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Chairman LoBiondo, Ranking Member Larsen, and Members of the Subcommittee:

Introduction

I appreciate the opportunity to appear before you to discuss the state of air service at small and rural communities. The Department of Transportation has a broad mandate to ensure that small and rural communities have access to regularly scheduled air service within the National Airspace System (NAS) (see 49 U.S.C. § 40101(a)). Like Congress, the Department understands how vitally important air service links are to communities of all sizes, particularly those communities that are geographically isolated or that have few reliable transportation options.

The Department is the steward of two Congressionally supported programs that provide communities with resources to address air service deficiencies--the Essential Air Service (EAS) program and the Small Community Air Service Development Program (SCASDP). The Department works to make these programs as efficient and successful as possible. I will spend the majority of my testimony explaining how these two programs complement each other and what their impact is on small and rural communities.

This is a challenging time for air service development. In recent years, the U.S. airline industry has undergone tremendous structural change. While the largest airlines have shown a remarkable ability to adapt and earn profits the last four years, the reality is that many small communities are confronting increasing challenges in maintaining their desired level of air service. High fuel prices, changes in business models, lack of availability of small, fuel-efficient aircraft, the consolidation of airline networks, and new legislation and regulation are being cited as being among the many factors that are changing the economics of serving small and rural communities and the baseline qualification standards and duty limits of commercial airline pilots. Some analysts believe these factors will come to a head in a matter of a few short years, creating some difficult choices for airlines as they may have too few pilots, planes, or resources to sustain their existing domestic networks. I commend this subcommittee for looking at these

issues now, as it may take a number of years for new commercial and public policy solutions to become effective.

In this challenging environment, the Department is pursuing a broad strategy to address small and rural community access to the NAS. In addition to administering EAS and SCASDP, one component of the strategy is making substantial airport infrastructure investments to improve the quality of air service to small and rural communities. The Department – through the Federal Aviation Administration (FAA) – provided $5.8 billion in Airport Improvement Program grants for small- and non-hub airport infrastructure between fiscal years 2009 and 2013.

The Department also develops creative solutions when specific air service issues arise. For example, we determined that the Department could play a valuable role in preserving small and rural community air service in connection with the recent merger of American Airlines and US Airways. As the Justice Department was preparing to settle its antitrust lawsuit with the airlines, the Department reached a side agreement to largely preserve service to small and rural communities from Ronald Reagan Washington National Airport (DCA). This agreement – the first of its kind – recognized that American and US Airways would continue to hold a majority of the "commuter slots" at DCA, which are special landing and takeoff rights to operate aircraft of 76 seats or fewer. Because these slots are well suited for use in small and rural communities, the Department sought the airlines' commitment to continue serving small communities. The Department side agreement requires that the airlines continue to schedule at least 75 daily round trips from DCA to small cities, with at least 56 of those round trips earmarked for small- and non-hub airports, for a period of at least five years. While the agreement does not require the airlines to serve any particular community, it does ensure that small and medium-sized cities, as a class, maintain access to the nation's capital during the term of the agreement. The Department's successful efforts to reach agreement with airlines serve as an indication of how important we think access to the NAS is, and of how we work with all industry stakeholders to address air service issues.

The Essential Air Service Program

The EAS program was established by Congress as a safety net for the smaller and more isolated communities across the country that had scheduled air service at the time the Airline Deregulation Act (Act) was passed in 1978. Under the Act, these communities were assured that, for ten years, they would continue to receive scheduled service to a hub airport--by federally subsidized flights if necessary. Congress later extended the program for another ten years, and ultimately made it permanent. The Department administers this program and has worked hard to stretch every available dollar. The EAS program is currently subsidizing service to 160 communities nationwide, ensuring that communities across America can tap into the economic and quality of life benefits that air service offers, including access to health care, education and business opportunities.

It is every EAS community's objective to stimulate enough traffic that airlines will be attracted to provide air service on a competitive, rather than a subsidized, basis. Some communities have successfully reduced their reliance on subsidy in recent years using the EAS program as a platform. We work closely with the community leaders to achieve their goals by soliciting the community's input and we afford substantial weight to the community's views when making a carrier selection.

In Joplin, Missouri, for example, the community's response to American Eagle's service – which began in 2010 – has resulted in a much lower subsidy as the market continues to gradually improve. Joplin required a subsidy of $2,778,756 in 2010, but by 2012, the subsidy amount dropped to $342,560, saving the EAS program and taxpayers more than $2 million per year. The communities of Sioux City and Waterloo, Iowa, as well as Garden City, Kansas, responded in a similar fashion and were able to significantly cut their subsidies. These efforts led to more sustainable air service in their communities and saved more than $2.8 million per year. The communities of Rock Springs and Riverton, Wyoming; Dickinson, North Dakota; and Manhattan, Kansas, all benefitted from favorable traffic and revenue results under the EAS program. They are now served totally without federal subsidy.

The positive developments experienced by some EAS communities must, however, be put in context. In the years since deregulation, low-cost/low-fare carriers have expanded in popularity, reach, and offerings. Based upon 2013 revenue data, low-cost/low-fare carriers represent more than 30% of domestic passenger revenues. This increased LCC presence prompts passengers to drive an extra distance to the airports where they operate. The EAS program now operates in a landscape that is dramatically different than the landscape in 1978. In today's environment, with dramatically higher fuel costs, the EAS program subsidy rates continue to escalate, notwithstanding that Congress capped the program so that no new communities (except those in Alaska and Hawaii) can enter the program. In FY2011, the program obligated $195 million. In FY2012 and FY2013, obligations increased by $29 million and $31 million, respectively. In FY2014, the program funding level is $269.6 million. While the number of subsidized EAS communities has remained about the same, these upward costs are driven primarily by two factors.

First, the number of regional airlines that have the appropriately sized aircraft for the EAS program has continued to decline. For the last 20 years or more, the backbone of the EAS program has been 19- 34-seat aircraft. Aircraft in the 19 to 34-seat segment, such as the Beech 1900, are well suited to serve many EAS communities because they are typically pressurized and offer an appropriate number of seats to match the modest demand. Yet, carriers have been retiring their 19- 34-seat turboprop aircraft because they are becoming extremely expensive to maintain. The result is that regional airlines are relying more heavily on much larger aircraft, such as 50-seat regional jets or 74-seat turboprops, or in some cases, much smaller aircraft, such as 9-seat unpressurized turboprop aircraft suited towards short-haul services. In fact, with only a

handful of exceptions, in the lower 48 states, the only 19-seat service is in subsidized EAS markets. As a practical matter, the 19-seat aircraft is largely obsolete.

Within the last few years, four EAS providers that were serving fully one-third of the EAS communities in the lower 48 states with small turboprops went out of business: Big Sky Airlines, RegionsAir, Air Midwest and Skyway Airlines. On July 15, 2011, Mesaba Airlines and Colgan Air, both owned by Pinnacle, filed 90-day notices of their intent to suspend service at 34 EAS communities. In both cases, the reason given for leaving the markets is that the carriers were retiring their entire fleet of 34-seat turboprop aircraft. This decrease in both right-sized aircraft and carriers that participate in the program has diminished the number of carriers competing for subsidy, thereby driving up subsidy costs. For example, the actual costs to replace these carriers are significantly higher than the subsidy rates that were in effect at the time that Mesaba and Colgan filed to suspend service. At the ten Colgan communities, the aggregate 10-city rate went from $19.2 million to $24.3 million, an increase of $5.1 million. At the 16 communities where Mesaba filed notice and where it was already receiving subsidy, the aggregate rate went from $24.7 million to $36.8 million. Six of those communities had never required subsidy support before. These trends of cost escalation are likely to continue because smaller, right-sized aircraft are not being manufactured and so there will be fewer and fewer airlines willing or able to participate in the program. Given the age of the 19- and 34-seat aircraft, and the fact that no aircraft of that size have been manufactured for years, we are fast approaching the time when EAS will be provided with either 9-seat or 50-seat aircraft, and even the 50-seaters are being retired at a steady rate.

On the plus side, there are a handful of EAS communities that are large enough to support regional jet aircraft at subsidy rates that are comparable to, or even less than, turboprop EAS markets. Whether that will continue in the long run, given the relatively higher cost of operating regional jets compared to turboprops, is an open question.

Second, recent legislative and regulatory action concerning pilot flight and duty time and minimum requirements for new hires have, at least temporarily, affected the supply of pilots, particularly for the smaller regional carriers who are now adjusting their compensation and training programs. The lack of adequate aircraft and airlines positioned to serve small markets is now complicated by at least a short-term pilot shortage, which could be further exacerbated by the number of network airline pilots facing mandatory retirement at age 65 in the coming years. A February 2014 report by the General Accounting Office (GAO) found that regional airlines faced difficulties filling entry-level pilot vacancies. GAO reported that the major regional airlines in the United States have been able to meet about 50% of their hiring targets. According to a April 2014 study by William Swelbar of the Massachusetts Institute of Technology, 14,000 pilots are expected to retire from the largest four airlines between 2015 and 2022. In addition, other pilots will be required for growth at these and other airlines. Since large airlines typically recruit their pilots from the regional airlines, the demand for pilots by the large carriers is likely to surpass the 18,000 pilots flying for regional airlines today. The pilot shortage

may therefore negatively affect the ability of small communities to retain and expand their air service, at least for a few years.

According to some analysts and airline representatives, the recent legislative and regulatory changes, while improving the safety of commercial air travel, result in implementation and compliance costs that have implications for rural air service. The impacts are most acute at the smallest regional carriers. For example, Great Lakes Airlines and Silver Airways, which provide a significant amount of subsidized air service under the EAS program, have seen their pilot pools shrink rapidly. At the current time, it is proving difficult for these carriers to retain pilots as larger carriers are able to offer more attractive compensation packages. In late 2013, Great Lakes Airlines and Silver Airways significantly reduced their planned flight schedule, citing the reduced availability of pilots, and resulting in service reductions for subsidized and non-subsidized communities in their route networks. Within the last 3-4 months, Great Lakes Airlines shut down service at 12 EAS communities, and the Department is in the process of securing replacement service. Silver Airways has just recently filed to suspend service at 10 communities, and the Department is securing replacement service for those communities as well.

To address the escalating costs and structural problems with the EAS program, Congress has, over a period of years, enacted a number of changes to the program's eligibility criteria. For example, Congress imposed a $1,000 subsidy-per-passenger cap for all communities except those in Alaska and Hawaii, regardless of how far they are located from a hub airport. To implement this statute, the Department has terminated eligibility for four communities, saving $6-8 million annually. Congress also included the requirement that eligible communities (outside of Hawaii and Alaska) within 175 miles of a large or medium hub have average enplanements of 10 or more each service day (the 10 enplanement provision), as well as the requirement that EAS subsidies do not exceed $200 per passenger (the $200 per passenger subsidy cap).

For many years, the Department has worked with EAS communities where exogenous events and temporary declines in traffic may have skewed the true nature of the demand for air service. In 2012, Congress provided the Department with specific authority to grant waivers from the 10-enplanement provision and the $200 per passenger subsidy cap. This new authority allows the Department to continue to take into consideration distortions to passenger and subsidy levels that do not reflect a community's true traffic generation potential, while, at the same time, enabling us to develop a more regularized and predictable way of establishing program eligibility.

To ensure consistency and fairness, the Department has decided to take the same measured approach with respect to both the 10-enplanement provision and the $200 per passenger subsidy cap. We are beginning with the 10-enplanement provision. Earlier this month, the Department analyzed the most recent fiscal year data available and tentatively terminated EAS subsidy for 13 communities whose subsidies totaled about $25 million. Affected communities have an opportunity to object to our tentative findings, and, if they are not successful, they may seek a

waiver. Moreover, if a waiver is not granted, they may petition to re-enter the program in the future. I can assure this subcommittee that Department will do everything we can to work with Congress and our EAS stakeholders to mitigate potential impacts to communities affected by these actions and protect the long-term viability of the EAS program. The Department proposed a similar plan regarding the $200 per passenger subsidy cap about a week ago and requested comments from stakeholders.

Small Community Air Service Development Program

In 2000, Congress authorized a new program, the Small Community Air Service Development Program, which it funded beginning in 2002. SCASDP is complementary to the EAS program, and, in our experience, is not well understood. SCASDP is a competitive grant program that encourages small airports to develop innovative approaches to attract or retain air service and to connect communities to the NAS. Communities of varying sizes, up to the size of small hubs, may apply for funds and the Department applies rigorous statutory criteria to select the most meritorious proposals. Communities may apply funds to a wide range of activities, including revenue guarantees to backstop new air service, air service development studies, start-up cost offsets to help attract new airlines, and marketing support to improve usage of the airport. A majority of grantees use the funds for revenue guarantees or other forms of risk abatement for the airlines, while approximately 40 percent use the grants primarily for marketing or other project components. EAS communities may apply for SCASDP grants, but in the years since SCASDP was authorized there has not been significant overlap between the programs. EAS communities have accounted for less than 15% of all SCASDP grants. The small amount of overlap is due in part to the Department's policy of ensuring that SCASDP grants for EAS communities are only used to market the EAS service. This policy ensures that the two programs do not work at cross purposes.

Consistent with Congress' objectives for the program, the Department has viewed SCASDP as a means to explore creative and innovative approaches to air service development. Since 2002, the Department has issued 349 grants totaling $140 million in appropriations. These grants funded a wide range of projects, including various kinds of financial incentives to airlines, intermodal solutions such as shuttle services to the airport, leakage studies, cutting edge marketing techniques, and start-up cost offsets. Each of these approaches has a chance of working for the community that receives the grant; but other communities can also learn from the results of these projects and make adjustments to their own air service development efforts. SCASDP projects are described in detail in a public docket, where applications are posted. Communities can, therefore, learn from the approaches taken by SCASDP grantees, creating a record of "lessons learned." Additionally, the SCASDP grant administrators serve as a neutral resource for communities as they develop and implement their own strategies.

In SCASDP, projects are funded on a reimbursement basis according to a defined cost share, with many communities contributing a substantial amount of the total project cost. Throughout the history of the program, more than half of the grantees, or 52 percent, have contributed greater than 20 percent of the total project cost; 18 percent contributed at least 40 percent of the cost; and 12 percent contributed at least 50 percent of the total project cost. Grants have a duration of one to five years depending upon the circumstances, and any funds not expended at the end of the grant term are typically reallocated to other communities in a future solicitation. SCASDP is funded entirely from annual appropriations, and has received $10 million or less every year since 2006. In this respect, SCASDP is comparatively small in size.

Unlike the EAS program, which has a static list of eligible communities and works on a straight subsidy to air carriers, SCASDP helps communities adapt to the changing dynamics of air service demand by giving them resources and by encouraging them to develop innovative approaches with a range of local partners. In many grants, the funds are used as guarantees to mitigate the risk the airlines take by entering a new market. To the extent that the services are profitable, funds may never be drawn down and they may be potentially recovered and reallocated to other communities for new projects. This ability to provide flexible risk abatement, combined with the fact that the program works on a reimbursement and cost-share basis, makes SCASDP unique and popular with small communities.

Three grant projects serve as useful examples of successful SCASDP grants. In 2002, the Department awarded a grant to Akron-Canton Airport in Ohio to launch new nonstop flights to New York's LaGuardia airport on AirTran Airways, now part of Southwest Airlines. The community successfully leveraged the grant funds to demonstrate the existence of a robust air travel market in the region. After AirTran's entry, traffic at the airport increased by an estimated 100 percent, and fares decreased, as other airlines added new services as well. Based upon the community's success, the airport did not need to draw down all the grant funds. It returned more than $200,000 to the program, and that money was later reallocated to other grantees.

In 2010, the Department awarded a grant to Provo, Utah, to establish new scheduled air service on a low-cost/low-fare carrier. As a result of the grant, Provo secured its first commercial air service since the 1960s, at first attracting Frontier Airlines and then later attracting Allegiant Airlines when Frontier altered its fleet strategy as part of its changing ownership. Like Akron-Canton, Provo experienced significant traffic growth. When Allegiant saw the positive results of its first service at Provo, the airline added additional destinations and flights which, according to the airline, are producing load factors above 90 percent. Allegiant now serves Phoenix, Oakland, and Los Angeles from Provo.

In 2011, the Department awarded a grant to Harrisburg, Pennsylvania, to secure new westbound service. The community reached an agreement with Frontier Airlines to provide new low-fare service three, and then four, times per week to Denver. The community estimates that the Harrisburg-Denver market grew by more than 200 percent and that Harrisburg now has the

region's lowest fares to Denver, which stimulates traffic. The existence of the SCASDP-backed revenue guarantee was critical to mitigate the risk that Frontier Airlines faced in entering a new market. But when the airline did enter, the route performed well and no revenue guarantee funds were ultimately needed. The funds will remain available to reallocate to a future SCASDP grantee. Harrisburg now believes that it has proven itself as a potential base for future low-cost/low-fare operations. In 2012, the community estimated the economic impact of the in-bound traffic to be $2.7 million.

Yet, even with a SCASDP grant, communities still face challenges in realizing their air service development goals. Some grantees are unable to attract new air service, while others find that the air carrier terminates the service soon after the financial support ends or for reasons unrelated to the SCASDP grant. In its 2005 study, the GAO reviewed 23 projects from the initial years of the program and determined that results were mixed. The GAO concluded that about 50 percent of the airports with grants reported air service improvements that were self-sustaining after the grant was over. The GAO stated, however, that it was, at that time, too soon to assess the overall effectiveness of the program.

Subsequently, a group at the Massachusetts Institute of Technology (MIT) reviewed the program and published its results in January 2014. The MIT study reviewed 115 projects funded by grants issued between 2006 and 2011. MIT only evaluated projects in which the community sought to provide airlines with financial incentive packages to secure new service; other projects, such as marketing projects to sustain current service or air service development studies, were not evaluated. MIT determined that communities were successful – that is, they attracted and sustained new air service throughout the grant period, up to 28 months – only 36.5 percent of the time. It must be noted that MIT's data sample includes projects that are still ongoing, and may thus still be successful towards the end of the grant period.

While these studies are useful references, I believe a more balanced and inclusive assessment is possible, particularly if the following three factors are considered.

First, Congress authorized and funds the program with the knowledge that communities would use the grants to experiment with a number of differing approaches to attracting and retaining air service. Such objectives are inherently difficult and risky in a marketplace with rapidly changing dynamics such as fuel price, aircraft availability, and labor costs. All communities participating in the program have, by definition, experienced some degree of failure in attracting airlines in the past. Applicants for SCASDP grants are seeking new air service in markets that are at or beyond the margins of what the major airlines are willing to serve. SCASDP's role is to minimize risk and provide an incentive for airlines to try serving a new market. In addition, some grants are designated for studies or other cooperative efforts that are used as future building blocks to connect residents in the airport's catchment area to the NAS. Communities typically view these grants as extremely successful.

Second, many communities view SCASDP grants as tools for broader economic development, which affects how success or failure is measured. Communities without air service, or without robust air service development efforts, can struggle to retain businesses or attract new jobs. For a single community that gains new service, there is a positive economic impact on regional jobs and economic activity. Moreover, in a program designed to foster innovative approaches, even failures can be a success in that communities can learn collectively through the transparent SCASDP administration process what works and what does not work.

Third, it is helpful to assess results from a larger sample size of communities over a longer period of time. The initial years of the program occurred during a particularly turbulent time in the airline industry, which had to absorb a series of severe demand shocks and restructuring efforts. SCASDP projects take two to five years to implement, because successful projects require careful planning and buy-in from airports, community governments, community businesses, and the airline.

Conclusion

The Department has taken seriously its obligation to administer the EAS and SCASD programs, and I believe these programs have had their successes. However, we must acknowledge this is a particularly challenging time for air service development. The problems faced by small and rural communities are fundamental and structural, and there are no clear or easy answers. But, in light of the importance of air service to residents of rural America, it is essential that we make a concerted effort to respond to these challenges. As Congress debates reauthorization of aviation programs, I commend this subcommittee for taking a close look at air service issues. I look forward to continuing to work with all stakeholders, including the members of this subcommittee, as we move forward to address these challenges.

Chairman LoBiondo, this concludes my testimony. I would be happy to answer any questions you or your colleagues may have.