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Before the House Committee on Small Business

Regarding "Grounded: *How the Air Transportation Crisis is Hurting Entrepreneurs and the Economy*"

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Madam Chairwoman and Members of the Committee, thank you for requesting that the Business Travel Coalition (BTC) appear before you to represent the interests of the business travel community on the subject of a U.S. commercial aviation industry in full-blown crisis and heading toward a catastrophe, and the impacts on entrepreneurs, small and mid-size communities, the economy and the American way of life.

I. Introduction

Let's start with a simple equation, without numbers or fancy formulas:

Record-high Fuel Prices +Major U.S. Airlines + Weakened U.S. Economy = A Catastrophe

The catastrophe would arise if one or more large U.S. airlines failed, something that experts say is likely if oil remains at $130 per barrel, and a certainty if oil climbs to the stratospheric levels that some industry experts have forecast (a top energy analyst at the investment firm Goldman Sachs is predicting $200/barrel oil within 24 months). Here is a sobering assessment from Ray Neidl, a respected airline analyst with Calyon Securities: "This is worse than 9/11. After the 2001 terror attacks, at least you knew passengers were coming back. Oil at $130 is unsolvable." This paper will explain how catastrophic multiple liquidations of legacy U.S. airlines would also have devastating impacts on many facets of the U.S. economy.

Airlines are paying about twice as much for fuel as they were just a year ago, and roughly four times as much as in 2000. Fuel as a share of total airline operating expense has jumped from about 15% in 2000 to more than 40% today, and is still climbing. It has become the largest single airline expense, now larger than either labor or aircraft leases. Roger King of CreditSights, a provider of credit research, summed up the situation: "The race is on to see if airlines can raise fares high enough to cover the fuel bills before they run out of cash" (*Wall Street Journal*, May 22, 2008). Of course, what makes this race an uphill climb is that oil prices continue to rise to previously unthinkable levels – and pushing air travel far beyond affordability for the vast majority of the traveling public.

Multiple U.S. airlines are poised to lose the race for survival, some perhaps before the end of 2008. Already-depleted cash reserves are dwindling fast, and unless the fuel crisis lessens, airlines face not the now-familiar protracted restructuring in bankruptcy, but outright and immediate extinction.

Why no Chapter 11? In the past two cycles of crisis, the early 1990s and the early years of this decade, airlines entered bankruptcy and continued operating. To the public, it seemed like business as usual. This time it's different because the credit crisis has dried up the interim, or "debtor in possession," financing that banks and investors used to provide to carriers that went into Chapter 11.

Without access to more cash, five smaller U.S. airlines – Aloha, ATA, Champion, Eos, and Skybus – have stopped operating since March. After Aloha ended service, Hawaii's largest wholesale bakery, in Honolulu, actually had to fly loaves and buns to the mainland on Delta, then back to Maui, Kauai, and the other islands. ATA's abrupt shutdown stranded thousands of customers, and the Hawaii Tourism Authority generously stepped in and spent about $500,000 to buy return fares on other airlines for more than 2,200 visitors who had worthless ATA tickets. The impact of major airlines failing would be a large multiple of this devastation.

In this report, we will present the probable impacts of the failure of one or more major U.S. airlines on the national and global economies. It would be not possible, fair or useful to predict which airlines might succumb; rather, it will be more instructive to present the full range of effects. Nine are most important: **1)** loss of tens of thousands of good jobs at airlines; **2)** indirect effects of this job loss on the economies of host communities; **3)** elimination of business for airline suppliers; **4)** decline in travel and tourism; **5)** disruption to supply chains from loss of cargo services; **6)** decline in overall business activity and economic development; **7)** loss of tax revenues; **8)** increase in public outlays for social services; and **9)** weakened U.S. competitiveness.

II. An Ugly Reality

At first glance, you might think that an airline failure would be no big deal – surely the impact would be limited and local, felt in that carrier's hubs and a few of its major markets, and that other airlines would pick up the slack. Airline employees would lose their jobs, local airports some rent, and the economy would barely notice.

Reality, however, would be much different, especially if multiple carriers failed in a short period of time. It would be the catastrophe in the equation above because airline networks are an integral part of the transport grid that supports the U.S. economy. It has become easy and a staple of stand-up comedy to complain about airlines, but they are absolutely essential to the well-being of our society. The failure of a single large airline with 15% market share would have huge local effects and substantial impact nationally, but multiple failures would be catastrophic and as impactful and demoralizing to the nation as a terrorist attack.

We usually associate the word "grid" with electricity supply, and it's a useful analogy here. In the U.S., we take reliable electric power for granted. We flip a switch and we get what we want. But once in awhile the power fails, and we quickly understand our dependence on the electricity grid. Power failures are so disruptive that years later we remember where we were when the lights went out, when our lives quickly and sometimes frighteningly ground to a halt.

Though few of us board a plane every day, we depend on the air transport grid. Aviation is the primary source of intercity transportation in the U.S., and it supports our prosperity and way of life. When we have business to conduct anywhere in the country or the world, or when holidays and vacations approach, we expect air service will take us where we want or need to go. We take for granted that supermarkets and restaurants will have their shelves and menus stocked with fresh food flown in from distant parts of the country and the world. We know that airlines will get our packages and mail to where we need them to go, often overnight.

Multiple major airline failures caused by unsustainable oil prices would tear a vast hole in the grid, and would have devastating effects on the quality of our lives. The hole would not be localized, but broad and gaping, spreading across the entire nation and around the world. Airlines move people, but also high-value, time-sensitive or perishable cargo. Failure of one large U.S. airline would disrupt the travel of 200,000 to 300,000 passengers per day and thousands of tons of goods. The almost-full planes of remaining airlines would not be able to absorb much of those volumes. Failure of multiple airlines would paralyze the country and our way of life, leaving us less productive, more isolated, less happy and more vulnerable.

III. What Would Happen?

If a single major airline failed, tens of thousands of well-paid, skilled airline employees would instantly be out of work, and the loss of their paychecks, those of workers that directly supply and support the airline and those of employees at businesses where laid-off workers shop would cause massive negative economic and social impacts. With multiple failures, the number could easily exceed 100,000. (For comparison, Enron, the nation's largest-dollar bankruptcy, led to the loss of 21,000 direct jobs.)

The indirect impacts would push hundreds of thousands of others who depend on the airline system through the hole in the grid – hotel maids in New York City, waiters and waitresses in Harrisburg, travel agents in Grand Rapids, construction workers in Miami, florists in suburban Denver, and many others.

VI. The Impacts

A. Direct Employment

Each of the seven largest U.S. airlines employs between 30,000 and 75,000, with an average of 44,000 workers across the nation and overseas (U.S. Department of Transportation, Bureau of Transport Statistics, March 2008). For 2007, salaries, wages and benefits for these 7 companies totaled more than $26 billion, ranging from $2.3 to $6.7 billion. The collapse of one of these airlines would thus cause large job losses, and multiple failures could lead to job losses above 100,000. In most cases, these well-compensated workforces are concentrated in each airline's headquarters city and hubs, and a small number of other places. Some of the city totals are large. For example, Delta employs about 21,000 in Atlanta, United's Chicago workforce is about 15,000, and 18,000 work for Continental in Houston. However, many well-compensated pilots live in small and mid-size cities and commute to the larger airports where they join the aircraft they are going to fly,

B. Communities and Indirect Jobs

To accurately assess local economic effect, indirect losses must be added to the loss of direct airline jobs. Economists who specialize in regional development have for many years built and refined models to estimate local impact using variants of the multiplier effect, which combines the value of direct employment, the value of employee spending in the community and a firm's purchases from nearby suppliers (discussed below). This indirect impact would be large, because airline employees earn – and thus spend – significantly more than the U.S. average. Total per-employee compensation (wages and benefits) at Continental, for example, was more than $85,000 in 2007; although pilot and senior-management pay skew this upward, even an adjusted per capita number would be far above the 2006 U.S. median household income of $48,200.

Although measuring methods vary and the size of the multiplier effect ranges by market and over time, each airline job creates large numbers of indirect local jobs offered by local retailers, service providers, construction, government, and elsewhere. Airlines, their employees and passengers are the drivers of economic activity at airports, which in turn support economic activity. For example, a recent study of DFW Airport in Texas estimated that it annually generated $16.6 billion in total economic output and 305,000 total jobs (data from 2005) – far more than the direct jobs that airlines provide Likewise, a 2002 study at Atlanta's airport estimated job creation at more than 640,000. Los Angeles World Airports calculated that while 59,000 people work at LAX, its aggregate employment totals than 400,000, with economic impact of $61 billion annually. But it's not just big airports – in many smaller communities, the local airport is vital to the local economy and to attracting business and jobs.

C. Purchases from Suppliers

Among major carriers, typically 50%-60% of total operating expenses goes to companies and public entities that provide the range of products and services a large airline uses: aircraft, jet fuel, landing fees, advertising and promotion, construction services, software, maintenance supplies, and many others. Both Boeing and Airbus recently noted the likely impact of the upward fuel spike on future aircraft orders, referring to reductions among surviving companies, not the impact of a failure, which would be even greater. In the public sector, failure would have far-reaching effects on hub-airport operators, up to and including default on bonds sold to finance airport expansion or renovation. In an effort to be good corporate citizens, many airlines have committed significant shares of their purchases to minority and women-owned (MWBE) firms, and these companies would also suffer in a collapse.

D. Tourism

Tourism has become a strong engine of economic development. Airline failures would devastate this sector, from large metropolitan areas to small resort towns, coast to coast, and abroad. In general, just more than half the passengers on U.S. airlines are traveling for leisure reasons, whether for pure vacation, to visit friends and relatives or for other non-business purposes. Moreover, business travel expenditure is rightly classified as part of tourism, and many hotels, car-rental firms, restaurants, and related service providers that cater to independent business travelers, as well as meeting and convention attendees, must be included.

Whether traveling for business or leisure, passengers stay in hotels or other accommodations, eat in restaurants, use taxis or rental cars for ground transportation and purchase a variety of other services away from home. The *Travel Industry Association* estimates (at its website *poweroftravel.org*) that total 2006 U.S. spending for travel was $700 billion and generated $110 billion in tax revenue at all levels of government (an effective tax rate of almost 16%).

These totals include automobile-based travel, but air transport is used for 55% of one-way trips longer than 750 miles, rising to 82% of trips longer than 1500 one-way miles (Department of Transportation, Bureau of Transport Statistics). And some vacation choices and destinations depend heavily or entirely on airlines such as cruise lines and the states of Hawaii and Alaska. It's also important to remember that as manufacturing jobs have declined, communities nationwide have turned to tourism to fill the gap.

The geographical impact of airline failures would be locally severe. United Airlines, for example, has historically provided the majority of "lift" into Hawaii, and has been indispensable to Colorado tourism via its Denver hub. Delta and US Airways have long been important to tourism throughout the Southeast. American delivers tens of thousands of vacationers to South Florida and other parts of the state. The closure of US Airways' hub in Las Vegas would instantly hurt that city. Every community that depends on air-based tourism would feel the effect of an airline industry collapse.

E. Logistics and Supply-chain Management

Although we tend to think of UPS and FedEx as the expert links in just-in-time supply-chain management, all major passenger airlines carry large amounts of cargo, ranging from high-value parts used in U.S. manufacturing to designer clothing to cut flowers to the fresh salmon that you enjoy at your favorite restaurant. Some U.S. airlines also have mail contracts with the U.S. Postal Service, and a few even subcontract with express operators to carry overflow. Airline failures would disrupt supply chains and raise prices for shipping and postage.

If we could "walk down the aisle" of an aircraft belly, we would see a remarkable range of products and materials, for example:

- Fresh and frozen seafood from Chile, Southeast Asia and Europe
- High-value tropical fruit from Hawaii and Asia; and temperate-zone fruit from Argentina and Chile
- Tulips from the Netherlands, flowers from Hawaii and roses from Ecuador and Colombia
- Ingredients for pharmaceuticals shipped to Puerto Rico, and finished product shipped back to North America
- Lightweight vehicle components made in Japan and flown to assembly plants in the U.S.
- Semiconductors manufactured in the Boston area shipped to China, and finished product returned to the U.S.
- Designer fashions flown from garment makers in India and China not only to Fifth Avenue and Rodeo Drive, but even to local Target stores
- Consumer electronics, from music players to made-to-order PCs
- Legal papers, currency and other original documents
- Mail from the U.S. Postal Service

Because we don't see the supply chain, we tend to take efficient logistics for granted. But air cargo is not something only a few use – it benefits everyone. We expect the florist to have fresh flowers, the chef to prepare seafood from far-off waters, the supermarket to stock ripe berries in winter, the new PC to arrive in days, the mail to arrive on time. We expect these things at affordable prices. All these and more depend on passenger aircraft.

F. Business Activity

Airlines are catalysts to national and global economic expansion. What we commonly call business travel is really the flow of human capital, which precedes or facilitates other flows, such as information and investment in the private sector, nonprofit organizations, and public institutions. Because of this catalytic role, an airline failure would disrupt this activity. Such disruption would range from mild to severe – imagine a time-sensitive large business transaction where the delay of even a few days would render unviable a deal that had been in the works for months. These effects would obviously be greater in hubs and major markets of the failed carriers.

G. Tax Revenues

Airlines and their well-paid employees contribute significantly to many tax coffers. Instant unemployment of thousands of workers and the loss of excise, use and other airline-paid taxes would be bad news for state and local governments already struggling with declining revenues from the softening U.S. economy. Here, too, the impact would be greatest in the failed carrier's headquarters city, its hubs and major markets and facilities. American Airlines, for example, is the largest private employer in Oklahoma, thanks to the almost 7,000 employees at its main overhaul base in Tulsa. In addition, as noted, visitor spending in destinations contributes significant revenues through hotel, use, and sales taxes. Furthermore, these revenues are often earmarked for city projects – stadiums, parks, police, and of course, tourism promotion.

H. Government Outlays

Concurrent with a decline in tax revenues, the impacted employees (and, in some jurisdictions, businesses) would immediately place demands on public funds, through unemployment compensation, retraining programs (where offered), and public hospitals and health-care resources. And these would be in the very cities and states least able to afford the expense because of the loss of tax revenues. Furthermore, significant job loss inevitably produces social dysfunction like rising crime, which in turn costs governments and taxpayers. Assuming the customary duration (26 weeks) and average benefit, unemployment relief for 100,000 jobless would cost almost $800 million.

I. U.S. Competitiveness

Most U.S. airline growth in the past decade has been in international markets, and today up to 40% of major carriers' operations are to and from foreign destinations. Thus, an airline failure would have economic and political implications overseas. One national priority is improving America's competitiveness in the global travel industry. At its heart is the effort to compete for a greater share of international visitors, who according to the U.S. Department of Commerce, directly spend $103 billion annually in the United States. More than undermining this goal, multiple U.S. airline failures would lead to a huge reduction in this spending, bringing an enormous negative financial impact. After September 11, international arrivals to the U.S. declined 17%. Another drop of this size would lead to a direct financial hit of over $17 billion annually from international travelers alone. Our increased isolation would damage national security, public diplomacy and America's image abroad.

V. Conclusion

Oil at $130 per barrel or more is unsustainable across many industries, and will be especially traumatic for airlines, which are critical to Americans' personal freedom and economic well being. The impact of unsustainable oil prices goes far beyond the airlines charging $2 for a can of Coke or $15 for a checked bag – two consumer annoyances that will have little impact on the airlines' prospects for survival and should not distract anyone from the catastrophe that is looming on the near horizon.

The equation at the beginning of this paper is not hyperbole. Left unchecked, these high prices will bring catastrophe.

To recap, the impacts that would arise from failures of major airlines are:

- The end of tens of thousands of good jobs at airlines
- Indirect negative effects of this job loss on the economies of host communities
- Loss of business at airline suppliers
- Sharp declines in travel and tourism in destinations
- Disruption to supply chains from loss of cargo services, leading to unavailability of or higher prices for a range of goods
- Declines in overall business activity and economic development
- Loss of tax revenues
- Increase in public outlays for social services
- Weakened U.S. competitiveness

Taken together, these effects would be devastating and widespread, with disproportionate effect in key employment centers and destinations reliant on air travel. This burden would further weaken a domestic economy coping with the prospects if not the reality of recession.

Given the precarious state of the domestic airline industry, multiple failures of major U.S. airlines are not a remote prospect. Even without failures, however, fuel-driven network retrenchment is already beginning to impact passengers and communities across the country. Thirty communities have already lost air service entirely in the past year. American, Continental, and United have all announced they will soon shrink by 10-15%, and others will surely follow. If oil remains at record prices, and fares rise to the levels they must, we will see a decline in air travel for the first time in many years, with impacts on travel and tourism businesses and many other companies.

Indeed, just last week at the Merrill Lynch transportation conference, Southwest Airlines chairman and CEO Gary Kelly made the point, according to the Dallas Morning News, that: "The carrier is going to be aggressive about winnowing out routes that aren't making money, perhaps hundreds at a time, he said. 'Unlike the previous 36-year history for Southwest where we were continuing to grow the route system, here we're going in and we're trimming out continuously flights that we don't believe will be successful with $135 crude oil,'" he [Kelly] said.

Herb Kelleher, the founder and former chairman Southwest Airlines, recently said in light of the fuel crisis, flying could become something that only business travelers or the affluent can afford, much as it was in the 1950s and 60s. "You may see a lot less air service across the United States, and that's really a shame," Kelleher said. "We are heading back in that direction." The easy, inexpensive mobility we have long taken for granted will begin to disappear, and that would be the ultimate catastrophe for our economy and our personal lives.

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