



Consumer Federation of America

**STATEMENT OF DR. MARK COOPER
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on behalf of

THE CONSUMER FEDERATION OF AMERICA AND CONSUMERS UNION

on

**THE FINANCIAL STATE OF THE AIRLINE INDUSTRY AND THE POTENTIAL IMPACT OF A
DELTA/NORTHWEST MERGER**

**Senate Committee on Commerce Science and Transportation
Aviation Subcommittee**

May 7, 2008

Mr. Chairman and Members of the Committee,

My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America. I greatly appreciate the opportunity to testify yet again on the serious consumer problems with the airline industry and commend the committee for holding a hearing that investigates the general condition of the industry. I appear today on behalf of the Consumer Federation of America¹ and Consumers Union.²

This is truly an industry that makes no one happy, as the opening paragraph in a *New York Times* column put it recently

¹ The Consumer Federation of America is an advocacy, research, education and service organization established in 1968. CFA has as its members some 300 nonprofit organizations from throughout the nation with a combined membership exceeding 50 million people. As an advocacy group, CFA works to advance pro-consumer policy on a variety of issues before Congress, the White House, federal and state regulatory agencies, state legislatures, and the courts.

² Consumers Union, the publisher of Consumer Reports®, is an independent, nonprofit testing and information organization serving only consumers. CU does advocacy work from four offices in New York, Washington, San Francisco, and Austin. CU's public policy staff addresses a broad range of telecommunications, media and other policy issues affecting consumers at the regional, national and international level. CU staff members frequently testify before Federal and state legislative and regulatory bodies and participate in rulemaking activities at the Commission and elsewhere.

What a time for airlines. Delays and cancellations. Oil more than \$100 a barrel. Customers are furious and flight crews are bedraggled. And that's before the economic slowdown in the United States brings its own misery. Warren E. Buffett once famously said of his fellow investors in the airline industry, "If we knew then what we know now, we'd have shot the Wright Brothers down." ("A Profitable 18 Hours That's All Business," Tuesday March 11, 2008, C-6)

Consumers are frustrated by lousy service and pricing that is, at best erratic. Investors are buffeted by boom and bust cycles. Emerging from another wave of bankruptcies, the worst on time performance record in history, and confronted with a likely merger wave that would reduce the number of major carriers from a handful to a precious few, it is time for Congress to consider the proposition that this industry just does not work as an unregulated market. In my remarks today I will lay out the basic causes of the problem and give some initial thoughts about the solution, but my primary goal is to convince Congress to begin asking the right questions regarding endemic problems in the industry that must be addressed. The occasional hearings, triggered by this or that merger, are not enough to solve these problems because they do not provide a proper context for the thorough policy rethinking that the industry needs and the public demands.

From a policy point of view, the key factor is that competition is at best sporadic in the industry, limited to a small subset of routes and metropolitan areas, primarily on the on the coasts. Left to its own devices, the industry will over schedule take-offs and landings at the most competitive airports to drag customers to the airport under a false claim about when they will leave or arrive. They get away with it because there are only a few of them and they tend to do it en masse. There is too little competition to punish the abusers.

The middle of the country is dominated by fortress hubs, that force consumers into additional take-offs and landings and provide the trigger points for cascading delays.

Consumers not only have longer travel times, but those who are captive to these hubs pay a heavy price in terms of higher fares on the many routes with little competition.

The most famous of the cut-rate competitors has just been hit with the largest fine in the history of the industry for failing to properly inspect its aging fleet – aging because that is the best way to squeeze a little profit out of the skies. The most prominent of the recent new entrants into the industry has had repeated melt downs of service, keeping consumers prisoner on planes for hours on end. In fact, they all keep consumers captive on planes for long periods, rather than risk losing a take-off slot, or a body in a seat. They get away with it because they tend to do it en masse and there is too little competition to punish the abusers.

It is time to rethink public policy toward the airline industry. To say that the thirty-year experiment in deregulation has been a wild ride would be a gross understatement. When a market performs this badly, this consistently, from every point of view – consumer, investor and labor – it is time to consider major changes. More and more, it appears that the original public policy judgment about the industry by policy makers in the 1930s, that it is destructively competitive, subject to vicious boom and bust cycles, and prone to exploitation of the consumer, was correct.

Moreover, this is not just an industry that manufactures widgets. It is infrastructure that supplies an essential input to other industries that has an effect on the growth and vibrancy of regional and national economies.

The industry is also fundamentally dependent on public resources for its existence. It relies on the public airways, and facilities that are supported by public dollars, airports and air traffic control, which reinforces the justification for more direct intervention to protect the public from the abuse it suffers at the hands of the industry.

The pending mergers and those that are likely to follow are an admission of failure. The industry cannot support financially healthy airlines with vigorous competition. Delta and Northwest tell us that the merger won't harm competition because they don't compete, in some cases they have withdrawn from competition with each other over the past few years. If other mergers are proposed, and rejected, the airlines will reduce their overlap and propose mergers down the road. In the end, consumers have less and less competition. Without vigorous competition the abuse of consumers will continue and become worse.

Nobody wants to go back to price and quantity controls, but the industry has lost its right to be unregulated by consistently abusing the traveling public. A consumer bill of rights would be helpful, but if we do not change the incentive structure and back it up with energetic enforcement by public authorities, it will not lead to long-term solutions to the vast problems I have detailed. In many cases, individual abuses by individual airlines are not the problem; it is the overall structure that is.

Dealing with delays and cancellations – weather, mechanical or economic – is a delicate problem. We never want an unsafe plane to take off or a safe one to take off in unsafe conditions. However, there are a number of practices that abuse the public that have nothing to do with the difficult question of safety versus service.

Over-scheduling is a perfect example, where all airlines share the blame and the solution is a reduction of all schedules proportionate to the number of flights. They will not voluntarily solve the problem and they certainly should not be allowed to publish schedules that they cannot meet. The FAA should respond quickly and aggressively to over-scheduling. A landing slot is a perishable commodity whose value varies widely between airports and over the course of a day. The allocation of those slots to users should reflect their value. The

public will benefit much more from a systematic approach to the problem, than the sporadic, after the fact fixes that have been applied in the past. The airlines would initially be free to set schedules as they like, but if they behaving badly and produce situations of chronic over-scheduling, then the regulator would shape the traffic curve adjusting the fee structure and/or administratively reducing the number of flights at congested airports/times. The reductions in flight should be spread across all airlines that have shown chronic delays.

Imprisoned passengers are a similar collective problem that demands a collective solution. The problem of passengers imprisoned on airplanes for long hours will not be solved as long as standing in line is the way we allocate take-off slots. An industry that manages thousands of planes moving hundreds of miles an hour in the air at one time ought to be able to manage dozens of planes standing still on the ground at an airport better. When it takes half an hour to load and embark a plane, it is absurd that people should be forced to sit on runways for hours because the airline does not want to lose its place in the queue. The regulator should institute queuing policies that do not reward, perhaps even punish, airlines for keeping people sitting on the tarmac for excessive periods of time.

Overbooking and lost baggage are individual airline issues that can be dealt with by improving consumer rights. If the penalties are stiffened, the individual airlines will have more incentive to do a better job.

In the long run, expanding capacity will enable the airlines to better serve the public, but if we expand capacity without reforming the incentive structure, the industry will, soon enough, recreate existing problems. Capacity or the lack thereof is not the cause of the current problem. The irresponsibility of the airline industry is the problem. It is the failure of the industry to offer service to the public that fits within the capacity of the current system –

air traffic control and airport landing slots – that harms the public. If you build it, without setting new rules, they will come and come and come until it is overburdened.

Again I thank you for the opportunity to express the consumers' frustration with the airline industry and urge you to undertake a top-to-bottom review of its market failure. The Consumer Federation of America looks forward to assisting you in any way we can in that important endeavor.