S. HRG. 107–1124

AIRLINES VIABILITY IN THE CURRENT ECONOMIC CLIMATE

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

OCTOBER 2, 2002

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

92–436 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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AIRLINES VIABILITY IN THE CURRENT ECONOMIC CLIMATE

WEDNESDAY, OCTOBER 2, 2002

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m. in room SR–253, Russell Senate Office Building, Hon. John D. Rockefeller IV, presiding.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Good morning, everyone. I welcome the witnesses, and I also offer apology, a very sincere apology, because this is a profoundly serious subject, and that is that we have a special briefing on Iraq in the Intelligence Committee at 9:30 and I cannot miss that. I do not want to miss this. I have to miss one, and so I apologize to you. We have plenty of people who are here who can do this, and my people are here, and I will be informed of everything that went on.

A couple of points, and that is, after September 11th this Congress, really in the first action we took passed a $15 billion direct Federal aid and loan guarantee package, and many people have wanted that and not many have gotten it. You did. It has cost about $5.8 billion to fund the Transportation Security Administration this year, more than even the highest estimates of what the airlines will spend. This represents for us overwhelming deficits, and a massive amount of expenditure.

A year later, the airline situation remains very, very bleak. I fully understand that. Some predict airline losses as high as $7 billion this year. I am going to be meeting with another airline CEO, not present here, later this afternoon. Almost 100,000 airline employees are out of work. That parallels what has happened very recently in the steel industry.

There have been several high profile bankruptcies. Some of you who are usually more optimistic in your expressions have not been so in recent months, and there is a reason for that. There are rumors of other bankruptcies. This is felt very strongly in communities like West Virginia and Montana and other places where recent cutbacks threaten our vitality and our growth, so we feel it and all States are suffering tremendously. We understand that the airlines are in trouble. That is not in dispute, and we recognize their importance throughout the country.

We simply cannot help every troubled industry, nevertheless. I do not believe we can do that even if we want to. Steel and telecommunications are in trouble. State governments, as I indicated, are in severe trouble. The Federal budget is in trouble. In this environment, it is very difficult to justify picking out one industry which is also in trouble and say we are going to do you, but we cannot do the rest of you, and all of this less than 1 year after the last relief package, which others did not receive, was passed.

We can look for ways to help, however, but we need to separate security issues like war risk insurance, mail and security costs, from the basic systemic problems that predate the attacks. Those problems cannot be solved by Congress. Last week, before the House Aviation Subcommittee, the airlines acknowledged that fact, but it bears repeating here.

On security costs, I think the mix between Federal and airline responsibility has been pretty good, from my point of view, at least. Last year, airlines were responsible for all aviation security costs. Now, with increases in aviation security, the Federal Government pays more than half. I certainly would not support eliminating the airlines' share, or getting rid of security fees, nor would I favor reducing the Federal participation. If the airlines want to discuss specific areas in which the interplay between Federal and airline responsibilities needs to be reexamined, I am more than willing to listen and to act.

The Committee has already addressed war risk insurance and mail, you know that. We have done that in a way which I think is favorable to you. There may be other areas where we can help, and I am eager to hear the witnesses' testimony today.

I had not planned on doing a lot of opening statements, but I understand that there are some who do not like my plan, so if you have a short opening statement you want to make, please do so.

[The prepared statement of Senator Rockefeller follows:]

PREPARED STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

The last two years have been trying ones for our nation's aviation industry. On September 10th, 2001, it was already clear that our airlines were in trouble. But no one could have imagined what the nation and the aviation industry were about to face.

After September 11th and the unprecedented decision to bring air traffic to a halt, there was a real danger that, without our help, the attacks would force the industry into bankruptcy. This Congress—and this Committee—acted quickly.

A mere 11 days after the attacks, the Air Transportation Safety and System Stabilization Act was signed into law, providing up to $5 billion in direct federal aid and an additional $10 billion in loan guarantees to compensate the airlines for losses directly related to the terrorist attacks.

At the same time, we were crafting the Aviation and Transportation Security Act, federalizing airport security, and assuming roughly half the financial burden of screening passengers and bags. This year we will spend $5.8 billion to fund the Transportation Security Administration. This represents a massive federal investment.

A year later, however, the airlines' situation remains bleak. A slow economy is driving passenger airline losses that may reach $7 billion this year. Almost 100,000 airline employees are out of work. There have been several high-profile bankruptcies, and there are rumors of others on the horizon.

As a Senator from West Virginia, I am sensitive not only to the impact of continued losses on shareholders and employees, but their impact on the many smaller and rural communities whose vitality and growth depend heavily on service by one or two carriers. Sometimes, only a handful of flights a day separate these communities from economic and social isolation. When airlines cut back, these flights are often the first to go.

The number of small communities served by only a single airline increased from 83 in October 2000 to 98 by October 2001. By August 2002, however, carriers had notified DOT that they intend to discontinue service to 30 communities, despite last year's stabilization package.

This is especially disappointing for me, because I see federal aid to the airlines as part of a compact between carriers and communities to ensure truly national service, and I believe that airlines are obligated to ensure that rural Americans have the same opportunity that urban citizens do. Airlines should not ask rural Americans to shoulder the burden of their economic difficulties.

The airlines' trouble poses a great dilemma for us. Although we understand that the airlines are truly in financial trouble and we recognize their importance to communities throughout the country, we simply cannot help every troubled industry, even if we wanted to.

The airlines are not alone. Thirty-five steel companies have filed for bankruptcy, and more than 100,000 steelworkers are out of work. The telecom sector is in a virtual free-fall, having lost trillions in market capitalization and laid off half a million workers. The Nasdaq is near a six-year low. Similar stories can be found in almost every sector. In this environment, and with the federal budget deficit exploding, it is difficult to justify singling out the airlines for additional aid less than one year after the last package was approved.

This doesn't mean that we can't look at ways to help. But, just as we did last year, we need to be careful to separate security issues raised by the airlines—like war risk insurance, mail, and the proper mix of federal and industry assumption of security costs—from the basic, systemic problems that pre-date the attacks. Those problems cannot be solved by Congress. Last week before the House Aviation Subcommittee, the airlines acknowledged this fact—but it bears repeating here.

On security costs, I think the mix between federal and airline responsibilities has been pretty good. Before September 11, airlines were responsible for *all* aviation security costs. Now, with increases in aviation security requirements, the federal government pays more than half of aviation security costs, and that percentage appears to be increasing. This strikes me as about the right balance; government and industry both have responsibilities for aviation security. I would not support federal assumption of *all* security-related costs, or the elimination of security fees.

If, however, the airlines want to discuss specific areas in which the interplay between federal and airline responsibilities need to be reexamined, we are willing to listen—and to act. Already, this Committee has reported legislation directing the FAA to extend the federal war risk insurance program for nine months, and to extend it to hull, passenger, and crew insurance. We have also addressed items related to carrying mail. There may be other areas where we can help, and I am eager to hear the witnesses' testimony today.

We all want to see the airline industry rebound from its current crisis—we want to see the economy expand, and we need to see laid-off workers recalled. I feel a particular urgency in this matter, as my home state of West Virginia depends heavily on air transportation. If a different, more accurate, allocation of security cost and responsibilities will help revitalize passenger aviation, I'm willing to take a closer look.

The Senator from Montana.

STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. Mr. Chairman, thank you for holding this hearing, and thank you for being here on time.

I had to throw that back at him.

Mr. Chairman, we are talking about something that is very serious today, and we have some excellent witnesses to bring us up to date on what is happening in their industry and maybe give us a better picture. I do not think it will help our putting together a road map of solving all the problems that aviation faces today. And when we look at what we did last year after 9/11, and we have done nothing for general aviation, and we have created a TSA that

I would submit went in the wrong direction, and I will forever remember the conference on that.

We have put rules and regulations on the airlines, and we have not lived up to our share of paying the bill on those. We have passed along a lot of expense to airport authorities, and we have not taken a look to just see what is the problem here of people not climbing back on the airplanes, and I would imagine that we will probably hear some of that today.

We have not done a very good job of telling the American public that it is safe to fly, everything is OK, but on the other hand, we find out that people are not afraid to fly. They are afraid to go through the hassle at the airport. I have told this story a hundred times, I lost a lot of pairs of socks in this thing. Us guys that wear boots most of the time, socks have to match now and you cannot have any holes in them, and it just becomes a hassle. In fact I think in some cases it becomes a harassment factor, because we have found in some cases that the Peter principle really works.

So I think we are going to hear a lot today. I am troubled by the fix that we are in, and I really am at odds with coming up with much of an answer, but I think it is a culmination of things that is happening in the industry that we should take a look at, and start chipping away at the situation, and trying to alleviate some of the problems we had before the passenger ever gets on the airplane.

We are blessed in this country to have a competitive airline industry. We have an industry that operates with greater, probably, efficiency than any other airlines in the world, but nonetheless we find ourselves in the fix of sometimes the Government underdoing and sometimes Government overdoing, and not shouldering its part of the responsibility and passing that along to the airlines, and they have not been able to pass those expenses along to the flying public.

So thank you for holding these hearings.

Senator ROCKEFELLER. Thank you, Senator. Senator Brownback.

STATEMENT OF HON. SAM BROWNBACK, U.S. SENATOR FROM KANSAS

Senator BROWNBACK. If I could, or if you want to bounce to the other side, I just have a brief opening statement. I want to share a couple of charts. You have rightly identified the financial plight of the airline industry, and that is important, and it is something we really do need to focus on. We need to get these airlines up and going and stronger.

I want to draw your attention, if I could, quickly to the aviation manufacturing industry that is centered in my State. Kansas is known as the aviation manufacturing capital of the world, and we have had a huge fall-off in numbers of employment since September 11th. If I could get those charts, I just want to show those to you quickly. We have the main manufacturers of Boeing, Raytheon, Cessna, and Bombardier in my State. They have all had major layoffs. Each manufacturing job that is laid results in nearly two losses in the rest of the Wichita economy. So when you lose one, you lose two other jobs. You can see the percentage loss of several of these manufacturers: 27 percent for Boeing, 33 percent for Bombardier, 13 percent for Cessna, 2 percent for Raytheon.

And the next chart shows what cumulative that is of aviation manufacturing jobs in my State; a loss of 23 percent of aviation manufacturing jobs. And I know your focus is primarily on the airlines, and that is important, because if they are not healthy they are not going to be buying planes. That is certainly true of Boeing manufacturing. But the other area, general aviation, is important as well. As I mentioned at a hearing last week, we need to be focused on not hurting these groups unduly, because it continues to hurt more manufacturing, and these are key jobs.

Now, we have taken a big hit, 23 percent loss in aviation manufacturing jobs since September 11th. I hope we can also look at that end of the spectrum and make sure that we are looking at what is happening to the manufacturing side of this, because it is directly related to what takes place in the airline industry with any rules we make which make it tougher for people to fly—we have got to be concerned about safety and security. That is paramount. That is the top order, but we also should not unduly harass people, whether it is in general aviation, in flying, or if it is with the airlines to make sure we can get people back up in the air. I just would ask you and other Members of the Committee to also think about the aviation manufacturing jobs, because they have really been hit hard and direct since September 11th.

Mr. Chairman, thanks for holding the hearing.

Senator ROCKEFELLER. Thank you. Senator Wyden.

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman. I will be very brief. Mr. Chairman, I am anxious to hear from our witnesses, but it just seems to me that the way out of the airlines' predicament does not lie primarily with the Congress giving the airlines more breaks and more advantages that other companies do not get. It seems to me the best way to address this is to promote competition, improve airline industry productivity, and improve passenger service.

Those are the issues that I am most interested in, and it seems to me Congress has shoveled an awful lot of money at the airline industry. A lot of the problems the industry had before September 11th are more pronounced today, and I just do not think the way out of this lies primarily with the Congress giving the industry more breaks that nobody else in the country seems to get.

Thank you, Mr. Chairman.

Senator ROCKEFELLER. Thank you, Senator Wyden.

Senator Cleland, did you have a statement?

STATEMENT OF HON. MAX CLELAND, U.S. SENATOR FROM GEORGIA

Senator CLELAND. Thank you, Mr. Chairman. It is wonderful to have all of our panelists here today, especially the distinguished head of Delta Airlines from my home State of Georgia.

Mr. Chairman, on September 20 of last year this Committee held a hearing on the financial state of the airline industry. At that point in time, just 9 days after the worst terrorist attack ever on the Nation, the entire industry was reeling. I was particularly stunned when executives at Morgan Stanley sent a letter to Treasury Secretary O'Neill which stated, and I quote, "today there are virtually no markets"—this is last year now—"today there are virtually no markets open to these carriers." This is 9 days after 9/11. "The major U.S. credit rating agencies have downgraded the debt securities of U.S. carriers dramatically, and have signaled that there are likely to be more downgradings. Trading in even the most highly secured debt securities has virtually shut down."

That was an absolute shock, a very scary thing to hear. One year later, with the one exception of Southwest Airlines, the bonds of the major carriers are still rated as junk bonds.

The industry is in unprecedented financial crisis. Some major airlines are running out of cash. US Airways has filed for bankruptcy protection. United has said it may file in the coming months, a very scary thought. U.S. air carriers have already reduced flight schedules by about 20 percent. They have cut 16 percent of their work force, which has resulted in more than 100,000 people losing their jobs. In the past few weeks, American and Northwest Airlines have said they plan to slash another 8,000 jobs collectively, and Delta just announced a $350-million loss in the third quarter and said it will lay off 1,500 flight attendants, one tenth of its force.

Issues that impact our airlines have a ripple effect across the country. Just let me say up front that Delta is Georgia's largest corporate employer. Its economic impact on the State exceeds $10 billion annually. This equals 5 percent of Georgia's estimated Gross State Product.

Just as Delta is vital to the economy of Georgia, the health of the airline industry is critical to America's economic security. Clearly, the industry is suffering, and prospects for a quick turnaround today appear grim.

Mr. Chairman, I thank you for holding today's hearing. We are looking at an industry that has lost over $7 billion 2 years in a row. I am told that up to 40 percent of this unprecedented loss is due to terrorism-related security costs. Mr. Mullin, the very capable CEO and chairman of Delta, is one of our witnesses—and I understand he will testify on recommendations by the industry on how the Government can help relieve some of the burden from heavy security-related costs and lost revenue.

Let me just say that this Committee has already acted on extending Government-backed war risk insurance for 9 months. The aviation security bill we reported out of Committee less than 2 weeks ago should make it possible for carriers to carry mail again. I look forward to hearing from Mr. Mullin and our other panelists. We need to act on this national crisis immediately.

Thank you, Mr. Chairman.

Senator ROCKEFELLER. Thank you. Senator Fitzgerald.

STATEMENT OF HON. PETER G. FITZGERALD, U.S. SENATOR FROM ILLINOIS

Senator FITZGERALD. Thank you, Mr. Chairman.

Mr. Chairman, last year, in the immediate aftermath of September 11th, Congress hastily approved a $15 billion bail-out package for our Nation's airlines with little examination of the numbers. In an atmosphere of near-panic, and with almost no debate, Congress gave the airlines $5 billion in up-front cash and made available an additional $10 billion for an airline loan guarantee program.

I voted against the package for several reasons. First, it was not an industry bailout per se, but more precisely, a bailout for airline investors. There was, in fact, no bailout for sky caps, baggage handlers, flight attendants, or mechanics. Only airline shareholders got bailed. Airline industry employees were left twisting in the wind, and tens of thousands of them were promptly fired.

Second, while it might have been acceptable to compensate the airlines for their losses during the 4-day Government-imposed air traffic shutdown, there was nonetheless no justification for paying the airlines many times what they lost during that period. The combined total revenue of all the airlines in the country prior to September 11th was $340 million a day. If you bother to do the calculation, 4 days multiplied by $340 million per day adds up to $1.36 billion, not $5 billion, and certainly not $15 billion. It seems that in its eagerness to shovel money at the airlines Congress never did bother to do the calculation.

Other industries, such as hotels, car rental companies, and travel agencies, indeed, the entire hospitality industry, suffered as well after 9/11 but none of them got a Federal handout. The inequity here is striking.

Now, just 1 year later, the airlines are back asking for more money but this time, in light of the public outrage that resulted from last year's bailout, they are packaging their request in a different way. Instead of openly asking the Government to write them a check, like they did last year, the airlines are suddenly seeking to shift unspecified billions of their own operating costs to the taxpayers.

Mr. Chairman—and I will wrap up. Mr. Chairman, as excessive as last year's airline bailout was, at least it was straightforward. The airlines were at least being upfront in asking for money to be forked over to them. This year, they are being deliberately obscure. By asking the Government to absorb a multifaceted menu of their own variable expenses, the airlines are seeking to prevent the public from quantifying their take. They are making themselves harder to pin down and harder to criticize.

Finally, Mr. Chairman, this bailout is certain to be many times last year's bailout. As big as last year's bailout was, it was at least a one-time bailout. The cash assistance was limited to $5 billion. This year's bailout will be a bailout that recurs annually, every year, forever. It will go in perpetuity, so the size of this year's bailout is many, many times, it is infinitely greater than last year's bailout.

Thank you, Mr. Chairman.

Senator ROCKEFELLER. Thank you, Senator. Senator Dorgan.

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, I just came from a meeting on the economy, and that is always a depressing thing these days, because part of the point of the meeting was to hear the expressions of Mr. Lindsey from the White House saying everything is really going very well, the economy is doing quite well. In fact, we are here today to talk about an industry that is not doing well at all.

One piece of important evidence that our economy is in some great difficulty, and we would be better off paying attention to it and working together, the White House and the Congress, to address it—I am just sick and tired of people saying, well, let us talk about something else. There is nothing wrong with this economy. The fundamentals are sound. That is nonsense.

This industry is an industry that is critical to this country. Our economy will not work without a strong airline industry. Now, the airline industry is not a perfect object of sympathy, let me be the first to agree. They are not a very sympathetic figure, as a matter of fact, and I agree with my colleague from Oregon, competition is important. No one has fought harder for competition than I have, but I think it is also important to understand that there are fewer people flying, we have a soft and troubled economy, fuel costs are up, the hassle factor of people flying these days because of the security issues post 9/11 has affected the number of people who fly. This affects not just this industry, as Senator Brownback said, it also affects the equipment manufacturers and many others, and I think that we ignore this at our own peril.

We talk about bailouts and so on, but the fact is, we have to find solid footing not just for this industry, but for others as well, and that means we have to try to fix what is wrong with this economy.

The airline industry talks to us about substantially increased security costs. Well, that is not crying wolf. Go to an airport at some point. Take a look at the added costs that have been affixed to this point, and what it means in terms of the hassle of people flying, and what it means in terms of fewer passengers in these seats. Flying into that kind of a situation with added security costs at the same time that you have a soft economy has put this industry in significant peril, and I think we ignore that, and we do this country no service.

I do not know exactly what the answer is, but I am not someone who believes that we ought to just blithely suggest things are just fine, let it all happen; if we have carriers who go bankrupt, somebody will pick up a plane and fly it some place. I will tell you, this economy is in some very serious trouble, and the quicker the President and Larry Lindsey begin to understand that, and the quicker we begin to understand it and begin to address these questions day after day, industry after industry, the better off this country will be. And today, this hearing is the start of one piece of a very important public policy. What do we do to address the serious problems that exist with the airline industry?

Senator ROCKEFELLER. Thank you, Senator Dorgan. I totally agree with you about the use of the word bailout. The first $5 billion was simply an addition of the Federal Government shutting down the passenger service, and the second $5 billion was the cargo.

Senator Smith, do you have any comment?

STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Senator SMITH. I do, Mr. Chairman. Thank you for holding this very important hearing on the state of this vital industry. I have a few comments. I am going to put in the record my more lengthy statement. Let me speak for a second as a resident of the State of Oregon. Oregon has two members of this Committee on it. We both voted for the airline support after 9/11. I think everyone understands that it was not the fault of the airline industry or anyone else. It was a dastardly attack, and so I felt like interfering in the private sector in an emergency like that was appropriate for this Government to do.

But I am concerned that as we contemplate doing more, our State is having airline schedules cut, prices increased, and a major airline, or at least cargo carrier, Evergreen, is being jerked around in trying to get any relief as it relates to what we already passed. In the normal times, they would be able to roll over debt without any difficulty, but they are not getting the kind of support that they ought to get from the effort we already have made on this Committee. So in fact I would like to put in the record, Mr. Chairman, a statement from four-star General John Handy that he wrote to Capitol Hill regarding the fact that Evergreen is critical to U.S. Transcom's wartime effort, and I ask that his letter be placed in this record as well.

Senator ROCKEFELLER. So it will.

[The information referred to follows:]

UNITED STATES TRANSPORTATION COMMAND
Scott Air Force Base, IL, April 26 2002

Hon. Walter B. Jones,
United States House of Representatives,
Cannon House Office Building,
Washington DC.

Dear Mr. Jones:

I enjoyed talking with you this morning and greatly appreciate your commitment to our nation's airlift capability. As we discussed, Evergreen International Airlines has a long history of excellent service as a member of our nation's Civil Reserve Air Fleet. In the first two quarters of this year Evergreen flew almost three times the amount of missions they flew all of last year in support of USTRANSCOM's Air Mobility Command—a nearly 600 percent mission tempo increase for the same period. This of course is a result of the air intensive nature of Operation ENDURING FREEDOM and the heavy demands placed upon our country's airlift force. Lift, such as that provided by Evergreen is indeed a national resource and suffice it to say, we could not execute the Global War on Terrorism without the enormous contribution of our civil fleet. Evergreen is critical to USTRANSCOM's wartime effort.

Since the beginning of Operation ENDURING FREEDOM, Evergreen International Airlines has been awarded 44 percent (760 out of 172E) of all the widebody cargo missions and 51 percent of all the B–747 missions contracted by Air Mobility Command. To put that in perspective, Evergreen has shouldered approximately 50 percent of the heavy commercial lift with only 25 percent of the assets. Perhaps even more significant is the extremely responsive nature of Evergreen's support, typically filling very short-notice requirements. Since 1 Oct. Evergreen has flown 305 missions as direct channel backfill, meaning that they came in and picked up the shortfall in our scheduled missions when organic C–17s or C–5s were unavailable. This was 48 percent of all the backfill we have needed and made it possible for our organic fleet. the C–17 in particular, to be released for duties in direct support of operations in Afghanistan—a mission only the C–17 could perform. This was vital to sustain the war effort.

Simply, operations to date would have been impossible without the contribution of Evergreen and our Civil Reserve Air Fleet partners—we cannot do it without them, I hope this information is useful. I thank you again for your interest in this vital issue and for all you do in support of our great nation.

Sincerely

JOHN W. HANDY
General, USAF Commander in Chief

Senator SMITH. Mr. Chairman, as we contemplate doing more—Senator Wyden and I represent the State of Oregon. Oregon is getting reamed right now, and I am interested in how our State gets treated going forward, because we have not been treated well to this point.

Thank you, sir.

[The prepared statement of Senator Smith follows:]

PREPARED STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Mr. Chairman, thank you for holding this hearing today on the financial state of the airline industry.

I am very concerned about the state of this industry, and particularly, the continued frustration the airlines experience when applying for loan guarantees from the Air Transportation Stabilization Board.

Ten months ago, Oregon-based Evergreen International Airlines applied for a federal loan guarantee under the Air Transportation Safety and System Stabilization Act.

Shortly thereafter, the Commander in Chief of the United States Transportation Command, Four Star General John W. Handy, wrote the following in a letter to Capitol Hill stating, "Evergreen is critical to USTRANSCOM's wartime effort." (I ask that Gen. Handy's letter be placed in the record)

According to General Handy, Evergreen has conducted over 50 percent of the Boeing 747 missions in the current Operation Enduring Freedom and "Perhaps even more significant is the extremely responsive nature of Evergreen's support, typically filling very short-notice requirements."

Chairman Hollings, I know you and several others on this Committee have been very supportive of Evergreen's loan application and thank you for that. Quite frankly, in light of this unequivocal statement from the Pentagon, it is amazing to me that the ATSB has seen fit to give others more expeditious consideration in the granting of a loan guarantee.

My understanding is that Evergreen is faced with a rollover of its debt that in normal times would not be a problem.

As this hearing today makes crystal clear, these are not normal times in the airline industry. As such, Evergreen's service to this country and to the war on terrorism is being put in jeopardy.

This is precisely why the Congress passed the Air Transportation Safety and System Stabilization Act—so that otherwise self-sufficient air carriers such as Evergreen, that do not present a risk to the U.S. taxpayer, can address the unique challenges confronting them in the wake of September 11th.

I understand that the ATSB has recently begun to finally focus on Evergreen's situation and I urge the ATSB to move quickly to bring this application to a favorable resolution.

Thank you Mr. Chairman.

Senator ROCKEFELLER. Thank you very much, Senator Smith. We now go to—and I apologize for the statements which some of us gave, and now we turn to Ms. JayEtta Hecker, who is Director of Physical Infrastructure at the indisputably always correct General Accounting Office.

STATEMENT OF JAYETTA HECKER, DIRECTOR OF PHYSICAL INFRASTRUCTURE GROUP, GENERAL ACCOUNTING OFFICE

Ms. HECKER. Thank you, Mr. Chairman. I am very pleased to be here. Mr. Chairman and Members of the Committee, like you, I was recalling that a year ago today GAO provided support for you and addressed some guidelines for providing financial assistance to the industry. Of course, the Congress found the importance of a strong and vibrant industry, acted in creating the Stabilization Act, and also included important protections for taxpayers, competition, and consumers. So it is fitting that we return today to look at the state of the industry's health.

Drawing on the work that we have done, actually, for many of you, on mergers, on alliances, on the use of regional jets, and on changes in small community service over the past year, my statement today will focus on three major points: the financial condition of the industry, steps taken by the industry to improve its financial health, and finally, some broad public policy issues confronting the Congress.

To begin with, I think it is important to remember the backdrop of the promise and the performance of the Airline Deregulation Act. It has led to lower fares and better service for most travelers attributable to increased competition, new entry, and new initiatives and innovation by existing carriers. In our recent small community work, we reported that nearly 97 percent of total U.S. domestic enplanements at not only large and medium hubs but also small hubs had experienced competition from an average of five carriers in 1999.

The first topic I wanted to cover is the industry's financial performance. It goes without saying, the airline industry is experiencing a second consecutive year of record losses. There is a notable exception, though, and it is important in this environment, to note: the low cost carriers, not only Southwest, which is really among the majors in its share, but also the newer entrants, such as JetBlue and Airtran. All of them have positive net income. Of course, we know that they have very different business structures than most major U.S. airlines, and substantially lower operating costs. All those innovations by those carriers are in existence only because of deregulation. It is precisely the flexibility that they were given to enter markets and to innovate in pricing that is behind the success of those carriers.

Another context about the financial condition of the industry to remember is that it is inherently a cyclical industry. It historically has had many ups and downs, and has established some significant record of recovery.

Another important matter that several of you mentioned concerns the potential for bankruptcies. Some have already occurred, and some that are expected or anticipated to occur. Bankruptcies are in many ways an important way of looking at the other side of free entry. If you do not have free exit, then you cannot have free entry, because you are freezing in the assets and contributing to overcapitalization and inefficiency in the industry.

The key concerns about the financial condition of the industry are that underlying needs exist for reducing high operating costs and reforming carrier pricing models which are no longer working to attract and maximize the revenue gain from business travelers.

The second issue is carrier actions to improve their financial health. I will skip over this one quickly. The carriers have taken many actions to lower their costs in restructuring, and as many of you have also noted, in some cases eliminating all service to some small communities. Our recent report on this to many of you indicated that since September 2001 carriers have notified DOT of their intention to discontinue service at 30 small communities. This is eliminating service to those locations.

Another move that airlines are taking to increase revenues, and I know it is of interest to the Committee, is their proposals to create new marketing alliances.

The bottom line of the carrier action issue is that further restructuring and consolidation is underway, and it is affecting and will continue to affect the competitive landscape of the industry.

I recognize another issue is on the table, and the more immediate issue that the Congress is now deliberating, and that is the appropriate Federal/industry share of greatly increased security costs.

Finally, and these are really the key points that I want to leave with you today. There are three key public policy issues confronting the Congress, in our view. The first one is focusing on maintaining a competitive environment. The benefits of competition are real. Moreover, re-regulation would not forestall some of the problems we have now. There is not a simple answer here that somehow you could re-regulate and stop all of these problems with costs or service.

The second point is monitoring travel options for small communities. Clearly, it is an area of interest to a lot of members, and a lot of communities. We have some work ongoing as well as completed that I will tell you a little bit about.

The third area is different than the major focus today on the domestic industry, and it is the importance of the globalized community. The point is the importance of moving forward with global liberalization and ensuring competition in global markets.

I do not have a lot of time. I wanted to add a few points on each of those. The main thing about the competitive environment is that restructuring is occurring. These alliances raise competitive issues. In fact, the existence of the ATSB, as well as these consolidations and alliances, all have the potential to substantially impede entry. Moreover, security costs can have a differential impact on low cost carriers and short hauls. The effectiveness, as many of you have mentioned, of the security role of TSA and its performance is important clearly not only to the American public but to the industry as well.

The small community issue I know you care a lot about. Basically, the concern that we have about the DOT Small Community Air Service Pilot Program and the EAS program is that there are excessive pressures on them. There is no way, with current levels of funding and criteria, that all of the communities now eligible and becoming eligible can be served, so fundamental issues are facing the Congress about the performance, effectiveness, and cost of these two programs, and what kind of options might exist if the Congress determines that providing stability of service to small communities is in the national interest.

The third issue is globalization. There are important developments underway in the European Union which could alter the legal basis of many of our important bilaterals with European partners. There are very clear, significant benefits that flow to both consumers and carriers for liberalizing aviation trade, and therefore continued focus on liberalization and competition in the international market is important to remember at this time as well.

That concludes my remarks. I apologize for going over and look forward to questions.

Thank you.

[The prepared statement of Ms. Hecker follows:]

PREPARED STATEMENT OF JAYETTA HECKER, DIRECTOR OF PHYSICAL INFRASTRUCTURE GROUP, GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Committee:

Thank you for inviting us to testify today on the economic state of the airline industry. Just over a year ago, we testified before this Committee on guidelines for providing financial assistance to the industry.[1] The Congress has long recognized that the continuation of a strong, vibrant, and competitive commercial airline industry is in the national interest. A financially strong air transport system is critical not only for the basic movement of people and goods, but also because of the broader effects this sector exerts throughout the economy. In response to the industry's financial crisis generated by the events of last September, the Congress passed the Air Transportation Safety and System Stabilization Act.[2] Thus, it is fitting that we now return to this Committee to review the state of the industry's financial health and competitiveness.

Over the past several years, we have issued a number of reports that focus on changes within the airline industry. They include analyses of the potential impacts on consumers of airline mergers and alliances, carriers' use of regional jets, and changes in service to the nation's smaller communities.[3] Our statement today builds on that body of work and provides a current overview of (1) the financial condition of major U.S. commercial passenger airlines; (2) steps taken by airlines to improve their financial condition; and (3) some public policy issues related to current conditions and changes in the aviation industry's competitive landscape.

In summary:

- Many, but not all, major U.S. passenger airlines are experiencing their second consecutive year of record financial losses. In 2001, the U.S. commercial passenger airline industry reported losses in excess of $6 billion. For 2002, some Wall Street analysts recently projected that U.S. airline industry losses will approach $7 billion, and noted that the prospects for recovery during 2003 are diminishing. Such projections could worsen dramatically in the event of additional armed conflict, if travel demand drops and fuel prices rise. Several carriers have entered Chapter 11 bankruptcy proceedings. Yet Southwest Airlines, JetBlue, and AirTran continue to generate positive net income. These low-fare carriers have fundamentally different business structures than most major U.S. airlines, including different route structures and lower operating costs. However, federal security requirements have altered the cost of doing business for all carriers.
- Carriers have taken many actions to lower their costs and restructure their operations. Since September 2001, carriers have furloughed an estimated 100,000 staff, renegotiated labor contracts, and streamlined their fleets by retiring older, costlier aircraft. Carriers have reduced capacity by operating fewer flights or smaller aircraft, such as substituting "regional jets" for large "mainline" jet aircraft. In some cases, carriers eliminated all service to communities. For example, since September 2001, carriers have notified the Department of Transportation (DOT) that they intend to discontinue service to 30 small communities. At least two carriers are modifying their hub operations to use resources more efficiently by spreading flights out more evenly throughout the day. Finally, to increase revenues, some carriers have proposed creating marketing alliances under which the carriers would operate as code-sharing partners.[4] United Airlines and US Airways announced plans to form such an alliance on July 24, 2002, as did Continental Airlines, Delta Air Lines, and Northwest Airlines one month later.

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[1] *Commercial Aviation: A Framework for Considering Federal Financial Assistance* (GAO–01–1163T), September 20, 2001.
[2] Pub.L. 107–42.
[3] See list of related GAO products attached to this statement.
[4] In general, "code sharing" refers to the practice of airlines applying their names—and selling tickets via reservation systems—to flights operated by other carriers.

As the aviation industry continues its attempts to recover, the Congress will be confronted with a need for increased oversight of a number of public policy issues. First, airlines' reactions to financial pressures will affect the domestic industry's competitive landscape. Some changes, such as extending airline networks to new markets through code sharing alliances, may increase competition and benefit consumers. Others, such as carriers' discontinuing service to smaller communities, may decrease competition and reduce consumers' options, particularly over the long term. Second, airlines' reductions in service will likely place additional pressure on federal programs supporting air service to small communities, where travel options are already limited. Finally, while domestic travel has been the focus of our concern today, there are numerous international developments—especially regarding the European Union (EU)—that may affect established international "open skies" agreements between the United States and EU member states. Various studies have illustrated the benefits to both consumers and carriers that flow from liberalizing aviation trade through such agreements. As international alliances are key components of major domestic airlines' networks, international aviation issues will affect the overall condition of the industry.

Background

The Airline Deregulation Act of 1978 has led to lower fares and better service for most air travelers, largely because of increased competition. The experiences of millions of Americans underscore the benefits that have flowed to most consumers from the deregulation of the airline industry, benefits that include dramatic reductions in fares and expansion of service. These benefits are largely attributable to increased competition, which has been spurred by the entry of new airlines into the industry and established airlines into new markets. At the same time, however, airline deregulation has not benefited everyone; some communities have suffered from relatively high airfares and a loss of service.

The airline industry is a complex one that has experienced years of sizable profits and great losses. The industry's difficulties since September 11, 2001, do not represent the first time that airlines have faced a significant financial downturn. In the early 1990s, a combination of factors (e.g., high jet fuel prices due to Iraq's invasion of Kuwait and the global recession) placed the industry in turmoil. Between 1990 and 1992, U.S. airlines reported losses of about $10 billion. All major U.S. airlines [5] except Southwest reported losses during those years. In addition, several airlines—most notably Braniff, Eastern, and Pan Am—went out of business, and Trans World Airlines, Northwest Airlines, and Continental Airlines entered bankruptcy proceedings. By the start of 1993, the industry had turned the corner and entered a period during which nearly all major U.S. airlines were profitable. The industry rebounded without massive federal financial assistance.

The events of September 11th accelerated and aggravated negative financial trends that had begun earlier in 2001. Congress responded quickly to address potential instability in the airline industry by enacting the Air Transportation Safety and System Stabilization Act. Among other things, that act authorized payments of $5 billion in direct compensation (grants) to reimburse air carriers for losses sustained as a direct result of government actions beginning on September 11, 2001, and for incremental losses incurred between September 11 and December 31, 2001 as a direct result of the terrorist attacks. The act provided $10 billion in loan guarantees to provide airlines with emergency access to capital and established the Air Transportation Stabilization Board (the Board) to administer the loan program. [6] The Board is tasked not only with providing financial assistance to airlines but also with protecting the interests of the federal government and American taxpayer. The act requires the Board to ensure that airlines are compensating the government for the financial risk in assuming guarantees. This requirement defines the loan guarantee as a mechanism for supporting airlines with reasonable assurances of financial recovery. In addition to the grants and loan guarantees, the federal government has also established other ways to ease the airlines' financial condition. [7]

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[5] For the purpose of this report, major airlines include Alaska Airlines, America West Airlines, American Airlines, American Trans Air, Continental Airlines, Delta Air Lines, Northwest Airlines, Southwest Airlines, United Airlines, and US Airways.

[6] The Air Transportation Stabilization Board is composed of the Chairman of the Federal Reserve, the Secretary of Transportation, the Secretary of Treasury, and the Comptroller General. The Comptroller General is a non-voting member.

[7] The Air Transportation Safety and System Stabilization Act (Title III) authorized the Secretary of the Treasury to change the due date for any tax payment due between September 10 and November 15 to some time after November 15 (with January 15, 2002 as the maximum extension). The act specifies taxes that may be postponed to include excise and payroll taxes. Under Title II, (Aviation Insurance), the act also authorized DOT to reimburse qualifying air

Many Carriers Face Deep Financial Losses

Many major U.S. passenger airlines are experiencing their second consecutive year of record financial losses. In 2001, the industry reported a net loss of over $6 billion, even after having received $4.6 billion from the federal government in response to September 11th.[8] For 2002, some Wall Street analysts have projected that U.S. airline industry losses will total about $7 billion, but this projection may worsen in the event of additional armed conflict, particularly if this results in decreasing travel demand and rising fuel prices. According to industry data, airlines' revenues have declined 24 percent since 2000, while costs have remained relatively constant. US Airways and Vanguard Airlines filed for Chapter 11 bankruptcy during this summer. United Airlines officials stated that they are preparing for a potential Chapter 11 bankruptcy filing this fall. Furthermore, some Wall Street analysts predict that it will likely take until 2005 for the industry to return to profitability. Attachment I summarizes the financial condition of major network and low-fare carriers.[9]

Major airline carriers' revenues have fallen because of a combination of a decline in passenger enplanements[10] and a significant decrease in average fares. As figure 1 shows, major carriers' enplanements increased for every quarter of 2000 compared to the same quarter of the previous year, but flattened in the first quarter of 2001 and then dropped, with the steepest drop occurring in the quarter following September 11, 2001.

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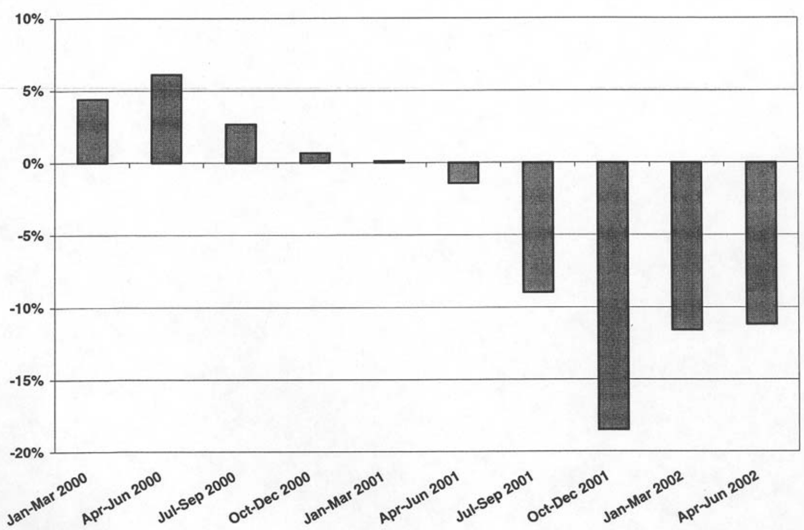
carriers for insurance increases experienced after the events of September 11th for up to 180 days. Funding constraints effectively limited the program to reimbursing carriers their excess war risk insurance premiums for only 30 days.

[8] The federal government has provided significant amounts of financial assistance under the Stabilization Act. First, according to data from DOT, as of September 18, 2002, 396 passenger and cargo carriers had received payments totaling $4.6 billion. Second, 16 carriers submitted applications for loan guarantees. The Board approved a loan of $429 million to America West Airlines, and conditionally approved the applications of US Airways, Inc. for a federal guarantee of $900 million and American Trans Air for a federal guarantee of $148.5 million. The Board has denied the applications of four airlines. Third, various airlines have taken advantage of the tax deferment. For example, Southwest stated that it deferred approximately $186 million in tax payments until January 2002. Finally, the Federal Aviation Administration provided reimbursements to air carriers for up to 30 days of increased war risk insurance expense. To date, 188 air carriers have received $56.9 million in reimbursements. We are completing reviews of the $5 billion financial assistance program and the War Risk Insurance Reimbursement program to ensure that payments made were in compliance with the act.

[9] Network carries are defined as carriers using a hub and spoke system. Under this system, airlines bring passengers from a large number of "spoke" cities to one central location (the hub) and redistribute these passengers to connecting flights headed to passengers' final destinations. We adopted DOT's definition of low-fare carriers, which includes AirTran, American Trans Air, Frontier, JetBlue, Southwest, Spirit, and Vanguard.

[10] "Enplanements" represents the total number of passengers boarding an aircraft. Thus, for example, a passenger that must make a single connection between his or her origin and destination counts as two enplaned passengers because he or she boarded two separate flights.

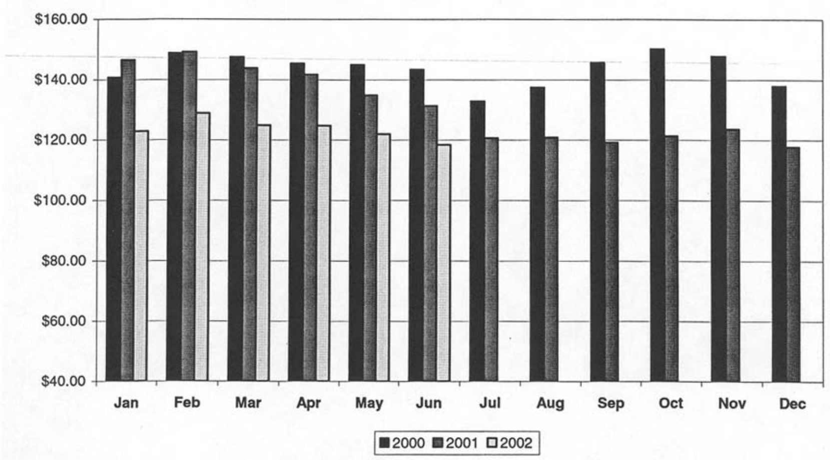
Figure 1: Major Airlines' Passenger Enplanements (quarterly) - Percentage Change from Prior Year



Source: GAO analysis of data from the Air Transport Association.

Over the same period, major airlines have also received lower average fares. Data from the Air Transport Association indicate that the average fare for a 1,000-mile trip dropped from $145 in June 2000 to $118 in June 2002, a decrease of about 19 percent (see fig. 2). Average fares started dropping noticeably in mid–2001 and have not risen significantly since. Industry data suggest that the decline is due to the changing mix of business and leisure passenger traffic, and particularly to the drop in high-fare business passengers.

Figure 2: Average Domestic Airfares for Major Network Carriers, January 2000 Through June 2002



Note: Data are in nominal dollars for 1,000-mile trips on U.S. major airlines (excluding Southwest).
Source: GAO presentation of data from the Air Transport Association.

Through June 2002, all major network carriers generated negative net income, while low-fare carriers Southwest Airlines, JetBlue, and AirTran returned positive net income. Like the major carriers, these low-fare carriers' passenger enplanements dropped in the months immediately following September 2001. Attachment II summarizes passenger enplanements for individual major and low-fare carriers for 2000, 2001, and the first 5 months of 2002.

Why have some low-fare carriers been able to earn positive net income in current market conditions, while network carriers have not? The answer seems to rest at least in part with their fundamentally different business models. Low-fare carriers and major network carriers generally have different route and cost structures. In general, low-fare carriers fly "point-to-point" to and from airports in or near major metropolitan areas, such as Los Angeles, Chicago, and Baltimore-Washington. In comparison, major network carriers use the "hub and spoke" model, which allows them to serve a large number of destinations, including not just large cities, but small communities and international destinations as well. American Airlines, for example, can carry a passenger from Dubuque, Iowa, through Chicago, to Paris, France.

Low-fare carriers have also been able to keep costs lower than those of major airline carriers. For example, 2002 data reported by the carriers to DOT indicate that Southwest's costs per available seat mile (a common measure of industry unit costs) for one type of Boeing 737 is 3.79 cents. For the same aircraft type, United Airlines reported a cost of 8.39 cents—more than twice the cost at Southwest.

All airlines are now entering an environment in which some of the costs of doing business have increased. The federal Transportation Security Administration has taken over responsibility for many security functions for which airlines previously had been responsible. The Air Transport Association (ATA) estimated that the airline industry spent about $1 billion for security in 2000. [11] Despite the shift in func-

[11] The amount that the industry paid for security in 2000 is in question. ATA's $1 billion estimate, made in August 2001, included $462 million annually for direct costs, $50 million for security technology and training costs, and $110 for acquisition of security equipment. Since then, ATA certified that the industry incurred only about $300 million in security-related costs. The amount is important, because the airlines are required to remit an amount equal to the security costs incurred by the airlines in calendar year 2000 to the U.S. government, which assumed certain civil aviation security functions through the Transportation Security Administration. DOT's

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tional responsibilities, airlines have stated that they continue to bear the costs of other new federal security requirements. In August 2002, Delta Air Lines estimated the cost of new federal security requirements that it must bear to be about $205 million for 2002. This includes the cost of reinforcing cockpit doors, lost revenues from postal and cargo restrictions, and lost revenues from carrying federal air marshals.

Airlines Have Taken Numerous Actions to Address Changing Market Conditions

To address mounting financial losses and changing market conditions, carriers have begun taking a multitude of actions to cut costs and boost revenues. First, many carriers have trimmed costs through staff furloughs. According to the Congressional Research Service, carriers have reduced their workforces by at least 100,000 employees since last September. Further, some carriers, including United Airlines and US Airways, have taken steps to renegotiate contracts in order to decrease labor and other costs. A US Airways official stated that its renegotiated labor agreements would save an estimated $840 million annually.

Carriers have also grounded unneeded aircraft and accelerated the retirement of older aircraft to streamline fleets and improve the efficiency of maintenance, crew training, and scheduling. Carriers accelerated the retirement of both turboprops and a variety of larger aircraft, including Boeing 737s and 727s. For example, United and US Airways retired the Boeing 737s used by United's Shuttle service and US Airways' MetroJet system, and the carriers discontinued those divisions' operations. Industry data indicate that the airlines have parked over 1,400 aircraft in storage, with more than 600 having been parked since September 2001.

Although carriers had begun reducing capacity earlier in 2001, those reductions accelerated after the terrorist attacks. Between August 2001 and August 2002, major carriers reduced capacity by 10 percent. Carriers can decrease capacity by reducing the number of flights or by using smaller aircraft, such as replacing mainline service with regional jets, which are often operated by the network carrier's regional affiliate and normally have lower operating costs. For example, American Airlines serves the markets between Boston, New York (LaGuardia), and Washington, DC (Reagan National) only with regional jet service provided by its affiliate, American Eagle. Another way carriers have reduced capacity is to discontinue service to some markets, primarily those less profitable, often smaller communities. Our previous work showed that the number of small communities that were served by only one airline increased from 83 in October 2000 to 95 by October 2001. Between September 2001 and August 2002, carriers had notified DOT [12] that they intend to discontinue service to 30 additional communities, at least 15 of which were served by only one carrier and are now receiving federally-subsidized service under the Essential Air Service (EAS) program. [13]

Some carriers are modifying their "hub and spoke" systems. American is spreading flights out more evenly throughout the day instead operating many flights during peak periods. American began this effort in Chicago and has announced that it would expand its "de-peaking" efforts to its largest hub at Dallas/Fort Worth beginning November 2002. American officials stated that these changes would increase the productivity of labor and improve the efficiency of gate and aircraft use. Delta officials said they are also taking steps to spread flights more evenly throughout the day.

Beyond the steps individual carriers are taking to restructure and cut costs, some carriers are proposing to join forces through marketing and codesharing alliances in order to increase revenues. Under these proposed alliances, carriers would sell seats on each other's flights, and passengers would accrue frequent flyer miles. Company officials stated that the carriers would remain independent competitors with separate schedules, pricing, and sales functions. On July 24, 2002, United and US Airways announced a proposed codesharing alliance to broaden the scope of their networks and potentially stimulate demand for travel. United and US Airways estimated that the alliance would provide more than $200 million in annual revenue for each carrier. One month later, Northwest announced that it had signed a similar

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Inspector General is examining the discrepancy between the $1 billion and the $300 million estimates.

[12] Under 49 U.SC. 41734, carriers must file a notice with DOT of their intent to suspend service, and DOT is compelled by statute to require those carriers to continue serving those communities for a 90-day period.

[13] The EAS program, established as part of the Airline Deregulation Act of 1978, guaranteed that communities served by air carriers before deregulation would continue to receive a certain level of scheduled air service, with special provisions for Alaskan communities. As of July 1, 2002, the EAS program provided subsidies to air carriers to serve 114 communities.

agreement with Continental and Delta. According to Northwest, this agreement builds on the alliance between Northwest and Continental that had been in existence since January 1999. These alliances would expand both their domestic and international networks. The Department of Transportation is currently reviewing these proposals.[14]

Critical Public Policy Issues Are Associated With the Industry's Changing Competitive Landscape

Because a financially healthy and competitive aviation industry is in the national interest, and because carriers' and the federal government's efforts to address the current situation may affect consumers both positively and negatively, Congress will be confronted with several major public policy issues. These policy issues underscore the difficulties this industry will encounter as it adapts to a new market environment. We are highlighting three of these issues: the effect of airlines' current financial situation, including new business costs, on industry health and competition; the impact of reductions in service on federal programs designed to protect service to small communities, and international developments that may further affect the domestic industry.

- **How will the carriers' reactions to current financial pressures affect the industry's competitive landscape?** There is a new aviation business reality that has increased the airlines' financial pressures and which ultimately will be felt by U.S. consumers. Increased federal security requirements, which are part of this new reality, are adding to the cost of competing in the industry. The cost of these policies will most likely be borne both by industry, through higher operational costs, and the consumer, through higher fares. In the current pricing environment, carriers may not be able to pass on these costs to consumers, and thus may be bearing their full impact during the short run. On the other hand, these same security requirements may be helping the airlines maintain some of its passenger revenue; some portion of the airlines' current passengers may be flying only as a result of knowing that these heightened security requirements are in place. Thus, the question arises about the net impact of the new market environment and new security requirements on the carriers and their passengers while the industry restructures.

While understandable from the perspective of an individual airline's bottom line, the restructuring activities of individual carriers will significantly change the competitive landscape. When carriers decrease available capacity in a market by reducing the number of flights, decreasing the size of aircraft used to meet reduced demand, or dropping markets altogether, the net result is that consumers have fewer options. In doing so, airlines reduce the amount of competition in those markets. As has been shown repeatedly, less competition generally leads to higher fares in the long run.

A related issue concerns the industry's consolidation, whether through marketing alliances among or mergers between carriers. Because of the potential that consolidation presents for competition, federal oversight has been critical. As we have noted before, while alliances may offer potential consumer benefits associated with expanded route networks, more frequency options, improved connections, and frequent flyer benefits, consolidation within the industry raises a number of critical public policy issues.[15] These include increasing potential barriers to market entry, the loss of competition in key markets, and a greater risk of travel disruptions as a result of labor disputes.[16] Since these alliances and mergers have a direct impact on the level of competition within the airline industry and would therefore influence the affordability of air travel to many consumers, these issues are still relevant.

- **How will the Federal Government's support of small community air service be affected?** The Congress has long recognized that many small communities have difficulty attracting and maintaining scheduled air service. Now, as airlines continue to reduce capacity, small communities will potentially see even further reductions in service. This will increase the pressure on the federal

[14] DOT is authorized under 49 U.S.C. 41712 to block the airlines from implementing their agreements, if it determines that the agreements' implementation would be an unfair or deceptive practice or unfair method of competition. Such a determination is analogous to the review of major mergers and acquisitions conducted by the Justice Department and the Federal Trade Commission under the Hart-Scott-Rodino Act, 15 U.S.C. 18a.

[15] *Airline Competition: Issues Raised by Consolidation Proposals* (GAO–01–402T), February 7, 2001.

[16] GAO has recently initiated an analysis of issues relating to airline industry labor-management

government to preserve and enhance air service to these communities. There are two main programs that provide federal assistance to small communities: the Essential Air Service (EAS) program, which provides subsidies to commercial air carriers to serve the nation's smallest communities, and the Small Community Air Service Development Pilot Program, which provides grants to small communities to enhance their air service.[17]

As we reported in August, the number of communities that qualify for EAS-subsidized service has grown over the last year, and there are clear indications that that number will continue to grow. Federal awards under the program have increased from just over $40 million in 1999 to an estimated $97 million in fiscal year 2002.[18] As carriers continue to drop service in some markets, more communities will become eligible for subsidized EAS service.

In 2002, nearly 180 communities requested over $142.5 million in grants under the Small Community Air Service Development Pilot Program. DOT awarded the total $20 million available to 40 communities in 38 states to assist them in developing or enhancing their air service. The grants will be used for a variety of programs, including financial incentives to carriers to encourage either new or expanded air service, marketing campaigns to educate travelers about local air service, and support of alternative transportation. We are currently studying efforts to enhance air service in small communities, and expect to report on these programs early next year.

- **How will future international developments affect established agreements between the U.S. and EU member states?** There are a number of international issues that will influence the domestic aviation industry's attempts to recover from financial losses. The European Court of Justice is expected to reach a decision in the near future on the authority of individual European Union nations to negotiate bilateral agreements. This could raise uncertainties over the status of "open skies" agreements[19] that the United States has signed with individual European Union nations. This is especially critical with regard to negotiating an open skies agreement with the United Kingdom, our largest aviation trading partner overseas. Because almost all of the major U.S. carriers partner with European airlines in worldwide alliances, this decision could potentially impact the status of antitrust immunity for these alliances, which could in turn affect alliances established with airlines serving the Pacific Rim or Latin America. These alliances are key components of several major airlines' networks and as such significantly affect their overall financial status. Various studies have illustrated the benefits to both consumers and carriers that flow from liberalizing aviation trade through "open skies" agreements between the United States and other countries.

This concludes my statement. I would be pleased to answer any questions you or other Members of the Committee might have.

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[17] Congress created the Small Community Air Service Development Pilot Program under the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (Pub.L. 106–181). That act authorized $75 million over 3 years. DOT made no awards under the act in fiscal year 2001, because the Congress did not appropriate any funds for the first year of the program but $20 million was appropriated for fiscal year 2002.

[18] Figures in constant 2002 dollars.

[19] "Open skies" agreements are bilateral air service agreements that remove the vast majority of restrictions on how the airlines of the two countries signing the agreement may operate between, behind, and beyond gateways in their respective territories. DOT has successfully negotiated open skies agreements with 56 governments, including many in Europe.

Attachment I:

Summary of Network and Low-fare Airlines' Financial Condition, 2000 – June 2002

Network carriers	**Net income (loss) 2000**	**Net income (loss) 2001**	**Net income (loss) 2002:2Q**
Alaska	($70,300,000)	($39,500,000)	($4,500,000) (1)
America West	$7,679,000	($147,871,000)	($366,759,000) (2)
American	$813,000,000	($1,762,000,000)	($1,070,000,000) (3)
Continental	$342,000,000	($95,000,000)	($305,000,000)
Delta	$897,000,000	($1,027,000,000)	($583,000,000)
Northwest	$256,000,000	($423,000,000)	($264,000,000)
United	$50,000,000	($2,145,000,000)	($850,000,000) (4)
US Airways	($269,000,000)	($2,117,000,000)	($517,000,000) (5)
Total	**$2,026,379,000**	**($7,756,371,000)**	**($3,960,259,000)**
Low-fare carriers	**Net income (loss) 2000**	**Net income (loss) 2001**	**Net income (loss) 2002:2Q**
AirTran	$47,436,000	($2,757,000)	$2,027,000 (6)
American Trans Air	($15,699,000)	($81,885,000)	($53,518,000) (7)
Frontier (8)	$54,868,000	$16,550,000	($2,935,572)
JetBlue	-	-	$27,590,000 (9)
Southwest	$603,093,000	$511,147,000	$123,683,000
Vanguard	($26,031,626)	($30,914,459)	($7,963,262) (10)
Total	**$663,666,374**	**$412,140,541**	**$88,883,166**

Source: Airline annual reports and SEC filings.
Notes: Unless otherwise stated, 2002:Q2 data is for six (6) months ended 6/30/02. Spirit Airline's data is unavailable as it is a privately held concern.
(1) Three (3) months ended 6/30/02. Alaska Air Group, Inc.
(2) America West Holdings Corp.
(3) AMR Corporation.
(4) UAL Corporation.
(5) US Airways Group.
(6) AirTran Holdings, Inc.
(7) ATA Holdings, Inc. and subsidiaries. Formerly Amtran, Inc.
(8) Data reflects Frontier FY 2001 ended 3/31/01; FY 2002 ended 3/31/02; FY 2003:1Q three (3) months ended 6/30/02.
(9) JetBlue Airways Corporation went public on 4/11/2002.
(10) Three (3) months ended 3/31/02. Filed Chapter 11 on 7/30/02.

Attachment II:
Summary of Network and Low-fare Carrier Enplanements, 2000-2002 (January to May)

Network carriers	2000	2001	Percentage change (2000-2001)	2002 (Jan to May)	2001 (Jan to May)	Percentage change (Jan to May 2001-2002)
Alaska	12,841,367	13,241,705	3.1%	5,067,518	5,570,751	-9.0%
America West	19,989,290	19,432,305	-2.8%	7,506,559	8,484,761	-11.5%
American	69,431,436	62,661,131	-9.8%	31,772,755	27,156,822	17.0%
Continental	37,118,040	35,085,749	-5.5%	13,445,688	15,311,743	-12.2%
Delta	100,389,816	88,928,779	-11.4%	34,372,033	38,791,329	-11.4%
Northwest	49,464,897	45,570,838	-7.9%	17,328,913	19,515,133	-11.2%
United	73,757,167	65,259,307	-11.5%	22,852,094	28,424,896	-19.6%
US Airways	58,035,050	53,806,153	-7.3%	19,428,304	24,287,301	-20.0%
Low-fare carriers	**2000**	**2001**	**Percentage change (2000-2001)**	**2002 (Jan to May)**	**2001 (Jan to May)**	**Percentage change (Jan to May 2001-2002)**
AirTran	8,014,274	8,306,772	3.6%	3,868,744	3,661,883	5.6%
American Trans Air	6,183,661	6,856,076	10.9%	3,056,609	2,938,045	4.0%
Frontier	3,065,564	2,907,611	-5.2%	1,468,583	1,329,633	10.5%
JetBlue	1,147,761	3,118,096	171.7%	2,055,962	1,131,841	81.6%
Southwest	82,170,284	82,234,829	0.1%	32,570,332	34,679,716	-6.1%
Spirit	2,817,734	3,290,277	16.8%	1,443,537	1,537,719	-6.1%
Vanguard	1,880,257	1,421,062	-24.4%	664,479	587,492	13.1%

Source: GAO analysis of data from BACK Aviation Solutions.

Related GAO Products

Options to Enhance the Long-term Viability of the Essential Air Service Program. GAO–02–997R. Washington, DC: August 30, 2002.

Commercial Aviation: Air Service Trends At Small Communities Since October 2000. GAO–02–432. Washington, DC: March 29, 2002.

Proposed Alliance Between American Airlines and British Airways Raises Competition Concerns and Public Interest Issues. GAO–02–293R. Washington, DC: December 21, 2001

"State of the U.S. Commercial Airlines Industry and Possible Issues for Congressional Consideration", Speech by Comptroller General of the United States David Walker. The International Aviation Club of Washington: November 28, 2001.

Financial Management: Assessment of the Airline Industry's Estimated Losses Arising From the Events of September 11. GAO–02–133R. Washington, DC: October 5, 2001.

Commercial Aviation: A Framework for Considering Federal Financial Assistance. GAO–01–1163T. Washington, DC: September 20, 2001.

Aviation Competition: Restricting Airline Ticketing Rules Unlikely to Help Consumers. GAO–01–831. Washington, DC: July 31, 2001.

Aviation Competition: Challenges in Enhancing Competition in Dominated Markets. GAO–01–518T. Washington, DC: March 13, 2001.

Aviation Competition: Regional Jet Service Yet to Reach Many Small Communities. GAO–01–344. Washington, DC: February 14, 2001.

Airline Competition: Issues Raised by Consolidation Proposals. GAO–01–402T. Washington, DC: February 7, 2001.

Aviation Competition: Issues Related to the Proposed United Airlines-US Airways Merger. GAO–01–212. Washington, DC: December 15, 2000.

Essential Air Service: Changes in Subsidy Levels, Air Carrier Costs, and Passenger Traffic. RCED–00–34. Washington, DC: April 14, 2000.

Aviation Competition: Effects on Consumers from Domestic Airline Alliances Vary RCED–99–37. Washington, DC: January 15, 1999.

Senator DORGAN. (presiding) Ms. Hecker, thank you very much.

Mr. Mullin, why don't you proceed, and your entire statement will be made a part of the permanent record.

STATEMENT OF LEO F. MULLIN, CHAIRMAN AND CEO, DELTA AIR LINES

Mr. MULLIN. Thank you very much, Senator Dorgan. I am extremely grateful to be able to appear before this Committee, and thank you for the opportunity to be before you today on behalf of the Air Transportation Association just 1 year after the brutal terrorist assault on September 11th which rocked our Nation. As is so well-known, because terrorists used commercial aircraft as weapons of the new war, aviation security suddenly became an essential component in the larger national effort to combat terrorism. In recognition of that sea change, Congress quickly passed the Aviation and Transportation Security Act, creating a new Federal aviation security system as part of the larger restructuring of national security.

Much has been done, as a result, to make the whole aviation system more secure to the benefit of many, but 1 year later a review of the financial impact of the Government-policy-based, post 9/11 changes in aviation security shows that U.S. airlines are bearing an estimated $4 billion of the security burden that was totally unanticipated, all stemming from our Nation's war on terrorism.

Four billion dollars is a staggering amount for any industry to absorb and, indeed, no other private sector organization or industry has been asked to finance national security costs to this extent. The burden falls with particular weight on U.S. airlines, in light of our current unprecedented financial crisis.

Mr. Chairman, it is the belief of the airline industry that the Government had every intention of paying for the new security requirements when it passed the security act last year, and certainly the purpose was not to worsen airlines' plight by the actions. Today, in keeping with that intent, we are asking for relief for the airlines from the cost of fighting the war on terrorism and providing national security for our citizens, responsibilities that are fundamentally governmental functions appropriately paid for by the U.S. Government.

However, Mr. Chairman, while the industry's crisis makes swift and decisive action essential, we want to be clear that we are not asking Congress for special treatment, or for what has often been termed a bailout. Specifically, we are not here to request any aid related to any portion of our industry's losses, which are the result of economic and competitive challenges, that would constitute a bailout. Those marketplace factors are the responsibility of airlines themselves to be solved, using the tools of the free market, and we accept that responsibility.

Now, to provide context for why speedy action on this matter is required for the stability of the air transportation system, I would like to begin with a brief industry overview. As Exhibit 1—and I hope you do have those exhibits at your table—of my testimony shows, analysts' estimates for the industry losses in 2002 have now reached $7 billion. This result is especially disappointing, because 2002 had been expected to improve considerably from the $7 billion loss of 2001. The picture is not improving.

The next page, Exhibit 2, illustrates that as of June 2002 airline debt has grown by $18 billion, a 21 percent jump since January 1 of 2001. The industry in effect has funded growing losses with huge increases in debt, weakening substantially airline balance sheets that were already weak prior to September 11th.

Airlines have been taking dramatic self-help actions to cope with the difficult challenges we face. The 6 major hub-and-spoke carriers alone have trimmed costs since 9/11 by $14 billion in a series of difficult steps illustrated by Exhibit 3. We have cut operating expenses by $8.7 billion, or 13 percent. We have removed 15 percent of available seat miles from the system, and 267 aircraft from the fleet that are essentially sitting in the desert in California, and cut capital expenditures by $5 billion, or 49 percent.

Commensurate with these reductions, we have taken the most difficult step of all, eliminating fully 70,700 airline jobs at the larger aircraft, 100,000 throughout all of aviation, 16 percent of the hub-and-spoke carrier employees.

Even as the industry has struggled to trim losses, the falling value of financial investments has led to yet another challenge, underfunded pension plans, as shown in Exhibit 4. At the end of 2000, airline pension plan assets totaled $34.8 billion, which was slightly below the projected benefit obligation, but within a normal fluctuation range. But by 2001, reflecting the drop in the stock market and the changes in interest rate, that gap had grown to $12 billion. Consequently, substantial expense and cash contributions to pension plans will be required in the upcoming year by many airlines at a time when the industry can least afford it.

Now, though costs have been cut, the most obvious reasons for the industry's continued losses is that revenue remains depressed, running as a sorrowful point of context at levels last seen in 1996. As Exhibit 5 indicates, the degree and pattern of this drop off reveals a deeply troubling trend. For 20 or more years prior to 9/11, the first quarter of 1981 on the chart, 20 years, airline fares correlated reasonably closely with the Gross Domestic Product. Following September 11th, however, this connection appears to have become unhinged. The change is huge, as this exhibit portrays, and there is no indication that the correlation will improve in the near term.

Mr. Chairman, let me note at this point that our industry has fully supported the Aviation Security Act and the important improvements that have followed, even as we may have issues with some specific techniques, yet as time passed following 9/11, we began to observe that the upward trends in passenger traffic were not yielding any bottom line improvement, cost reductions notwithstanding.

This led us, starting in the second quarter, to begin scrutinizing a new source of spiraling financial pain, security cost. When we at Delta analyzed the cost, or lost revenue for our airline related to the Government-related items shown in Exhibit 6, we found the magnitude of the post 9/11 financial impact to be extraordinarily surprising.

Let me review these briefly. A new security tax of $2.50 per segment is costing Delta $265 million. This security tax on airline tickets was intended to be passed on to passengers, but high supply and low demand for airline seats means carriers do not have the pricing power to increase ticket prices, so the taxes become a direct hit to our bottom line.

Increased terrorism insurance costs $150 million. Terrorism insurance premiums, which cost Delta only $2 million in 2001, have increased by more than $150 million in 2002, $2 million to $150 million. Revenue losses due to new restrictions imposed on air carriage of U.S. mail as well as on freight shippers, $90 million. Following 9/11, the Government suspended the airlines' right to carry mail over 16 ounces, and restricted the number of shippers we could serve.

Unreimbursed costs for cockpit door fortification, $20 million. The Government has paid a portion of the initial cockpit door modification, but $20 million remains unfunded. The loss in potential seat revenue as part of the Federal Air Marshal program, $35 million. Federal air marshals occupy space in the cabin closest to the cockpit, generally high-premium, first class seats which the airlines can no longer sell.

Other mandated but unreimbursed security costs, $60 million, which includes costs to meet new requirements for ramp security, document verification, screening and catering supplies, and many others.

And finally, a DOT-imposed fee for passenger screening costs of $40 million, given that the DOT has chosen to exercise discretionary authority to impose monthly fees for additional screening cost reimbursements.

Added together, the total estimated 2002 impact of these items on Delta is $660 million, and extrapolating that estimate to the rest of the industry, the impact for 2002 approximates $4 billion for the industry, as I mentioned earlier.

Now, based on current estimates, this $4 billion Government-imposed impact could account for up to 35 percent of the industry's pre-tax operating losses for 2002, but Mr. Chairman, the numbers presented so far do not account for another security consequence which has received much criticism and done major damage to airline revenues, referred to in the opening statement by you, the so-called security hassle factor. Delta has conducted market research to determine the revenue loss resulting from the hassle factor, and we believe it accounts for roughly 20 percent of our revenue drop from 2001 to 2002. This amounts to almost $410 million of annual revenue loss for Delta, or, extrapolated to the other airlines, about $2.5 billion for the industry as a whole, and this is shown in Exhibit 7, the last exhibit.

Adding the hassle factor to the items I listed earlier, the extrapolated security-related impact of the airline industry could be on the order of $6.5 billion, providing a key explanation for the extreme degree of financial trouble the industry is experiencing.

Now, as I noted earlier, it is the airlines' responsibility to deal with the marketplace factors of the current industry crisis The major reductions in fleet capacity, capital expenditures, expenses and, most regrettably, personnel, give evidence of the hard steps already taken. However, as I have described, the industry's ability to address the current crisis has been seriously limited by the high and unanticipated cost of well-intended post 9/11 actions by the Government.

We recognize that the Committee has already provided flexibility for airports unable to meet the explosive detection system screening requirement at the end of this year, and we applaud this step. We are also pleased that the Committee bill, S. 2949, would provide Government terrorism or risk reinsurance through next year.

In addition to supporting enactment of these provisions, we are also here today to ask you to consider a five-step legislative agenda:

1. Eliminate the $2.50 ticket segment security tax.
2. Immediately authorize airlines to carry U.S. priority mail.
3. Obtain reimbursement to the airlines for unfunded security mandates.
4. Eliminate the monthly security fee the airlines are currently paying to the DOT.
5. For any armed pilots program or cabin crew self-defense training, make sure that associated costs are not levied on the airlines.

Removing the national security burden from the airlines as outlined in these five steps is crucial not only to my industry, but to the millions of people, businesses, and organizations that depend on a secure, healthy, and efficient air transportation system, as Senator Brownback earlier alluded to for Kansas.

Mr. Chairman, I want to end on one very important conceptual point. we are not asking the Government through this hearing for special treatment. We are asking for an end to special treatment, for relief from the Government-imposed consequences of the war on terrorism, now uniquely being borne by the airline industry.

Thank you very much.

[The prepared statement of Mr. Mullin follows:]

PREPARED STATEMENT OF LEO F. MULLIN, CHAIRMAN AND CEO, DELTA AIR LINES

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to testify before you today on behalf of the Air Transportation Association airlines, just over one year after the brutal terrorist assault of September 11 which rocked our nation.

As is so well known, because terrorists used commercial aircraft as weapons of the new war, aviation security suddenly became an essential component in the larger national effort to combat terrorism.

In recognition of that sea change, Congress quickly passed the Aviation and Transportation Security Act, creating a new federal aviation security system as part of the larger restructuring of national security.

Much has been done as a result to make the whole aviation system more secure—to the benefit of many.

But one year later, a review of the financial impact of government-policy-based, post-9/11 changes in aviation security shows that U.S. airlines are bearing an estimated $4 billion of the security burden that was totally unanticipated—all stemming from our nation's war on terrorism.

Four billion dollars is a staggering amount for any industry to absorb—and, indeed, no other private sector has been asked to finance national security costs.

The burden falls with particular weight on U.S. airlines in light of our current, unprecedented financial crisis.

Mr. Chairman, it is the belief of the airline industry that the government had every intention of paying for the new security requirements when it passed the Security Act last year—and, certainly, the purpose was not to worsen airlines' plight by these actions.

Today, in keeping with that original intent, we are asking for relief for the airlines from the costs of fighting the war on terrorism and providing national security for our citizens—responsibilities that are fundamentally governmental functions, appropriately paid for by the U.S. Government.

However, Mr. Chairman, while the industry's crisis makes swift and decisive action essential, we want to be clear that *we are not asking Congress for special treatment, or for what has sometimes been termed a "bail out."*

Specifically, we are *not* here today to request aid related to any portion of our industry's losses which are the result of economic and competitive challenges—that *would* constitute a bail out.

Those marketplace factors are the responsibility of airlines themselves, to be solved using the tools of the free market—and we accept that responsibility.

Now, to provide context for why speedy action on this matter is required for the stability of the air transportation system, I'd like to begin with a brief industry overview.

Referencing **Exhibit 1** in the charts attached to my statement today, you can see that in 2001, industry losses for the nine major airlines totaled $7.4 billion.

As the footnote indicates, these losses would have reached nearly $10 billion without the aid provided by this Congress as part of the Air Transportation Safety and System Stabilization Act of 2001.

You can see also that airline stock analysts' estimates for 2002 currently reach as high as $7 billion.

This is one of the most discouraging numbers in this presentation, since the expectation had been that losses would be substantially reduced for 2002 as the industry fought its way to recovery.

The next page, **Exhibit 2**, illustrates that, as of June 2002, airline debt has grown by $18 billion, a 21 percent jump since January 1, 2001.

The industry, in effect, has funded growing losses with huge increases in debt, weakening substantially airline balance sheets that were already weak prior to September 11.

The average carrier now has a debt to capitalization ratio in excess of 90 percent—far higher than the average ratio for all publicly held corporations.

Except for Southwest, the bonds of all other carriers are now rated as "junk bonds" by Standard and Poor's.

In the face of such challenges, airlines have acted quickly to cut losses by adjusting operations to meet the new demand environment.

Since September 11, the major U.S. carriers[1] alone have trimmed costs by $14 billion in a series of difficult steps with far-reaching consequences:

These self-help measures are illustrated on the chart marked **Exhibit 3**:

- The six major hub-and-spoke carriers have **cut operating expenses by $8.7 billion or 13 percent**, and many airlines are also working through the painful process of renegotiating labor contracts to further lower costs.
- We've **removed 86.8 billion available seat miles**, or ASMs, from the system, a 15 percent reduction, *and* **267 aircraft from the fleet.**

  These cuts have resulted in unfortunate service reductions for many cities and towns and, for the international carriers, even the elimination of service to some countries.
- And we've also **cut capital expenditures** by $5 billion, or 49 percent, affecting the economic health of the industries that supply goods and services to airlines and putting important technology-based customer service improvements on hold.
- Commensurate with this reduced capacity and fleet, **in a step that has been most difficult for all of us, 70,700 airline employees have lost their jobs**—representing fully 16 percent of the people working for the hub-and-spoke carriers.

Even as the industry has struggled with its unique challenges, another source of financial stress has occurred as a result of the fall in the value of financial investments—namely the increasing need to deal with underfunded pension plans.

This is shown on **Exhibit 4**.

At the end of year 2000, assets in airline pension plans amounted to $34.8 billion, which was slightly below the projected benefit obligation.

This year 2000 gap indicated normal fluctuations that occur in pension assets and liabilities.

But by 2001, reflecting heavily the drop in the stock market and changes in interest rates used for asset and liability estimates, the gap had grown to $12 billion.

[1] Source: SEC filings of American, Continental, Delta, Northwest, United and US Airways

Now, and in the upcoming year at least, substantial expense and cash contributions to pension plans will be required by many airlines during a time when the industry can least afford such contributions.

We can all hope that the financial markets improve soon, since that recovery would clearly help in relieving this problem.

But in the near term, it will cost the industry a lot to deal with the pension funding issues.

Now, though costs have been cut, the most obvious reason for the industry's continued losses is that revenue remains depressed—running, as a sorrowful point of context, at levels last seen in 1996.

This reflects the development of a deeply troubling trend, which is indicated on the chart marked **Exhibit 5**.

For 20 or more years prior to 9/11, airline fares correlated closely with the GDP—fluctuating near .95 percent of GDP.

But following September 11, this connection appears to have become unhinged, with revenue amounting to only .7 percent of GDP.

This is a huge change and, at the moment, there is no indication that the correlation will improve in the near-term.

While economic factors may play some role, this clear and dramatic de-linking also suggests strongly that the airlines' revenue shortfall is closely associated with the events of 9/11 and its aftermath.

Mr. Chairman, let me note at this point, that our industry has fully supported the Aviation Security Act and the important improvements that have followed, even as we may have issues with some specific techniques.

Yet as time passed following 9/11, we began to observe that the upward trends in passenger traffic were not yielding any bottom line improvement—cost reductions notwithstanding.

This led us, starting in the second quarter, to begin scrutinizing a new source of spiraling financial pain—security costs.

When we at Delta analyzed the cost or lost revenue for our airline related to the government-related items shown in **Exhibit 6**, we found the magnitude of the post-9/11 financial impact to be extraordinarily surprising.

Let me review those with you now:

- New security tax of $2.50 per segment—$265 million

  This security tax was imposed on airline tickets to help offset the federal cost of security and was intended to be passed on to passengers.

  But airlines have no current pricing power, simply because our supply of seats so far exceeds passenger demand.

  In this high-capacity, low-demand environment, airline customers do not have to accept price increases—and they don't.

  They shop on the Internet for the lowest possible price, for example, so airlines by necessity end up absorbing the new tax.

  This converts what was intended to be a price add-on to an expense, so the tax has become a direct hit to our bottom line.

- Increased terrorism insurance costs—$150 million

  Terrorism insurance was essentially a throw-in item for our airline insurance program prior to September 11, costing Delta only $2 million in 2001.

  Following September 11, premiums rose by an incredible $150 million for 2002.

- Revenue losses due to new restrictions imposed on air carriage of U.S. mail as well as on freight shippers—$90 million

  This loss is due to the elimination of airlines' right to carry mail over 16 ounces in the cargo holds of our planes, as well as restrictions on the number of shippers we can serve.

  The cargo carriers have been a major beneficiary of these rulings.

- Unreimbursed costs for cockpit door fortification—$20 million

  The government has paid a portion of the initial cockpit door modifications, but $20 million remains unfunded—and additional fortification costs are still ahead.

- Loss in potential seat revenue as part of the Federal Air Marshal program—$35 million

  Federal air marshals occupy space in the cabin closest to the cockpit, generally high-premium first class seats which the airlines can no longer sell.

- Other mandated but unreimbursed security costs—$60 million

This category includes the costs to meet new requirements for increased ramp security, document verification, and screening of catering supplies.

- DOT-imposed fee for passenger screening costs—$40 million

  The DOT has chosen to exercise discretionary authority to impose monthly fees for additional screening cost reimbursement.

Adding the financial impact of all these categories together—the new security tax, increased insurance costs, new restrictions on U.S. mail and freight, mandated cockpit door fortification, other unreimbursed security costs, and the monthly fee to the DOT—the 2002 estimated impact on Delta is $660 million.

In addition to these items, pending legislation to arm pilots and provide self-defense training to flight crews could create large new unfunded mandates.

Also, the current TSA plan to implement new screening requirements for checked baggage by the end of 2002 has enormous potential to impact the industry with new costs, including increased staffing demands and reduced efficiencies.

Now, the numbers just presented are Delta numbers—airlines have not yet made a full survey to judge the industry wide impact.

However, given that Delta represents just over one-sixth of the industry, we can roughly extrapolate to the rest of the industry by multiplying Delta's numbers by slightly more than six.

The resulting rough estimate for the total post 9/11 security-related impact on the U.S. airline industry would be about *$4 billion*.

Now, based on current estimates, this $4 billion government-imposed impact could account for up to 35 percent of the industry's pretax operating losses for 2002.

But, Mr. Chairman, the numbers presented so far do not account for another security consequence which has received much criticism and done major damage to airline revenues—the so-called security "hassle factor."

Delta has conducted market research to determine the revenue loss resulting from the hassle factor—and we believe it accounts for roughly 20 percent of our revenue drop from 2001 to 2002.

That amounts to almost $410 million of the annual revenue loss for Delta—or, extrapolated to the other airlines, about *$2.5 billion* for the industry as a whole, as you can see in **Exhibit 7**.

Adding the hassle factor to the items I listed earlier, the extrapolated security-related impact on the airline industry could be on the order of *$6.5 billion*—providing a key explanation for the extreme degree of financial trouble the industry is experiencing.

Now, as I noted earlier, it is the airline's responsibility to deal with the marketplace factors of the current industry crisis.

The major reductions in fleet capacity, capital expenditures, expenses, and—most regrettably—personnel, give evidence of the hard steps already taken.

However, as I have described, the industry's ability to address the current crisis has been seriously limited by the high and unanticipated costs of well-intended post-9/11 actions by the government.

We recognize that the Committee has already provided flexibility for airports unable to meet the Explosive Detection System screening requirement at the end of the year, and we applaud this step.

We are also pleased that the Committee's bill, S. 2949, would provide government terrorism/war risk reinsurance through next year.

Therefore, in addition to supporting enactment of these provisions, we are also here today to ask you to consider a five step legislative agenda:

1. Eliminate the $2.50 security ticket segment tax.
2. Immediately authorize airlines to carry U.S. priority mail.
3. Obtain reimbursements to the airlines for unfunded security mandates.
4. Eliminate the monthly security fees airlines are currently paying to the Department of Transportation.
5. For any armed-pilots program or cabin crew self-defense training, ensure that associated costs are not levied on the airlines.

We ask you for your support in the rapid implementation of these initiatives for two important reasons.

First, as I noted earlier, we believe the government generally has expressed through legislative intent—that increased aviation security should be viewed as an appropriate national security response to the September 11 national attacks which used airlines as the instruments of destruction.

As a result, these costs should be funded through the national security funding mechanisms, not as taxes or costs imposed specifically on airlines.

Secondly, as the final point for today, we ask for that help because aviation is key to our nation's economic health.

The statistics are well known:

Airlines are a vital infrastructure for U.S. commerce, carrying 620 million passengers and 22 billion ton miles of cargo each year.

Air travel makes a significant contribution to the $700 billion travel and tourism industry, which employs approximately 1 of every 7 people in the U.S. civilian labor force.[2]

Airlines' directly provide approximately 1 million jobs.

We pay $17.7 billion in taxes—$10 billion of those at the federal and state level.

And airlines provide an essential social and business link between America's cities and its smaller communities.

Removing the national security burden from the airlines as outlined in these five steps is crucial not only to my industry, but to the millions of people, businesses, and organizations that depend on a secure, healthy, and efficient air transportation system.

Mr. Chairman, I want to end on one important conceptual point.

We are not asking the government, through this hearing, for special treatment.

We are asking for an *end* to special treatment—for relief from the government-imposed consequences of the war on terrorism now *uniquely* borne by the airline industry.

Thank you.

[2] Source: Travel Industry Association of America

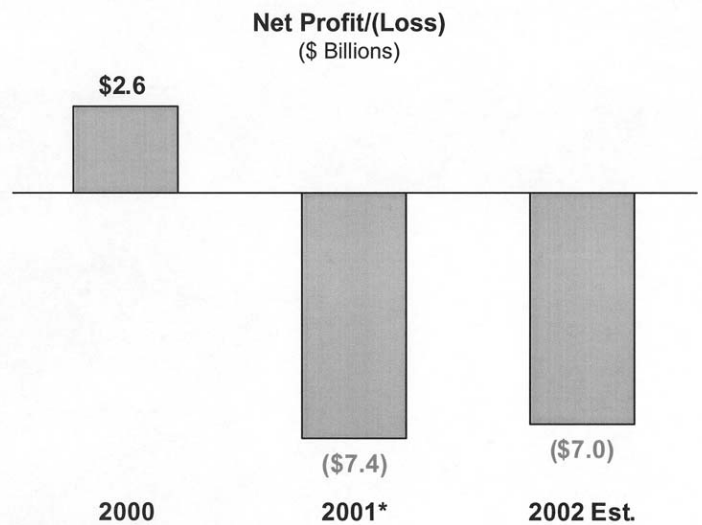
State of the Airline Industry One Year After 9/11

AIR TRANSPORT ASSOCIATION

Exhibits Supporting Congressional Testimony of Leo F. Mullin
October 2, 2002

EXHIBIT 1

Losses are Extremely High – and Are Not Recovering



* 2001 loss as shown mitigated by federal compensation remitted to air carriers under Stabilization Act (P.L. 107-42), without which net loss would have been $9.8 billion

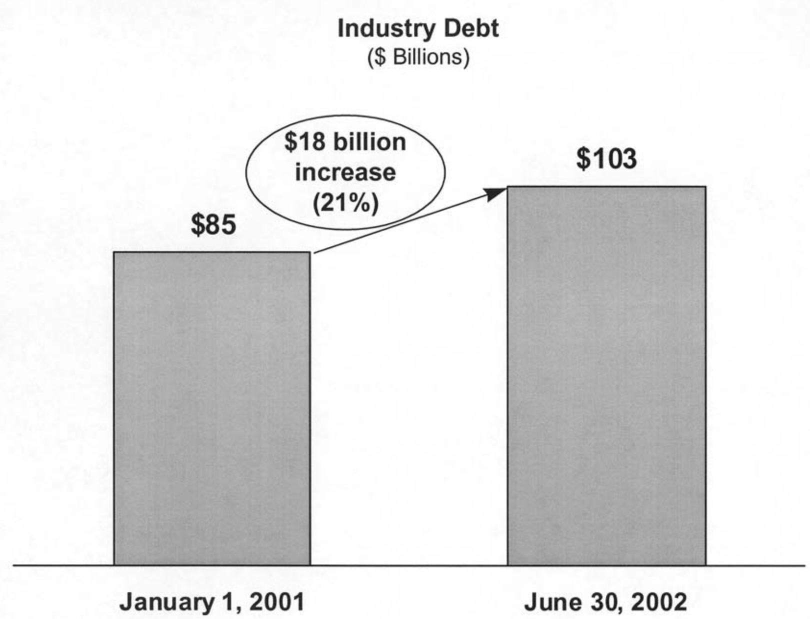
Note: Includes American, United, Delta, Northwest, Continental, US Airways, Southwest, Alaska, and America West

Source: 2000 and 2001 from SEC filings; 2002 estimates from UBS Warburg (Sept. 13, 2002)

Air Transport Association

EXHIBIT 2

Airlines Have Taken on Massive Debt



Source: SEC filings. Data includes off and on balance sheet debt of Alaska, American, America West, Continental, Delta, Northwest, Southwest, United, and US Airways

EXHIBIT 3

Airlines Have Undertaken Self-Help Measures

Top Six Network Carriers
Nine Months Ended June 2002 vs. Prior Year

	Reduction	% Change
Operating Expenses	$8.7 billion	(13%)
Capacity	86.8 billion ASMs	(15%)
Mainline Fleet	267 aircraft	(8%)
Headcount	70,700 employees	(16%)
Capital Spending*	$5.0 billion	(49%)

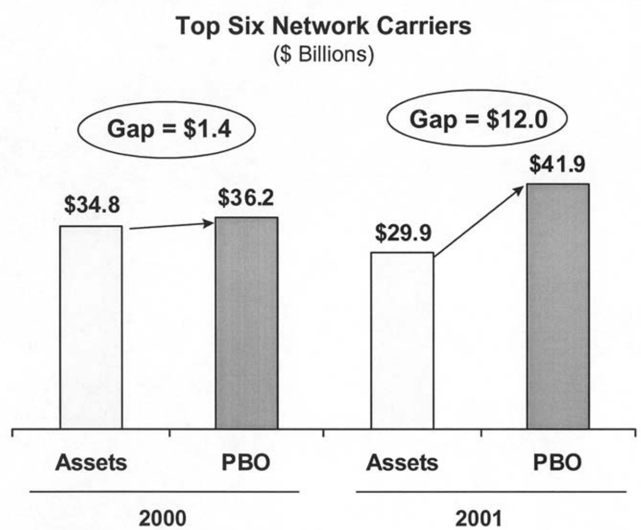
* Defined as amount used to acquire or improve property and equipment; includes aircraft and ground equipment
Source: SEC filings of American, Continental, Delta, Northwest, United and US Airways

AIR TRANSPORT ASSOCIATION

EXHIBIT 4

Pension Benefit Obligations Increasingly Underfunded

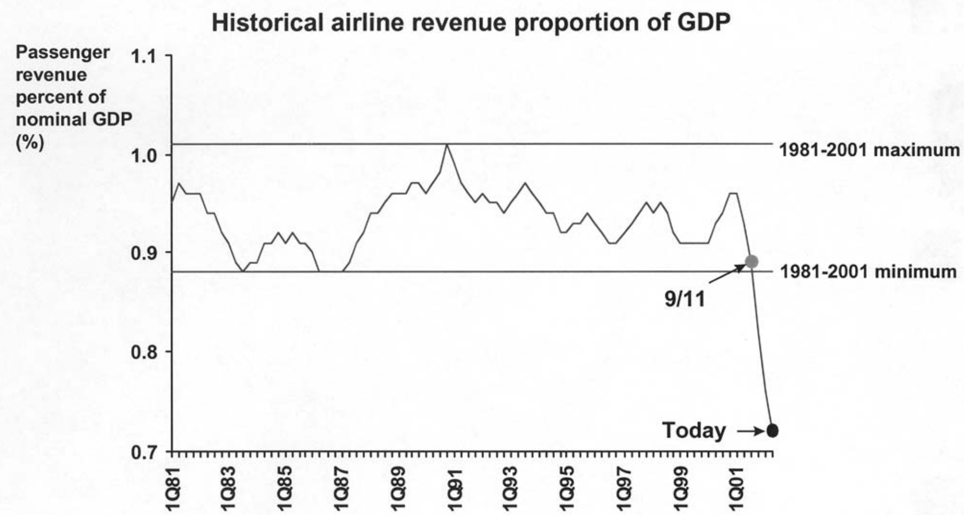
Assets vs. Projected Benefit Obligations ("PBO")



Source: Company 10-K SEC filings; includes American, Continental, Delta, Northwest, United and US Airways. Delta and US Airways measured on 9/30/01; all others on 12/31/01

EXHIBIT 5

Airline Revenues Have Fallen Off The Chart Relative To The Economy



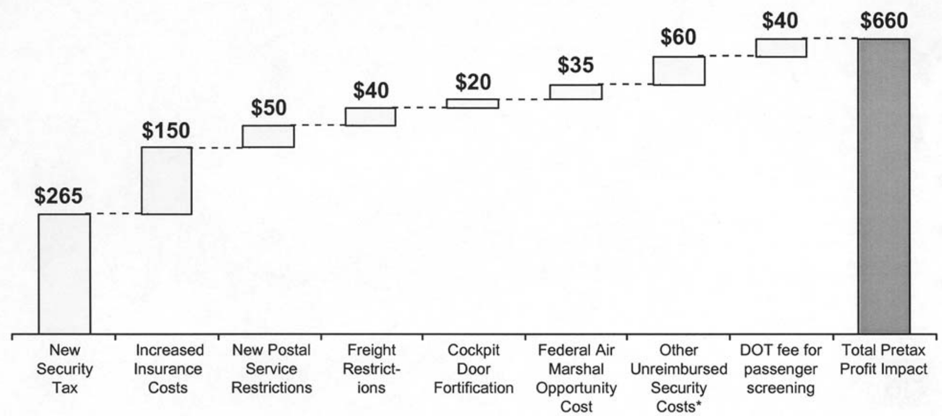
Source: UBS Warburg Global Equity Research; U.S. Bureau of Economic Analysis; DOT Form 41

EXHIBIT 6

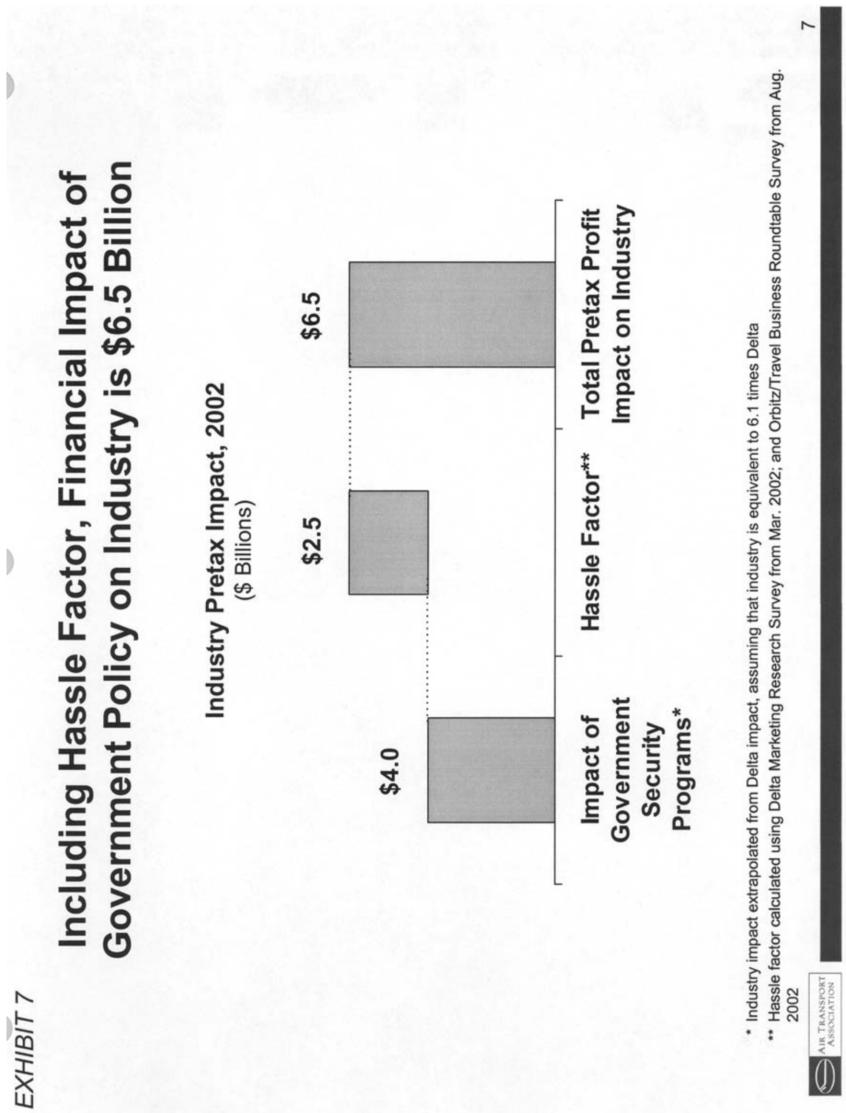
Delta Air Lines: Financial Impact of Government Security Programs

Additional Delta Pretax Costs, 2002

($ Millions)



* Includes ramp security, checkpoint document verification, screening of catering supplies and materials, airport space occupied by TSA, security equipment, and training



Senator DORGAN. Mr. Mullin, thank you very much.

Next, we will hear from Ms. Susan Donofrio, accompanied by Allison Poliniak, Deutsche Bank Securities, New York City.

STATEMENT OF SUSAN DONOFRIO, SENIOR U.S. AIRLINE ANALYST, DEUTSCHE BANK SECURITIES, ACCOMPANIED BY ALLISON POLINIAK

Ms. DONOFRIO. Yes, I will be speaking—I am an airline analyst for Deutsche Bank Securities, and I just cover the major——

Senator FITZGERALD. Can you bring the microphone closer?

Ms. DONOFRIO. Mr. Dorgan, Members of the Committee, I do appreciate the chance to address the Committee on the current state of the U.S. airline industry. What I would like to focus upon today is the current financial state of the airline industry and how it has been impacted since September 11th's tragic events a year ago.

With respect to our expectations prior to September 11th, going into 2001, we actually thought it would be another banner year for the airlines, and this was due to robust demand. However, revenue quickly turned sour as demand faltered due to the softening economy. This was evident in business demand for the industry, which dropped 41 percent year over year from January to July.

Acting responsibly, as opposed to the 1980's, most U.S. airlines have shown a very quick response with respect to reining in capacity growth. There was also a move by the industry to scale back whatever costs they could. Even in the face of this, it was still going to be a year of substantial losses going into the tragic events of September 11th. Much of this is due to unavoidable costs such as wages, fuel, maintenance, as well as the soft demand. Our net loss estimate prior to September 11th last year was a decline in net income for the majors of roughly $4 billion for 2001. This was getting close to the $4.8 billion loss that the industry sustained in 1992, the worst year during the past airline downturn.

With respect to the airline industry post 9/11, certainly the $5 billion grant, along with $10 billion in loan guarantees, certainly stemmed what could have been even more of a disastrous financial year. In sum, the 9 U.S. majors sustained over $7 billion in losses, sharply eclipsing the level of losses in any 1 year of the early 1990's.

As we started to move further away from September 11th, it did appear that there were some signs of a revenue recovery, and we began to become a little more optimistic. This proved to be short-lived, however, as rebounding demand began to falter. This is evident in pricing and revenue data.

With respect to demand, not only did overall traffic growth falter, but we have statistics that show that short haul traffic has declined disproportionately more than longer haul traffic. We think it is due to the increased hassle factor, taxes, and overall economic sluggishness that have caused passengers to either drive or stay at home altogether.

The industry also continues to grapple with increased fees and taxes that now have grown to represent 26 percent of the price of an airline fare versus 15 percent in 1992, and 7 percent in 1972. This is even greater for the low fare airlines, representing over 30 percent of the price of their airline fares.

Last, the recent surge in fuel prices has also become quite burdensome from a cost standpoint, since every $1 change in the price of crude oil results in an additional $140 million in annual operating costs for the 9 majors.

From a leverage standpoint, long term outstanding debt, including the capitalization of off-balance-sheet operations for the 9 majors, stands at approximately $94 billion, versus $88 billion at year-end 2001. The net debt, the cap ratio for most of the majors, is currently well over 80 percent.

What this tells us is that just renewing the loan guarantee program to the industry may not be such a good idea, since the industry is already burdened with a very heavy debt load. Many of these companies therefore become even more highly leveraged. What may, in fact, happen is that very weak carriers may be forced to cut fares to cover the loans from the Government, weakening the stronger airlines. We therefore believe that the solution is likely to be some type of tax relief for the airlines, especially if an Iraqi conflict further exacerbates the airlines' already tenuous financial position.

Why is this downturn different from the one in the early Nineties? From a revenue standpoint, the duration of the revenue weakness has already been more prolonged, and much more precipitous. Based on a weak economy, the lack of any pricing power, airport hassle factor, fears of terrorism, continued oversupply and the possible upcoming Iraqi conflict, we anticipate that we are not likely to see a meaningful revenue rebound until 2004 at the earliest.

From a cost perspective, while it appears that the airlines have been reining in what they can, taxes and fees, as well as labor costs, have been increasing at rapid rate, far outpacing inflation and yields. This is putting further pressure on an already financially challenged industry, further exacerbating the cost side of the equation, and certainly a sizable increase in post 9/11 security insurance-related costs. Our estimate is that these costs have put an additional cost burden to the industry of $3.5 to $4 billion.

Our expectation going forward is a net loss of $5.7 billion for the 9 U.S. majors in 2002, and $2 billion loss in 2003. Given higher than expected oil prices and what appears to be an imminent Iraqi invasion, we think that this amount is likely to be a best case scenario.

So what do we think should be done? With respect to Government intervention, we think that immediate tax relief should help stem industry losses, since the U.S. airlines have been hit so much harder than their international counterparts. In addition, there needs to be some cost relief with respect to post 9/11 security-related costs, which we again estimate roughly $3.5 to $4 billion.

Now, turning to the airline managements, and more specifically the big six—American, Continental, Delta, Northwest, United, and US Air—what do we think they should do? We think they need to figure out how to adapt to what appears to be a new operating environment. On the revenue side, this means figuring out how to adjust to a more competitive revenue environment as well as the weak economy.

In addition, we think that many airline managements need to do a much better job in pricing their product. It is evident in the average business fare that we believe is now over seven times the average leisure fare, causing many business passengers to very easily justify trading down to lower fare levels with even more fare restrictions. In addition, while we have been very impressed with capacity scale backs, they have not been enough to stem the tide of weak demand.

On the cost side, these airlines have to continue to attack their overall cost structures that have not been able to support the drop off in demand and pricing.

I hope you will look at my testimony. I have got a lot of graphs and exhibits in there. Thank you so much for your time and the opportunity to speak before this Committee.

[The prepared statement of Ms. Donofrio follows:]

PREPARED STATEMENT OF SUSAN DONOFRIO, SENIOR U.S. AIRLINE ANALYST, DEUTSCHE BANK SECURITIES, ACCOMPANIED BY ALLISON POLINIAK

Mr. Chairman and Members of the Committee:

I appreciate the chance to address the Committee on the current state of the U.S. airline industry. What I would like to focus upon today is the current financial state of the airline industry and how it has been impacted since September 11th's tragic events a year ago.

Our Expectations Prior to September 11th

Going into 2001, we thought that this would be another banner year for the airlines due to robust demand. However, revenue quickly turned sour, as demand faltered due to a softening economy. This was evident in business demand for the industry, which dropped 41 percent year-over-year from January to July.

Acting responsibly (as opposed to the 1980s), most U.S. airlines have shown a very quick response with respect to reining in capacity growth. There was also a move by the industry to scale back whatever costs they could. Even in the face of this, it was still going to be a year of substantial losses going into the tragic events of September 11th. Much of this is due to unavoidable costs such as wages, fuel, and maintenance, and soft demand. Our net loss estimate prior to September 11th was a decline in net income for the majors of roughly $4 billion for 2001. This was getting close to the $4.8 billion loss that the industry sustained in 1992, the worst year during the past airline downturn.

The Airline Industry Post 9/11

No Sign of a Revenue Recovery

The $5 billion cash grant along with $10 billion in loan guarantees certainly stemmed what could have been even more of a disastrous financial year. In sum, the 9 U.S. majors sustained over $7 billion in losses, sharply eclipsing its level of losses in any one year of the early 1990s.

As we started to move further away from September 11th, it appeared that there were some signs of a revenue recovery and we began to become more optimistic. This proved to be short-lived, however, as rebounding demand began to falter. This is evident in pricing data, which we have charted against the average of historical (monthly from 1990–2000, a full business cycle) pricing data in order to get a better view as to what is really occurring in overall pricing.

Figure 1: Domestic RASM Comparison

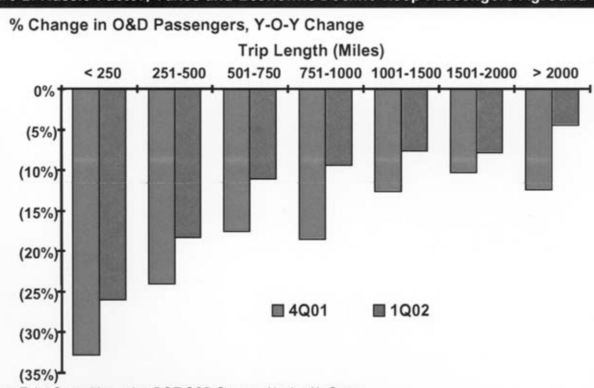
Average Domestic Monthly RASM: 1990-2000		2002 Domestic RASM		% Change
Jan	8.21	Jan	7.86	-4.2%
Feb	8.80	Feb	8.77	-0.4%
Mar	9.56	Mar	9.44	-1.3%
Apr	9.21	Apr	8.91	-3.2%
May	9.08	May	8.71	-4.0%
Jun	9.47	June	8.97	-5.3%
Jul	9.02	July	8.39	-7.0%
Aug	9.19	Aug	8.35	-9.1%
Sep	8.57			
Oct	9.02			
Nov	8.87			
Dec	8.26			

Source: Air Transport Association

Short-Haul Markets Are Down Disproportionately

With respect to demand, not only did overall traffic growth falter but it is clear that short-haul traffic has declined disproportionately more than longer-haul traffic. We think that it is due to the increased hassle factor, taxes, and overall economic sluggishness that have caused passengers to either drive or stay at home altogether.

Figure 2: Hassle Factor, Taxes and Economic Decline Keep Passengers Aground

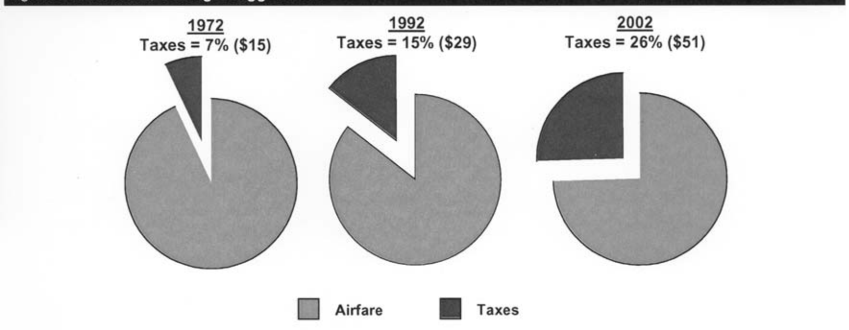


Source: Eclat Consulting using DOT O&D Survey, Alaska Air Group

Increased Fees and Taxes

The industry also continues to grapple with increased fees and taxes that have now grown to represent 26% of the price of an airline fare versus 15% in 1992 and 7% in 1972. This is even greater for the low fare airlines, representing over 30% of the price of their airline fares.

Figure 3: **Taxes Are Taking a Bigger Bite**

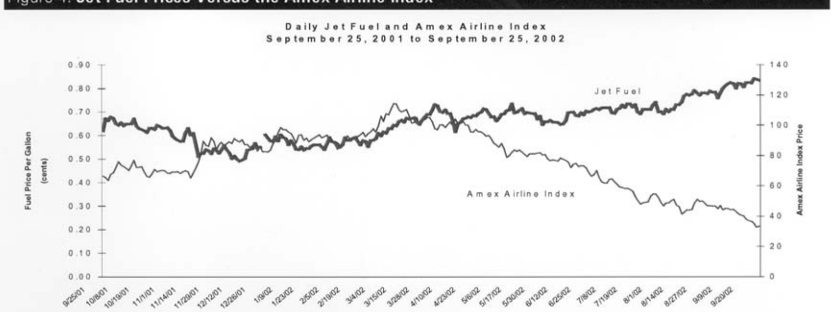


Source: Industry data. Note: Based on a $200 Single-Connection Domestic Roundtrip Ticket With $4.50 PFC

The Surge in Fuel Prices Hinder the Recovery

Last, the recent surge in fuel prices has also become quite burdensome from a cost standpoint since every $1 change in the price of crude oil results in an additional $140 million in annual operating costs for the 9 US majors.

Figure 4: **Jet Fuel Prices Versus the Amex Airline Index**



Source: Deutsche Bank Securities Inc. estimates and company information

Leverage Has Increased Dramatically

From a leverage standpoint, long-term outstanding debt, including the capitalization of off-balance sheet obligations, for the 9 majors stands at approximately $94 billion versus $88 billion at year-end 2001. The net debt/capital ratio for most of the major airlines is currently well over 80%. What this tells us is that just renewing the loan guarantee program to the industry may not be such a good idea since the industry is already burdened with a very heavy debt load. Many of these companies will, therefore, become even more highly leveraged. What may in fact happen is that very weak carriers may be forced to cut fares to cover the loans from the government, weakening the stronger airlines. We, therefore, believe that the solution is likely to be some type of tax relief for the airlines, especially if an Iraqi conflict further exacerbates the airlines' already tenuous financial position.

Figure 5: **Deutsche Bank Securities U.S. Airlines Financial and Liquidity Analysis**

Company	Revenues	Net Income	Liquidity[1]	Free Cash From Operations (FCFO)[2]	Outstanding Debt[3]	Net Debt[4]	EBITDAR net fixed charge coverage	FCFO / net debt	Net debt / capital
Airtran	$636	($17)	$109	($81)	$557	$448	0.9x	-18.1%	91.7%
Alaska	**$2,117**	**($95)**	**$707**	**($299)**	**$2,223**	**$1,516**	**1.1x**	**-19.7%**	**64.9%**
American	$17,235	($2,268)	$2,563	($5,744)	$21,745	$19,182	-0.6x	-29.9%	81.4%
America West	**$1,896**	**($214)**	**$487**	**($1,082)**	**$3,142**	**$2,656**	**0.3x**	**-40.8%**	**93.4%**
Atlantic Coast	$665	$48	$200	($50)	$1,126	$927	1.9x	-5.4%	78.0%
ATA Holdings	**$1,218**	**($57)**	**$154**	**($139)**	**$1,551**	**$1,398**	**1.0x**	**-10.0%**	**95.1%**
Continental	$8,147	($465)	$1,311	($2,104)	$16,829	$15,518	0.8x	-13.6%	93.1%
Delta	**$12,838**	**($1,303)**	**$1,841**	**($3,741)**	**$18,527**	**$16,686**	**0.4x**	**-22.4%**	**83.0%**
Northwest	$9,165	($621)	$2,807	($2,402)	$10,174	$7,367	0.4x	-32.6%	107.0%
SkyWest	**$683**	**$61**	**$364**	**($18)**	**$817**	**$454**	**NA**	**-4.0%**	**43.4%**
Southwest	$5,303	$215	$2,118	($368)	$3,334	$1,217	3.2x	-30.2%	22.4%
United	**$14,137**	**($2,064)**	**$2,704**	**($3,806)**	**$22,936**	**$20,232**	**-0.6x**	**-18.8%**	**90.3%**
US Airways	$7,166	($1,150)	$532	($2,598)	$10,175	$9,643	-0.6x	-26.9%	147.4%
Industry Range	**-**	**-**		**-**	**-**	**-**	**-0.6x-3.6x**	**-53.6% to -4.1%**	**23.5%-141.4%**
Industry Median	-	-		-	-	-	0.6x	-19.7%	90.3%

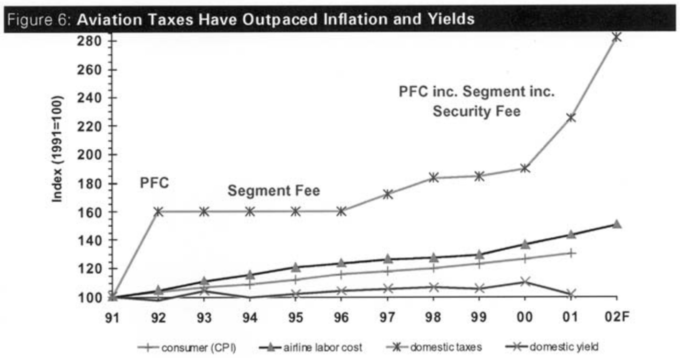
Source: Deutsche Bank Securities Inc. estimates and company information Note: All $ in millions. Income statement numbers are on a trailing twelve month basis as ofJune 2002. 1. As of June 30, 2002. 2. FCFO equals EBITDA less capex, interest expense and aircraft rental expense. 3. Outstanding debt equals long-term debt plus capital leases and capitalized operating leases. 4. Net debt equals outstanding debt less cash.

Why is this Downturn Different from the One in the Early '90s?

From a revenue standpoint, the duration of revenue weakness has already been more prolonged and precipitous. Based on the weak economy, the lack of any pricing power, airport hassle factor, fears of terrorism, continued oversupply, and a possible upcoming Iraqi conflict, we anticipate that we aren't likely to see any meaningful revenue rebound until 2004, at the earliest.

From a cost perspective, while it appears that the airlines have been reigning in what they can, taxes and fees as well as labor costs have been increasing at a rapid rate, far outpacing inflation and yields. This is putting further pressure on an already financially challenged industry. Further exacerbating the cost side of the equation is a sizable increase in post-9/11 security/insurance related costs. Our estimate is that these costs have put an additional annual cost burden on the industry between $3.5-$4.0 billion.

Figure 6: **Aviation Taxes Have Outpaced Inflation and Yields**



Source: Air Transport Association.

Figure 7: **Industry Financial Performance From Cont. Ops -- Today vs the Early 1990s**

		Operating Revenue Growth*	Operating Expenses Growth*	Operating Margin	Net Margin	Net Income
2000A-2003E						
	2000	10.7%	13.0%	6.1%	2.8%	2.8 B
	2001	-13.4%	-1.4%	-7.0%	-5.9%	(5.1) B
	2002E	-5.9%	-5.3%	-7.6%	-7.1%	(5.7) B
	2003E	1.1%	-5.3%	-0.9%	-2.5%	(2.0) B
1989A-1992A						
	1989	8.8%	12.0%	2.6%	0.2%	$132.6 MM
	1990	9.7%	15.5%	-2.5%	-5.3%	(3.9) B
	1991	-1.1%	-1.3%	-2.4%	-2.7%	(1.9) B
	1992	4.9%	5.6%	-3.1%	-3.9%	(4.8) B

Source: Company reports for the 9 US majors and DBSI estimates.

Our Expectation Going Forward

Our current industry forecast is a net loss of $5.7 billion for the 9 US majors in 2002 and $2.0 billion in 2003. Given higher-than-expected oil prices and what appears to be an imminent Iraqi invasion, we think that this amount is likely to be a best-case scenario.

Figure 8: Industry Forecast for the 9 U.S. Majors (from continuing operations and excluding special items)

	2000	1Q01	2Q01	3Q01	4Q01	2001	1Q02	2Q02	3Q02E	4Q02E	2002E	2003E
Financial Data												
Passenger Revenues ($ millions)	89,801	21,288	22,171	19,387	15,154	77,302	16,658	18,633	19,208	18,235	72,444	73,503
Freight & Mail Revenues ($ millions)	3,593	816	803	696	673	2,967	612	682	675	765	2,733	2,769
Other Revenues ($ millions)	5,852	1,542	1,527	1,454	1,177	5,635	1,353	1,487	1,461	1,340	5,642	5,446
Total Operating Revenues	99,246	23,646	24,501	21,537	17,004	85,904	18,623	20,802	21,344	20,340	80,819	81,719
Yr/Yr Change	*10.7%*	*3.6%*	*-5.3%*	*-17.7%*	*-30.3%*	*-13.9%*	*-21.8%*	*-16.0%*	*-0.9%*	*20.3%*	*-6.3%*	*1.5%*
Wage & Benefits	33,463	8,881	8,721	8,821	8,178	34,278	8,499	8,873	8,686	8,881	34,939	32,549
Fuel	13,713	3,542	3,402	3,204	2,411	12,418	2,236	2,664	2,887	2,634	10,415	9,936
Commissions	5,260	1,172	1,160	915	702	3,921	776	662	643	605	2,686	2,481
Aircraft Rentals & Landing Fees	9,328	2,347	2,253	2,236	2,338	9,000	2,307	2,342	2,367	2,534	9,550	8,898
Depreciation & Amortization	5,338	1,393	1,393	1,431	1,406	5,593	1,320	1,334	1,324	1,333	5,312	5,524
Maintenance	5,258	1,395	1,378	1,320	1,140	5,212	1,157	1,199	1,278	1,224	4,859	4,498
Food Service	831	217	215	201	181	795	184	197	175	167	724	663
Other	19,990	5,223	5,810	5,630	4,197	20,685	4,374	4,466	5,300	4,402	18,542	17,890
Total Operating Expenses	93,181	24,169	24,334	23,758	20,553	91,903	20,853	21,738	22,662	21,780	87,027	82,438
Yr/Yr Change	*13.0%*	*10.0%*	*6.4%*	*-1.5%*	*-15.1%*	*-1.4%*	*-13.7%*	*-10.7%*	*-4.6%*	*6.0%*	*-5.3%*	*-5.3%*
Operating Income ($ millions)	6,065	-523	167	-2,221	-3,549	-5,999	-2,229	-936	-1,318	-1,439	-6,208	-720
Nonoperating Income	-1,140	-470	-429	-534	-636	-2,035	-630	-684	-692	-694	-2,699	-2,548
Net Income	2,827	-609	-106	-1,725	-2,758	-5,089	-1,742	-1,023	-1,283	-1,345	-5,767	-2,026

Source: Deutsche Bank Securities Inc. estimates and company information

So What Should Be Done?

With respect to government intervention, we think that immediate tax relief should help stem industry losses since the U.S. airlines have been hit so much harder than their international counterparts. In addition, there needs to be some cost relief with respect to post 9/11 security-related costs which we estimate to be between $3.5-$4.0 billion.

Turning to airline managements and, more specifically, "the big 6" (American, Continental, Delta, Northwest, UAL Corp., and US Airways), we think that they need to figure out how to adapt to what appears to be a new operating environment. On the revenue side, this means figuring out how to adjust to a more competitive revenue environment and a weak economy. In addition, we think that many airline managements need to do a better job in pricing their product. This is evident in an average business fare which we believe is now over 7 times the average leisure fare, causing business passengers to easily justify trading down to lower fare levels, even with more fare restrictions. In addition, while we have been impressed with capacity scale-backs they have not been enough to stem the tide of weak demand. On the cost side, these airlines have to continue to attack their overall cost structures that have not been able to support the drop-off in demand and pricing. This is evident in the tables below.

Figure 9: Comparison of "the big 6"* versus Southwest, JetBlue, and AirTran -- 2Q02A (US cents)

	Big 6	Southwest	JetBlue	AirTran
RASM	10.5	8.4	7.7	9.1
CASM	11.1	7.5	6.3	8.5

*Source: Deutsche Bank Securities Inc. estimates and company information * RASM: Opg Revs/Available Seat Mile, CASM: Opg. Expenses/ASM.*

Figure 10: **Comparison of "the big 6"* versus Southwest, JetBlue, and AirTran -- 2Q02A (US cents)**

	Big 6	% of CASM	Southwest	% of CASM	JetBlue	% of CASM	AirTran	% of CASM
Wages & Benefits/ASM	4.6	42%	2.9	39%	1.9	31%	2.4	29%
Fuel Expense/ASM	1.3	12%	1.1	15%	0.9	14%	1.9	22%
Maintenance/ASM	0.6	5%	0.6	8%	0.1	1%	0.7	8%
Commisssions/ASM*	0.4	3%	0.1	1%	0.6	10%	0.9	10%
Rentals & Landing Fees/ASM	1.2	11%	0.8	10%	1.0	16%	1.3	15%
Depreciation & Amort./ASM	0.7	6%	0.5	7%	0.3	5%	0.2	2%
Other/ASM	2.4	21%	1.5	20%	1.5	23%	1.2	14%
Sum	***11.1***	***100%***	***7.5***	***100%***	***6.3***	**100%**	***8.5***	**100%**

*Source: Deutsche Bank Securities Inc. estimates and company information. * Commissions/ASM may include other distribution expenses as well.*

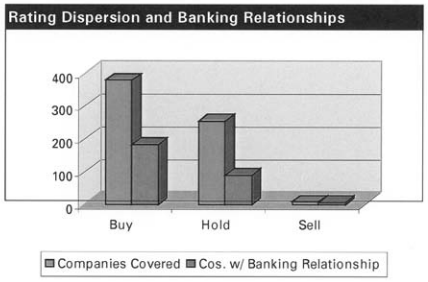
Rating Key

Buy: Total return expected to appreciate 10% or more over a 12-month period

Hold: Total return expected to be between 10% to –10% over a 12-month period

Sell: Total return expected to depreciate 10% or more over a 12-month period

Rating Dispersion and Banking Relationships



Disclosures

Company	Ticker	Price	Disclosure
Alaska Air Group	ALK	$17.70	None
AMR Corporation	AMR	$4.18	6
America West Holdings Corporation	AWA	$1.45	None
Continental Airlines, Inc.	CAL	$5.39	6
Delta Air Lines	DAL	$9.29	6
Southwest Airlines	LUV	$13.06	6
Northwest Airlines Corporation	NWAC	$6.68	1,2
UAL Corporation	UAL	$2.14	6
AirTran Holdings, Inc.	AAI	$3.11	None
Atlantic Coast Airlines, Inc.	ACAI	$9.25	1,2
ATA Holdings Corp.	ATAH	$3.40	2
JetBlue Airways	JBLU	$40.33	None
SkyWest, Inc.	SKYW	$13.10	2,6

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Senator DORGAN. Ms. Donofrio, thank you.

Last, we will hear from Mr. Edward Wytkind. Mr. Wytkind is executive director of the Transportation Trades Department at AFL–CIO. Mr. Wytkind.

STATEMENT OF EDWARD WYTKIND, EXECUTIVE DIRECTOR, TRANSPORTATION TRADES DEPARTMENT, AFL–CIO

Mr. WYTKIND. Mr. Dorgan, Members of the Committee, thank you for having me here. I am pleased to appear on behalf of our 35 member unions in the AFL–CIO transportation labor movement. You know, the events of 9/11 will forever remind airline workers that this industry has changed forever. If you are a pilot, a mechanic, a flight attendant, a fleet or customer service or other employee of this industry, the events that unfolded on that day were especially horrendous. For the first time in America's aviation history, as everyone knows, a U.S. airliner was in our skies and used as a weapon of destruction against the United States.

Not a day passes for a worker in this industry when he or she is not confronted with that horror, and not a day since 9/11 has passed without the airline unions and the AFL–CIO reaffirming their collective pledge to never, and we mean never, allow the Nation's transportation system to be a venue for acts of terror against the United States.

Obviously, air travel in America will never be the same. As we build a multilayered system of security, this system we believe is now part of our national security. In other words, business as usual has changed forever and, indeed, our members after 9/11 were the first to bear the brunt of the economic consequences of this act.

A year later, this industry has not rebounded. You have already heard all the data. I do not need to restate it. And despite the good intentions of Congress with the airline rescue legislation, tens of thousands of workers in our industry are either laid off or face the uncertain future of downsized and possibly bankrupt carriers.

As we evaluate the state of the industry, we also have to look at the weakness of the overall economy. More than 8 million Americans are out of work. 2.8 million of those workers have been jobless for 15 weeks or more. Senator Dorgan is right, despite Larry Lindsey's rosy analysis, this is a lousy economy and our Government has not done enough about it. 430,000 workers ran out of unemployment insurance in July. That is an increase of 67 percent since last year. Unemployed workers today have the dubious distinction today of making the top 10 list of worst months of unemployment insurance exhaustion since the Labor Department began monitoring that data.

As the airlines have racked up their record losses that again will approach $7 billion this year, workers have suffered immensely, and they brace for the additional economic hit they will take if, as it appears likely, we go to war in Iraq.

Aviation industry workers, including employees of airlines, Boeing and aerospace suppliers and airports, have suffered unprecedented job loss. 100,000 airline workers out of work, another 30,000 Boeing workers out of work, 51,000 additional aerospace workers jobless, but the multiplier effect is what is most startling. If you look at the total data and the total numbers of all the sectors of this industry, every airline worker translates into 18 jobs in the U.S. economy.

As Congress and this Committee responded to the economic crisis facing the airlines last fall, it enacted a package of assistance supported by our organization that included $5 billion in direct assistance and $10 billion in loan guarantees. While the legislation failed to provide relief to jobless airline workers that we had fought for, the bill did create a framework designed to give air carriers a chance to recover from the staggering losses of 9/11.

Unfortunately, the loan guarantee program administered by the so-called ATSB has not lived up to the expectations of this Committee and of Congress. Nothing in the emergency relief legislation was intended to saddle applicants with such onerous requirements that would actually deter them from applying for assistance, and Congress hardly intended for the ATSB to exercise such broad powers to directly intervene in the collective bargaining process, as it has on so many occasions.

To correct the record, to this day only one applicant, America West, has secured a loan guarantee. American Transair ATA last week received conditional approval. That is a fancy word for "you don't get the money yet," and US Airways' attempt to get the loan guarantee never really happened, because they submerged into bankruptcy protection after trying to jump over every hurdle erected by the ATSB.

What is clear is that these applicants and many others were subjected to a bureaucratic and unwieldy process, as well as grossly unrealistic demands for wage concessions and other concessions that did not reflect the will nor the intent of Congress.

Mr. Chairman, I would like to submit for the record a policy resolution that was adopted by our 35-member executive Committee yesterday calling for Congress to curb the ATSB overreach into the collective bargaining process and to expedite the loan guarantee process and to extend the arbitrary deadline for submitting applications to the board.

Senator WYDEN. (presiding) Without objection, we will put that in the record.

Mr. WYTKIND. Thank you. Regarding the need to address the industry's massive costs associated with national security, let me offer a couple of observations. The airlines have offered a number of legislative solutions intended to relieve them of what they term as excessive costs relating to the war on terrorism. We believe, frankly, and in short, that this assistance is warranted, but it must also include something for laid-off workers in this industry.

We must come to grips with the fact that workers are suffering. We must also come to grips with the fact that the airline security regime we now have in place really has become a part of our national responsibility, and an important element of national defense and homeland security. We agree that things like assistance on war risk insurance and helping reimbursement of costs that are currently being borne by this industry ought to be considered by Congress, and ought to be considered quickly, and we agree that a war with Iraq would have very dramatic consequences for this industry, its workers, and thousands of communities Nation-wide.

The fact is that aviation security is now a major objective of our homeland security in this country. With the war on terrorism growing in size and intensity, the importance of U.S. airlines and their workers will grow as well. We are urging Congress and the President to insulate the airlines, their employees and passengers and communities, from paying an astronomical piece for national security. The costs are unsustainable unless Congress funds them through the national security and defense funding mechanism, not as expenses imposed on airlines; but the needs of airline workers must be a part of that effort.

One of our most bitter disappointments was the inaction, following 9/11, of our Government to provide laid-off workers with relief. Last fall, as many of you know, we mobilized behind Senator Carnahan's efforts to provide worker relief, to provide extended unemployment training or retraining and health care for workers who were laid off.

Although a filibuster killed the Carnahan bill, we received 56 votes. Airline workers and their families owe a debt of gratitude to Senator Carnahan and many of you on this Committee who supported this effort to try to help the working men and women of this country. We intend to keep fighting for laid-off workers, and we will not stop until they receive what they deserve, which is assistance at their most darkest hour.

We have a four point plan: 26 weeks of extended unemployment compensation, a 75 percent health care subsidy, training and retraining, and a new provision is to try to provide enforceable hiring preference for laid-off airline workers to apply for these thousands and thousands of unfilled TSA security jobs.

To wrap up, let me just say that we must work together to find the measures needed to instill confidence in the American traveler. Until the American traveler comes back to the safest airline industry in the world and demonstrates that he or she is confident that we are doing everything we can to make air transportation safe, this industry's finances will continue to suffer. More resources will be needed to ensure the proper deployment of security measures, and Congress must finance more of the extraordinary costs associated with meeting these important security needs.

We will not, however, support the unwarranted rollback of aviation security requirements simply because of cost. Indeed, we will join in making the case for the Federal resources, but we cannot support actions that will ultimately contribute to air travelers' already shaken confidence, and as you and the Bush administration consider ways to expedite the movement of passengers through security checkpoints, perhaps with some type of trusted traveler program, we urge you to come up with a trusted employee program, and help the workers become credentialed so that they can also move in and out of airports, get to their jobs, and not cause more delay and contribute further to the so-called hassle factor.

In the weeks and months ahead, we will advocate for policies that will reverse the shaken confidence of air travelers. We will insist on resources to cover the industry's national security costs. We will join the debate over the unfunded security costs being borne by the airlines, and whether they are intrinsically linked with defending our homeland security. We will defend the collective bargaining rights of aviation employees and oppose attempts by certain parts of the airline industry to take away the basic bargaining rights of our members.

Senator WYDEN. I am sorry, at this point if you could just summarize.

Mr. WYTKIND. In summary, we are going to work very hard to represent our members, to secure this industry from the costs that are being imposed, and we look forward to working with this Committee to accomplish that goal.

Thank you.

[The prepared statement of Mr. Wytkind follows:]

PREPARED STATEMENT OF EDWARD WYTKIND, EXECUTIVE DIRECTOR, TRANSPORTATION TRADES DEPARTMENT, AFL–CIO

My name is Edward Wytkind. I am the Executive Director of the Transportation Trades Department, AFL–CIO (TTD). I am pleased to appear before you on behalf of the 35 affiliates including the member unions of our Aviation Coordinating Committee.[1] Mr. Chairman and Members of the Committee; thank you for allowing us the opportunity to share our views on the state of America's airline industry.

[1] Attachment 1 is a list of TTD's 35 member unions.

While I know you will hear a great deal about the many economic and policy issues that are contributing to this industry's severely depressed state, I would like to offer the perspective of transportation labor and specifically the hundreds of thousands of men and women employed in the aviation industry who form the backbone of air transportation in this country.

America watched with disbelief and horror as the events of September 11 played out before our eyes. For the dedicated workers in this industry, the attacks were especially horrendous—for the first time in America's aviation history a domestic air carrier, our members' workplace, was used to carry out an act of terrorism in the United States. As you know, 33 pilots and cabin crew members died on-board the aircraft used as weapons of destruction. Several hundred more union members, from firefighters and police whose courageous acts still inspire us, to those who simply went to work that day, perished as well.

Obviously, in the days, weeks and months that followed, the nation's airline workers—our members—knew that air travel in America would never be the same. We recognized immediately that security would take on significantly greater importance and that business as usual was going to change. And indeed, immediately after September 11 our members were the first to bear the brunt of the economic consequences of this horrendous act of terror. A year later, this industry has not rebounded and tens of thousands of airline employees are either laid-off or face the uncertain future of downsized and possibly bankrupt airlines. In addition, unless Congress extends unemployment benefits before it adjourns, these laid-off employees will exhaust their benefits and will face a future with no hope of receiving even the most basic government assistance.

State of Economy and Aviation Industry

At the outset, let me state that no one cares more about the safety and the economic health of the aviation industry than the employees whose livelihoods depend on strong airlines. We agree that something must be done to stabilize this vital sector of our economy. We cannot lose sight of a simple fact: for airline workers and their families, the survival of this industry means the ability to pay the mortgage, send the kids to college and protect retirement security. In this slumping economy, when a worker gets a pink slip, the economic security that he or she fought so hard to obtain can disappear without warning and with little recourse. And for the millions of Americans who rely on air service, we must stop this industry's financial tailspin and do everything we can to ensure their safety and security.

As we evaluate the state of the airline industry, we must also look to the continuing weakness of the overall U.S. economy. There are currently more than 8 million Americans out of work, with 2.8 million workers being jobless for 15 weeks or more. Nearly 430,000 workers ran out of unemployment benefits in July—an increase of 67 percent over last year. Unemployed workers today have the dubious distinction of making the Top 10 list of "worst months" of unemployment insurance exhaustion since the Department of Labor began tracking this data three decades ago. There is still no sign of turnaround in the manufacturing sector—including aircraft producers such as Boeing—where almost 1 million workers have lost their jobs in the last year.

This desperate situation facing working families is what inspires the labor movement to demand action by Congress and the President to extend unemployment benefits and to provide assistance to the millions of men and women who face a future with little hope of obtaining long-term employment and with the very real prospect of losing health care insurance. It seems to us that the greatest economic power in the world should be able to find the political will and the resources to stop the hemorrhage in our economy and protect the livelihoods of so many Americans who are suffering.

With that backdrop, one of the hardest hit segments of the economy is the airline industry. We have all seen the data and it paints a bleak picture for airlines, their workers, air travelers and the economy. According to the Air Transport Association, airline industry losses in 2001 were $7.7 billion. Projected losses in 2002 may again exceed $7 billion and in 2003 the situation may improve slightly, but in the process service and jobs will be slashed, aircraft purchases will be deferred and canceled, and travelers will pay the price with diminished choice, lost frequency and a lower quality of service. The forecast will surely worsen however if, as it appears likely, we go to war with Iraq. A hike in fuel prices alone will have an immediate and devastating impact.

Aviation industry workers, including employees of airlines, Boeing and aerospace suppliers, and airports, have suffered unprecedented job loss and economic uncertainty. Some 100,000 airline employees are out of work or facing imminent lay-off. Another 30,000 Boeing workers are laid-off along with 51,000 additional aerospace employees. But it is the multiplier effect of airline lay-offs that is most startling. Airline industry data show a combined workforce exceeding 600,000. However, the total workforce, if related job sectors such as airports, aircraft manufacturing and suppliers are included, totals 10.9 million. In other words, one airline worker translates into 18 additional jobs in our economy. And with bankruptcies looming large, it is easy to conclude that the staggering job losses will only grow.

Proposed "Fixes"

Unfortunately, at a time when this industry needs to collaborate with its employees to reverse this severe financial downturn, it appears some want to direct attention at "scapegoat" issues that attach blame for these problems to airline employees and their collective bargaining rights. As we have demonstrated time and again, aviation labor is dedicated to preserving the future of this industry but will oppose those who would have Congress believe that the latest financial crisis can be "solved" on the backs of airline workers.

As Congress and this Committee responded to the economic crisis facing the industry last fall, it enacted a package of economic assistance, supported by TTD, that included $5 billion in direct assistance and $10 billion in federal loan guarantees. While the legislation failed to provide relief to jobless airline and other industry workers as we had insisted, the bill did create a framework that was expected to give air carriers the chance to recover from the staggering losses associated with 9/11. Unfortunately, the loan guarantee program, administered by the newly created Air Transportation Stabilization Board (ATSB), has not lived up to the expectations of Congress.

The fact is that nothing in the emergency relief legislation was intended to saddle applicants with such onerous requirements that would actually deter air carriers from taking advantage of this important assistance. Moreover, it was not the intent of Congress to allow the ATSB to exercise such broad powers to directly intervene in the collective bargaining process in carrying out its responsibilities.

To this day, one applicant, America West, has secured a loan guarantee. American Trans Air (ATA) last week received conditional approval for a $150 million loan guarantee. And US Airways' attempts to seek a loan package met with such resistance from the ATSB that the airline eventually filed for bankruptcy protection. What is clear is that these applicants and many others were subjected to a bureaucratic and unwieldy process as well as grossly unrealistic demands for employee wage concessions that did not reflect the will nor the intent of Congress. A bipartisan Congress moved quickly to shore up a vital industry and its workforce and clearly intended to build a bridge from 9/11 to a day when the industry's financial fortunes would stabilize. That underlying principle has hardly defined the ATSB's work to date in processing applications for federal assistance. Mr. Chairman, I would like to submit for the record a policy resolution that was adopted yesterday by our Executive Committee which calls on Congress to curb the ATSB's overreach into the collective bargaining process, to expedite the loan guarantee process and to extend the arbitrary deadline for submitting applications to the Board.[2]

There are some policy proposals that should be debated. The major airlines have offered a number of legislative solutions intended to relieve them of what they term as "excessive" federal fees and costs. It is certainly understandable why the industry's attempts to gain additional economic relief from the government have drawn criticism from some in Congress, especially since we continue to witness air carrier inspired legislative attacks on the rights of airline workers. Our members have grown accustomed to the airlines' tactic of "blaming someone else" when economic trouble strikes.

Nevertheless, although the dedicated employees of this industry are weary of these tactics, Congress should consider the industry's economic relief proposals in the context of finding ways to stabilize the deteriorating finances of airlines and halt the alarming rate of lay-offs and furloughs. Overall, our government must come to grips with the fact that airline security is a national responsibility and has become an important element of our national defense and homeland security. We agree with the contention that certain costs, such as the deployment of new security technologies and the staggering price for "war risk" insurance, cannot be financed entirely by the airline industry and its employees. Furthermore, a war with Iraq could have consequences from which the industry, in its current fiscal state, may not recover. The fact is that aviation security has become one of America's top homeland security objectives. Congress will, of course, have to ensure that whatever

[2] Attachment 2 is TTD's policy resolution "The Air Transportation Stabilization Board Must Comply with Congressional Intent"

temporary or long-term relief is afforded to the airlines does not come at the expense of funding needed for our air traffic control system and airports.

The airline industry is far too important to our economy and our national security to allow the current fiscal tailspin to continue. With the war on terrorism growing in size and intensity, the importance of U.S. airlines—and its workforce—will grow as well. We are urging Congress and the President to insulate the airlines, their employees and passengers from paying the astronomical price for national security responsibilities that should be part of our national defense and homeland security. Clearly, this industry is being saddled with expenses related to the war on terrorism, which is a federal responsibility. These costs are unsustainable unless Congress funds them through the national security and defense mechanisms, not as expenses imposed on the airlines.

Transportation labor will work with the carriers to urge Congress to take action before it adjourns but we cannot push for a package of airline assistance related to the war on terrorism if it fails to include relief for jobless aviation industry workers.

Relief for Workers

Even as Congress and the President consider providing additional assistance to the airlines, we remain committed to securing federal assistance for the skyrocketing number of laid-off workers.[3] One of our most bitter disappointments is the inaction of our government to help the thousands of aviation industry workers who, through no fault of their own, lost their jobs following the 9/11 attacks. Last fall, we mobilized behind Senator Carnahan and her worker relief bill to provide extended unemployment benefits, training and retraining assistance and a health care safety net for laid off airline industry workers. Although the bill was killed by Republicans who waged a filibuster, airline workers and their families owe a debt of gratitude to Senator Carnahan for her dedication, hard work and unwavering support to this day. Senator Carnahan, transportation labor intends to continue this fight with you. We will not again allow hollow promises to put off what is the right thing to do for airline workers.

We propose a four point plan that would provide laid off airline industry workers with (1) 26 weeks of extended unemployment compensation, (2) a 75 percent federal subsidy for health care coverage, (3) training and retraining assistance, and (4) hiring preference for laid off airline workers to fill the thousands of remaining federal security positions at the TSA.

The same rationale that led Congress to enact emergency legislation providing $15 billion in relief for air carriers should have inspired lawmakers to do the right thing for workers who endured economic hardship of unprecedented proportions. This is especially disturbing since it appears that the turnaround we had hoped for will not materialize anytime soon and at the same time laid-off workers are bracing for pending bankruptcy reform legislation that would force them to carry their debts for the rest of their lives.

We will not rest in our effort to convince Congress to pass an extension in unemployment insurance and to finally address the fact that too many Americans face a future without health insurance. To this day, our members wonder why Congress and the President failed to address the desperate needs of airline workers in their darkest days—as the labor movement had advocated when the airline bail-out bill was pending last fall—and why now Congress appears poised to leave for the fall elections without finishing the job. Let it be stated today that thousands of airline and other workers will exhaust their jobless benefits and will lose their health insurance in the months between congressional adjournment and when the 108th Congress convenes.

Security and Confidence in Air Travel

For airline workers nothing is more important than the security and safety of the air transportation system—their workplace. For current employees and future generations of workers in this industry, the September 11 attacks will serve as a painful reminder of the many unexpected dangers they face on the job. Both during and following these brutal attacks, airline workers, air traffic controllers and other government employees such as FAA technicians and inspectors demonstrated their commitment, courage and skill. I urge you to consider the contributions of employees, especially the thousands of workers who reported to work just a few days after 9/11—when the nationwide ground stop was lifted by our government, and to this day staff the front lines of this nation's dedicated aviation workforce. I also urge you to ensure that our government and the air carriers listen to the workers in this

[3] Attachment 3 find a policy resolution unanimously adopted on October 1, 2002 by TTD's Executive Committee, "The Aviation Industry and the War on Terrorism."

industry who can offer hands-on experience in developing and implementing aviation security measures. That was not the case in the weeks following 9/11, as a number of proposals, including those geared towards addressing passenger and cargo security risks in the nation's airports, were developed without the input of airline employees.

These issues are especially important because until we answer the typical weary air traveler's questions about the safety and security of air transportation, the economic state of this industry will continue to erode. Airline workers know all too well that for our industry and our nation to rebound and thrive, we must restore faith in the safety and ease of air transportation in America. In other words, we must not allow other issues to distract us from our mission: to bring the American traveler back to the safest airline industry in the world and to demonstrate our resolve to never again allow acts of terror to be carried out in our air transportation system.

Congress has a large responsibility to play as well. We will continue to push for more resources to ensure the proper deployment of security measures and will join the airlines and the airports in calling on you to fund more of the extraordinary costs associated with meeting the nation's airline security needs. We will not, however, support the unwarranted roll-back of aviation security requirements simply because of costs; indeed, we will join in making the case for more federal resources, but we cannot support actions that will ultimately contribute to air travelers' already shaken confidence. Worker training is especially important in these times, as training under existing practices and federal mandates is not and never was geared towards situations such as the 9/11 attacks. We are pleased to see progress in this area but much more can be done that will contribute greatly to the preparedness of our aviation workforce and, by extension, to the security of air travel. We also hope this Committee will urge the TSA to act promptly on the credentialing of airline and airport employees and to develop and implement a new security screening process for these employees.

We must also assert our strongly held view that aviation security and workers' rights are compatible and not conflicting propositions. Federal workers' rights to collectively bargain and whistleblower protections have unfortunately become one of the core subjects of disagreement in pending legislation to create a new cabinet level Department of Homeland Security. This unfair assault on workers' rights is especially disturbing to transportation labor as no one questioned the important role in our homeland defense that air traffic controllers and other FAA employees—essential members of our federal workforce—played in carrying out orders to land almost 5,000 planes in about two hours without serious incident or mishap. Their dedication and commitment to defending the security of America was never questioned and we urge Congress to move on with Homeland Security legislation, leaving the collective bargaining rights of the new agency's employees intact. Completion of this important legislation will contribute a great deal to making Americans feel safer and more secure about flying.

Looking Ahead

Unfortunately, the future of the aviation industry is uncertain at best. There is no uncertainty, however, about the importance of air transportation to America. In the weeks and months ahead we will advocate for policies that reverse the shaken confidence of air travelers. We will insist on ample federal resources to cover the cost of security. We will join the debate over the fees and taxes paid by the airlines and consider what costs are intrinsically linked with defending America's homeland security and thus should be borne by our government. We will defend the collective bargaining rights of aviation employees and oppose industry attempts to vilify our members who struggle to manage through these difficult times. We will urge you to ensure that all the benefits of the emergency relief legislation enacted last fall are realized. And we will continue to push Congress and the President to further extend unemployment benefit for laid-off workers and to consider the millions of American workers who face the loss of health care coverage in this reeling economy.

The labor movement is dedicated to stabilizing the finances of the nation's airlines and securing our airways for the nation's air travelers and our members. This industry is extremely crucial to our economy, to every community in America and to millions of working men and women.

We look forward to working with this Committee and thank you for allowing us the opportunity to share our views.

ATTACHMENT I

TTD Affiliates

The following labor organizations are members of and represented by the TTD:

Air Line Pilots Association
Amalgamated Transit Union
American Federation of State, County and Municipal Employees
American Federation of Teachers
Association of Flight Attendants
American Train Dispatchers Department
Brotherhood of Locomotive Engineers
Brotherhood of Maintenance of Way Employes
Brotherhood of Railroad Signalmen
Communications Workers of America
Hotel Employees and Restaurant Employees Union
International Association of Fire Fighters
International Association of Machinists and Aerospace Workers
International Brotherhood of Boilermakers, Blacksmiths, Forgers and Helpers
International Brotherhood of Electrical Workers
International Brotherhood of Teamsters
International Federation of Professional and Technical Engineers
International Longshoremen's Association
International Longshore and Warehouse Union
International Organization of Masters, Mates & Pilots, ILA
International Union of Operating Engineers
Laborers' International Union of North America
Marine Engineers Beneficial Association
National Air Traffic Controllers Association
National Association of Letter Carriers
National Federation of Public and Private Employees
Office and Professional Employees International Union
Professional Airways Systems Specialists
Retail, Wholesale and Department Store Union
Service Employees International Union
Sheet Metal Workers International Association
Transportation Communications International Union
Transport Workers Union of America
United Mine Workers of America
United Steelworkers of America

ATTACHMENT 2

The Air Transportation Stabilization Board Must Comply With Congressional Intent

In response to the government ordered "ground stop" on all airline operations following the 9/11 terrorist attacks, Congress moved quickly to pass and the President signed an emergency legislative package of airline financial assistance. While the legislation ignored the needs of laid-off workers, it provided $5 billion in direct cash assistance and $10 billion in federal loan guarantees to offset the massive losses incurred by the airlines due to 9/11. Unfortunately, the loan guarantee program, administered by the newly created Air Transportation Stabilization Board (ATSB), has not lived up to the expectations of Congress.

Nothing in the emergency relief legislation was intended to saddle applicants with such onerous requirements that would actually deter air carriers from taking advantage of this important assistance. Moreover, it was not Congress' intent to permit the ATSB to exercise such broad powers to directly intervene in the collective bargaining process as it has on several occasions. For example, right out of the box the ATSB tried to impose a 7-year wage freeze on the employees of American West as a condition for granting that carrier a loan guarantee.

To this day, America West is the only air carrier that has secured a loan guarantee. USAirways' attempt to seek assistance from the ATSB was met with such resistance that the airline eventually filed for bankruptcy protection. What is clear is that these two applicants and many others were subjected to a bureaucratic and unwieldy process as well as grossly unrealistic demands for employee wage and other concessions. Congress intended for this emergency relief assistance to stem the airlines' record losses until the industry's deteriorating finances could turn around. Instead, only a fraction of the loan guarantee benefits has been doled out.

Meanwhile, air carriers are expected to lose close to $7 billion this year and at least 150,000 airline, Boeing and other industry workers are already jobless. Congress must act to ensure the airline assistance benefits are fully realized and that the ATSB exercises its broad powers consistent with congressional intent; otherwise, the airline rescue package passed with such fanfare last fall is doomed to failure and several airlines may not survive the current financial tailspin.

Therefore, be it Resolved, That TTD Affiliated Unions Will:

Urge Congress to modify the legislation that created the airline assistance program by:

- compelling the ATSB to expedite processing of applications and halt the use of its broad powers to intervene in the collective bargaining process and to unfairly deny benefits to ailing air carriers that otherwise qualify for assistance under the statute; and
- re-opening the deadline for air carriers to submit applications for assistance beyond the arbitrary date set in regulation by the ATSB.

ATTACHMENT 3

The Aviation Industry and the War on Terrorism

America watched with disbelief and horror as the events of September 11 played out before our eyes. For air carriers and their workers, these terrorist acts were especially horrendous—for the first time in American aviation history, a domestic airline was used to carry out an attack against the United States. The results of the terrorist assaults were unthinkable and they left behind an airline industry that has changed forever as our nation grapples with the myriad challenges arising out of 9/11 including the escalating war on terrorism and the impending military conflict in Iraq.

One of those challenges is to find a solution to the airline industry's deteriorating finances and massive layoffs in the wake of 9/11. Another challenge is to ensure the airlines and their employees, already reeling from the crushing economic effects of 9/11, are not further ravaged by the certain economic hit—such as a substantial hike in fuel prices—they will take from a war in Iraq. Overall, our government must come to grips with the fact that airline security is a national responsibility and has become an important element of our national defense and homeland security.

Airlines are slated to lose almost $7 billion this year, following last year's losses of $7.7 billion. And the projections for 2003 are not much better as announcements of service and jobs cuts and declining revenues continue to dominate industry headlines. As a result, aviation industry workers have suffered unprecedented job losses. An estimated 90,000 airline employees are laid-off or furloughed. Another 30,000 Boeing workers are laid-off, along with 51,000 additional aerospace employees. Several thousand of these workers have exhausted their unemployment insurance benefits and lost health care. Last fall, we mobilized behind the Carnahan worker relief bill to provide assistance to the thousands of airline employees who were bracing for the enormous toll of 9/11. Although the bill was killed by a minority bloc of unsympathetic Republicans who waged a filibuster, airline workers and their families owe a debt of gratitude to Missouri Senator Jean Carnahan for her tenacity and passion and her unwavering support to this day.

Now with predictions for air travel and aircraft purchases becoming more and more pessimistic, we conclude that laid-off workers in the various aviation industry sectors have no short- or intermediate-term hope of being rehired or re-employed. Transportation labor will mobilize to urge Congress to take action before it adjourns in October, but we cannot push for a package of airline assistance related to the war on terrorism if it fails to include relief for jobless aviation industry workers.

In calling for action, we are not relieving the air carriers of their obligation to operate safe and secure airlines. In fact, quite the contrary: few have fought harder for improved airline safety and security than aviation unions and their members. And we are outraged that a few major airlines continue to direct attention at "scapegoat" issues in an attempt to somehow attach blame for the industry's severe financial downturn to the collective bargaining rights of airline workers. We condemn these blatantly hostile attacks on workers' rights and will work to defeat them. Nevertheless, we are urging Congress and the President to insulate the airlines, their employees and passengers from paying the astronomical price for national security responsibilities that should be part of our national defense and homeland security. Clearly, this industry is being saddled with expenses related to the war on terrorism, which is a federal responsibility. These costs are unsustainable unless Congress funds them through the national security and defense funding mechanisms, not as expenses imposed on the airlines.

Transportation labor will push Congress and the President to enact legislation that provides laid-off employees of airlines, Boeing and related aerospace suppliers, and airports six months extended unemployment insurance; 75 percent health care subsidies; training and re-training assistance; and mandated and enforceable preferential hiring rights to apply for the thousands of unfilled federal security jobs at the Transportation Security Administration (TSA).

In support of airlines' skyrocketing national security related costs, we will support no less than one year of terrorism/war risk reinsurance coverage; reimbursement for several terrorism-related security expenses including unreimbursed items such as cockpit fortification; lifting of restrictions on airlines carrying U.S. priority mail and other freight; resources for updated anti-terrorism worker training; and other assistance related to the cost of post-9/11 security mandates and the war on terrorism.

The airline industry is far too important to our economy and our national security to allow the current financial tailspin to continue. With the war on terrorism growing in size and intensity, the importance of U.S. airlines will grow as well. Almost 11 million workers earn a living in the overall aviation industry; one airline worker translates into 18 additional jobs in our economy. Congress must step in before it adjourns for the fall elections and pass legislation that covers the soaring security costs that are borne by this industry in connection with the war on terrorism. Most importantly, lawmakers must finally provide relief to the almost 150,000 airline industry workers who have suffered through a year of massive layoffs, security threats on the job and a growing sense that government leaders are indifferent to their needs in the aftermath of the brutal terrorist attacks on this country.

Therefore, be it Resolved, That TTD Affiliated Unions Will:

- Call on Congress and the President to enact a package of assistance that provides six months extended unemployment, health care subsidies, training and retraining assistance, and mandated and enforceable preferential hiring rights for unfilled TSA security positions; and
- Urge Congress and the President to cover the soaring airline security costs associated with the war on terrorism and to protect the airlines and their employees and passengers from the severe economic effects of a military conflict in Iraq.

Senator WYDEN. Thank you. In order of appearance, Senator Burns is first.

Senator BURNS. Thank you very much, Mr. Chairman. I am disturbed this morning, Mr. Wytkind. What would you submit if you think the economy is so bad—you know, the other day, just yesterday, the passage of the 1996 act, telco act—now, this is getting into another area. The telecommunications industry's income was around $160 billion a year. Today, is over $220 billion. Now, that is not the case with the airlines here. They have stayed static. So we know there are growth factors in this economy.

Now, the New York Stock Exchange is not the real measure of what the economy is doing. That measures the emotion of the investor. Now, you come here, and you are critical of everybody but yourself. What would you suggest that we do?

Mr. WYTKIND. We have put forth—I am not being critical.

Senator BURNS. I mean, you identified all the problems. We have identified all the problems. Everybody is looking for some answers.

Mr. WYTKIND. We understand that, and we are not being critical of anyone here. We worked very hard on the airline legislation.

Senator BURNS. What would you want the Government to do right now?

Mr. WYTKIND. Well, my testimony spells it out in detail.

Senator BURNS. I mean, for the economy.

Mr. WYTKIND. For the economy or for the airline industry?

Senator BURNS. The economy. That was your lead-off here.

Mr. WYTKIND. What I said was, the state of the U.S. economy from a worker's perspective is not very good.

Senator BURNS. It ain't from a farmer's, either.

Mr. WYTKIND. We understand that, and we think something should be done for the farmers, too. We have been very supportive of all efforts to find Government policy and private sector solutions to figure out what to do about this economy.

What we are seeing in this industry is an industry that (1) is being strangled with cost, and (2) has not found a way to recover from the effects of 9/11 and the effects since then, and we still have 150,000 industry employees who are laid off, and we still have a bunch of those workers, thousands of them who have exhausted all of their basic unemployment and health care benefits. All we are asking for is some consideration for those employees.

We agree with Senator Brownback, who said this airline industry's crisis is not just about the airlines. It is about airline manufacturing, it is about aerospace, it is about the absolute rippling effect that, as I said in my testimony, depending upon whose numbers you use, it is as high as 18 to 1, the impact that one airline job has on this economy, just like you see in the auto industry. They have multiplier effects that are very similar.

So we are not being critical of this Committee. We are being critical of the fact that we do not think enough is being done to deal with some of these issues.

Senator BURNS. Well, I would say, what else—I do not know what else we can do. You offered no suggestions on picking up the economy. The answer, some of it, is a problem besetting the young lady to your right, and she is in the financial industry. We have got to get the airlines in some kind of position to where they can go into the markets for venture capital or operating capital, and we know that.

We did overdo on TSA, I would agree with you 100 percent, and we went 180 degrees the wrong way on what we should have done there, but that was one of those June bug issues that was coming down the track, and I lost that debate in conference. We did extend unemployment. We did do some things that were pointed toward the employees, that their jobs were impacted, and we have done that.

The recovery, however, has not been as fast as it should have been, but to come before this Committee and identify the problem, yet offer no suggestions on what we should do is not the reason for this hearing.

Mr. WYTKIND. I did offer a number of solutions.

Senator BURNS. Well, some of those I agree with, but you cannot paint with a broad brush, because I am not talking about this Committee or this industry, and you were not either, at your opening.

Mr. WYTKIND. All I tried to provide was an employee snapshot of the state of this economy and it is not doing very well. That is all I tried to do.

Senator BURNS. It is not a pretty picture on that snapshot.

Mr. WYTKIND. I wish I was smart enough to give you every solution.

Senator BURNS. I wish I was, too.

Mr. WYTKIND. All we can do is our best job to represent workers, and I think Congress can do a lot to deal with the jobless in this economy, including health care, which is something we have been fighting for as well.

Senator BURNS. Who is going to pay for it?

Mr. WYTKIND. Well, in the trade adjustment assistance legislation on a bipartisan basis that you finished, you provided a health care subsidy of 65 percent.

Senator BURNS. Somebody has got to pay.

Mr. WYTKIND. Sometimes when workers are out of work and they have no health care they need a safety net, and in our case we are going to fight for that safety net, and if the Government has to pay for it, so be it.

Senator BURNS. Somebody has got to pay for it. Are you willing to raise taxes on the citizens?

Mr. WYTKIND. I am not calling for a tax increase. I am saying we have too many workers in the U.S. economy and the airline industry with no health care, and something needs to be done about that.

Senator BURNS. Tell us who is going to pay for it. We will be happy to work with you.

Senator WYDEN. This is going to be a spirited morning, I can tell.

Mr. Mullin, let me begin with you, and sort of offer up that my sense is that the industry has a legitimate point on the national security question, the question of paying for the security functions that benefit everybody, but I will tell you—and we have talked about this before, that much of the industry's problem is self-inflicted. Many of these wounds are self-inflicted, and I want to ask you about those, because I think that the most important part of what we are trying to do now is to sort of sort out what the Government ought to be doing? What are the Government's responsibilities, and what are the industry's responsibilities?

Now, let me give you two examples of areas that I think are self-inflicted and see if we can get your sense of whether the industry is willing to turn it around. Professor Richard Gritta, who I admire very much, is a professor at the University of Portland, and he has written at some length about how the industry's problems to a great extent stem from the massive debts that it is taking on, that it is taking on high debt, high risk financial structure, so that every time the economy turns down and we have bankruptcies and the like, this will be of special importance as it relates to the airline sector.

I think you also know that I am very concerned about passenger rights, and how consumers are treated, and it seems to me that the industry just in recent weeks has inflicted a couple more wounds on itself with respect to passengers at a time when we want to get more people flying.

At a time when we want to get more people flying we have got the industry putting together new fees for flying standby, we have got the industry talking about denying customers credits if flights are missed, and this kind of thing, and it would seem to me that if the industry is hoping to have help from the Government yet again, and it is not as if—with the original bailout legislation, and even just a couple of weeks ago with respect to insurance questions the Committee was there again, that the Government has a right to expect the industry to deal with some of these problems that are self-inflicted, some new accountability.

I mean, people ask me all the time, they say, the industry is willing to cut this and cut that, but the things that are important to them they are not willing to cut, and I think what we are looking for is some sense that the industry is going to make some changes that reflect these tough times as well.

Mr. MULLIN. Thank you very much, Senator Wyden, for your comments. I will respond to both of your points, dealing first with the point made by the professor from Portland that the industry has too much debt. I could not agree more. Some of you may know I spent 15 years in the banking industry before I came to the airline industry. This is the most debt-laden industry in America, and when I came to the industry 5 years ago I certainly felt that the industry had too much debt at that point, and now we find that situation worsening considerably.

As I indicated in my testimony, the industry has been having unprecedented losses and we have, in fact, been using debt, private capital debt in order to fund those losses. That is the worst possible use that anybody could make for debt. Debt should be used for capital purposes, buying airplanes, investing in technology and the like, and so it is a very sorrowful kind of a situation, so I would readily agree with the professor that the industry is too leveraged.

Unfortunately, what is going to happen is these losses continue is that that situation is likely to get worse, so we have no illusions that with respect to that situation, that it is going to continue.

On your second point, I want to pay credit to you, because you are the first person in 1 year who has raised issues of customer service as it relates to the kinds of questions in the customer service plan that occupied so much of our dialog prior to September 11th. In fact, the improvements through the customer service plan were our top priority prior to September 11th, and you and I have talked about that personally many times.

Since that time, I can honestly say nobody has raised questions of customer service plan. It has all been security, security, security, and we need to get back to the point where we are worried about the customer orientation. Everything you have said with respect to improving the customer's orientation toward wanting to deal with the airlines as a positive travel experience is what we have to be about.

Now, you have raised a couple of questions about changes in prices that have been made within the last couple of weeks, and you are correct, those changes have, in fact, been made. The reason those changes in pricing have been made is because our capacity in this industry to charge a price that would make us viable has disappeared since September 11th. We have no pricing power in this industry as I speak, none. We have attempted to put forward about 30 price increases acting independently as airlines, but hoping that perhaps we would be matched by some of our competitors.

Zero have succeeded, so every single airline in this country is looking now for ways to improve the pricing in this industry, and during a time period where we have 250 airplanes stored in the desert, when our load factors are far lower than they need to be in order to make us viable as an industry, you will see that struggle continue.

We long for the day when we have enough revenue where we can return some of those customer service amenities and have a pricing structure that takes out some of this nuisance factor type items to which you just referred.

Senator WYDEN. I will tell you, I do not think they are amenities at this point, and I have not raised this issue for a year for a reason as well. For the last year people have been concerned about one thing, and that is getting there. That is all that they have been concerned about. But now it seems to me that you are in a position that if you want to make this industry healthy again you are going to have to take some steps to meet Government and these passengers halfway.

I mean, for example, services are being cut everywhere, and I think when I look at the next set of requests from the airline industry I am going to ask, what are you going to do for rural communities? Now, I am sure the answer is going to be, there is nothing we can do, we cannot do it and the like.

The reality is, as you know, there are a bunch of low cost industries—excuse me, low cost airlines that are making it through this difficult time. They are doing some things right that somehow some other airlines are not able to do, so I hope that the lesson gets through here that there is going to have to be some new accountability on the part of the industry.

You have a legitimate case with respect to this national security question. I am prepared to support assistance in this area, but I do not think that the route out of this, as I suggested earlier, is primarily the Government shoveling more money. I mean, we have done that again and again on this Committee, and I think there is going to have to be more of an effort on the part of the airlines to deal with that, to deal with passenger service, to deal with rural communities, some showing that for this extra money there is going to be an effort to address some of these problems.

Otherwise we will just have the same old cycle that we had through the Nineties. When times were good, the air industry did good. When times were bad, the industry somehow seemed to say Government had to step in and deal with it, and I think we have to do better.

My time has expired, and I think next in order of appearance is Senator Cleland.

Senator CLELAND. Thank you, Mr. Chairman, and Mr. Mullin, good morning to you and to our panelists. I am just sitting here thinking about your last appearance before our Committee about a year ago, where you spoke eloquently as a representative of the American airline industry about the need to act quickly to help this vital industry. What Mr. Wytkind has pointed out, the multiplying factor of the airline industry on the American economy is awesome. I can testify to that, that when we did not fly our airlines for just 4 days, and when Delta did not fly for just 4 days, I can remember painfully restaurants shutting down, hotels going empty and the like. That was an indication to me that the airlines are vital to our entire economy.

Having said that, I was sitting here thinking that maybe one of the ways to support passenger rights and to rescue the airlines and get more people to fly is to bring back peanuts, because I really believe that the absence of Georgia peanuts in particular has been an assault on passenger rights, for those of us who fly all the time.

But, seriously, we are not talking about peanuts, are we, Mr. Mullin, in terms of dollars. We are talking about $4 billion. You mentioned the security cost impact or the overlay on an already troubled industry in a sinking economy. What if we tacked another war onto that? Do you see a war with Iraq—in addition to the war on terrorism and the $4 billion it is already costing American airlines, or is going to cost somebody. Do you think a war in Iraq would make matters better for you, or worse for you, or it would not matter one way or the other?

Mr. MULLIN. Well, first of all, Senator, I want to begin with just a general statement that I think the questions of war and peace and life and death, frankly, that you all are grappling with are far larger than any topic on aviation that we have here today, and I just extend all of my best wishes to all of you in dealing with this. I am just expressing this as an American citizen, so you should just make those decisions even without respect to what we are talking about here today.

But taking your question, which is a business oriented question, I guess I would refer back to the Persian Gulf situation as offering the best possible consequence in recent experience, and what happened in that circumstance is that for a period of two quarters there was a 10 percent or so drop in the international traffic, and for one quarter there was a 5 percent immediate drop in traffic domestically throughout our country and, of course, oil prices spiked and doubled in a very short period of time, which created an enormous difficulty for us in terms of dealing with that economic crisis.

So what happens here is clearly associated with a what-if question. If a war is conducted, and it is of short duration, I suspect that the consequences would be small. If it goes longer, then we will have to talk to the Government about some of these kinds of consequences that would emerge.

Senator CLELAND. Thank you very much. Both *The Wall Street Journal* and *The Atlanta Journal-Constitution* published editorials last week supporting your request for congressional relief from post 9/11 governmental security costs. Of the 5 items you pointed out and identified in your testimony, what do you think, in your opinion, is the most critical, and what do you believe are the consequences if the Congress does not act?

Mr. MULLIN. Well, if I could, just for reference's sake, look at the Exhibit 6 which was associated with my testimony, I think that the two most significant leverage items are to the left-hand side of the page, which are the security tax which has been levied on us, the $2.50 cent segment tax that increased insurance cost, where I mentioned that terrorism insurance went from $2 million last year to over $150 million this year. Those would clearly be the ones that would have the most dramatic impact on us.

In terms of immediate relief, I believe firmly that this Committee and the Senate and, in fact, the U.S. Congress intended that the cost of security would be borne by the Federal Government, and so the unreimbursed security costs shown as $60 million here, the Federal Air Marshals cockpit door fortifications and the like are clearly ones that I think that you should just reinforce, particularly to the TSA, that they should be, in fact, paying the airlines for security costs that we are bearing, and that this Committee and this Senate intended that that be so, so I think that those are things that could be done quickly.

I think quite clearly there has been a reference to the fact of not eliminating the security tax, but the security tax, the theory was it was going to be tacked onto the ticket. It cannot be tacked onto the ticket. The airlines are paying it right out as a direct cost, and consistent with what I think all of us have said here, including my panel colleague from Labor, to view airline security as a national security imperative would say that that security tax burden should be alleviated here, and that we should not be paying that.

There is no other industry—I come from the nuclear power industry before I came here, the banking industry and so forth. Those kind of charges for security are not being imposed. It has to do with the fact that airlines were used as guided missiles during the crisis that we had that somehow this cost was imposed on us. We asked for relief and to be treated like every other industry in America in that respect.

Senator CLELAND. One reason I supported the $15 billion Stabilization Act when the airlines first went to the junk bond status a year ago, and one reason I became an original cosponsor of the aviation security legislation that passed this Senate 100 to nothing, in my view, is that aviation security should now be a governmental responsibility. At that time I equated the security of the airlines with national security. I made that equation, that it was not just a private sector McDonald's or Burger King out there, and if one fell, no big deal.

I equated the security, the economic security of the American airline industry with national security, and wanted the Federal Government to take over that security role and bear its cost. So conceptually I agree with you, and thank you very much for being here.

Thank you, Mr. Chairman.

Senator WYDEN. Senator Fitzgerald.

Senator FITZGERALD. Mr. Chairman, I would just like unanimous consent to put in the record the disclosures page of Ms. Donofrio's testimony that shows all the airlines that she and Deutsche Bank work for. I think it is important in this Committee, where we had hearings on the conflicts that analysts have, and we had all the Enron analysts, and we had all the employees who lost all their money and were buying stock because analysts were telling them to right up to the end, that we be very careful about assuming that there is complete independence on the part of research analysts.

Senator WYDEN. Without objection, it will be entered into the record at this point.

[The information referred to follows:]

Disclosures

Company	Ticker	Price	Disclosure
Alaska Air Group	ALK	$17.70	None
AMR Corporation	AMR	$4.18	6
America West Holdings Corporation	AWA	$1.45	None
Continental Airlines, Inc.	CAL	$5.39	6
Delta Air Lines	DAL	$9.29	6
Southwest Airlines	LUV	$13.06	6
Northwest Airlines Corporation	NWAC	$6.68	1,2
UAL Corporation	UAL	$2.14	6
AirTran Holdings, Inc.	AAI	$3.11	None
Atlantic Coast Airlines, Inc.	ACAI	$9.25	1,2
ATA Holdings Corp.	ATAH	$3.40	2
JetBlue Airways	JBLU	$40.33	None
SkyWest, Inc.	SKYW	$13.10	2,6

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Ms. DONOFRIO. May I make a comment on that? I do not own any airline stock personally.

Senator FITZGERALD. But you list almost every airline in the country. Do you work for Deutsche Bank?

Ms. DONOFRIO. I work for the investors of airlines, and I am actually quite negative on the sector, so I have actually been telling my investors not to own airline stocks.

Senator FITZGERALD. But your company owns airline stock, and they will benefit if they get this taxpayer cash, OK? And that is your own disclosure in your testimony, so we are entering that. Thank you.

Mr. Mullin, in this week's Newsweek Alan Sloan wrote an article in which he suggested, using statistics from the Air Transportation Association, that the airlines from 1938 through the end of this year, the total combined income of the airline industry cumulatively over those last 65 years would only be $3 billion, which means that if you subtract out last year's $5 billion bailout, the industry would have lost a cumulative $2 billion. Do you believe your industry will be profitable if this request that you have before us is enacted?

Mr. MULLIN. No, sir, I do not. I believe that consistent with the $7 billion estimate, which is an after-tax estimate, converting that to a pretax, roughly, say, $9 billion, and if we got everything in here in terms of aid with respect to the reimbursement of the security charges, that would be $4 billion, so it would have only 4/9ths, or 44 percent, and the other 56 percent, if we got everything, and frankly I do not expect that will happen, we would still have an enormous burden to take care of in terms of making ourselves profitable, using the kinds of techniques that Mrs. Donofrio offered in her testimony.

Senator FITZGERALD. As has been pointed out repeatedly during this hearing, Southwest and maybe a few other no-frills carriers are the only ones that are profitable, and they have a different business model than the big six carriers. You are all hub and spoke operators. You do not make money, but the point to point carriers, some of them, like Southwest, do.

In fact, I would like to have a chart put up. This shows that Southwest's balance sheet has continued to improve even in the aftermath of 9/11. Their debt as a percentage of their revenue has continued to stay low throughout 2001. The six largest hub and spoke carriers, their debt has skyrocketed. It started to skyrocket at the start of 2001. Maybe it went up faster before 9/11 than after 9/11, but by enacting another aid package, are we not locking into law, or trying to help a failed business model?

Mr. MULLIN. I do not think so, and I would always hesitate to quote Herb Kelleher, but I do honestly believe that if Herb Kelleher were here, having testified with him in various forums, he would absolutely agree with the thrust on security that has been advanced here today. I think he would endorse that, although he will have to speak for himself. He is the most successful airline in the country.

In fact, he is a man I admire. I admire what Southwest Airlines has done over this time period, but Southwest Airlines' net income is dropping dramatically this year. Southwest Airlines will be profitable, but their profits by various analysts' estimates are going to drop between 50 and 70 percent for this year, so the impacts of the kinds of issues we are talking about right here——

Senator FITZGERALD. So you are still a believer in the hub and spoke model, that is the way to go, even though they do not make money?

Mr. MULLIN. I think in Delta's case we are blessed with having the greatest hub in the world, if I may add, O'Hare notwithstanding, and I am a former Chicago resident, as you know, for 15 years, and that is a magnificent asset to the people of Atlanta, the State of Georgia and, frankly, to Delta Airlines.

Senator FITZGERALD. Well, you bring up O'Hare. Clearly somebody is not telling the truth here. United and American would seem on one hand to be saying they need more Government assistance, but on the other hand, in the other chamber, they are pushing to have a bill that will require the expansion of O'Hare Airport, requires the FAA to approve their plans to expand O'Hare, and that will cost $6 billion, which United and American largely have to pay for, so they have $6 billion to burn in tearing up all the existing runways at O'Hare. One of them is 14,000 feet. They are going to tear it up and move it like, 400 feet, and reposition it. They have got money to burn.

So who is telling the truth? Did they have the money to build the six new runways at O'Hare, tear up and rebuild the whole airport, or do they need the bailout? They cannot both be true.

Mr. MULLIN. Relative to their financial status, I think it is well disclosed that United is struggling, and their potential bankruptcy has been referred to by United. American, I could not comment on that.

Senator FITZGERALD. They keep publicly reaffirming they want to go forward with the tearing up and rebuilding of O'Hare.

Mr. MULLIN. I hesitate to get into this, but I would endorse the expansion of O'Hare, having lived there for 15 years.

Senator FITZGERALD. Now, Delta actually terminated one of their construction projects after 9/11, didn't you?

Mr. MULLIN. Yes, we have.

Senator FITZGERALD. Which project was that?

Mr. MULLIN. We have stopped our progress at JFK.

Senator FITZGERALD. That seems prudent. That was $1.4 billion, was it not?

Mr. MULLIN. Yes.

Senator FITZGERALD. And you are cutting back. United and American are going forward. They have got a bill now, dozens of lobbyists working on it, ready to spend $6 billion. They cannot need new Government money if they have the $6 billion to tear up and rebuild O'Hare.

I would like to come back if we could give Senator Carnahan— I just want to say, and let the record reflect that the Committee asked United and American's CEOs to testify. They declined. I personally wrote them. They declined. I think that is too bad, because it is not fair to have you answer for the other airlines. Delta is one of the best-managed airlines in the country, and I think United American, the two biggest airlines who are going forward with the $6 billion expansion at O'Hare, should have had the courage to come and testify, but thank you, Mr. Mullin.

Senator WYDEN. I thank my colleague.

Senator Carnahan.

STATEMENT OF HON. JEAN CARNAHAN, U.S. SENATOR FROM MISSOURI

Senator CARNAHAN. Thank you, Mr. Chairman. In this ailing economy I think two things are very apparent, and that is that the airline industry continues to suffer and that airline employees are experiencing unprecedented job losses and economic uncertainty. It is estimated that approximately 100,000 airline employees are currently out of work, and thousands of other layoffs have been announced. Tens of thousands of additional Americans have been laid off from airline manufacturing jobs.

I was hopeful that the assistance that we provided to the airlines last year would stabilize the industry and prevent other job losses, but that has not been the case. It is my understanding that our colleagues in the House are poised to consider a new expanded relief package for the airlines industry, and we must act with them, because ensuring the long term health of the airline industry is absolutely imperative. I supported expanding the war risk insurance program in this Committee recently. I think that it is appropriate to consider additional assistance to the airlines as well. It would be unfair to do so, however, without addressing the plight of laid-off workers.

Last year, I proposed providing health care and job training and other assistance to airline industry employees who lost their jobs as a result of 9/11. That assistance was blocked by a minority here in the Senate, but it is time, I feel, to revisit this issue. Part of that task is seeing to it that airline industry workers who have lost their jobs do not have to become the latest economic victims of the 9/11 fallout.

I would like to address my first question to Mr. Wytkind. As you know, I have been committed for some time, and continue to be, to including assistance to laid-off workers in any airline assistance package. First of all, do you anticipate any additional layoffs in the industry, and if so, what type of benefits would you find to be most useful, health care, job training, or what sort of things?

Mr. WYTKIND. Thank you for that question, Senator. First, let me say that the labor movement, but especially the Nation's airline workers, owe a debt of gratitude for what you have done to fight for them in their darkest hour. We fought with you to try to pass the Carnahan relief bill and unfortunately, despite our best efforts, we did not get it through, but the anticipation, it was announced already in the last couple of days, is that there will be more layoffs, and we have already heard that there will be thousands more at the major carriers.

Delta Airlines unfortunately had to announce another 1,500 flight attendants being laid off, and the issue for us is, how do we deal with that, how do we provide some stop gap kind of safety net protection. And our plan is fairly simple, and it reflects the Carnahan bill model but adds one more twist to it. The first is, we are seeking 26 weeks of unemployment insurance extension, because thousands of workers have exhausted those benefits, too. With the strangling cost of health care, our members cannot afford the very expensive COBRA charges that they will face, so we are looking for a subsidy that at a minimum reflects what the Congress did for victims of trade policy when you adopted trade adjustment assistance benefits. That includes health care. We think the model should be a little better. We think that the subsidy should be a little higher, maybe 75 percent, but we are looking for that.

Training and retraining is obvious. If the industry does not come back soon, workers will have to find gainful employment in another industry, so we need to help them do that.

And last, there has been a lot of discussion about whether the TSA is structured right, funded right, or doing the right thing, but one thing they are doing is, they are hiring massive numbers of security personnel, and there is not a better pool of trained and skilled workers who could fill those Federal security jobs than our laid-off members, and we think we should give them preferential hiring treatment.

Senator CARNAHAN. Thank you very much.

Mr. Mullin, a question for you. I certainly am in sympathy with the financial difficulties being experienced by the industry right now. As I said, I think it is important for us to strongly consider providing additional assistance to air carriers in one form or another. I know laying off employees has got to be one of the most difficult things that a CEO has to do, but in light of all of the jobs that have been lost in the industry, don't you think that it is only fair and reasonable for us to include a provision to address the needs of laid-off workers in any airline assistance package we put forward?

Mr. MULLIN. I am very much in favor of assistance to laid-off workers. I testified to that point in hearings last year, and I continue to hold that view. I think from the standpoint of the way that it has gone at Delta, I would just echo what you just said.

I think the most difficult task I have ever had to do was to lay off employees. The Delta employees are Delta Airlines, and they represent and they are what we are, and as we look forward here at Delta, we have attempted to do the best we could through a series of voluntary leave programs when we laid off about 10,000 employees last September to provide the kinds of assistance on our own to which you are referring.

Those voluntary programs carried some medical benefits for some time, included some flight privileges for some time, and I would echo that I think anything that we can do to help workers in this time of duress is a good thing.

Senator CARNAHAN. Thank you, Mr. Chairman.

Senator WYDEN. I thank my colleagues. We will begin another set of questions for each of the Senators.

Mr. Mullin, your model for business travelers does not seem to be working very well, and I am interested in knowing whether you think it is time for the industry to rethink its approach there. I mean, clearly business people are coming to us and saying we are being gouged, we are getting less service, we are unhappy. They are not flying the way they used to, and going other routes. Do you think this is something the industry needs to rethink?

Mr. MULLIN. I do, Senator. I think that we have to constantly think about how we are going to have a much greater appeal to the business traveler, and the business traveler is the core of the revenue problem we have and will be the core of the revenue recovery eventually, and so we have to find the mechanisms to appeal to them in the immediate term, your comment on so-called gouging notwithstanding.

Senator WYDEN. That is what they tell us. I am very mild in my comments about the airline industry, but that is what they tell us, that they feel that they are being gouged.

Mr. MULLIN. I think the evidence statistically is to the contrary. As I mentioned in my testimony there has been a huge drop in revenue, a huge drop in the average ticket price. Certainly it is running about 15 to 17 percent below last year for Delta. It is the best time in the world for anybody to want to travel on an airline, and that includes for the business traveler, but we do need to rethink it and develop mechanisms for greater appeal, and that is going on as we sit.

Senator WYDEN. If there is war with Iraq, do you think—or in the case of your company, do you think that you should get a break from the jet fuel tax?

Mr. MULLIN. I would withhold on that recommendation. This is a classic, it depends type answer. I think we have to wait and see what happens in Iraq and, as I mentioned earlier, those are questions that are far larger than aviation. If the military action is of relatively short duration I would not anticipate that we would have to discuss that. If it is of a longer duration, and it really begins to effect a tremendous drop in passengers and, say, fuel spikes, then we will have to come back and talk about it at that time, but I have no preconceived notion on what ought to be done in relation to these scenarios that might unfold.

Senator WYDEN. Well, let us stay with that, then. How long would it take before you would favor a break on the jet fuel tax—a conflict of 2 weeks, a month? Because my understanding is that there are some in the industry who are already saying that they should get a break on jet fuel taxes.

Now, this raises a fundamental fairness question, because if there is war with Iraq, there is going to be a lot of people that are going to be concerned about their fuel costs, and given the fact that there are some in the industry already talking about it, I think it would be helpful to get your sense of when, if ever, you think you would need this.

Mr. MULLIN. Well, I think first of all I would note that we are already bearing what I would consider to be a very substantial increase in the fuel problem that I think heavily derives from the potential situation in Iraq.

If you look, for example, at the average cost per barrel of oil, that is running about $31 right now. At this time last year it was running at $23. That is a huge, huge increase in fuel prices that has taken place in this country since last year, and so in effect, the effects of a potential Iraq crisis I think are already somewhat embedded in the fuel price, and we are absorbing that now and have been for some time, and it has not, in fact, brought us to the point where we felt that that kind of conversation on relief as it relates to that is appropriate.

I do not at this point have a recommendation to conduct those discussions. I know you have heard it from some of the colleagues who asked me the question directly. I do not feel it is appropriate to ask you about that at this point.

Senator WYDEN. Let me return for my final question to this question of the debate now about what it is Government ought to do and what people in the private sector ought to do, and I have told you that I am sympathetic with this argument that Government ought to be dealing with national security, and clearly the industry has been asked to do that, but supposing the Congress said—this is a recommendation that I have seen in the pages of *The Wall Street Journal* and elsewhere, that if the Government clearly picks up the bills for national security the industry should walk away from some of these other steps that the Government has offered, particularly the insurance breaks and the $10 billion bailout package. Is that something that you think would be reasonable?

Mr. MULLIN. You mentioned several things quickly, and I will comment——

Senator WYDEN. I am just saying that I think the industry has got a legitimate claim on national security. What I am asking you is, this Committee constantly is shoveling out money and assistance for a variety of other things, so supposing we said, to really look to the long term and sort of break some of these cycles that the industry has, that we will deal with national security. That is something the taxpayers would see as a legitimate concern for the Government.

But in return, the airline industry would say, we are not going to come up there all the time asking for this other stuff, and we saw that with the assistance after 9/11, we saw that with the legislation. And I am wondering whether you think something like that ought to be discussed, and whether that is something that strikes you as the kind of approach that would make sense for the long term.

Mr. MULLIN. I would bluntly not favor it, and my reasons are extremely straightforward. I think that national security is something that ought to be supplied for all industries in this country. I do not think one should single out and say, if, in fact, the Government agrees to pick up its legitimate role in national security for aviation, that somehow some other governmental program should be imposed on the industry as a quid pro quo. That is not going on for nuclear power plants. That is not going on for chemical plants, or ports, or bridges, all of the industries in our country.

My final point was, we are not asking for special treatment. We are asking to be treated like everybody else—like everybody else—and Senator Wyden, I have appreciated your help last year, but I want to be very, very clear, this industry, all of the words notwithstanding that are printed in the newspapers, does not regard what happened last year as a bailout, as Senator Fitzgerald indicated in his arithmetic that he did, in the 4 days, which basically I agree with your numbers in terms of the impact of the 4 days.

What was not included was the tremendous revenue cost that we took. You do not get back your revenue after a crisis like that, and so in effect the $5 billion took care of about 8 to 10 weeks of the pain of September 11th after that. That was all the $5 billion did, and of course so far on the loan guarantee program one significant loan has been made, and that is the loan to America West. United and US Airways are still outstanding, and even if they were done, that would be $3 billion.

I do not favor the extension of the loan guarantee program further, Senator. I do not. I think that it did its job. I commend the Committee for having passed it. It has expired, and I think at this point the better attempt is to deal with these security issues directly, face up to them, and that that would be a tremendous help to the industry that is consistent with Government policy in this regard.

Senator WYDEN. I am not sure I understand your position. You are saying that the insurance, or the Government assistance bailout is not needed any more. You do not favor renewing it?

Mr. MULLIN. I personally do not. I think that when one looks at the program that was established to stabilize the financial capital markets and provide emergency financial assistance to the industry—and I am speaking personally, not as a member of the Air Transport Association as I say this, this is my view—I think that were we to extend the program which expired on June 28, according to the rules of the Air Stabilization Board, that that in effect could be viewed as consistent with supporting a further, quote, "bailout" of the industry. It would deal with the economic problems of the industry that, through this testimony, I am saying are our responsibility.

I think the focus of this Committee and the Federal Government should be on the relief of the security burdens associated with what is a national security imperative.

Senator WYDEN. I do not think it sounds like you are ruling out the concept, and that makes some sense. I have told you, I am supportive of the national security function. Let me repeat that. I am supportive of the national security function, but I will tell you that businesses in Coos Bay, Oregon and Pendleton, Oregon do not get a lot of the assistance that we have offered the airline industry over the years, and I am just hopeful that as we try to sort this out, that people in the industry will say, look, we are going to be serious about dealing with our long term problems, and I have outlined a number of them, including the debt, including the passenger service, including the rural communities.

And also you will walk away with the impression, at least from my standpoint, that when we are going to deal with national security, then we are doing something that makes sense to the public. When we continually pass out assistance, as this Committee does again and again and again for matters that my constituents do not get, and they do not see as national security measures, that does not pass the smell test.

Mr. MULLIN. You know something, Senator, I could almost endorse everything you have said. We are not asking here for help with those. We are on board together in talking about the reimbursements, and help should be related to national security.

Senator WYDEN. Senator Fitzgerald.

Senator FITZGERALD. Thank you, Mr. Chairman. I just want to say that I think the airlines would like the loan guarantee program to continue but for one factor. The loan guarantee legislation that we passed requires the airlines to give an equity stake up to the Government in return for the loan guarantees, and I do not think they want to do that, and that was a requirement Senator Corzine and I put in there, and that is why I think a lot of airlines did not apply for it. They did not want to give up an equity stake in the airlines that would dilute the holdings of the senior management.

Mr. MULLIN. May I respond to that briefly, Senator?

Senator FITZGERALD. OK.

Mr. MULLIN. Just real briefly, as you know, the ATSB established three criteria, (1) the airline could not have access to the private capital markets, (2) that it had a business plan that was bankable, that it would pay back the loan, and (3) that the loan guarantee was consistent with the national aviation priorities. Those are the three criteria that governed it.

Delta, for example, has had access to private capital markets during this whole time period, and so we would in a sense flunk that first criteria. I think we would fulfill it in the other ones, and that is the reason. It did not have to do with that.

But I think, you know, as you know from your background and my background, taking an equity participation at a time when there is a high risk loan being put forward is a common practice in the banking industry, and so I think at times it is appropriate, but it reflects the risk that is associated.

Senator FITZGERALD. I got that idea from Bob Aboud, who you may remember at First Bank of Chicago. He worked on the Chrysler bailout.

But in any case, I do want to ask if you could please be specific on how much your proposal would cost. I noted that, I believe for public relations reasons this year, you are not asking for a specific amount, that instead you have been deliberately obscure. You have asked to shift a variety, a whole menu of your costs over to the taxpayers.

Extrapolating from your testimony, I see that you cite about $660 million worth of Delta's cost that would be shifted over to the taxpayers, roughly speaking extrapolating out over the whole industry. That means it would cost the taxpayers about $4 billion a year, and so can you put that $4 billion price tag on this bailout?

Mr. MULLIN. Yes, sir. In responding to your question on specificity, first of all, Exhibit 6 lays out the specific elements, and behind Exhibit 6 is detail at Delta Airlines which I would be very willing to share with any governmental authority that would want to come back down and discuss that.

Senator FITZGERALD. Would you allow the GAO to audit your books to verify all these costs?

Mr. MULLIN. Absolutely.

Senator FITZGERALD. And all the other airlines, would that be part of your package?

Mr. MULLIN. I think any time we deal with the Government we have to be prepared to open our books, and we have been doing that.

Senator FITZGERALD. I am pleased to hear that. So this would cost $4 billion a year. You agree that it would not just be this year, that it would be in perpetuity, isn't that correct?

Mr. MULLIN. Right. In fact, that is a very important point you are making. If you go back even to the $5 billion of the program of last year and recollect what I have just said in response to Senator Wyden's comments, the debt was associated with the immediate term consequences of September 11th, a one-time shot, a term you used I think in your own statement. This $4 billion is an ongoing burden on our industry, frankly.

Senator FITZGERALD. And that burden would be shifted to taxpayers.

Mr. MULLIN. The burden is on us right now.

Senator FITZGERALD. But it would be shifted to taxpayers, right?

Mr. MULLIN. Correct, but if you were to ask me would I rather have the shifting of this $4 billion, the appropriate taking of the responsibility on the part of the Federal Government for security, versus not having the $5 billion of last year, I would take that trade.

Senator FITZGERALD. But the bottom line, because it goes on year after year, it is really a much bigger cost to the taxpayer than last year's one-time bailout, OK? We had established that.

Now, 9/11 hurt airlines, we all know that, but it hurt lots of other industries, too. Didn't hotels, some of them, in big cities suffer, car rental agencies, travel agencies? A lot of them got hurt. A major car rental company in suburban Chicago filed bankruptcy. They did not get a Federal handout, did they, those other industries?

Mr. MULLIN. They did not, and the reasons why, which were discussed in this Committee, why the assistance was rendered to the airlines is derived from two key points. One is, airlines were used as the instruments of destruction directly during this horrible terrorist act which was conducted. Our industry is absolutely unique in that respect.

Second, we are the underpinning factor for the second most important industry in America, which is travel and tourism, just exactly the kinds of organizations you mentioned. If you do not have an effective aviation system, you do not have an effective car rental, you do not have effective hotel occupancy rates, you do not have the theme parks of America filled with traveling tourists. That is the reason why the aviation industry got the help that it did post September 11th.

Senator FITZGERALD. Well, that is your perspective. My perspective is, you had the most formidable lobby on Capitol Hill. I think you had 63 lobbyists meet maybe the afternoon of September 11th to figure out how to get your assistance package. All those other industries came in and asked for bailouts, but the fact of the matter is, they do not have the raw political clout that the airlines have. That is my perspective on why you got the bailout and they did not.

Now, Delta continues to pay a stock dividend, is that correct?

Mr. MULLIN. Yes, a very small one.

Senator FITZGERALD. Ten cents a share?

Mr. MULLIN. Yes.

Senator FITZGERALD. And you paid it 35 days after September 11th, isn't that correct? In October of last year, you continued to pay a dividend. I mean, couldn't a taxpayer reasonably say, hey, we gave that $5 billion and you turned around and funneled it out the door to your shareholders? You also did a stock buy-back in the late 1990's that ate up almost $2 billion worth of your capital.

Now, when you buy Treasury stock like that, and that is very expensive, that puts you in a vulnerable position if there is a downturn. When you bought back as much stock as you did, $2 billion—you would have $2 billion more of equity almost if you had not done that stock buyback, and a lot of the other airlines did stock buybacks, too, and they left themselves vulnerable to a downturn. Now, do you think the taxpayers should reward the investors in those companies who made out well when you were doing that stock buyback to drive up their stock prices? Isn't that a problem?

Mr. MULLIN. I think in retrospect that doing stock buybacks to the extent that they were done was unfortunate under the existing financial circumstance, but we had a target of maintaining a debt to capitalization ratio at Delta of 65 percent to 70 percent, and we were doing that, and so under that circumstance—and serving our shareholder interests, and we do intend to serve shareholder interest. The stock buyback program in 1999 made some sense under that existing circumstance. None of us anticipated September 11th.

Senator FITZGERALD. Well, I just do not feel that the taxpayers should now have to pay because the airlines made what in retrospect were improvident management decisions back then.

Then you have United Airlines. They went out and spent an awful lot of money trying to set up a private corporate jet subsidiary called Avila, where they contracted for billions of dollars of private jets. They just had to terminate that program this year, but it still cost them a lot of money. United Airlines had their failed merger with US Air. That cost them a lot of money. All of these management decisions have put them in a bad way.

One other alternative to help you deal with your security costs is, we could take away all those security requirements. We could take away the requirement of an air marshal, of all the added screenings. How would you feel about that?

Mr. MULLIN. I would not advocate that at all.

Senator FITZGERALD. That is because you benefit from the enhanced security, is that not correct?

Mr. MULLIN. I think that America as a country benefits from the enhanced security.

Senator FITZGERALD. You do not think your airlines benefit from it?

Mr. MULLIN. I think we do as part of the American economy. We clearly do.

Senator FITZGERALD. So why should the taxpayers pay for all of this that is benefiting your companies?

Mr. MULLIN. I think we are going to a fundamental question of the role of Government versus private industry, and I think in the United States it has been accepted that the protection of the country to provide national security is, in fact, a Federal Government responsibility. It has been accepted since the time of the Constitution, and therefore for the Federal Government to pick up this responsibility——

Senator FITZGERALD. But not to pay for security costs for private businesses. We do not pick up security costs at any other private business in America, even if they are required.

Mr. MULLIN. For national security you do. For security as it relates to, say, internal to the company, hiring policemen, for example, at banks, banks used to have their own security forces.

Senator FITZGERALD. They paid for those.

Mr. MULLIN. Right, and I agree with that, and we have in any security that is unique to Delta, but when you are talking about national security as it involves a war on terrorism, that is a national Government responsibility.

Senator FITZGERALD. If you owned the John Hancock Building in Chicago, it could be a terrorist target. Whoever owns that building, they are paying for their own security, aren't they?

Mr. MULLIN. The National Government is protecting the John Hancock Building and all other tall buildings in the United States.

Senator FITZGERALD. They are paying for the security there?

Mr. MULLIN. Certainly, through our military forces and the CIA.

Senator FITZGERALD. Now, come on. In that sense, they are paying for your security, too.

Mr. MULLIN. That is correct.

Senator FITZGERALD. But we are not paying for the security checks as you enter that building. That is a cost borne by the private sector. We are about to pass a bill that is floating around here, we may pass it, on enhanced security requirements for chemical plants. Chemical plants would have to pay for that. The nuclear power plants, the security that Commonwealth Edison has at their power plants they pay for, and that is a cost of their doing business, and if you did not have this security no one would want to fly your planes, so you are benefiting from it.

Mr. MULLIN. I am making the distinction, Senator Fitzgerald, between national security and other forms of security, and this whole discussion here relates to the war on terrorism as it emanated from September 11th and the unfortunate role that airlines played in that heinous act, and so that is where our conversation is. Other forms of security should be borne by the companies themselves.

Senator FITZGERALD. All right. Well, we could go around and around on that.

On the fuel cost, you hedge yourself on fuel. Don't you have derivatives contracts that would prevent you, and that would pay you in the event that fuel prices go up?

Mr. MULLIN. We do. We are about 50 percent hedged through the remainder of this year, and then after that our hedging contracts drop off. As again you would know from your financial background, that it is very difficult to put hedges on in a market where the fuel prices are clearly going up, and nobody can hedge against that.

Senator FITZGERALD. But you cannot have a perfect hedge, but you can have somewhat of a hedge so that the whole rising fuel cost, that is something that you have been contending with for years in your risk management department.

Mr. MULLIN. We have.

Senator WYDEN. I know this is a subject my colleague cares passionately about, as do I, and if it would be acceptable to you, if you could submit additional questions in writing.

Senator FITZGERALD. Could we get United and American to answer, to explain how they could afford the $6 billion expansion at O'Hare in writing?

Senator WYDEN. We can certainly ask.

Mr. MULLIN. We can certainly ask.

Senator FITZGERALD. Don Carty wrote me a letter and said you could speak for him, but I thought that would be a stretch. I would appreciate it if they could explain that. That is a conundrum to me.

Senator WYDEN. We will allow for any member to submit questions in writing. We appreciate the patience of all the witnesses. Do any of you have anything you would like to add further before we adjourn?

Mr. MULLIN. Thank you very much, sir, for having the hearing.

Senator WYDEN. The Committee is adjourned.

[Whereupon, at 11:30 a.m., the Committee adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

Good Morning. By most accounts the airline industry in the U.S. is in its worst economic condition possibly since commercial service began. Air carriers have slashed some 100,000 jobs, schedules have been cut by roughly 20 percent, and a thousand airplanes have been moved into storage.

The downward spiral of the nation's economy has ravaged airlines in the U.S. The air carriers were anticipating industry-wide losses of up to $2 billion in 2001, before the devastating effects of the September 11. The terror attacks in conjunction with the increasingly poor performance of our economy has made it even harder for the industry to recover.

The stock market has lost $17 trillion in value from its peak in 2000 and the Dow Jones Industrial has dropped more than 3,000 points over the past 18 months. The gross domestic product (GDP) of the U.S. has grown by just 1 percent over this same period. This slow economic growth and a steadily falling stock market, coupled with rising unemployment have led to reductions in corporate travel budgets and a dramatic decrease in business and leisure travel.

The loss of domestic business passenger enplanements, which have dropped by nearly 12 percent over the past year, are especially hard on the major carriers which count on business and repeat travelers for as much as half of their yearly revenue. When times are good corporate travelers are the most dependable and attractive income source, but if these travelers cannot be counted on the industry suffers—as it is doing today.

It has been just about a year since Congress acted to help the airline industry through the aftermath of September 11. As you know, we quickly passed the Air Transportation Safety and System Stabilization Act (Pub.L. 107–42) to provide the carriers with needed financial support by giving them access to $5 billion in direct compensation and $10 billion in federally guaranteed loans.

Now, the airlines are here to seek further support from Congress in the form of insurance extensions, reduced taxes and fees, and other beneficial regulatory changes. This raises many questions, some which we hope to answer today, as to what the return on such an investment will be for the taxpayers. Yes—the airlines are hurting, but so are many, many other businesses across the country. They did not get a "bailout" after the terror attacks, and some have not survived the aftermath. In this current economic climate the airlines must still convince many Members of this body that there is a compelling need to provide additional relief.

Some people have begun to question the profitability of the airline industry, and question whether Congressional action will produce worthwhile results. It is my understanding that, according to ATA statistics and projected losses for the coming year, the airline industry's total profit over the past 65 years will basically be a wash—that's zero dollars! No profit, and things will not improve until the economy does.

The market capitalization for the major air carriers is somewhere in the neighborhood of $5 billion, while Southwest Airlines is worth double that alone. Congress could have purchased the major airlines with the $10 billion in funds that have been provided for loan guarantees. Some of this money is still available and will be distributed, but many wonder if we are throwing good money after bad, and should take a different approach.

We need the airlines to come forward and show us how things are going to change, and for the better. Air fares are down on average according to GAO, but will that be a short term dip or is there some way to work towards affordable prices for the majority of the traveling public? The industry is taking steps to cut costs, but will airlines work towards a better business model that will improve their financial outlook while benefitting the traveling public?

This hearing will provide the industry an opportunity to tell your side of the story. I am hopeful that we can work together for solutions that will be useful to both the airline industry and the American public, as we search for bigger answers to the linering bad effect of the U.S. economy.

PREPARED STATEMENT OF HON. OLYMPIA J. SNOWE,
U.S. SENATOR FROM MAINE

Thank you, Mr. Chairman, for holding this hearing on the financial state of the airline industry. I think today is especially important, because while we have held numerous hearings on the state of aviation security since 9/11, we have not heard much from our airline industry.

First, I wanted to express my gratitude to Delta CEO Leo Mullin, with whom I met yesterday, for his decision to introduce new 70-seat jet service between Bangor International Airport and Cincinnati. I know this is a tough time for Delta to be expanding service, and I thank you.

Mr. Chairman, there is no question as to the significance of airline service not only to our quality of life, but also our national economy. According to the Air Transport Association, airlines generate three percent of the gross domestic product, almost $273 billion. Moreover, the Maine Department of Transportation reports that over 56,000 jobs, $1.29 billion in payroll, and $3.73 billion in sales are tied to the availability of scheduled commercial air service.

Nationwide, the airline industry was certainly suffering before 9/11—due to a sluggish economy and runaway labor costs—the attacks transformed an industry downturn into a life-or-death industry crisis. Congress responded by enacting the Air Transportation Safety and System Stabilization Act, which provided a total of $5 billion in compensation to various air carriers, and provided for up to $10 billion in airline loan guarantees.

Over a year after the enactment of the Stabilization Act, the industry has not recovered, and may even be in a worse financial state. There is no doubt that the airlines are in deep financial trouble—with losses projected to exceed $7 billion for Fiscal Year 2002. Also, I understand that up to 40 percent of the industry's expected losses this year can be attributed to post-9/11 security costs. Today, our witnesses will lay out the options Congress has to mitigate the impact of these increased security costs.

As a member of the Conference Committee on the aviation and transportation security legislation, I am proud of the work we did last year to revamp the aviation security infrastructure. We all fought for the strongest possible enhancements to the status quo at the time, and I believe we set a strong foundation for reform.

At the same time that we provide for the safest possible commercial aviation system, and reassure the American people that it is indeed safe to fly, we must be mindful of the financial impact our security mandates have on the air carriers. We can all agree that the goal is to have an air transportation system that is both safe from attack and financially stable.

This Committee has taken some action to help offset the burden of post-9/11 security costs. Last month we unanimously passed legislation that included a provision to extend "war risk" insurance to the airlines for an additional nine months. I understand that, in Delta's case, annual war risk premiums jumped from $2 million pre-9/11 to $150 million post 9/11. And for some carriers who don't fly internationally, war risk premiums have jumped as much as 14,000 percent!

The Committee bill also would institutes a new air cargo security regime, and would allow Postal Service employees to be considered federal screeners using procedures set by the TSA. This provision would eliminate the biggest obstacle to a lifting of the ban on airlines transporting mail of more than 16 ounces—the fact that under the aviation security law all screeners must be federalized according to TSA standards. In the case of American Airlines, this restriction cost them almost $300 million in FY 2002.

Again, Mr. Chairman, thank you for scheduling this hearing. I believe this is an important opportunity to discuss ways that we can assist our beleaguered airlines, whose health is so vital to the U.S. economy.

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