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No 'soft landing' for U.S. airlines

by Anthony K. Wikrent

The crash of the U.S. airline industry, with the recent bankruptcy filings by the giants Continental, Pan American, and Eastern, demonstrates the utter bankruptcy of the "free market" deregulation which this magazine has been fighting for more than a decade. The free market "solutions" now generally being put forward to deal with the 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.

The Dec. 3 bankruptcy filing by Continental, the Jan. 8 bankruptcy filing by Pan Am, and the final dissolution of Eastern, which had operated under bankruptcy protection since March 1989, are attributed to the run-up in fuel costs since August—jet fuel reached $1.40 a gallon at one point, from only 60¢ earlier in the year—as the immediate cause. According to the Air Transport Association, the airlines use 41 million gallons of jet fuel each day, or 15 billion gallons a year. An increase in the price of oil by $1 a barrel increases the cost of a gallon of jet fuel by 3¢. For the airlines, that means $1.25 million a day, or almost $500 million a year.

The airlines have attempted to raise fares to recover their increased fuel costs, but worry about a negative impact on passenger traffic. Airline Economics chairman George James warned in October that if fares were not raised to recover higher fuel costs, the industry would suffer an operating loss of at least $2 billion in 1991, and losses of $14.5-17.2 billion in 1992.

Problems decades in the making

Beyond rises in fuel costs, analysts are admitting that the airlines have been brought to their knees by "problems decades in the making." They are referring to deregulation—originally hyped as the means to increase competition, improve service, and reduce fares. What has occurred is exactly the opposite: Eight airlines now control 90% of the market, and only three—American, United, and Delta, which account for 55%—are expected to survive; the air traffic system faces congestive failure in the next few years; and the U.S. lacks the capacity to even properly repair its fleets of aging airliners.

The airline collapse also gives the lie to a few other popular nostrums of the 1980s. Remember the whining by economists and business executives that American labor was overpaid? The three bankrupts were among the four airlines with the lowest labor costs in the industry. Continental had the lowest ratio of labor to operating cost ratio, 23.9%, with an expense of $36,424 per employee. The respective figures at Eastern were 27.7% and $39,720; and Pan Am, 28.8% and $45,536. By contrast, the expected three survivors are among the airlines with the highest labor costs—with Delta having the highest of all, paying $56,077 per employee for 40.6% of operating costs.

Or recall the incantation that high levels of debt were not harmful, but rather disciplinary tonics that would maximize value for shareholders. TWA, Continental, and Eastern were the three airlines with the largest interest payments. For the year ended June 1990, TWA paid out almost $400 million in interest, while Continental paid just under $300 million and Eastern paid about $245 million. American and United were the next two highest, with interest payments of $125-150 million, followed by Pan Am, which doled out about $120 million to its creditors. Delta had the lowest interest cost, of just under $25 million.

Foreign airlines to come in

Even United, American, and Delta are expected to bleed red ink this year, and their chances for recovery are diminished by the difficulty of securing financing in the United States. With the possible exception of Northwest, all the airlines have been basically written off. "The challenge is finding ways of financing equipment needs of those not in the financial league of American Airlines," Stuart M. Warren, a partner of the Los Angeles law firm of Warren, Clark and Sklar, told an air transport conference in December. In October, Moody's lowered the bond ratings of American and Delta. With the least wounded airlines receiving such treatment, what chance do the more critically wounded airlines have? Frank J. Costello, of the Washington law firm Zuckert, Scout, and Rasenberger, which represents major U.S. and foreign airlines, wrote in the Jan. 22 *Journal of Commerce* that Washington bureaucrats are asking, "So what's wrong with having only three national passenger airlines?"

The rumblings indicate that, rather than admit the policy of the past 20 years in the U.S. has been a failure, the Bushmen are preparing to discard the restrictions against foreign airlines operating on domestic routes and limiting foreign ownership of a U.S. airline to 25%. Jeffrey Shane, Assistant Secretary of Transportation, and previously the leading airline route negotiator at the State Department, longs 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. "The issue is," Shane told the *New York Times* on Dec. 30, 1990, "are we ever going to reinvent the global frame in a way that removes the concern about foreign investment?"

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