

POLICY BRIEF
An electronic publication of
The Allegheny Institute for Public Policy

October 12, 2001

Volume 1, Number 33

The Federal Government Has A Role In Shaping Airline Industry Future

As we see it, there are four critical issues to be resolved post September 11 events in order to first stabilize and then set the American airline industry on an upward flight path.

- Security must be uncompromisingly established system wide in a fashion that permanently restores public confidence.
- Careful, prudent financial guarantees must be provided to ensure that healthy airlines can operate for the next 24 months.
- The true financial condition of each independent airline must be determined with recognition that healthy carriers must absorb some failing airlines; assistance facilitating those mergers should be provided.
- Sound infrastructure (airports, air traffic control, security, capacity, etc.) reforms must be undertaken in a manner that internalizes the costs in order that a true equilibrium between demand for and supply of air travel services is achieved.

Security

What must be avoided in the aftermath of the terrorist attacks on New York City and Washington, DC is counter-productive blame shifting. In a perfect world it would be admitted that the terrorists themselves are responsible, and those who suffered from the heinous acts would not seek to punish financially either the airlines or the taxpayers of this country. In that perfect world the attention of the airlines and our government would be exclusively focused on discovering the failings of the current security system, and devising ironclad remedies going forward, rather than be diverted by any posturing necessary to avoid the tender mercies of trial lawyers.

The suggestion that the military or law enforcement take over airport security, either temporarily or permanently, is not necessarily a bad one. We estimate the cost of a military security force, using active duty troops, to be approximately \$1 billion per year. Given a conservatively estimated passenger count of 450 million for the next several years, the cost could be captured by a fee of less than \$3 dollars per ticket. Now, upgrading to a private security force of paramilitary status might cost as much as \$2 billion per year. But, again, that would translate into an additional \$4.50 per ticket. It appears highly feasible, and it is essential, that the cost of improving air travel security to acceptable standards be internalized; that is, entirely borne by airline passengers themselves.

Financial Guarantees

There is no question that the airline industry has been deeply shaken by the loss of passenger volume following September 11. What's more, there was a period of approximately a week, when no travel was allowed whatsoever, and airlines were in the unique position of having to refund hundreds of millions of dollars to passengers whose travel was disrupted. Coming on top of an economic downturn that had

already produced a significant decline in passenger traffic, the terrorist acts pushed the industry to the brink and spelled the death of at least one, and perhaps more airlines.

It is therefore proper for the federal government to step up and back airline credit while cautioning financiers that any reckless lending will not be rescued. Loan guarantees should be made available only after an airline has exhausted its own cash, rather than merely shift risk to the government. In other words, airlines should not be able to borrow at government-risk rates in order to conserve their own cash.

Industry Analysis

It is essential that any comprehensive plan start from a realistic appraisal of the financial condition of each independent airline. Nothing could be worse than using tax dollars merely to prolong the life of failing airlines and, in the process, weaken sound airlines. What should and can emerge from a properly researched, developed and implemented effort is a financially sound and competitive airline industry. That requires some brutal honesty in identifying those airlines that simply will not make it on their own, and then carefully partnering them with healthy airlines.

This very process—called consolidation—was attempted last year by the industry, but frustrated and effectively halted by Congress and regulators. Now there is no longer the luxury of standing back and letting the market work its course, unless Congress is willing to tolerate a painful dislocation not seen since the decline of the American steel industry. Calls have already begun from Congress for aid to workers furloughed or laid off. In that light, critical husbanding of “bailout” funds is essential.

Bolstering Infrastructure

There has been no lack of harsh criticism of the FAA and DOT in the wake of September 11. And, the final phase of the restructuring of our airline industry is a complete reformation of its infrastructure. We believe the drumbeat of complaints regarding poor service by Congress and regulators helped create a climate in which convenience took a front seat to safety. We pointed out repeatedly that complaints regarding delays, cancellations and lost baggage were infinitesimally miniscule over the past two years, a period during which the airline industry demonstrated a public safety record equaled by no other transportation sector.

Congress should ensure that any plan emphasizes the primary, overarching mission of the airlines: delivering passengers to their destination safely. We recommend privatizing air traffic control, with any additional costs resulting captured, like our security costs above, by a per-ticket surcharge. We argue that consolidation of the present number of airlines into a smaller, more profitable and competitive number will go a long way toward addressing the air traffic infrastructure’s previous capacity problems.

Paul Stiffemire, Senior Policy Analyst

Policy Briefs may be reprinted as long as proper attribution is given.

Allegheny Institute for Public Policy
835 Western Avenue* Suite 300* Pittsburgh PA 15233
Phone (412) 231-6020 * Fax (412) 231-6037
E-mail: aipp@alleghenyinstitute.org