Committee on Commerce, Science, and Transportation
United State Senate
Hearing on Enhancing Consumer Protections and Connectivity in Air Transportation
March 23, 2023

Testimony of Jeffrey N. Shane[1]

Madam Chair, Ranking Member Cruz, and other member of the Subcommittee:

I appreciate very much having the honor and privilege of speaking to you this morning at this important hearing. Thank you for the invitation.

Introduction

Let me say at the outset that I am here representing nobody but myself. My primary credential, if any, is a long career in public service – 25 years spread over 40 – most of which was at the Department of Transportation, and most of which was also, in one way or another, all about economic regulation. It was even the subject I enjoyed most in law school, although I attended law school before the word "deregulation" had even been coined.

I began my career in Washington as a government trial attorney, representing the public interest in hearings at some long-gone regulatory agencies – the Federal Power Commission, the Interstate Commerce Commission, and the Civil Aeronautics Board. I even did a case at the Federal Maritime Commission, which still exists, but I have no memory of what that case was about.

In any event, I claim to know something about economic regulation – what works and what doesn't. It was that experience that turned me into an unapologetic believer in the benefits of a free and competitive marketplace.

Much later, I had the good fortune to be appointed, with the approval of this Committee and the full Senate, to some senior policy positions at DOT. These were not aviation-specific positions – they were about all modes of transportation. I soon discovered, however, as I suspect members of this Committee have discovered, that aviation policy is never far from the top of the list. Because it is an industry that everyone knows so well, airlines are always in the spotlight.

Thus, for more than 10 years, either as DOT's Assistant Secretary for Policy or later as Under Secretary for Policy, I had broad responsibility, subject of course to the leadership of the Secretary of Transportation, for DOT's economic regulation of the airline industry. It was far and away my most enjoyable professional experience, both because the issues were so

[1] Jeffrey N. Shane served as Under Secretary for Policy at the Department of Transportation from 2003 to 2008 and Assistant Secretary for Policy and International Affairs from 1989 to 1993.

important to so many, and because of the extraordinary colleagues I was lucky enough to work with throughout that time. Some are still there. I miss them all.

Importance of the Airline Deregulation Act

The reason why so many of our citizens know aviation so well, of course, is that Congress democratized it in 1978. I'm talking, of course, about the Airline Deregulation Act. That legislation, initially championed by Senator Ted Kennedy, was nothing less than a miracle of public policy. Increasingly forgotten is that the airlines were adamantly opposed to the legislation. They had become very comfortable in the familiar cocoon provided by the CAB and they pulled out all the stops to keep the bill from being passed. The public, for most of whom air travel was still a rare and expensive experience, wasn't particularly interested. There was no groundswell of public support for the bill because nobody really understood what its impact would be. Well organized opposition and weak, diffuse support is usually a prescription for failure in the legislative process. Yet somehow, remarkably, the law was passed, President Carter signed it, and aviation would never again be the same.

Airline deregulation not only benefited Americans; it was actually one of America's most profoundly important gifts to the world, although not always welcomed in the first instance. In the 1980s I spent four years at the Department of State serving as the chief U.S. aviation negotiator, working with other governments on the bilateral agreements that define international landing rights for U.S. and foreign airlines. Most of the foreign carriers back then were creatures of government – either government-owned or acting as though they were. We encountered resistance everywhere, an entrenched protectionism that had impeded the growth of international air travel for decades. Through an initiative launched during the Carter Administration in parallel with domestic deregulation, we slowly sold our trading partners, one by one, on the benefits of an open market. U.S. airlines were as opposed to that initiative as they were to domestic deregulation, but administration after administration kept it going. It became easier over time because we could demonstrate quantitatively how much faster liberalized international markets grew than regulated markets.

In 1992, the United States announced an Open Skies policy and signed the first Open Skies agreement with The Netherlands. America today has about 125 Open Skies agreements – in other words, with most of our trading partners – and the model has been replicated even in air travel markets that don't touch the U.S. It is a bipartisan success story of the first magnitude.

Central to the genius of the Airline Deregulation Act are a couple of overarching principles. One, of course, is that airlines are businesses. Congress intended that henceforth government would *treat* them as businesses and give them the widest scope for innovation and competition. That is why the legislation prohibited any regulation of airline rates, routes, or services – the areas where they wanted that innovation and competition to take place..

Second, because airlines for the most part are so conspicuously in interstate commerce, any future oversight and regulation – most obviously safety regulation – was reserved to the

federal government alone. A single, nationally consistent set of rules, Congress knew, was essential to safe, efficient, and economical operations.

Notwithstanding their emancipation from traditional regulation, airlines are still subject to a lot of government oversight. Obviously we never deregulated the safety of airlines, which is why commercial flight continues to be the safest form of travel. DOT also has authority under 49 U.S.C. §41712 to prevent unfair and deceptive practices and unfair methods of competition. A lot of regulations have been promulgated under that rubric in the interest of consumers, most importantly ensuring the transparency of airline offerings and thus ensuring that airline customers know what they are buying. DOT has a mandate in the Air Carrier Access Act to prevent discrimination against passengers with disabilities. And I would also argue that the Department's authority to review the managerial and financial wherewithal of airlines – conducted in parallel with the FAA's review of airline operational fitness – is another way the Department protects the interests of consumers.

Has deregulation gone too far?

Recent developments in the industry have triggered a conversation, however, about whether deregulation has gone too far, and whether it is time for government to get back into the game of disciplining the way airlines do business.

I don't want to overstate this: I don't believe anyone is talking about repealing the Airline Deregulation Act and resurrecting the Civil Aeronautics Board. Nevertheless, I have seen a number of proposals that certainly appear to channel the spirit of the CAB, and that would require DOT to reconstruct at least some of the CAB's long-forgotten regulatory jurisprudence.

If my experience over all the years I toiled in this field taught me anything, it is this: the government must exercise extreme caution in promulgating rules designed to alter the conduct of private business. Allow me to illustrate what I mean by reference to some of the current targets of concern.

Ancillary fees

What we call "ancillary fees" in aviation are an example of what economists call "unbundling." Unbundling was actually invented by regulators based on the simple and unarguable principle that people shouldn't be required to pay for what they don't want – like a black rotary-dial telephone when all you wanted was a phone line.

In an effort to provide basic air transportation at the most affordable prices, low-cost and ultra-low-cost carriers have delinked the baggage part of the transaction from the travel part. I hope nobody is thinking about requiring ULCs and ULCCs to desist from unbundling – charging all passengers the same thing whether they check a bag or not. If they did, the bizarre result would be to require passengers traveling with nothing more than a carry-on to subsidize the passengers who check bags free of charge. That would be the very anthesis of transparency in pricing, and arguably even an "unfair and deceptive practice."

Passengers complain that the baggage fees are unreasonable. Even if airlines are not required to abandon ancillary baggage fees, therefore, some suggest that DOT should play price regulator and try to figure out what a reasonable baggage fee is.

First, lest there be any doubt, that would be an explicit renunciation of the Airline Deregulation Act's central prohibition against the regulation of airline rates and services. Congress can certainly do that if it wants to, but why would it want to? If it's okay to prescribe what an airline charges for putting a suitcase in the belly of an airplane, why not prescribe what it costs to buy a pastry and coffee in the terminal? What distinguishes the purchase of space in the baggage hold from any other transaction in our private sector economy? It just isn't normally the government's job to prescribe prices charged by private companies to their customers, and the fact that the target is an airline doesn't create an exception to that principle.

And, by the way, how would DOT actually go about deciding what a reasonable bag fee is? Would it have to hire a cadre of administrative law judges and conduct formal proceedings pursuant to the Administrative Procedure Act? Would DOT require the disclosure of confidential cost information in order to ascertain the "real" cost of checking a bag? Would there be a right of appeal if the airline disagrees with the Department's definition of "reasonableness" or with the fees DOT orders the airline to charge? If so, to the Secretary? I would submit that DOT has more important things to do.

Concentration

The late Michael Levine was a supremely talented lawyer and economist, and is widely credited with being one of the intellectual fathers of airline deregulation. He was also a very good friend. Speaking about the early days of deregulation, he once said that the founders thought that, once the regulatory wraps were removed, a whole galaxy of new airlines would appear and light up the firmament. "What we actually got," Mike said, "was a meteor shower." He was referring to the large number of startup airlines that came rushing into the newly opened marketplace just because they were allowed to. Most quickly flamed out, some because they didn't know what they were doing, and others simply because the market couldn't deliver enough business to support that many airlines profitably. That chapter carries an important lesson, I think, for anyone who thinks good antitrust policy should be something akin to "the more the merrier."

The 1980s saw a spate of airline mergers, all approved by DOT because the statutory authority to review domestic airline mergers wouldn't migrate to the Department of Justice until 1989. By the time the first Bush administration took office in that year, there were widespread concerns about whether the market for air travel had simply become too concentrated. Samuel Skinner, the newly appointed Secretary of Transportation, took the complaints seriously and let it be known that if the concerns were borne out by empirical evidence, he would seek authority to take appropriate action in the interest of consumers.

I was the Assistant Secretary for Policy at this time, and a detailed study was conducted by my office – led by my superb deputy, Patrick Murphy. When it was finished, it filled nine peer reviewed volumes.

What we found, in a nutshell, was that, while there were indeed fewer airlines serving the domestic U.S. market, the actual choices available to travelers in actual city pair markets had actually increased, and price competition in the market continued to be robust. In the end, we saw no need for any tinkering with the Airline Deregulation Act. I testified at a number of congressional hearings on airline competition during that administration, and thanks to the unbiased and objective quality of that study, I emerged mostly unscathed.

There have been more mergers since then. One important result is a financially healthier airline industry – putting aside for the moment the devastating impact of the pandemic. It is fair to ask whether that improved financial health has come at the expense of consumer welfare. I am not a professional economist and I'm in no position to offer a first-hand answer to that important question. According to all that I've read, however, airfares continue to fall and consumer choice continues to increase. There are few barriers to new entry, as the launch of Breeze Air and Avelo at the height of the COVID pandemic should make clear. The deregulated aviation market appears to be working well.

Caution, therefore, should be the order of the day. What do the numbers actually tell us? You don't make competition policy based simply on the number of airlines in the market, or on the aggregate market share enjoyed by the "big three" or "big four"; instead, you carefully examine the quality of the choices available to actual passengers in actual city pairs and you look objectively at actual pricing trends.

Transparency

One of DOT's greatest successes in its continuing work on behalf of consumers is its transparency requirements for airlines and their agents. Customers should know everything about the transaction they are about to enter into – the identity of the airline on every segment of a journey, the actual prices to be paid, which services are covered by those prices and which are not, and so forth. DOT's required reporting of airlines' on-time performance, market by market, has been another great boon to travelers.

I have seen proposals for going even further, however, and I find them concerning. Like the firms in every sector of our economy, airlines seek to compete not only on price and ubiquity, but also through product differentiation. They know there is a tendency to treat air travel as a commodity, but they really don't think it is, and they don't want their customers to think so either. If you spend a few hundred million dollars upgrading the interior of your airplanes, or your lounges, or cabin connectivity, or the check-in process, or even your food and beverage service, you want potential customers to know about those improvements. You want those improvements to attract *more* customers.

Not long ago, if you booked a flight using one of the major online distribution systems you found only the most basic information there: a list of available flights, their departure times, and their costs and fees. Those displays merely reinforced the impression that you were purchasing a fungible commodity. A few years ago there was a major dispute between the airlines and the major global distribution systems over the alleged failure of the GDSs to upgrade their technology in order to provide the richer content the airlines wanted. Make no mistake: this was an argument about whether the GDSs perceived deficiencies were actually

preventing the airlines from competing in the way they wanted to, merely reinforcing the commodity narrative, and squandering much of the value of airline investments in product quality.

The GDSs are clearly upping their game in response to their customers' requirements, and those customers include the airlines themselves. But quality varies. Given the importance to airlines today of rich, user-friendly content, suggestions that airlines should be required to sell their services through any available platform should be viewed with the greatest skepticism. Airlines do not need any external motivation to distribute information about their services in the most effective way, but the assessment of what's most effective should be theirs alone.

Delays and cancellations

The European Union promulgated a regulation years ago called Regulation 261. I have said in many fora that Regulation 261 is quintessentially a bad regulation. It prescribes payments airlines must make to their customers automatically whenever there's a delay. The payments are graduated according to the length of the delay. It is a quintessentially bad regulation because it has absolutely no effect on the conduct of airlines. The simple test of a good regulation is whether it can be expected to improve consumer welfare by making something happen that wouldn't happen if you didn't have the regulation. Regulation 261 clearly fails that test since airlines already have the greatest possible incentive to operate on time. The costs of delay – particularly for a networked carrier where an entire day's schedule can be destroyed by a single late flight – are already immense. Requiring payments to passengers is nothing more than piling on. Yes, they provide a nice consolation prize to the inconvenienced passenger, but that's not the avowed purpose of the regulation. The purpose is to reduce the frequency of delays, and it can't add more incentive than airlines already have.

We are now seeing proposals to adopt Regulation 261 lookalikes in the U.S. What would they do? Consider the week-long Southwest meltdown over the holidays. Reportedly, that catastrophe, which seriously inconvenienced a couple of million passengers, will cost Southwest something north of $800 million dollars. If you're looking for a way to encourage Southwest to plan more effectively in order to avoid similar catastrophes in the future, subtracting $800 million from the bottom line would seem to qualify. Does it contribute anything to the public interest to add some automatic payment that Southwest would pay to each affected traveler, thereby tripling the financial cost? First, its only contribution would be a small windfall to passengers – not the change in behavior that the payment scheme was intended to encourage. Second, Southwest would have to find a way to recoup that additional cost, and the only way to do it will be through higher fares.

It's axiomatic that predicating a regulatory remedy on what was clearly a worst-case scenario is never a good idea. It's an even worse idea to impose costs on airlines when those additional costs can't be expected to engender any change in behavior that hasn't already been encouraged by the grave financial consequences of that behavior. Once again, there needs to be careful consideration of the actual costs vs. the actual benefits of such a rule.

Finally, I know some have considered whether it's unfair for airlines to put an expiration date – typically one year -- on a voucher provided to a passenger who has cancelled a nonrefundable ticket. Some airlines – Southwest for example – do not impose expiration dates. Should the government prohibit *all* carriers from establishing expiration dates? It would seem passing strange for the government, avowedly interested in increasing competition in the market, to promulgate a rule that takes away Southwest's competitive advantage

Conclusion

Thanks to – I'll say it again -- the *miracle* of deregulation, America today enjoys a highly competitive, rapidly evolving, technologically sophisticated airline industry. A defining feature of the business today is its continuing quest for innovation, for new ways of attracting customers, for distinguishing competitors from each other, and even for crafting new business models. After decades of struggle, the industry has found a way to maintain its financial health, thereby ensuring continued investment in consumer-facing improvements.

Please don't misunderstand. There is clearly scope for beneficial regulation in circumstances where market forces can't be expected to resolve an issue. The Air Carrier Access Act has made things better for disabled passengers, for example, but we can and should do more. My point is only that it would be a serious error of policy to adopt legislation and/or regulations that freeze the industry in its tracks, homogenize its means of distribution, prescribe what it can charge for some services and what it can't, and needlessly sap much of the competitive energy that should govern airline customer relations. If we are singling out airlines for a level of regulatory micromanagement that we wouldn't conceive of visiting on other businesses, we need to be clear about the public policy rationale for that different treatment.

Thank you again for the invitation to present these thoughts. I look forward to your comments and questions.

* * *