revealed the comparative mail revenue yields for the fiscal year 1975 for the same carriers.

The same basic condition in embedded subsidies for foreign international airlines continued in 1976 as prevailed for 1975 and earlier years.

As the two leading U.S. carriers, Pan American and TWA received in 1976 an average of 21 cents per revenue ton-kilometer—the CAB decreed mail rates established as being compensatory—mail revenues in excess of that standard may be construed as being a subsidy. As noted in the 1975 analysis, this subsidy, for the most part, has been paid by the governments to their respective national airlines.

On this basis, subsidies from this source for 1976 for leading international foreign airlines were as follows:

	Million
British Airways	$27.4
Lufthansa	27.3
JAL (Japan Air Lines)	17.9
Swissair	13.0
Air France	13.0
SAS	12.2

In many cases, mail revenues per ton-kilomter performed were higher in 1976 than in 1975. For example, Aerolineas Argenina received 92.8 cents in 1976 as compared with 80.8 cents the prior year. Sabena, which has incurred heavy deficits, received a mail rate of 73.2 cents in 1976 compared with 65.9 cents in 1975. Higher volumes of mail also helped boost subsidies from this activity.

TABLE B.—COMPARATIVE MAIL REVENUE YIELDS SELECTED INTERNATIONAL AIR CARRIERS, FISCAL YEAR 1976

	Total mail revenues (U.S. millions)	Mail ton-kilometer performed (thousands)	Mail revenue per ton-kilometer performed (cents)	Imputed subsidy (U.S. millions)
Air France	$30.6	83,527	36.6	$13.0
Aerolineas Argentina	6.3	6,815	92.8	4.9
Alitalia	8.7	24,029	36.2	3.7
British Airways	56.4	137,891	40.9	27.4
Iran Air	2.1	4,348	47.4	1.1
JAL	31.9	66,249	48.1	17.9
Lufthansa	39.5	58,003	68.1	27.3
KLM	13.3	31,905	41.6	6.6
SAS	20.4	39,084	52.3	12.2
Sabena	5.8	7,953	73.2	4.2
Swissair	18.2	24,848	73.3	13.0
Qantas	NA	NA	NA	NA
Pan American (Atlantic)	27.8	132,279	21.0	----------
TWA (Atlantic)	15.3	72,603	21.0	----------

Source: Individual company reports and ICAO financial data, 1976.