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Speech

Remarks of
Jeffrey N. Shane
Associate Deputy Secretary
U.S. Department of Transportation

before the

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"The Aviation Industry of Tomorrow: Emerging from the Crisis"

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I appreciate very much the opportunity to speak to you this afternoon about the state of commercial aviation. I also want to convey Secretary Mineta's warm wishes to all of you for a productive and insightful conference. The subject is one he knows well and is passionate about.

Before I share the Bush Administration's views about the global aviation industry of today and tomorrow, I want to acknowledge the exceptional progress our nation has made in improving aviation security since the terrorist attacks of September 11, 2001.

A year ago the Department of Transportation and the Transportation Security Administration faced 37 tough deadlines for a new Federal aviation security system - 36 from Congress and one from Secretary Mineta. The Secretary's mandate was straightforward -- to make sure the 36 Congressional deadlines were met, and in a way that enhanced both the security and efficiency of air travel.

A lot of skeptics said it couldn't be done. There were too many airports, too many screening checkpoints, too many administrative obstacles for the Department to overhaul aviation security as envisioned in the new Aviation and Transportation Security Act by the very aggressive deadlines prescribed in the statute. The doubters were wrong. Today we have 56,000 handpicked, well-trained screeners at 429 commercial airports across the country. These new public servants are delivering a more robust level of security to air travelers nationwide than we have ever had before. And as all of you who have flown in the system since the full deployment of TSA's cadre of new, highly professional screeners know, they are delivering world-class customer service at the same time.

In creating our new and more effective aviation security system, we consulted closely with the airlines and airports, and of course with law enforcement and security experts nationwide and overseas. We have used that expertise to create a multi-layered system -- one that doesn't rely on any one feature, but that takes advantage of a multiplicity of strategies.

For example, we are continuously improving our capabilities with respect to intelligence gathering and coordination. Thousands of Federal Air Marshals are flying with commercial air passengers to ensure their safety and security. By this spring, all aircraft cockpit doors will be completely reinforced. One hundred percent of all checked bags will be screened electronically or with other explosives detection systems.

On behalf of President Bush, I want to take this opportunity to thank Japan and its leaders for supporting the United States in the wake of 9/11. You have gone to great lengths to be a true partner in our fight against terrorism, and the President and all of us greatly appreciate your efforts.

Domestic Aviation Markets – Challenges and Change

Despite the very real success we have enjoyed on the security front, the U.S. airline industry remains stuck in the most difficult economic period it has experienced since it was deregulated almost 25 years ago. Wall Street analysts estimate that the airline industry will suffer about $9 billion in operating losses for 2002, following 2001's losses of $10 billion.

Most major carriers do not expect to experience passenger and revenue growth until at least 2004. Several airlines are in bankruptcy, including two large network carriers – US Airways and United. Several smaller airlines have ceased operating completely.

In reaction to these tough financial times, the major network carriers have been working to cut costs in an effort to become more efficient, and they have lowered prices to stimulate demand. All these carriers, nevertheless, have reduced capacity in an effort to curb their ongoing losses.

It is important to understand that the U.S. airline industry's financial difficulties do not stem only from, or even primarily from, the terrorist attacks of September 11, 2001.

Although 9/11 certainly contributed heavily to the industry's losses, changes underway well before then had already reversed several consecutive years of record profitability and set the stage for a significant restructuring of the industry. These changes included a simultaneous escalation in operating costs and a decline in demand, particularly from time sensitive business travelers.

But it is also important to understand that while there is reason to be concerned about the industry's current financial problems, we are encouraged about its prospects for ultimate recovery. Even today, not all the news is bad. A number of low-cost, low-fare airlines have remained consistently profitable, such as Southwest Airlines and JetBlue, to name just two. They are not only profitable; they are also growing.

It is of course interesting to note that the carriers making profits today are the carriers charging the lowest fares. People still want to fly, but only if the price is right. The core problem for the large network airlines – as just about everybody knows by now – is costs. And despite recent speculation to the contrary, their problem does not lie in their hub-and-spoke systems of service. These airlines earned record profits for several years before their costs began to escalate. Moreover, one of the new low-fare airlines, AirTran, operates its own version of a hub-and-spoke service, and does so from a major carrier's hub no less, in Atlanta. And it is making money.

I don't want to be cavalier about the magnitude of the challenge facing some of our largest network carriers today. But it is fair to say, perhaps more than ever before, that reality has set in. Both management and labor understand the unprecedented dimensions of the problems they face, and so I think there is reason to be hopeful. These companies are attacking the cost issue with a focus and determination we haven't seen before now. The measures required will be difficult and, for many, painful. But these carriers have to regain control of their costs to survive, and my bet is that most will.

It is important that they do so. The network airlines serve a large and important market sector that receives relatively little service from low-cost, low-fare airlines today. Their broad-based network systems enable them to provide effective, competitive service to small cities across the country and from all U.S. locations to cities of all sizes around the globe. Thus, both types of airlines – large, network airlines and low-cost, low-fare airlines -- are needed to fully service demand for air travel in today's marketplace.

While our airline industry, overall, continues to suffer huge losses, looking at financial results on an industry-wide basis does not tell the full story. Looking at the results in greater detail reveals marked contrasts between large network carriers versus low-fare carriers, and even between different groups of network carriers, with the highest-cost carriers reporting much larger losses than others in the network category.

For example, during calendar year 2001, the 15 airlines that comprise the vast majority of domestic operations incurred operating losses of $10.0 billion on revenue of nearly $86 billion, for a negative operating margin of 11.6 percent. During the fourth quarter alone – immediately following September 11 – this group of carriers posted a $4.5 billion operating loss on revenue of $16.8 billion, a decline of 30.8 percent from the fourth quarter of 2000. But 2001 losses for the six large network airlines were even higher than industry-wide losses: $10.2 billion, resulting in a negative operating margin of 13.9 percent. In the same year the low-fare carriers as a group reported an operating profit of $.7 billion, for a positive operating margin of 10.8 percent. This profit by no means hinged on Southwest Airlines alone; five of the seven low-fare carriers earned profits in 2001.

These same trends continued during the first three quarters of 2002, with the largest network airlines continuing to report substantial losses and the low-fare carriers remaining profitable.

These profit trends, and the cost issues that drive them, portend a major shift in the composition of the industry. The mainline operations of the large network airlines continue to shrink, while operations of their regional affiliates and the low-fare carriers continue to grow, and are doing so at an accelerating pace. A comparison of scheduled available seat miles for March 2001 and March 2003 shows a decline for the mainline carriers of almost 20 percent, but an increase of about 25 percent for their regional affiliates and almost one third for the low-fare airlines. As a result, the market share of the low fare carriers has increased dramatically during this two-year period from 12.5 percent to 18.2 percent. This is a huge swing in market share in an industry in which even relatively small market share shifts can have important consequences.

Despite these changes, and others likely to follow as the network carriers sort themselves out, my expectation is that the industry of tomorrow will be characterized by a blend of large network airlines -- with networks that extend to smaller cities throughout the country -- and low-fare airlines that will continue to expand service to a very large low-fare demand sector that has not yet been fully tapped.

International Aviation Markets

I am sure that many involved in the aviation industry in Asia and around the world have been watching closely the changes taking place in the U.S. airline market. As we all know, such changes always have an impact – sooner or later – on the global aviation industry.

Although our airlines are experiencing economic distress and our domestic market is changing rapidly, Secretary Mineta and the Bush Administration believe that it is important to continue eliminating barriers to airline competition in international markets. If we do this -- if we create an environment in which airlines of all nations have the flexibility to respond more readily to commercial opportunities, and commercial setbacks -- our aviation industries will be better able to withstand future economic downturns.

Our approach to aviation markets is guided by one fundamental principle: We believe that governments have an important role to play in the areas of safety and security, competition, and the environment. But beyond those areas, we believe that governments should create the framework for vigorous competition and get out of the way.

Our commitment to this principle has helped produce important public benefits in our domestic market as well as internationally, including invaluable opportunities for better service, lower fares, new jobs, and enhanced economic growth. The success of low-cost, low-fare carriers in a deregulated U.S. market, despite the current economic downturn and the effects of 9/11, is an important object lesson.

Unfortunately, the international aviation market is run to a much greater degree by governments, not market forces, pursuant to arrangements that emerged more than half a century ago as a result of the Chicago Convention.

The essence of that framework, as you all know, is that every nation has the right to grant or deny an airline from another nation permission to serve its territory. In other words, all these markets are assumed at the outset to be closed markets. Only through the bilateral negotiating process are they opened up -- sometimes flight by flight, airline by airline, gateway by gateway. That's the way the system was set up nearly sixty years ago, and some countries are still using it to limit competition. Consumers, communities, businesses, and the global airline industry that serves them are thus prevented from reaping the full economic benefits of a genuine international marketplace for air services.

But as many of you know, I am on a return visit to the federal government after nearly a decade in the private sector. And I am pleased to report that the legal and diplomatic framework for international air services doesn't look as awful today as it did when I left. Back then, we had just signed the very first Open Skies agreement – with the Netherlands. Today, 59 Open Skies agreements between the United States and its trading partners -- plus a number of similar agreements to which the U.S. is not a party -- have transformed much of the international aviation marketplace.

Moreover, the U.S. and six of its APEC partners -- Brunei, Chile, Peru, New Zealand, Samoa, and Singapore -- are now party to an interesting multilateral agreement which extends the benefits of Open Skies not only to travelers flying between the U.S. and the other six, but between the territories of all seven signatories. We hope that other countries -- whether or not they are listed among the APEC economies -- will accede to this important new agreement, and that it proves to be a much easier way to extend the benefits of aviation liberalization to more destinations.

Finally, we have even made some progress creating new opportunities for service and airline operating flexibility in a few very important international aviation markets that are not governed by Open Skies agreements: U.S.-Japan, U.S.-China, and U.S.-Hong Kong. There is much to do yet, but the world is clearly moving forward.

As to relations with Japan, we owe much to one of this forum's distinguished speakers, Mr. Jiro Hanyu, for his contribution to greater market entry and operating flexibility. He was chairman of the Japanese delegation that negotiated a 1998 aviation agreement that included important competition-friendly provisions. His vision and his leadership played a key role in making the 1998 agreement possible. We look forward to working with Japan to complete the process of achieving a fully liberalized aviation relationship.

We have relied on bilateral aviation agreements to establish open aviation markets around the world. Now we must work together to transform those separate markets into a single, international aviation market. The world's consumers -- our citizens -- and the needs of global commerce demand no less.

Other important developments are on the horizon. We look forward to negotiations with the European Union if and when it receives a mandate to engage the U.S. on aviation issues. We believe that the 11 Open Skies agreements we have with EU countries already lay a strong foundation for a broader, more liberal, multilateral agreement.

The International Civil Aviation Organization will host another Worldwide Air Transport Conference in March. It is entitled "Challenges and Opportunities of Liberalization." Encouragingly, the agenda for the meeting reflects a focus on "how to" liberalize aviation -- not "whether to." This new attitude toward air services liberalization in the 21st Century reflects a growing consensus that passengers, shippers, businesses and nations all benefit from free trade and competition.

Conclusion

Aviation is passing through a very challenging and uncertain time. Essential elements of the future growth and stability of the airline industry are safety and security. The United States, Japan, and our other G-8 partners have been working closely together to accelerate the deadline for reinforcement of cockpit doors and to establish and support a strong ICAO audit program. The APEC economies are now focused on the same critical objectives. We want to continue and expand that work. Despite all we and many of our partners are doing to tighten up the security of aviation, we need solutions that are embraced globally, providing greater security for air travelers in every part of the world.

We look forward to a full economic recovery and a once-again robust aviation marketplace. Much progress has been made in liberalizing aviation markets, but there is still a lot of work to be done.

Secretary Mineta and the Department of Transportation stand ready to work cooperatively with our aviation partners in Japan, throughout Asia and elsewhere to complete the liberalization process. These difficult times only heighten the importance of this task.

Thank you for inviting me to participate in this important meeting. I look forward to an interesting discussion with all of you this afternoon.

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