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Government Loan Guarantees Would 'Federalize' Failing Airlines

The good news is that, ranked according to the market value of their stock, seven of the world's top ten airlines are American. In fact, ten of the top fifteen airlines are American. The bad news is, USAirways is not among them. One must slide all the way to number 17 to find this region's largest private sector employer.

That says a great deal about how Wall Street, or the "smart money," views USAirways' prospects. Delta and American remain investor favorites because they are perceived as "survivors." Extensive domestic and international route systems, established relationships with key overseas carriers, and solid balance sheets are seen as guaranteeing that they will be around when the dust settles. Conversely, USAirways has been shuffled to the bottom of the deck so to speak because the smart money is betting the airline is far less likely to survive the shakeout.

Airlines' Market Values as of 1/1/01		(Millions)			
1	Southwest (US)	$14,142.7	6	British Airways (England)	$3,105.3
2	Ryanair (Ireland)	4,555.0	7	Continental (US)	1,452.6
3	Japan Airlines (Japan)	4,306.9	8	SkyWest (US)	1,444.3
4	Delta (US)	3,604.8	9	Northwest (US)	1,339.2
5	American (US)	3,445.4	10	Atlantic Coast (US)	1,022.7
17	**USAirways (US)**	**$431.9**			

Southwest and Ryanair, the US and Europe's largest discount airlines, account for about 43% of the total market value of the airline industry. Between them Southwest and Ryanair have less than 70 percent of the revenues of USAirways, and fully 17,000 fewer employees. But Ryanair and Southwest have earned a combined $692 million the past twelve months, while USAirways has lost more than $1.1 billion; and the market judges the Irish and American enterprises to be the future of the airline industry while USAirways is the past. Savvy investors realize that the days of airlines being able to hide their operating inefficiencies by gouging the public along protected routes are over. Price competition and ruthless efficiency are fast becoming the harsh realities of the industry today, and investors will provide capital only to those airlines they perceive have the ability to grow, and grow profitably, in such an environment. Big isn't better. Profitability and sustainable competitive advantage are.

USAirways' chairman Stephen Wolf's recent assertion that he has no plans to ask for government loan guarantees can be taken one of several ways. Perhaps the airline's downsizing strategy is well underway and there is no need for further debt. Or, Wolf has concluded that, even with government guarantees, no further debt can be sold. A third possibility is that the recalcitrance of USAirways' unions has convinced management that bankruptcy is inevitable if the kind of restructuring, cost cutting and debt-shedding that is needed to save the airline is to occur.

Continental Airlines, which came close to bankruptcy before management and labor totally overhauled the airline's structure, and Northwest Airlines, which used bankruptcy to right itself, remain among the top ten airlines in the world as valued by investors. Although not painless, it can be done, and without government loan guarantees.

The issue of federal guarantees is an important one. We cannot justify putting the taxpayer on the hook to subsidize struggling businesses, whether airlines or professional sports franchises. The AAA credit rating the magical application of federal guarantees provides will enable even failing airlines to go on a new debt binge. Those new loans would essentially carry no risk, but they would place current creditors in an even worse position than they are now. In the event of default, it is likely that only creditors able to put their loans back to the government—to the taxpayer—would be repaid in full. Faced with the realization that their weaker competitors are availing themselves of government-subsidized loans, even the strongest airlines may feel compelled to follow suit merely as a defensive measure. Thus, a wholesale granting of federally backed loans could undermine, rather than strengthen, the long-term financial health of the airline industry.

Absent a remarkable turnaround several airlines will likely exhaust their working capital this year, and no longer be able to meet their obligations. Recognizing this, Wall Street has reduced its exposure to the industry—airline stocks have declined some $21 billion overall in the last year. Recently, however, stock prices of the strongest competitors have begun to rebound. The real question is why taxpayers should be forced to "invest" in the weakest players in the industry; for, only those airlines that can't survive without government-backed debt will subject themselves to the strings Congress has placed on the guarantees. It would be preferable to force these weaker competitors into bankruptcy, and allow them to reorganize or liquidate without subjecting taxpayers to further risk

We understand that Congress would like to save jobs that will be lost in the event of airline industry consolidation. But it is time the government recognizes what Wall Street obviously does: consolidation is inevitable. Given the excess capacity in the industry and the growing importance of discount carriers, there is simply no way the market will sustain every US airline now in business at its current size and cost structure. Better to let the free market, and the existing bankruptcy framework, sort things out so that true equilibrium can emerge. Otherwise, the federal government—and taxpayers—may wind up owning a fleet of failed airlines; and that is one "federalization" we must avoid.

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