

Remarks of Carol Hallett President and CEO Air Transport Association to the International Aviation Club of Washington

Thank you, Richard, for that warm introduction.

Before beginning, I would like to recognize our distinguished guests...IATA Director General Giovanni Bisignani and retiring Director General Pierre Jeannot. It is an honor to have you join us today.

When I accepted the invitation to address this distinguished audience, I had, of course, intended to focus my remarks on predictable international aviation issues — the state of bilateral negotiations; prospects for multilateral relations; international competition and cooperation; and the future for multinational ownership and control.

With your indulgence, however, I want to focus on two more fundamental and gravely serious questions:

First: Is the United States airline industry headed for chaos and failure, and if so, what are the implications for the broader economy? And, second: What can be done to correct the situation?

After you have heard my comments, I want to ask each of you to work with us to “sound the warning” and to get the attention of governmental decision-makers before irreparable, widespread economic damage results. So, let me start with a few facts:

- The total impact of civil aviation in the United States has been measured at a full nine percent of the gross domestic product.

That’s over \$900 billion and 11 million jobs, with commercial aviation generating — directly, indirectly, and through induced spending and hiring — \$800 billion of that figure.

- Last year, those same airlines lost \$7.7 billion — despite federal compensation for the September system shutdown and its related losses.

In the first quarter of this year, those losses continued to mount by another \$2.4 billion. Today, the industry is carrying an on-balance-sheet debt burden of nearly \$110 billion, with debt-to-capital ratios more than double those of other industries. And the “hoped-for” return to profitability in 03 looks increasingly unlikely, with 04 offering the first ray of hope. Every new loss — every new tax or fee and every customer driven to seek an alternative to air transportation — is adding to this unsustainable debt burden, as the industry borrows more just to continue operating.

- Over the last fifty years, the industry’s net profit margin is one-half percent, compared to the average for all industries of approximately six percent.

The losses expected in 2002 will push that margin still lower.





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Keep in mind....

- Industry revenues are off a solid 20 percent from where they were a year earlier — and that revenue shows little sign of soon returning.

The bottom line is this: The economic underpinnings of the airline industry are highly fragile — even in the best of times. The industry has historically operated on a precarious balance of profit and loss, but has always managed to move from one crisis to the next and, in the process, to drive a huge sector of the economy.

There are some ominous signs that government decisions following the September 11 attack on the United States — and related costs the industry has had to sustain — may have tipped the scale so far out of balance that we cannot manage our way back to equilibrium unless government policies are modified. And that is the message I hope you will help us get across.

Now let me be clear about what is going on.

First, it must be acknowledged that, for virtually its entire history, the airline industry has suffered from an inability to keep wages in line with productivity. More than any other single factor, this has left the industry teetering chronically on that fine balance point between success and failure. It is a situation that is unhealthy for the airlines, for their employees, and for the economy in general.

Now, it is no secret that we believe this chronic malaise has its roots in the Railway Labor Act of 1926 — and that the RLA needs to be modified to correct this structural problem. However, I do not want to dwell on this subject today. As important as it is, this chronic condition is just that — an affliction that has plagued the industry for decades, but one that has been managed around. And while it has left the industry vulnerable to failure and needs to be corrected, it is not what has now placed the industry on the “critical list” and threatens the broader economy.

So...what is the cause?

Well, that is obviously a complex question. But it is absolutely clear that much of the cause traces to governmental policy decisions that have imposed higher taxes, witnessed dramatically increased industry costs, and depleted industry revenues from the reduction of mail and freight. And then there are the profiteering efforts of insurers.

Interestingly, the current analysts’ consensus projection of a \$4.7 billion industry loss in ’02 is nearly equaled by the total estimated increases in taxes, security-related costs, insurance rates, and the revenue losses from other governmental policy decisions. In the aggregate, these total close to \$4.2 billion by one estimate, which — versus the projected \$4.7 billion loss — would put us in the range of breaking even. On top of these costs, the airlines are also feeling the effect of what has come to be known as the passenger “hassle factor” — those passengers who simply avoid trips they would otherwise have taken, or find alternatives to air travel, because of the difficulty and uncertainty in accessing the aviation system.

Particularly because of the importance of business travel to the airlines’ bottom line, and the acute sensitivity of business travelers to wasted time, this problem is severe. And while it is very real, it is of course difficult to measure.

One of the best estimates of the impact of the “hassle factor” was developed by Leo Mullin, using





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Delta's revenue shortfalls, and comparing the first quarters of 2001 and 2002, and then attributing a share of that shortfall — based on customer survey information — to the nearly 27 percent of passengers who identify the “hassle factor” as their reason for not flying. Extrapolated industry-wide, this analysis puts the revenue impact at negative \$3.8 billion. While I would not allege that this or any analysis is perfect, it does present a compelling argument that the currently expected industry loss of \$4.7 billion could actually be a \$3.3 billion profit — if not for the impact of the post-9/11 government policy decisions.

Now, I want to be very clear. We do not make this point to criticize the government or government decision-makers. And my remarks should not be construed in any way as running counter to the imperative for the new system of aviation security. Rather, I raise this point to draw attention to the very serious negative consequences that can flow from even the most well-intentioned actions by government.

What happens, of course, is that in isolation a decision is made to pass “this or that” cost on to the air traveler... such as ticket taxes, segment fees, passenger facility charges, security surcharges, international departure and arrival taxes, customs fees, cargo waybill taxes, INS fees, etc. Each is viewed as small and benign and each is no doubt well intentioned. The combined result, however, is anything but benign.

These consumption taxes, with the applicable passenger facility charge on a low-priced, \$100 roundtrip ticket, now exceed 44 percent. On a \$200 ticket they are over 25 percent; and on a \$300 ticket, over 19 percent. Those figures exceed even the intentionally high federal tax rate of 18.2 percent on cigarettes — imposed, in part, to discourage consumption. In fact, airline tax rates appear to be among the highest federal consumption taxes of all industries — and they are nearly triple what they were in 1991.

Under present conditions, of course, the airlines have no ability to pass these costs through to the consumer. Rather, these taxes simply decrease the revenues derived by airlines to run their operations and, at the present time, require the airlines to accumulate more and more debt to continue operating. That ballooning debt will impede a healthy, growing industry for years to come.

Prior to September 2001, the airlines planned to acquire 283 new aircraft in 02, with options for 186 additional aircraft. These numbers have already been cut by 30 percent. Unfortunately, with hundreds of aircraft sitting idle in the desert and \$110 billion in debt to be serviced, placing new orders is virtually out of the question for many carriers. And projections of a 50 percent or greater decline in orders from peak years to the foreseeable future seem likely.

Similarly, the acquisition and improvement of new systems and facilities benefiting the traveling public will be curtailed. And, with those cutbacks, jobs in aviation and in the broader economy — all that economic activity the airlines generate — will continue to stagnate. Service to smaller and medium-sized communities is, of course, also in continuing peril.

Without pricing power, but faced with mounting costs — and particularly government-imposed costs, which pass right to the bottom line without any possible management control — airlines are scrupulously careful in trying to maximize what revenues they can derive. This always leaves more marginal markets in danger of losing service. The impact, once again — lost jobs and economic decline.





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I believe that, unfortunately, the facts are clear.

The answer to my first question is that the airline industry remains in grave danger — and with it the millions of jobs and billions of dollars that it pumps into the United States and world economies.

As to the second question: What can be done to correct the situation, the answer flows from what we know is wrong.

First, we need to change the way government thinks about aviation security and the idea that travelers or shippers should pay “user fees” to have themselves protected from terrorism. The fact is that for decades U.S. aviation has been the preferred target of terrorists as a surrogate for attacking the United States. Tragically, last September, that surrogate became an actual weapon for a direct attack.

After all, we do not charge a “user fee” for support of the military in the war against terrorism, nor for the work of the intelligence community in gathering vital information. Nor, do we charge a security fee to protect our citizens from terrorists when they ride the Metro, visit a museum or go to work in an office building. We should expect the government to allocate the appropriate resources to defend all of us against these threats.

Second, we need to halt the excessive taxation of the airline industry. The facts are clear. This industry generates vast amounts of wealth for society. Excessive taxation — particularly at a time when the industry lacks any ability to pass on these costs — runs the very real risk of destroying the circulatory system of our economy at the very time we need it to be at optimal performance.

Third, we need to really come to grips with the “hassle factor” to get those business travelers back in the air. We need to focus our national resources on a system that provides both excellent security and excellent customer service. In doing so, we need to make the best possible use of technology, including information technology.

Fourth, we need to eliminate the imposition of unfunded mandates on the industry. Security costs for protection against terrorism must not be masked with other labels and passed on to the industry.

Fifth, we need the continued cooperation of the government in the provision of War Risk insurance — until such time that real stability returns to the marketplace. The profiteering suggestions of some, seeking to force the industry into confiscatory arrangements for phony insurance, must be rejected!

Finally, we need to do everything possible to support the creation of the Department of Homeland Security and to consolidate its financing and controls. The President’s proposal to establish this Cabinet-level department rightfully recognizes aviation security as a federal governmental responsibility and a subset of national security. And as such, we believe that general tax revenues should finance these aviation security functions.

This is a historic opportunity to truly focus the resources of government to confront the crisis of our era. And we will be judged by history — just as prior generations have been judged — as to how we deal with this crisis. Certainly, there will be critics and skeptics...they will always be with us.

More importantly though, as past mobilizations in times of war have ultimately brought victory, we know this can be done — and this must be done! The stakes are high indeed. And what could be more serious than the safety of society, and the strength of America’s economic system that supports it?





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This is the reason that I again ask you to work with us in educating decision-makers about the very real and immediate economic challenges confronting the aviation industry, as well as the potential national and global consequences if we fail to act in a timely manner.

And ladies and gentlemen, the time to act is now.

Thank you.

