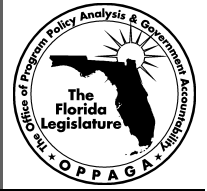




Office of Program Policy Analysis And Government Accountability



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February 1999

Preliminary Review of the Suspension of the State Contract for Air Carrier Service for Flights to and from Tallahassee

Abstract

The suspension of the state contract has had little impact on the Tallahassee Regional Airport or the general public.

- The number of scheduled commercial flights has increased, but jet service has declined slightly.
- The cost of air travel to the general public has not materially changed and fewer passengers have used the airport.

State travel costs have increased since the suspension of the state contract.

- State costs for air travel between cities that were previously under contract have increased substantially.
- Total state travel costs have increased by 9%.

The Legislature could consider three policy options for the pilot project.

- Discontinue the pilot project.
- Give the pilot project more time and clarify expectations.
- Consider other local initiatives to improve airline service to Tallahassee.

Purpose

The 1998 Florida Legislature determined that it was in the best interest of Florida to improve the quality, availability, and cost of air service in Tallahassee. The Department of Management Services was directed to implement a pilot project, lasting three years (August 1998 through July 2001). The pilot suspended the state

term contract for air carrier service for flights to and from Tallahassee to test the assumption that the contract limited competition in this market and thus served as a disincentive for airlines to improve service and lower airfares at the Tallahassee Regional Airport. The Office of Program Policy Analysis and Government Accountability (OPPAGA) was directed to review the effects and fiscal impact of the first six months of the pilot project and report its preliminary findings to the Legislature prior to the 1999 regular session. OPPAGA's analysis focused on the following questions.

- What impact has the pilot project had on the frequency, quality, and cost of commercial air service at the Tallahassee Regional Airport?
- What impact has the pilot project had on the cost of travel for state government?
- What alternatives are available to make the pilot project more effective or otherwise attract and retain quality affordable air carrier service in Tallahassee?

Background

For many years, the State of Florida has contracted with airlines to obtain price discounts for air carrier service for state employees. The Department of Management Services establishes annual term contracts with air carriers through a bid process. The contract establishes discounted airfares for travel between certain city pairs (e.g., Tallahassee to Tampa). The state contract enables state employees to purchase fully refundable, unrestricted tickets, which means tickets can be bought, exchanged, or refunded at any time prior to departure. While the state air carrier contract has enabled the state to obtain economical airfares, concerns have been raised that it also had the effect of adversely affecting the price and availability

of commercial air service at the Tallahassee Regional Airport. In recent years, several airlines have reduced or eliminated service to Tallahassee and public airfares from Tallahassee have been higher than those of other Florida cities. One of the reasons given for this situation has been that the state term contract may reduce the profit that airlines can earn in the Tallahassee market, inducing them to abandon the market and/or raise prices for non-state government passengers.

To address these concerns, the 1998 Legislature authorized the Department of Management Services to conduct a pilot project and suspend the state contract for air carrier service for flights to and from Tallahassee. The state contract was suspended on August 1, 1998, for flights to and from Tallahassee. However, the state contract is still in effect for travel among other Florida city pairs (e.g., Miami to Orlando). The department is authorized to reinstate the contract if state travel costs increase by at least 20% during the pilot project period.

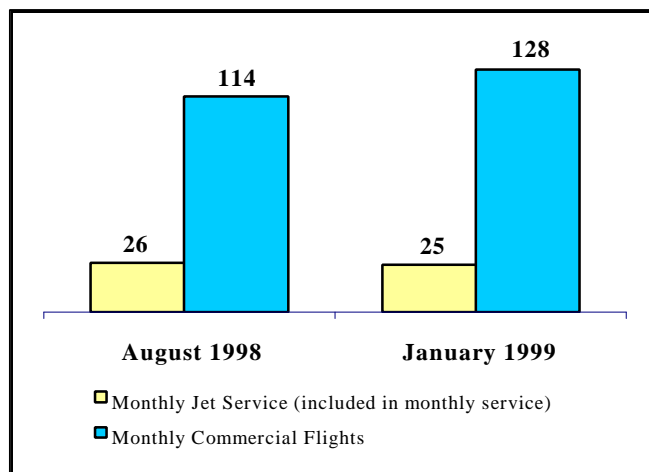
Findings

Under the pilot project the number of commercial flights to the Tallahassee Regional Airport has increased, although jet service has declined slightly. The cost of air travel to the general public has not materially changed and the number of passengers using the airport has declined.

The pilot project was intended to induce airlines to increase service to the Tallahassee Regional Airport and/or reduce the airfares charged to the public. To assess whether these benefits have been realized, we examined data on the availability and cost of commercial air service at the Tallahassee Regional Airport during the first six months of the pilot project (August 1998 through January 1999). We also tracked data on the number of passengers using the airport during this period.

Scheduled flights have increased slightly. The availability of commercial airline service has improved slightly during the pilot project period. According to data provided by the Tallahassee Regional Airport, the number of scheduled monthly commercial flights increased by 14 between August 1998 and January 1999 (see Exhibit 1). However, the number of commercial jet service flights decreased from 26 to 25 during this period.

Exhibit 1
The Number of Scheduled Commercial Flights Increased Slightly Over the Past Six Months



Source: Tallahassee Airport Authority

Commercial airfares have not declined. The cost of commercial air travel to and from the Tallahassee airport has not changed materially during the pilot project. To assess the impact of the pilot project on airfares charged to the general public, we tracked available fares for the seven city pairs for which the state contract was canceled.¹ Airlines offer a variety of airfares for which prices can vary depending on the time of purchase. We used a commercial Internet site to track the cost of tickets purchased the same day and 7, 14, and 21 days in advance.²

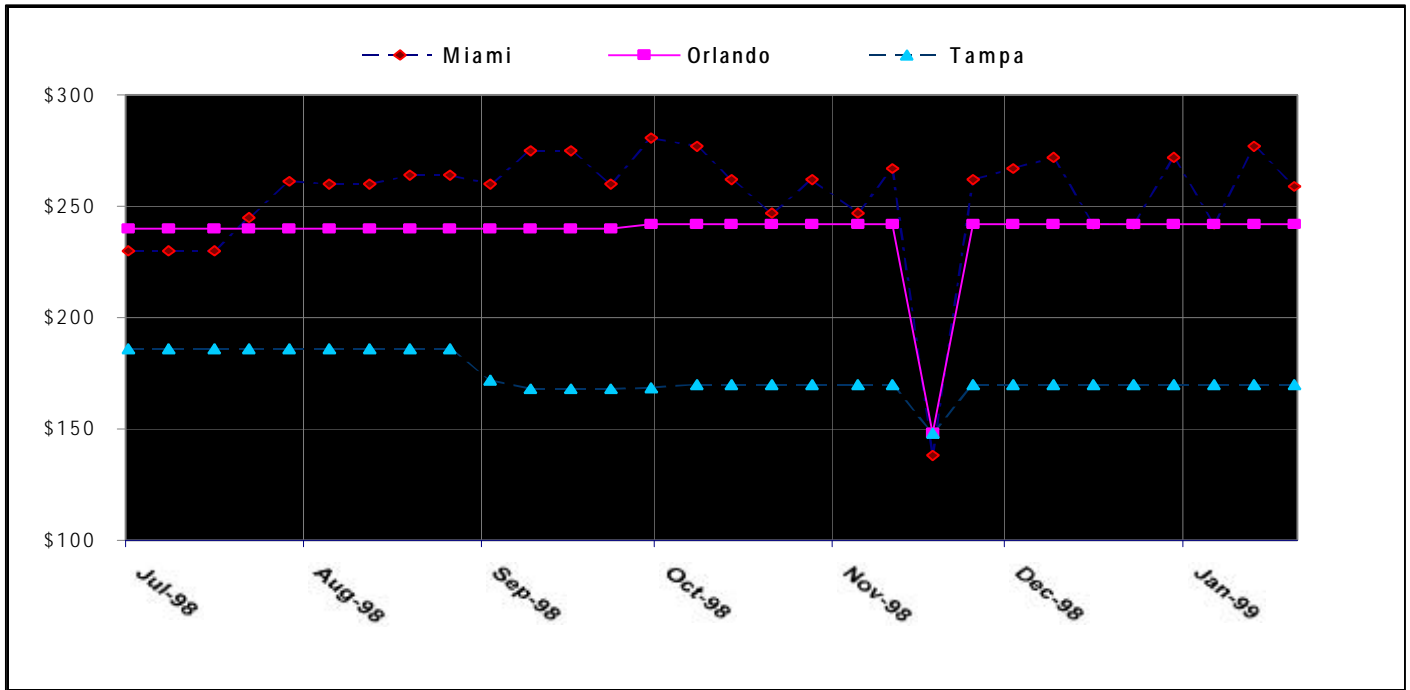
As shown in Exhibit 2, airfares between Tallahassee and Tampa, Miami, and Orlando remained generally constant over the July 1998 through January 1999 period. Exhibit 2 tracks the price of discounted airfares purchased 14 days in advance. These prices should be available to most travelers who can plan their travel and seek discounted airfares.³ All airfares purchased in advance showed this general pattern. Although same-day purchases had significant short-term fluctuations, these too remained relatively consistent.

¹ The contract was canceled for flights between Tallahassee and the cities of Miami, Orlando, Tampa, Fort Lauderdale, Fort Myers, Key West, and West Palm Beach.

² We used the internet site Expedia Travel and drew our sample of airfares every Wednesday during the period July 1998 through January 1999.

³ Discounted airfares are defined as fares that offer a price discount for the purchase of a ticket in advance that is non-refundable. The payment of a penalty and restrictions as to its future use are generally associated with the cancellation of a discounted airfare.

Exhibit 2
Airfares Available to the General Public Remained Fairly Constant During the Pilot Project



Source: OPPAGA

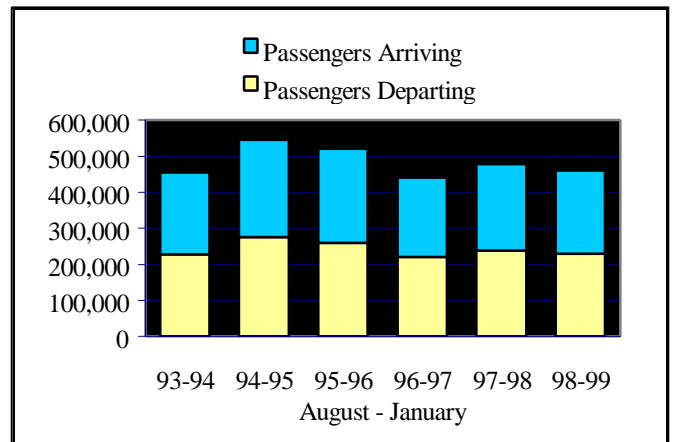
Airport usage has declined. As shown in Exhibit 3, the number of passengers using the Tallahassee Regional Airport has declined slightly during the pilot project. A concern raised by proponents of the pilot project was that, rather than using the Tallahassee airport, citizens were driving to other airports to obtain lower airfares. However, we concluded that the pilot project has not resulted in increased use of the Tallahassee airport probably due, in part, to the fact that Tallahassee airfares have not materially changed.

According to data provided by the Tallahassee Regional Airport, for the period August 1998 through January 1999, the number of passengers using the airport declined 5% from the same period in the prior year. The number of passengers fell during this period from 478,209 in 1997-98 to 455,252 in 1998-99. However, as shown in Exhibit 3, airport usage in Tallahassee has varied substantially over time. For example, for the period August 1997 through January 1998, the number of passengers using the airport increased by 9% from the same period in the prior year.

These preliminary results show the pilot project has not had a significant impact on the availability, quality, and cost of air service at the Tallahassee Regional airport. However, it is likely too early to tell whether

these initial results are an indicator of the long-term potential impact of the pilot, as the airline industry does not usually make service decisions or adjust service routes within six-months (the period that the pilot has operated). We cannot project whether the competitive market will adjust to the suspension of the state contract and improve air service to Tallahassee if given more time.

Exhibit 3
Passenger Usage at the Tallahassee Regional Airport Has Declined Slightly During the Pilot Project's First Six Months



Source: Tallahassee Airport Authority

Airfares paid by state agencies have increased substantially during the first six months of the pilot project. However, total state travel costs have not increased more than 20% during this period.

The Legislature recognized that the potential existed that the pilot project could result in increased cost of travel for state government employees. To be fiscally responsible, a safeguard was put into place that should travel costs to the state increase by at least 20% the contract may be reinstated. However, it was not specified whether the 20% threshold applied to air travel costs to state agencies or to total state travel costs.

State air travel costs have increased. State air travel costs have increased for flights that formerly were under the state term contract. Much of this increase occurred because state employees did not or could not use discounted airfares. The state's accounting system does not maintain summary data on the costs to state agencies to travel by air. To assess the pilot project's impact on state travel costs, we surveyed state agency administrative services directors and reviewed a sample of state travel vouchers.

More than half of the agencies responding to our survey reported that their costs to travel by air had increased since the suspension of the state contract. Of the 25 administrative services directors who responded to our survey, 17 reported that their agencies were paying higher airfares as a result of the pilot project. State travel vouchers indicate that state air travel costs have increased substantially compared to the prices previously available under the state term contract.⁴ As shown in Exhibit 4, actual airfares for round-trip travel in the vouchers we examined were an average of 38%, 69%, and 49% above the prices previously available from the state term contract for service to Miami, Tampa, and Orlando respectively.⁵ For example, a round trip ticket from Tallahassee to Miami under the

⁴ We examined a sample of 219 travel vouchers from eight agencies (the Department of Agriculture and Consumer Services, the Department of Corrections, the Department of Elder Affairs, the Department of Juvenile Justice, the Department of Legal Affairs, the Department of Labor and Employment Security, the Department of Revenue, and the Department of Veterans Affairs). We requested each of these agencies to provide us with a sample of 30 vouchers for intra-state travel to and from Tallahassee; some of the agencies did not make this many trips during the study period.

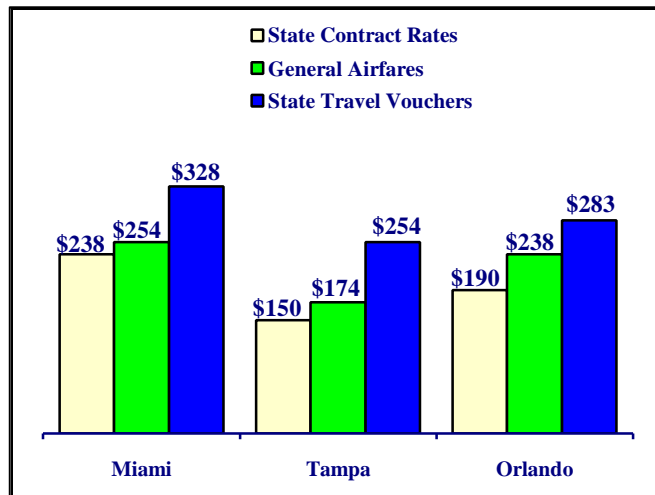
⁵ Comparative information is provided for these three cities as they represent the majority of travel included in our sample of state travel vouchers.

state contract cost \$238, while the average price paid by state agencies during the pilot project was \$328.

There were two primary reasons why state air travel costs increased. First, many state employees either could not or did not buy discounted airfares. Without the state contract, agencies must buy non-refundable tickets at least two weeks in advance in order to obtain the lowest prices for airfares. (Under the state term contract, the same airfare is charged regardless of the time of purchase and all tickets are fully refundable.) However, agency administrative services directors indicated that it is often not feasible for state employees to take advantage of discounted airfares. For example, legal staff are often required to attend judicial proceedings that are frequently scheduled or changed with little notice. Only 20% of the 219 travel vouchers we sampled were for tickets that were purchased at least two weeks in advance and only 34% were for non-refundable tickets.

Second, the discounted airfares that are now available to agencies are generally more expensive than the prices paid under the state term contract. As shown in Exhibit 4, average prices for non-refundable tickets purchased at least two weeks in advance to Miami, Tampa, and Orlando were 7%, 16%, and 25% higher, respectively, than the former contract prices.⁶

**Exhibit 4
State Round Trip Airfares from Tallahassee
Increased During the Pilot Project**



Source: OPPAGA

⁶ Average discounted airfares represent an average of the lowest price identified during our weekly tracking of airfares for flights booked two weeks in advance.

Total state travel costs have increased. Florida Accounting Information Resource Subsystem (FLAIR) records for the period August 1998 through December 1998 show that total state travel costs increased 9% over the same period in the prior fiscal year.⁷ While airfares paid by state agencies have increased under the pilot project, we could not determine to what extent the change in total state travel costs resulted from the pilot project. Other factors, such as increased incidence of state employee travel and higher hotel costs could also account for the higher total state travel costs.

Policy Options

We identified three policy options the Legislature could consider regarding the pilot project, either collectively or individually.

- Discontinue the pilot and reinstate contract fares.
- Continue the pilot project for a specified period and take steps to reduce its negative impact on state travel costs.
- Support other initiatives to develop improved commercial airline service to Tallahassee.

We do not recommend a fourth option of expanding the use of the state executive aircraft pool.

Option 1

Discontinue the pilot project and reinstate the contract for air carrier services for flights to and from Tallahassee.

As the pilot project has not resulted in improved air service to Tallahassee during its first six months, the Legislature may wish to discontinue the pilot and reinstate the contract for air carrier service in and out of Tallahassee, before the project's termination date of August 1, 2001. This option could reinstate the conveniences the state formerly realized through the state contract. However, the state may not be able to secure prices that equal the previous discounts.

⁷ FLAIR was formerly known as the State Automated Management Accounting Subsystem (SAMAS).

Airline representatives have indicated that several problems with the state term contract have limited their willingness to contract with the state and/or provide substantial price discounts. Specifically, the airline representatives have raised concerns that the current contract does not have sufficient controls to ensure that government employees use the discount rates for state travel only. Also, there are reportedly a large number of no-shows and last-minute cancellations that occur that preclude airlines from selling the seats to the public. Finally, airline representatives have expressed concern that state travelers are not required to use the contract airline if another carrier offers a flight with an equal or lower fare. OPPAGA suggests that the airlines knew or should have known about these factors when bidding on the contract and will consider these factors when competing for future state contracts.

Should the decision be made to discontinue the pilot project, the Legislature may wish to allow the Department of Management Services to modify the state contract to address these concerns. For example, airlines could be asked to bid on various proposals for state government travel, including the advance purchase of non-refundable tickets, the purchase of tickets through an official state purchase order or state credit card, tickets purchased under other discounted situations proposed by the bidder, and the purchase of fully refundable tickets at any time.

Option 2

Continue the pilot project for a specified period to allow more time for potential impacts to be realized.

The Legislature could allow the pilot project more time to operate. Given the nature of the airline industry, the market may not have had enough time to react to the elimination of the state contract through improved services and/or lower airfares. If the Legislature decides to continue the pilot project, it should more closely define its expectations for the pilot as well as clarify agency authority to pay ticket cancellation fees.

Project expectations should be clarified. If the pilot project is continued, the Legislature should establish more specific criteria for determining whether it is a success. For example, it is unlikely that the provision that total state travel expenditures must increase by 20% for the contract to be reinstated will ever occur. Because agencies did not receive additional funding to implement the pilot project, they would have to cut back on travel if their costs

substantially increased due to higher airfares. In addition, the Legislature could establish specific objectives for the pilot project, such as desired changes in airfare prices, number of scheduled flights, and/or changes in service quality (greater availability of jet and non-stop service). The Legislature should also establish expectations on how quickly these improvements are expected to occur.

Authorize payment of cancellation fees. The Legislature could reduce the negative fiscal impact of the pilot project by clarifying agency authority to pay penalties associated with the cancellation of a discounted airfare. Agencies can obtain substantial savings by purchasing non-refundable tickets at least two weeks in advance. Using an example of an agency that purchased 10 tickets to Miami during the year for which it found it was necessary to cancel two trips, a net savings of \$442 would be derived from the purchase of discounted airfares over non-discounted airfares.⁸ Agency administrative services directors estimated that an average of two-thirds of state travel could take advantage of these discounted airfares.⁹ However, our review of agency travel vouchers indicated that 80% of ticket purchases were not made two weeks in advance and 66% were for fully refundable tickets.

Agency managers indicated that many state employees are reluctant to purchase non-refundable tickets because they could be personally liable if they are subsequently unable to make the scheduled trip. Purchasing guidelines issued by the Department of Management Services specify that state funds can be used to pay penalties if a trip is canceled in the best interest of the state or due to illness of the traveler or illness or death of an immediate family member. However, the term “best interest of the state” has not been defined, which has discouraged employees from using non-refundable tickets.

The Legislature could authorize agencies to pay penalties that result from the cancellation of discounted airfares during the pilot project, once an agency has conducted a cost analysis as to whether the penalties

⁸ Specifically, if an agency were to purchase 10 discounted tickets to Miami, at an average cost of \$254, and found it necessary to cancel two trips, with an average penalty of \$75 per ticket, it would incur total costs of \$2,182. If the agency were to purchase 10 non-discounted tickets, at an average cost of \$328, and found it necessary to cancel two trips for which no penalty would be assessed, it would incur total costs of \$2,624. Although refunds for discounted tickets are generally in the form of a credit, they are transferable in terms of traveler and destination.

⁹ Responses ranged from 1% to 100% for agencies responding to the survey.

associated with canceling a discounted airfare outweigh the overall cost of purchasing non-discounted airfares. This would help to alleviate the confusion and apprehension some state workers have over using discounted tickets.

Option 3

Consider other local initiatives to improve service at the Tallahassee airport.

Since deregulation of the airline industry in 1978, many small and medium-sized airports have suffered from increased airfares and lower quality, which in many cases has resulted in the loss of jet service. Fundamentally, supply and demand determines pricing, frequency, and overall quality of air service. However, we identified two initiatives the Legislature may wish to consider that could help attract better air service to Tallahassee.

Support a community partnership. In an effort to improve air carrier service in their communities, some states are working in partnership with local governments, universities, and the private sector to offer local financial incentives to encourage expansion or new entrants to their commercial air markets. These partnerships work to identify the specific needs of communities for airline service and then work with airlines to see which expectations can be met. In the partnerships, entities such as state and local government agencies and large private sector employers commit to purchasing set numbers of airfares over a predetermined period, which can induce airlines to provide or improve service. After intense outreach efforts, officials from Chattanooga, Tennessee and Jackson, Mississippi were successful in attracting a low-fare airline to serve their airports and in improving the quality of their communities' air service.

A Tallahassee partnership could help attract improved airline service at the Tallahassee Regional Airport. However, this alternative could result in a state agency paying for unused seats should the community partnership not meet its utilization commitments.

Aggressively pursue "regional jet" service.

Given the relatively small size of the Tallahassee market, its best chance for improving airline service appears to be through attracting regional jet service. Airlines are now beginning to use 50-seat jets to serve in markets that are too small to support larger jets.

According to industry studies, airports that are able to attract regional jet service will tend to draw consumers from a wide region, while those airports that do not attract regional jets may lose all scheduled service. Comair has announced plans to add a round trip flight to its limited regional jet service in Tallahassee.

The state may wish to pursue the introduction of additional regional jet service to Tallahassee. The U.S. Department of Transportation is considering setting up federal loan guarantees for carriers to purchase regional jet aircraft. If the federal government follows through with this plan, it may be feasible for the state to encourage airlines to serve Tallahassee and facilitate their receipt of federal loans.

Option 4

Expand the state executive aircraft pool to offer greater flight availability for state employees.

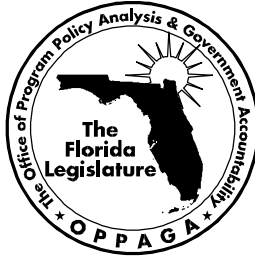
An option that OPPAGA does *not* recommend would be to expand the state executive aircraft pool to provide greater flight availability for state employees. Such an expansion would allow the department to offer scheduled round trip service to major cities (e.g., Tampa, Orlando, Miami) or round trip service to an airport from which employees could then secure lower airfares to major cities (i.e., Jacksonville).

In 1992, the Department of Management Services conducted a study on the feasibility of expanding the use of the executive aircraft pool. At the time of the department's study, this alternative was determined to be cost-prohibitive. While expanding the state executive aircraft pool may be a feasible option for the state in today's economy, any effort in this area should be carefully evaluated to assure they are cost-effective. There are substantial costs and risks associated with operating a state airline, including the large investment to the state of purchasing aircraft and the potential for significant operating losses should fewer employees fly than expected. Establishing a state airline also would probably lead to further reductions in the quality, availability, and cost of air service to citizens because a large percentage of the Tallahassee market would be diverted from the commercial market.

If this option is considered, any proposal should include an accurate cost-benefit analysis using sound methodologies to compare all costs associated with operating an airline to the benefits that would be realized by the state. Cost factors that must be considered in such an analysis include the purchase and maintenance of aircraft, expense associated with less than full seat utilization, expense of establishing and maintaining flight schedules as well as issuing and accounting of ticket sales, lease of gate arrangements for departure and arrival in all pair cities, and the purchase of all applicable insurance coverage.

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