U.S. airlines bleeding to death; British move in for the kill

by Anthony K. Wikrent

The latest round of quarterly financial reports from U.S. airlines should give pause to anyone inclined to accept the veracity of George Bush and Federal Reserve chairman Alan Greenspan's claims that the worst is over for the U.S. economy. The dynamic now ruling the U.S. economy is reflected in the bid by British Airways to buy a controlling stake in USAir: 20 years of "free trade," "free market," and deregulation policies have smashed U.S. industry, and now U.S. sovereignty itself is being swept aside, so that British subjects can come in and pick up the pieces.

Just as analysts had expected, the vicious fare wars that began in April have eroded the airlines' financial underpinnings in a flood of red ink. AMR Corp. (the holding company for American Airlines, the largest U.S. airline) reported a record second quarter loss of $166 million. UAL Corp. (the holding company for number two, United) reported losing $95.1 million; number three, Delta Air Lines lost $180.15 million.

The *Minneopolis Star Tribune* reported July 22 that number four, Northwest, privately held by Wings Holdings Inc., has been losing $1.5 million a day so far this year; $68 million was lost in the month of May alone, and even greater losses are expected in June and July. USAir, the nation's fifth largest carrier, reported losing $84.9 million during the quarter. Number six Continental, operating under the bankruptcy laws, reported losses of $99.2 million in the second quarter. TWA, the seventh largest U.S. airline, also operating under the protection of a bankruptcy court, is privately held, but persons familiar with TWA's finances told the *New York Times* on Aug. 4 that TWA is losing nearly $1 million a day.

Daily losses in the millions

U.S. airlines as a whole were already losing an average of $11.9 million a day as of April, which indicates that the hemorrhaging of red ink is now much worse. If these figures don't impress you, consider this: In the past 18 months, U.S. airlines have lost almost $7.5 billion, entirely erasing all profits previously recorded in the 67-year history of U.S. commercial aviation.

The weakening of the airlines' financial position that results from these losses comes at the same time that they are faced with the need to finance capital expenditures estimated at $180 billion over the next eight years. Long-term debt of the six largest U.S. airlines surviving at the end of 1991 had grown from $8.6 billion in 1987, to $18.4 billion, while their shareholders' equity barely budged, from $8.650 billion in 1987, to $8.656 billion in 1991. It is now doubtful if the debt load will grow—Moody's and Standard & Poor's have been steadily lowering the credit rating of all the airlines, making borrowing more costly and less likely. And the spectacular failure of the initial public offering of Guiness Peat Aviation (the world's largest lessor of aircraft) in June indicates how hesitant investors are to commit money to the airline industry.

Before the flood of red ink, the profit margin of the U.S. airline industry in the past few years was less than 1% of revenues, compared to an average of 5% margins for other U.S. industries.

Flying in the Depression

Unfortunately, no one in the industry is looking for the source of their woes outside the industry. No one is pointing to the ruinous losses as proof that deregulation has been a disaster; no one is pointing out how difficult it is to fly profitably when the United States is in a second Great Depression and 25 million Americans can't afford 21 meals a week. AMR Corp. chairman Bob Crandall, for example, told the London *Financial Times* in late May, "Either this industry fixes itself, or the U.S. is not going to have an industry."

So, the debate is limited to whether the industry has a cost problem or a revenue problem. Those who see a cost problem are urging more of the same austerity that created the depression in the first place: extract concessions from employees, slash benefits, curb pension "liabilities," and lower wages even further.

Those who argue that the problem is not enough revenue come closer to the truth, but in the end, they also advocate slashing costs somehow. Chris Miller, an analyst at U.S.

Travel, one of the five largest travel agencies in the United States, told *Aviation Week & Space Technology* on June 8 that the public's frenzied response to the lower fares "demonstrates a clear need for low-cost travel. The industry's problem," Miller argued, "is that it has no infrastructure that can provide what the public wants and still make money." Miller's advice is that the airlines should "redefine [their] product to succeed in the current competitive climate." What that means is that the airlines start thinking of "unbundling" their services: charging separate fees to handle baggage, serve meals, show a movie, etc.

Miller would have done much better to simply assert that there is a revenue problem, and stop right there. The next step would be to focus on the collapse in personal and family incomes in the United States over the past two decades and more. This is the result of national economic, financial, and monetary policies; the airlines could demand that the policies be changed, but that is exactly what nobody in the industry is doing.

With no one challenging the national policies that have led the United States into disaster, the usual conclusions are being drawn that the industry has to "consolidate," "learn pricing discipline," and "reduce capacity." Testifying before a Senate subcommittee on aviation in mid-June, for example, AMR chairman Crandall barked, "We must allow the market to finish the painful process of eliminating whatever number of carriers are surplus to the market's needs." And this, despite the loss of 9% of total U.S. airline capacity with the liquidation of three airlines (Eastern, Pan Am, and Midway) in 1991! Crandall's is the same worn argument made by free market ideologues about every other industry left reeling by the depression.

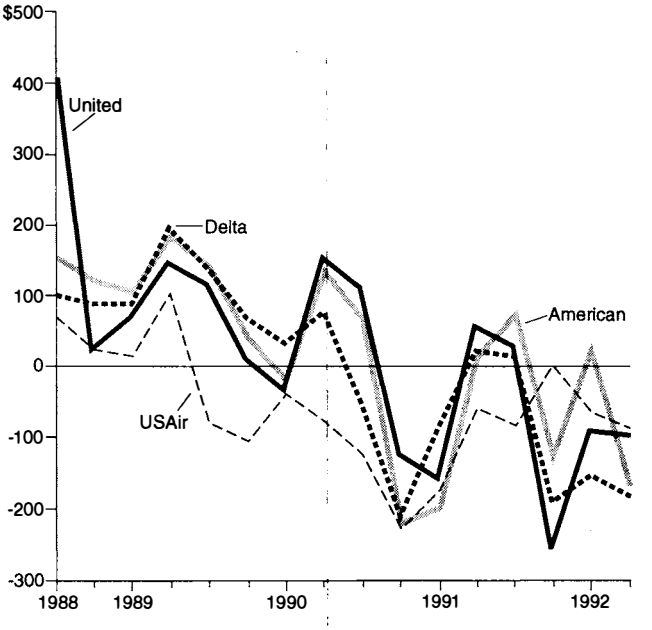
The theoreticians of deregulation, meantime—perhaps worried at the rapidly accreting evidence of their policy failure—have been arguing that U.S. industry would be strengthened if it were forced to deal with foreign competition. On Dec. 30, 1990, Deputy Assistant Secretary of Transportation Jeffrey N. Shane, previously the leading airline route negotiator at the U.S. State Department, told the *New York Times,* "The issue is, are we ever going to reinvent the global frame in a way that removes the concern about foreign investment?"

Two weeks later, in January 1991, *EIR* warned that "the free market 'solutions' now generally being put forward to deal with the [airline] crisis, will only make things worse, setting up what is left of the industry for foreign takeover. With U.S. airlines struggling to survive financially, the path may finally be clear to removing the present ban against domestic operations by foreign airlines, and the 25% limit on foreign ownership of American airlines."

What role Perfidious Albion?

Later in January 1991, the law was indeed changed: Foreign interests would be allowed to control up to 49% of a U.S. airline's stock, as long as the foreign interests controlled only 25% of the actual voting rights. Interestingly, one of the major proponents of the change was British Airways, which now proposes to buy a 44% interest in USAir for $750 million in cash.

U.S. airline losses have wiped out 67 years of profit
(millions $)



The USAir-British Airways deal should raise hackles, not only because of British Airways's pressing for sweeping changes in the U.S. law, but also because of its unique role in spurring the "shakeout" in the U.S. airline industry. In February 1991, British Airways cut its transatlantic fares by one-third.

It was the final blow for Pan Am and TWA, which filed bankruptcy petitions later that year. With their backs to the wall, Pan Am and TWA sought to raise cash by selling their valuable routes to, and landing rights in London, to United and American.

But British authorities refused to approve the sale until they had extracted major concessions from the United States. The British gave United and American fewer landing slots in London than Pan Am and TWA had before, while the United States was forced to agree to allow British Airways to operate between the United States and destinations in Asia and South America. No other foreign airline is allowed to serve the United States from other than its home country. The final result was that U.S. airlines could fly between London and eight U.S. cities, while British Airways could fly between 11 U.S. cities and London, plus other foreign

cities to boot.

The British also demanded at the time that the United States allow foreigners to own majority stakes in U.S. airlines.

The deal with USAir will make British Airways the first truly global airline, by providing British Airways access to the extensive USAir network inside the United States, the world's largest market. The ability to feed passengers from USAir into British Airways's overseas routes will be invaluable: British Airways will be the only airline to have feeder networks on both sides of the Atlantic.

Protests likely to fall on deaf ears

But American, Delta, and United have expressed strong opposition to the deal.

On Aug. 3, Delta charged that "the United Kingdom has repeatedly blocked Delta and other carriers which wanted to expand in the highly restricted U.S.-British markets, instead protecting British Airways from competition. . . . The US-Air-British Airways transaction must be seen for what it is: a foreign carrier cloaked in the protection of one of the most restrictive and anti-competitive international aviation regimes in the world, seeking control over a U.S. carrier in violation of our government's current law and policy."

Pointing to the veto power accorded British Airways by having four representatives on a USAir board expanded to 16 seats, and in which a super-majority of 80% must approve all major decisions, Delta argued that "British Airways will exercise control over virtually every significant business activity of USAir. . . . The Federal Aviation Act, as consistently interpreted and applied over the last 50 years, prevents a foreign air carrier from exercising control over a U.S. air carrier. Therefore, the Department of Transportation, as a matter of law, must take action to prevent consummation of this agreement."

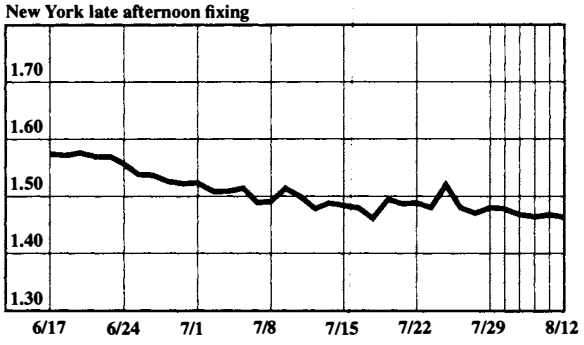
The problem is that the power of the U.S. government has been usurped by a band of free market ideologues who don't give a hoot about the smooth and safe functioning of industries. They don't even care about the intent of the law—witness how Glass-Steagall restrictions against commercial banks being involved in investment banking have been ignored. They desire to see the end of "economic anachronisms"—i.e., national governments seeking to succor and develop industries rather than abandoning them to the ravages of the free market.

Echoing Shane, U.S. Secretary of Transportation Andrew H. Card, Jr. described the proposed USAir-British Airways deal as an "innovative financial and operating agreement" offering "the promise of competitive benefits." Perhaps showing his cards too early, the secretary concluded, "The world's airline industry is clearly moving in the direction of cross-border alliances," and pledged that the deal would be reviewed on an "expedited basis."

Currency Rates

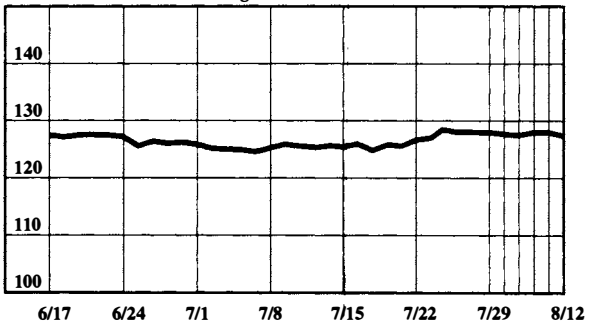
The dollar in deutschemarks

New York late afternoon fixing



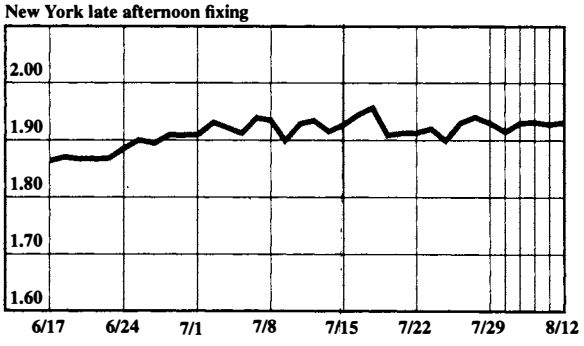
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing