To Save The Airlines, Re-Regulate Them

by Richard Freeman

Prior to the Sept. 11 deadly airliner attacks, the airline industry had already suffered serious economic problems, and some airlines were already on the bankruptcy path. This year, the deepening collapse of the U.S. and world economy had sharply contracted U.S. airline travel and revenue; by the second quarter of this year, major airlines like United and American had mounting losses.

But there is a second fundamental sickness, going back two decades, to President Jimmy Carter's insane decision on Oct. 24, 1978, to deregulate the airline industry. Deregulation ripped apart the preceding 40 years' dependable functioning of the aviation system, and has ravaged America's air transportation grid. In the world of deregulation, speculators took over airlines through leveraged buyouts, saddling them with huge debts; there was asset-stripping of the airlines: the precision and necessary upkeep and overhaul of plane engines and bodies, was reduced; costs were slashed; wages and benefits were sliced; air travel to dozens of smaller cities and towns was sharply reduced or abandoned.

Deregulation created a permanent management culture of cost-cutting, governing all airlines' management decisions, and leading the airlines to attempt to operate on the thinnest of margins. During so-called "normal" periods, this management culture allowed airlines to get by, even though it had debilitating effects on efficiency and safety. But, when the rate of U.S. economic depression became steeper, as it did this year, the airlines could not gouge enough further costs to survive; the pre-existing, deep and severe crisis came to light. Then, the Sept. 11 events intensified that crisis.

On Sept. 18, the U.S. Congress adopted a $15 billion assistance package for the airlines: $5 billion in grants, and $10 billion in loan guarantees. The stated intent to prevent the airline industry's collapse was a worthy one. However, the adopted legislation neither solves nor even addresses the airlines' long-term problems; it falls far short of the indispensable policy direction outlined by Lyndon LaRouche's proposal of Sept. 18, which calls for bankruptcy reorganization of this heavily indebted industry, and the extension of 10- to 20-year financing for capital projects necessary for its survival and that of its infrastructure (see *EIR,* Sept. 25, 2001).

A second step is indispensable: America must re-regulate the airline industry.

Thus, it is necessary to understand what regulation actually does in directing air transportation in the national interest, and the history of destruction that deregulation has produced, which lowered the functioning and solvency of the airline industry to a point of crisis well before Sept. 11.

The Positive Purpose of Regulation

Regulation provided for the growth and development of the infant airline industry. In 1929, the predecessor airline to Eastern Airlines began, as did many other U.S. airlines, as an entity to deliver the U.S. mail. Eventually transformed into a passenger airline, Eastern established a route along the East Coast of the United States. Another pioneering U.S. airline was Pan American World Airways, which travelled between Florida and Cuba, and branched out into other areas. Its founder and guiding spirit, Juan Trippe, called Pan Am the "chosen instrument" of the U.S. government, and wanted it to be treated and regulated like the Postal Service, the telephone system, or a public utility.

In 1938, the Civil Aeronautics Board (CAB) was created by the administration of President Franklin D. Roosevelt to regulate the airline industry. In its first phase, in order to ensure the survival of the industry, the CAB either channeled monies to airlines, in return for service delivering the U.S. mail, or else directly subsidized the airlines.

At the same time, the CAB established a procedure to determine the rate of fares that the airlines could charge, including the rates of increase, through effectively a rate bureau mechanism, that worked in consultation with the airlines. Under the system, the airline could set a fare at a rate which permitted the airline to generate sufficient revenues to cover the cost of production—capital goods purchases, precise and sufficient maintenance, decent wages for its pilots, mechanics, and staff—and to have a fair rate of profit. The profit enabled the airline to reinvest in expanding and technologically upgrading the level of production, and still have something left over to pay to its stockholders.

The fare level had an associated critical function: *To make sure America had an air transportation system as a whole, covering all cities that needed to be covered.* Accordingly, the fares were set at a level to reflect the cost needed to cover all cities and towns that legitimately needed air travel, so that even if a route to a small city was only marginally profitable, or not at all, the city still got air coverage.

Deregulators later complained that, under regulation, the more profitable routes had to subsidize the less profitable, even money-losing routes. *But this was the advantage and purpose of a regulated air system: so that all citizens, regardless of where they lived, had equal access to air service in the public interest.*

The CAB served the nation well. This is evident from the explosive growth of the commercial airline industry before deregulation. A key measure of the airline industry is the "revenue passenger-miles flown," taken on a *per-capita* basis, in order to take into account a growing population. During the 1950s, the compounded rate of growth in revenue passenger-miles flown per capita, was 13.5% per year. The airline industry was then still in its infancy, so one might expect a high rate of growth. But over 1960-78, the last year the airline industry was regulated, this measure still increased at a compounded rate of 9.2% per year. This contrasts sharply with the shrunken 3.7% annual compounded rate the airline industry has registered since deregulation, in 1979-2000. Even the supposed 3.7% growth rate is deceptive, because it is based on heavy price discounting to selected passengers. Without the selective discounting, the rate would be lower.

Deregulation Devastation

This functioning system was taken apart by President Jimmy Carter, who had been bankrolled into the Presidency by banker David Rockefeller's Trilateral Commission. Within two years of that 1978 action, Carter had also disastrously deregulated the trucking and rail industries.

In the name of "increased competition," the law eventually abolished the CAB, and opened up automatic entry for any airline wanting to join the industry. This deliberately set the conditions for the shake-out and pillaging of the industry. The large New York and other money center banks financed many low-fare (and often non-union) start-up airlines, which frequently served as wrecking operations. Many of the start-up airlines, as well as the existing ones, crowded into the routes which had the highest density of travel—say, New York to Chicago—and presumably the quickest profits. But, whereas these routes might support five big airlines and three small carriers, 20 or more would crowd into routes without enough passenger volume to support them. Price wars erupted, sending many carriers into bankruptcy.

At the same time, as intended, routes to the remotest or least-travelled parts of the country, which were no more than marginally profitable, were greatly reduced or abandoned.

This facilitated the wave of leveraged buy-out (LBO) takeovers, by speculator/asset-strippers, who purchased and traded airlines back and forth at escalating levels of debt. To pay the interest on the debt which the LBO had loaded on, they pillaged the airline's plant and equipment, fired its labor force, and sold off its assets—all the while justifying such actions in the name of "cost-saving."

Take the case of the model of takeovers and asset-stripping, Frank Lorenzo, who built an empire. The Harvard "Management School"-trained Lorenzo started with a tiny company, Texas Air, financed by Chase Manhattan Bank and mob-linked, Minneapolis-based financier, Carl Pohlad, in 1971. In 1981, Lorenzo, backed by Pohlad, launched a no-holds-barred, hostile bid for Continental Airlines. Lorenzo's Texas Air was a mouse to Continental, then America's eighth-largest passenger carrier. But Lorenzo was helped by Wall Street bankers, who hammered down the total value of Continental's stock until it was worth less than its fleet of planes, a near-impossible situation. In the face of Lorenzo's onslaught, which included many dirty tricks, Continental finally conceded defeat. On Aug. 9, 1981, in his office at the Los Angeles Airport, Alvin Feldman, Continental's chief executive officer, put a gun to his head and shot himself.

In subsequent years, Lorenzo tapped into money from Wall Street and Drexel Burnham Lambert, to take over Eastern Airlines—one of America's pioneering lines—People's Express, and Frontier Airline, and folded them, along with New York Air, and Continental Airlines, into his Texas Air ponzi scheme. By 1986, Lorenzo's Texas Air employed over 50,000 workers, owned 451 planes, and gathered $7 billion in annual revenues, making it the second largest airline in the world, after the Soviets' Aeroflot. In the process, Lorenzo drove many other carriers out of business, cut routes to "unprofitable cities," and slashed maintenance expenditures. A national air transportation grid, servicing the entire nation's development, was the furthest thing from Lorenzo's mind.

In this and subsequent periods, other asset-strippers moved in: A significant portion of TWA was taken over by gangster-linked green-mailer Carl Icahn; Northwest Airlines was assimilated by takeover artists Al Chechy and Gary Wilson; and USAir was snapped up by a joint partnership of British Airways and Warren Buffett.

To pay for this speculation, Texas Air built up a debt that, by 1988, exceeded $5.5 billion. The annual revenues of Texas Air's combined companies became insufficient to meet the annual debt service payments and continue operations at the same time. Lorenzo stepped up the level of looting, and his airline empire began imploding upon itself. By 1991, many of its pieces were in bankruptcy court. On Jan. 18, 1991, the pioneering Eastern Airlines was permanently liquidated. By then it had more than $1 billion in losses, and its share of the U.S. airline market had shrunk from 16% down to 3%. (One part of Texas Air, Continental Airlines, did emerge from this process, but in a significantly transformed manner.)

With Lorenzo's airline desperately intensifying the deregulation price wars in an attempt to stay aloft, it created destruction for everyone. The airline industry as a whole was pushed, starting 1985, and for nearly a decade afterward, into an impossible situation. By 1992, there were 117 U.S. airlines that had filed for bankruptcy.

'I Regret That Vote'

Airline deregulation had several other destructive effects. Whereas, before deregulation, there were often direct routes between cities, and usually, at most, one stopover, after deregulation, with the development of airline hubs, a traveller now must change planes three or four times before reaching his or her final destination. Trips might now take twice as long. The time lost in extra travel cost the American economy tens of billions of dollars annually.

The cost-cutting mentality of deregulation has led frequently to the underpayment of mechanics and baggage-handlers, and the under-maintenance of plane engines and bodies. In May 1996, as part of the cut-throat practices of cutting back on maintenance, ValuJet crashed in Florida, killing all 110 passengers and crew on board.

This has led to the elimination of air travel, or at least on a regular and convenient schedule, to many small cities. It has also led to insane pricing; if a city's airport is not close or connected to the airlines' major "hub centers," fares balloon upwards. A trip from Birmingham, Alabama to Washington, D.C. or Baltimore, Maryland, will cost in the range of $250 to $400. But a trip from Montgomery, Alabama, the state's capital, to the Washington-Baltimore area, will cost as high as $900. Appearing on TV Sept. 23, Sen. Robert Byrd (D-W.V.) said that to fly from Charlestown, his state's capital, less than 100 miles to Dulles International Airport in Northern Virginia, costs $600—more than to go from Dulles to London.

On Sept. 21, Senator Byrd spoke from the floor:

"Twenty-three years ago, the Senate passed the conference report on the airline deregulation bill . . . by a vote of 82-4. . . . I was Majority Leader at the time . . . and as I have mentioned on the Senate floor many times, I have regretted that vote ever since. . . . I regret that vote because ever since deregulation, numerous airlines have pulled out of West Virginia and other rural states altogether. My constituents and millions of other Americans who live in smaller communities have been left with infrequent air service at astronomical prices."

It is time to re-regulate the airline industry.

Airline Deregulation Compromised Security

by Carl Osgood

For more than 15 years, Congress's investigative arm, the Government Accounting Office, has been warning that one of the weakest links in civil aviation security is the screeners who operate the metal detectors and the X-ray machines at the nation's airports. While much of the failure to improve security has been blamed on bureaucratic inertia at the Federal Aviation Administration, the GAO's data show that responsibility can also be laid at the doorstep of then-President Jimmy Carter's airline deregulation of 1978, which was sold to the American public on the basis of the lie that more competition will give us better service, safety, and security.

The events of Sept. 11, when hijacked airliners were deliberately crashed into the World Trade Center and the Pentagon, show, once again, that deregulation has created a security nightmare, from which only re-regulation can save us.

The response of Congress, so far, has been to call for federalizing all airport security functions, including security of airport facilities as well as passenger screening. Senate Commerce, Science and Transportation Committee Chairman Ernest F. Hollings (D-S.C.) has introduced legislation to establish a deputy administrator for security at the FAA. The new deputy administrator would be responsible for day-to-day security operations at all U.S. airports, including the hiring and training of employees who would be providing aviation security. During the above-mentioned hearing, Sen. Kay Bailey Hutchison (R-Tex.) endorsed Hollings' bill and called for a division of security at the FAA that would have control of screeners as well as the air marshals who would provide security on board airliners.

Long-Accumulated Problems

While the exact role of the weaknesses identified by the GAO in the hijackings on Sept. 11 is still unknown, the role of cost cutting in creating the situation as it existed until Sept. 11 has not been lost on many members of Congress. Sen. John Kerry (D-Mass.) told the Sept. 20 hearing that the measures to address the problem have been available for a long time but "there has been an absence of willpower, an absence of a sense of urgency." However, he also noted that the airlines are the ones that have been responsible for the costs of passenger screening, and they were in financial trouble long before Sept. 11. "If your financial bottom line is affected by your security costs," he said, "then your security is affected."

Under deregulation, in the division of labor that exists