

**REMARKS OF ANDREW B. STEINBERG**  
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**BEFORE THE 32<sup>ND</sup> FAA AVIATION FORECAST CONFERENCE**  
**"AVIATION'S RESURGENCE: THE SHAPE OF THINGS TO COME"**  
**MARCH 15, 2007**

GOOD AFTERNOON. I AM PLEASED TO BE HERE TODAY WITH SUCH A DISTINGUISHED PANEL TO TALK ABOUT THE ENVIRONMENT FOR AVIATION IN THE UNITED STATES.

EVEN FOR AN INDUSTRY THAT IS NOTABLE FOR ITS DYNAMISM, THE PAST FIVE AND A HALF YEARS HAVE BEEN PARTICULARLY DRAMATIC. DURING THIS TIME, THE U.S. AIRLINE INDUSTRY HAS SHOWN ITSELF TO BE HIGHLY RESILIENT AND ADEPT AT DEALING WITH RAPID CHANGES. THE TRIALS AND TRIBULATIONS OF THE AIRLINE INDUSTRY ARE WELL-KNOWN AND WIDELY PUBLICIZED SO THERE IS NO NEED FOR ME TO RECITE THE SPECIFICS OF WHAT HAS OCCURED. BUT AS WE LOOK AT THE AVIATION MARKET TODAY, I WOULD LIKE TO DISCUSS – AND CHALLENGE – SOME OF THE ‘CONVENTIONAL WISDOM’ THAT WE HERE ABOUT U.S. AVIATION. FRANKLY, I THINK IT IS FUNDAMENTALLY FLAWED AND, TO THE EXTENT THAT IT SHAPES THE VARIOUS DEBATES AND VIEWS OF POLICY MAKERS, HARMFUL TO THE LONG-TERM HEALTH OF AIRLINE INDUSTRY.

THERE ARE FIVE GENERAL IDEAS WHICH I WOULD COLLECTIVELY DESCRIBE AS THE CONVENTIONAL WISDOM. THEY ARE AS FOLLOWS:

FIRST, THE U.S. AIRLINE INDUSTRY IS FINALLY EXPERIENCING A ROBUST AND LASTING RECOVERY.

SECOND, THAT U.S. CARRIERS ARE ABOUT ON PAR WITH FOREIGN AIRLINES.

THIRD, THAT AS LONG AS FARES REMAIN VERY LOW AND FLYING IS SAFE, THE GOVERNMENT'S JOB IS OVER.

FOURTH, THE INDUSTRY STILL SUFFERS FROM A BIG COST PROBLEM

AND FIFTH, THAT IF WE HAVE FEWER CARRIERS THE PUBLIC WILL SUFFER.

FIRST IS THE NOTION THAT THE AIRLINE INDUSTRY IS EXPERIENCING A BROAD RECOVERY. I SEE IT DIFFERENTLY. DESPITE DEEP CUTS IN CAPACITY AND COSTS, THE LONG TERM FINANCIAL OUTLOOK FOR THE U.S. AIRLINE INDUSTRY REMAINS UNCERTAIN. THE NUMBERS ARE STRIKING-- U.S. NETWORK AIRLINES HAVE REDUCED THEIR ANNUALIZED

MAINLINE COSTS BY MORE THAN 25% WHICH TRANSLATES TO NEARLY \$20 BILLION. THESE IMPROVEMENTS ARE THE RESULT OF OPERATIONAL IMPROVEMENTS BUT ALSO RENEGOTIATION OF LABOR CONTRACTS, AIRCRAFT LEASES, AND OTHER FINANCIAL OBLIGATIONS.

THEY HAVE ALSO SLASHED CAPACITY ACROSS THE BOARD IN A DRAMATIC WAY. ONE LARGE NETWORK CARRIER CUT ITS SYSTEM CAPACITY BY 28%. ON TOP OF THAT 22% OF INDUSTRY'S CAPACITY IS PROVIDED BY CARRIERS OPERATING UNDER BANKRUPTCY PROTECTION WHICH IS ACTUALLY AN IMPROVEMENT OVER THE HIGH OF 46% WE SAW IN 2005.

FOR ALL OF THAT EFFORT, THEY HAVE ONLY MEAGER RESULTS TO SHOW. IN 2006, THE INDUSTRY COLLECTIVELY EARNED \$1.9 BILLION ON REVENUES OF \$123 BILLION – LESS THAN A TWO PERCENT RETURN. IN 2007, ONE PROEJCTION SHOWS AN INDUSTRY PROFIT OF AROUND \$6 BILLION ON REVENUES OF \$129 BILLION. AND IT IS IMPORTANT TO REMEMBER THAT THESE NOMINALLY PROFITABLE YEARS FOLLOW A STRINGS OF YEARS IN WHICH THEY LOST TENS OF BILLIONS OF DOLLARS. IN ANY OTHER INDUSTRY, THESE RESULTS WOULD BE CONSIDERED ABYSMAL. RATHER I THINK THESE RESULTS, VIEWED IN THE AGGREGATE, ARE INDICATIVE OF LONG-TERM STRUCTURAL PROBLEMS IN THE INDUSTRY THAT THE MARKET HAS YET TO CORRECT.

FURTHER THIS DEGREE OF VOLATILITY MAKES IT DIFFICULT FOR FIRMS TO MAKE THE LONG-TERM CAPITAL INVESTMENTS NECESSARY TO COMPETE GLOBALLY IN THIS INDUSTRY.

THE SECOND BIT OF CONVENTIONAL WISDOM SUGGESTS THAT U.S. AIRLINES ARE ABOUT ON PAR WITH FOREIGN RIVALS. AGAIN, I THINK A CLOSE LOOK REVEALS A DIFFERENT STORY. U.S. CARRIERS HAVE FALLEN BEHIND THEIR RIVALS ON SEVERAL MEASURES OF SUCCESS. IN GLOBAL RANKINGS OF ON-BOARD SERVICE, U.S. AIRLINES FRANKLY FARE POORLY. IN ONE SURVEY, NOT A SINGLE U.S. AIRLINE RANKED IN THE TOP 40 FOR CUSTOMER SATISFACTION. THIS IS NOT FOR LACK OF MANAGEMENT ACUMEN. IN THE STRUGGLE TO SURVIVE, OUR AIRLINES HAD TO JETTISON MOST, IF NOT ALL, OF THE CREATURE COMFORTS OF AIR TRAVEL. IN CONTRAST, MANY OF THEIR FOREIGN RIVALS HAVE BECOME GLOBALLY RECOGNIZED BRANDS AND INNOVATORS OF CUSTOMER SERVICE. THIS IS GOOD FOR CONSUMERS, AND THE SOLUTION TO THIS PROBLEM – I WOULD EMPHASIZE – IS NOT TO CLOSE OUR MARKETS. INSTEAD, IT IS TO RECOGNIZE THAT IT IS IMPORTANT TO HAVE A VIABLE DOMESTIC AIRLINE INDUSTRY THAT CAN REINVEST IN ITS BUSINESS AND BECOME MORE COMPETITIVE AS GLOBAL MARKETS OPEN UP. U.S. AIRLINES STILL HAVE A NETWORK ADVANTAGE ASSOCIATED WITH BEING BASED IN THE UNITED STATES –

THE WORLD'S LARGEST AVIATION MARKET -- THAT WILL ALLOW THEM TO COMPETE EFFECTIVELY IN A MORE STABLE ENVIRONMENT.

ORDERS FOR NEW AIRCRAFT ARE A GOOD INDICATION OF HOW US AIRLINES HAVE LAGGED BEHIND THEIR FOREIGN RIVALS. 2005-2006 WERE RECORD YEARS FOR NEW ORDERS. IN THIS TWO YEAR PERIOD, BOEING SOLD NEARLY 2,100 AIRPLANES. DESPITE THE FACT THAT THE U.S. ALONE REPRESENTS ALMOST 40% OF THE WORLD'S AVIATION MARKETPLACE, OUR CARRIERS ONLY REPRESENTED 13% OF THE BOEING'S ORDERBOOK DURING THESE TWO YEARS. THE U.S. HUB-AND-SPOKE AIRLINES MADE UP ABOUT 4%. AT AIRBUS, THE STORY IS LARGELY THE SAME WITH THE U.S. CARRIERS. THEY REPRESENT A DISPROPORTIONATELY SMALL PART OF A RECORD ORDERBOOK-- SOMEWHERE BETWEEN 9-12%. UNFORTUNATELY, THE U.S. DID LEAD ON ONE MEASURE . . . THE NUMBER OF AIRCRAFT ORDER DEFERRALS IN 2005-2006.

THE THIRD BIT OF CONVENTIONAL WISDOM IS THAT SO LONG AS FARES ARE LOW AND FLYING IS SAFE, EVERYTHING ELSE IS PRESUMED FINE. IN SOME OF WAYS, THIS IS THE MOST CURIOUS PART OF THE STORY. THE BANKRUPTCIES OF SEVERAL US CARRIERS IN A SHORT PERIOD OF TIME HAD CONSIDERABLE FALLOUT FOR EMPLOYEES, RETIREES, SHAREHOLDERS, LENDERS, SUPPLIERS, AND TAXPAYERS. AIRLINE

CLAIMS COMPRISE MORE THAN 38 PERCENT OF PBGC CLAIMS WHILE THEY ONLY PAY 2.6% OF TOTAL PREMIUMS. AIRLINES HAVE BECOME GREATER DRAIN ON PBGC THAN THE STEEL INDUSTRY WHICH ACCOUNTS FOR 33% OF CLAIMS, WHICH IS TELLING.

IN TERMS OF LOST EMPLOYMENT AND WAGES, THE NUMBERS ARE STRIKING. PASSENGER AIRLINES IN THE UNITED STATES HAVE SHED 28% OF THEIR WORKFORCE SINCE 2001 AND CUT THEIR ANNUAL PAYROLL BY \$9.5 BILLION. WHEN MULTIPLIER EFFECTS ARE FACTORED INTO THE EQUATION, IT IS EVIDENT THAT A HIGH PRICE IS BEING PAID FOR CONTINUAL BELOW-COST PRICING.

DOT'S STATUTE, I WOULD POINT OUT, DOES NOT STATE THAT KEEPING FARES LOW SHOULD BE THE ONLY OR EVEN THE PARAMOUNT CONSIDERATION IN MAKING GOVERNMENT POLICY. IT SAYS WE SHOULD ALSO FOCUS ON "ENCOURAGING EFFICIENT AND WELL MANAGED AIR CARRIERS TO EARN ADEQUATE PROFITS AND ATTRACT CAPITAL"....."MAINTAINING A COMPLETE AND CONVENIENT SYSTEM OF AIR TRANSPORTATION FOR SMALL COMMUNITIES AND ISOLATED AREAS".... "AND STRENGTHENING THE COMPETITIVE POSITION OF DOMESTIC CARRIERS TO ENSURE AT LEAST EQUALITY FOR FOREIGN AIR CARRIERS." THUS, FOCUSING ONLY ON MAINTAINING LOW PRICES NECESSARILY MEANS SACRIFICING SOME OF THESE OTHER GOALS.

THE FOURTH BIT OF WISDOM IS THAT THE INDUSTRY STILL HAS A BIG COST PROBLEM. THE NUMBERS JUST DON'T SHOW THIS – THEY SHOW THAT THE MAJOR AIRLINES HAVE A REVENUE PROBLEM. AS I MENTIONED EARLIER, THE AIRLINES HAVE SHED TREMENDOUS COSTS IN THE PAST SEVERAL YEARS AND HAVE DRAMATICALLY REDUCED CUSTOMER SERVICE – AND YET THEY STILL OPERATE AT A SUBSISTENCE LEVEL. THE PROBLEM LIES IN EXTENDED PERIODS OF BELOW-COST PRICING. IN THE LAST 30 YEARS, AVERAGE AIRFARES HAVE LAGGED FAR BEHIND GROWTH IN THE CONSUMER PRICE INDEX AND HAVE EVEN MOVED IN THE OPPOSITE DIRECTION AT TIMES. EVEN WHEN COMPARED TO OTHER MASS-CONSUMED OR WIDELY CONSUMED GOODS AND SERVICES, THE RATE OF GROWTH IS REMARKABLY LOW. WHILE PRICES HAVE HOVERED AT LOW LEVELS, THE SAME CANNOT BE SAID FOR THE COSTS INPUTS. RISES IN THE PRICE OF FUEL IN PARTICULAR HAVE SOAKED UP MUCH OF THE SAVINGS GAINED BY THE SACRIFICES OF EMPLOYEES AND PRODUCTIVITY IMPROVEMENTS. THE RESULTS ARE APPARENT.

THE FIFTH PIECE OF COVENTIONAL WISDOM IS THE NOTION IS THAT IF WE WERE TO HAVE FEWER NETWORK CARRIERS, THE PUBLIC WOULD NECESSARILY SUFFER. I THINK THAT REFLECTS AN OVERLY SIMPLISTIC VIEW OF CONSOLIDATION. CONSUMERS COULD ACTUALLY BENEFIT

FROM A STABLE, LESS FRAGMENTED INDUSTRY. IF AIRLINES WERE ABLE TO ACHIEVE SUSTAIN PROFITABILITY THROUGH CONSOLIDATION—WHETHER THAT IS ACHIEVED BY MERGERS, EXIT FROM THE MARKET, OR DISCRETE ASSET SALE— THE CHANGE COULD BROADEN THE TERMS OF COMPETITION TO ENCOMPASS MORE THAN JUST PRICE. THEY COULD ALSO BEGIN COMPETING AGAIN IN TERMS OF SERVICE INNOVATIONS, EXPANDED NETWORK OPTIONS, AND OTHER ATTRIBUTES. YOU WOULD LIKELY SEE MORE SERVICE TO SMALLER COMMUNITIES, NOT LESS. IN MAKING THIS POINT, I AM NOT ADVOCATING MERGERS PER SE. BUT I AM SAYING THAT WE SHOULD ALLOW MARKET FORCES TO CORRECT STRUCTURAL PROBLEMS....CONSOLIDATION IS ONE WAY IN WHICH THE MARKET ACTS AND WE SHOULD KEEP AN OPEN-MIND ABOUT THE POTENTIAL UPSIDE FOR CONSUMERS...

IN SUM, AS WE IN GOVERNMENT FORMULATE POLICY ABOUT THE AIRLINE INDUSTRY, WE MUST ACCEPT THE FACTS AS THEY REALLY ARE, NOT AS WE WOULD WISH THEM TO BE. IF THE U.S. AIRLINE INDUSTRY IS NOT EXPERIENCING A ROBUST AND LASTING RECOVERY, AS HAS BEEN ASSUMED AND HOPED, THEN WE NEED TO UNDERSTAND WHY AND WHAT POLICY IMPLICATIONS IF ANY THE SITUATION PRESENTS. IF U.S. CARRIERS ARE LAGGING BEHIND FOREIGN AIRLINES, WE NEED TO LOOK AT MARKET-DRIVEN WAYS TO IMPROVE THEIR



COMPETITIVENESS. WE NEED TO ACKNOWLEDGE THAT THE FEDERAL GOVERNMENT'S JOB IN ITS OVERSIGHT OF THE AIRLINE INDUSTRY IS MORE THAN SIMPLY KEEPING PRICES LOW, ESPECIALLY WHEN THOSE PRICES FALL REGULARLY BELOW COST. AND WHEN WE EXAMINE AIRLINE FUNDAMENTALS, WE NEED TO CONSIDER THOSE COSTS IN THE CONTEXT OF THE DRAMATIC REDUCTIONS THAT HAVE TAKEN PLACE IN VIRTUALLY ALL DISCRETIONARY AREAS. AND FINALLY, WE SHOULD REMAIN OPEN TO AT LEAST THE POSSIBILITY THAT CONSOLIDATION IN THE INDUSTRY WILL BENEFIT RATHER THAN HARM THE PUBLIC INTEREST.

THANK YOU