



FACTS & OPINIONS

On Public Interest Issues

Quotes

Hegel was right when he said that we learn from history that man can never learn anything from history.

George Bernard Shaw

Hope is not the conviction that something will turn out well but the certainty that something makes sense, regardless of how it turns out.

Václav Havel

We've arranged a civilization in which most crucial elements profoundly depend on science and technology. We have also arranged things so that almost no one understands science and technology. This is a prescription for disaster. We might get away with it for a while, but sooner or later this combustible mixture of ignorance and power is going to blow up in our faces.

Carl Sagan

Don't Stop Air Service Deregulation Now

Robert W. Poole Jr. and Viggo Butler

In the 21st anniversary year of airline deregulation, air travel is again at the forefront of public policy. Policymakers have been besieged with a variety of complaints: that business fares are up, some smaller cities are not receiving the kinds and amounts of air service their residents would like to have, small start-up airlines can't compete effectively, and continued consumer complaints about congestion and delays. A variety of solutions have been proposed, including, for the first time since 1978, federal control over some of the prices charged and routes served by major airlines.

Any return, however, to a regulatory system that has the government micromanaging routes and services would be misguided. Such a "solution" would do little to improve air travel and would cause significant harm to consumers. Despite the criticisms, airline deregulation has provided—and continues to provide—enormous benefits to the average traveler. Economists from the Brookings Institution and George Mason University have estimated that consumers save some \$19.4

billion per year thanks to the lower fares resulting from a competitive airline marketplace. American cities have been offered much greater air travel access, thanks to an aviation marketplace in which airlines are free to provide service when and where demand exists, without having to seek permission from central planners. Millions of Americans began to fly for the first time in their lives. Airline deregulation democratized air travel in America.

There are, of course, serious problems remaining. But these problems stem not from too much reliance on market forces, but too little. In deregulating the airlines in 1978, Congress unleashed market forces on one segment of the air-travel system—but failed to free up the critical infrastructure on which the airlines depend, namely the airports and the air traffic control system. These essential elements of the air travel system remain not only government-controlled, but government-owned.

Not surprisingly, problems emerged when a consumer-responsive airline industry placed

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President
Dr. Don Racheter

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What's New at Public Interest Institute?

Doug Strickler

On August 14, 1999, Public Interest Institute and the Cato Institute co-sponsored a debate entitled "Is There a Future for Social Security?" The debate was held in Ames just prior to the Iowa Straw Poll.

A distinguished panel of policy experts, who specialize in Social Security issues, took part in the debate.

The panel included:

- Lisa Davis, Senior Policy Analyst with the National Committee to Preserve Social Security
- Scott Hodge, Senior Fellow for Tax and Budget Policy at Citizens for a Sound Economy
- Dr. James Hutter, Iowa Conference of Political Scientists
- Michael Tanner, Director of Health and Welfare Studies at the Cato Institute

The debate was moderated by Dr. David Roe, president of Central College, Pella, Iowa.

Immediately following the debate, presidential candidates Steve Forbes and Alan Keyes presented statements of their perspectives on the Social Security crisis, both stressing the need for individuals to gain control over their retirement future. *See photos, page 8*

Focus on Iowa Wesleyan College

IWC Marketing Office

Iowa Wesleyan College has successfully completed the race to raise \$4 million for a new multipurpose facility. The college has been in the throes of a campaign to raise \$2 million in order to qualify for another \$2 million in matching gifts.

Iowa Wesleyan turned to residents and organizations in Mt. Pleasant for support. The college raised nearly \$500,000 during the last two weeks of the campaign, averaging \$35,000 per day.

The new facility will provide opportunities for organizations throughout southeast Iowa. Besides serving as a fitness complex, the building will offer conference rooms and dining capabilities. A variety of events can be held in the center, such as summer conferences, conventions, and local and regional athletic tournaments.

If you would like more information on Iowa Wesleyan College, write or call:

**Iowa Wesleyan College
601 North Main
Mt. Pleasant, IA 52641
(319) 385-8021**

www.iwc.edu

Don't Stop Air Service Deregulation Now

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Robert W. Poole, Jr. and
Viggo Butler

What deregulation accomplished was to transform a static, cartelized aviation market into a dynamic, continually changing market.

demands on a still bureaucratically controlled infrastructure. The problems typically have been blamed not on the infrastructure managers, largely invisible to the traveling public, but rather on the airlines themselves. This is unfortunate. Instead of re-regulation, today's real policy challenge should be to remove the remaining government interventions in aviation infrastructure that restrict competition and hinder the growth of new forms of airline service.

What deregulation accomplished was to transform a static, cartelized aviation market into a dynamic, continually changing market. This process has gone through several waves— and is still continuing.

Deregulation's Initial Wave:

Hubs and Spokes. During the first 10 years of deregulation (the 1980s), the major airlines shifted dramatically from point-to-point to hub-and-spoke route systems. Following the example of pre-deregulation Delta, which pioneered the concept at Atlanta, the major trunk airlines built up major connecting hubs at what had been principally origin and destination airports—such as Charlotte, Dallas, Detroit, Minneapolis, Pittsburgh, and St. Louis. Hubbing made possible huge increases in service, for two categories of air traveler. First, those living in the hub-airport city gained access to a many-fold increase in the number of destinations and the number of flights. Second, residents of small cities on the spokes of the hub, who may have lost some point-to-point service, gained—via the hub—access to potentially hundreds of destinations via the hub. These major gains in air service, along with a pronounced and ongoing decline over time in inflation-adjusted air fares, have been well documented by the U.S. Department of Transportation (DOT).

This system came under extensive criticism, in large part because the large concentrations of flights at hub airports meant that a number of major airlines were able to gain huge market share at one or more hubs, providing more than 2/3 or 3/4 of all service at hubs such as Atlanta, Charlotte, Denver, Detroit, Minneapolis-St. Paul, Pittsburgh, and St. Louis. Critics pointed out that average air fares were significantly higher on flights to and from such hubs than to and from other larger airports. Even at these hubs, however, fares were lower than they were under the old regulatory system.

In addition to scheduling changes, airlines also reconfigured their fleets for hub-and-spoke service, shifting over time to smaller aircraft, so as to provide more frequent service, feeding hubs from a growing number of spokes.

But these changes by the airlines were constrained by the limitations of the aviation infrastructure—airports and ATC (air traffic control)—which had not been altered by deregulation. Huge increases in landings and take-offs at hub airports put enormous stress on the ATC system. Unlike an investor-owned network, the ATC system is not paid for directly by fees charged to customers. Thus, when traffic soared, the system's revenues did not. It still had to go to Congress every year to request funding for capital investments and for additional controllers. Its top-down, bureaucratic management style led to serious problems in developing and implementing technological modernization to cope with an airline system whose growth was now taking off in unpredictable ways.

Making things worse, in response to an unprecedented strike by air traffic controllers in 1981, a

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Robert W. Poole, Jr. and
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national form of rationing called “flow control” was instituted—essentially, slowing everything down so that growing air traffic volumes could be accommodated safely with obsolete computers and radar. That system remains in place today, seriously constraining aviation growth.

Airports, too, found it difficult to respond to changing patterns of demand. Their capital expenditures are funded in part by issuing revenue bonds and in part by federal Airport Improvement Program (AIP) grants. In exchange for AIP grants, airports must sign long-term (20-year) grant agreements, giving the Federal Aviation Administration (FAA) de facto economic regulatory control. One major consequence is that the FAA has made it virtually impossible for airports to respond to high airline demand by increasing the price of their services (landings and take-offs), which would reduce congestion and raise funds for airport expansion. Hence, the only alternative way to cope with airport congestion has been rationing—arbitrary “slot” allocations at four airports and the nationwide flow-control system for all the others.

The Second Wave: Low-Fare, Point-to-Point Service. The growing level of congestion at major hub airports during the 1980s created opportunities for alternatives. One such alternative was low-fare, no-frills, point-to-point service. Southwest Airlines, whose origins pre-date deregulation, was freed by deregulation to offer its then-unique type of short-haul service on an interstate basis. Shunning congested airports and direct competition with the major airlines, it carved out a thriving market niche during the 1980s by reviving point-to-point service. During the 1990s Southwest moved into the ranks of the nation’s top 10 airlines, and its service expanded to the East Coast

with new service to Florida, Baltimore, and Providence. Southwest’s aggressive low prices have greatly expanded the market. For example, in 1996, before Southwest’s arrival, daily passenger traffic to 14 Providence markets was 1,471. One year later, with Southwest having cut the average fare from \$291 to \$137, the daily passenger count had increased to 5,100.

The obvious appeal of the Southwest model led to a host of start-up airlines attempting to replicate its success. Many have failed, or have pursued other niche market strategies. Most recently, several of the major airlines—including Continental, Delta, United, and US Airways—have created subsidiaries offering low-fare, low-frills point-to-point service using a single type of aircraft and lower-paid crews. The low-fare, point-to-point revolution has succeeded thus far despite the constraints of bureaucratic, non-market aviation infrastructure. Southwest and its competitors have deliberately avoided most congested hub airports and routes with the most congested air traffic. They have sought out under-served city markets and secondary airports in major urban areas. But the very success of this type of service is putting stress on the airports it serves and on the ATC system. Its continued growth depends critically on freeing up this infrastructure to respond to increased future demand.

Virtually every under-served airport in the country has sought to attract service from one or more of these airlines, to provide new service at low fares. But the problem with many of these cities is that they are too small to generate the kinds of passenger loads needed to fill a 737, DC-9, or MD-80 aircraft. Thus, until now, these

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If current low-fare airlines can profitably offer point-to-point service between scores of city pairs in 737s, similarly entrepreneurial airlines ought to be able to offer profitable service between hundreds of other city-pairs in jetliners of 30 to 70 seats.

cities have found it difficult to attract any significant amount of jet service.

The Next Wave: Regional Jet Service. The term "regional jet" (or RJ) refers to a new type of small jet airliner, which began service in 1997. First to enter the market was Bombardier, with 50-seat and 70-seat versions of its Canadair Regional Jet, along with Embraer's 50-seat RJ-145. Within the next few years these aircraft will be joined by the 37-seat Embraer ERJ-135 and the 32-seat Fairchild Dornier 328-Jet, followed by variants with 44, 55, and 70 seats. These small jetliners are expected to lead to further major changes in the airline market.

The initial use of RJs is by regional airlines that serve as feeders to the hubs of major airlines like American, Delta, and United. In that market niche, RJs are proving highly popular with air travelers, who much prefer them to the small turboprop aircraft which they are replacing.

But the RJs' popularity with passengers is only one of their important attributes. Ultimately more important is their low seat-mile costs for medium-length routes capable of supporting only modest numbers of passengers. The RJs' direct operating cost (per seat-mile) is lower than that of a comparably sized turboprop for routes longer than about 400 miles. The ability to serve such markets economically with jet airliners opens up the possibility of adding smaller cities and more frequent service to the spokes of hubs. But it also offers the prospect of a new market for point-to-point service—whether offered by existing regionals or by another generation of new entrant airlines, applying something like the Southwest model to a much smaller size of aircraft than the 110 to 189 seat 737.

One example of the former is the recent announcement by regional airline Atlantic Southeast (principally a Delta connection operator) of nonstop RJ service from Stewart Airport north of New York City to Atlanta, replacing a former Delta flight on this route. Although Atlanta is a Delta hub (making this route technically still a spoke), many of this route's customers will be passengers flying point-to-point between Atlanta and New York City's northern suburbs. Likewise Continental Express has announced nonstop RJ service from Dallas' Love Field to Cleveland.

The possibilities for new RJ point-to-point service are breathtaking. If current low-fare airlines can profitably offer point-to-point service between scores of city pairs in 737s, similarly entrepreneurial airlines ought to be able to offer profitable service between hundreds of other city-pairs in jetliners of 30 to 70 seats. Boeing forecasts point out that one of the fastest growing areas for airlines over the next 10 years will be point-to-point routes overflying hubs. RJS will accelerate this pattern. For example, a trip from Houston to Wichita until recently required changing planes in Dallas. Today, that route is served nonstop via an RJ.

To illustrate the savings in passenger time, consider that today's trip from Wichita to Cincinnati now takes just two hours nonstop via RJ. But a similar trip from Wichita to Cleveland can be made only via turboprop, connecting through St. Louis, for a total trip time of more than four hours. The customer appeal of non-stop, point-to-point RJ service is obvious.

How large is the market for such planes? Bombardier estimates the U.S. market for 50 and 70-seat RJs to be 1,600 between 1997 and 2011. Fairchild Dornier estimates an

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Robert W. Poole, Jr. and
Viggo Butler

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additional U.S. market for over 400 30-seat RJs.

The projected 2,000 regional jets (to the extent that they do not merely replace small turboprops) would expand the current U.S. domestic jet airliner fleet by 44%. And because RJs fly shorter routes than do 737s or 757s, in a typical day an RJ will make more take-offs and landings than a larger jet. Thus, the 44% increase in the U.S. jet fleet produced by the addition of RJs would lead to a virtual doubling of the current 21,000 daily airline take-offs. Such a doubling will not be possible without major upgrades of the air traffic control system.

Coping with the RJ Revolution.

A doubling of U.S. flight activity in less than 15 years will require major upgrading of the nation's air traffic control system. Without fully factoring in the impact of the RJ revolution, the National Civil Aviation Review Commission warned of impending gridlock without a major restructuring of the way the ATC system operates.

One top priority for a revamped ATC organization would be to implement what has come to be called "free flight." Today most flights still traverse the country on a limited number of straight-line "airways," defined by the locations of ground-based beacons called VORs. The aircraft is directed by air traffic controllers to fly from the first VOR location to the next one, zigzagging its way across the country. Under free flight, pilots will be able to select their own direct routings from city A to city B, guided by satellite-based navigation (such as GPS) and other systems, rather than being confined to the limited number of currently designated airways. This change—eagerly awaited by the airlines—will greatly expand the volume of available airspace,

thereby facilitating the growth of air traffic.

Another pressing need is to increase capacity at the airport end of the infrastructure. Regional jets will open many smaller airports to jet airline service. RJs can operate on routes as long as 1,700 miles, but can make use of somewhat shorter runways than the current jet aircraft of choice for low-fare airlines, the 737. RJs can probably substitute for turboprop commuter planes at many airports which today cannot support jet service.

Another important impact of RJs is their ability to provide airline service at additional airports in major metro areas. RJs are dramatically less noisy than larger airliners such as 737s and MD-80s; their off-airport noise exposure is comparable to that of twin-engine propeller general aviation aircraft. Hence, they can provide jet service to scores of reliever airports near congested big-city airports but not currently receiving any airline service.

Opening such airports to RJ service will require changes to the regional air space and ATC procedures. In some cases it will also require upgrading the landing aids at these airports. The present FAA airport-grant system is not well equipped to make such changes in a timely fashion, but a use-funded, commercially oriented ATC organization would have strong incentives to do so. (See "For Safer, More Efficient Air Traffic Control," Consumers' Research, May 1998.)

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**Don't Stop Air Service
Deregulation Now**
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**Robert W. Poole, Jr. and
Viggo Butler**

*The air traffic
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Don't Stop Now. Given the enormous well-documented success of airline deregulation in expanding air travel and reducing air fares, why have proposals for partial re-regulation emerged? One factor is growing expressions of concern over the limited airline service to smaller cities such as Des Moines and Rochester. Another factor is the difficulties encountered by low-fare and start-up airlines in gaining access to major hub airports. A particular focus of attention in all the proposed bills is the extreme difficulty encountered by non-incumbent airlines in gaining access to "landing slots" at the four busy airports where such slots have been defined by the federal government: Chicago's O'Hare, New York's Kennedy and LaGuardia, and Ronald Reagan Washington National. (See "Why Fares Are Too High At Some Major Airports," Consumer Research, February 1997.)

It is ironic that these calls for re-regulatory action arise at precisely the time that deregulation is entering its next wave: the regional jet revolution. For the RJ's potential is precisely to meet the demand for better service to smaller cities and to secondary airports in major urban areas. But the ability of the U.S. aviation system to accommodate this next wave is a real question mark.

The air traffic control system is a major impediment to aviation growth. It had difficulty coping with the shift to hubs-and-spokes in the 1980s and the revival of point-to-point in the 1990s, and will have major difficulty coping with a doubling of landings and takeoffs due to regional jets over the next decade.

As noted in the final report of 1997's National Civil Aviation Review Commission, which was set up by Congress to rethink the

management and financing of the Federal Aviation Administration, "the United States' aviation system is heading toward financial and fiscal gridlock." Due to poor management and inadequate capital investment to modernize the air traffic control system, the average delay per airline flight is expected to triple by 2014. Without major structural change, NCARC found, "delays and congestion will become overwhelming." This kind of gridlock will make it much harder for new-entrant airlines to gain access to popular airports and it will foreclose the possibility of doubling the number of landings and take-offs, as implied by today's projected RJ growth.

Thus, the real challenge for aviation policy today is to finish the job of airline deregulation left incomplete by the historic 1978 legislation.

The regional jet's potential is precisely to meet the demand for better service to smaller cities and to secondary airports in major urban areas.

Mr. Poole is president of the Reason Foundation and Mr. Butler is chairman of United Airports Limited. This article is excerpted from their policy study, "Airline Deregulation: The Unfinished Revolution," published by the Reason Public Policy Institute (RPPI) and the Competitive Enterprise Institute. The excerpted article appeared in Consumers' Research v.82, no.7, July 1999. Reprinted with permission. For a copy of the full study, contact RPPI at (310) 391-2245 or www.rppi.org.

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Panel Photo

At Left: Panelists discuss the merits of privatizing Social Security at a debate sponsored by Public Interest Institute and Cato Institute. *Left to right:* Dr. David Roe, Central College; Scott Hodge, Citizens for a Sound Economy; Lisa Davis, Committee to Preserve Social Security; Michael Tanner, Cato Institute; Dr. James Hutter, Iowa State University; and Dr. Don Racheter, President, Public Interest Institute. The debate was held in Ames just prior to the Iowa Straw Poll. Story p.2.

Keyes

Forbes

*Do you have an idea or topic you'd like to see covered in **FACTS AND OPINIONS**? Let us know! See page two for information on how to contact us.*

Above: Presidential Candidates Alan Keyes and Steve Forbesspeak at the Debate, "Is There a Future for Social Security?"