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U.S. AIRLINES

Weak Financial Structure Threatens Competition

Statement of
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Before the
Subcommittee on Aviation
Committee on Public Works and
Transportation
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

We appreciate this opportunity to testify on the financial condition of the airline industry and its effects on competition. The deterioration of the industry's financial health over the past several years has raised concerns that, as carriers are forced out of the industry due to bankruptcy, competition will decline and prices will rise. This could undermine the gains achieved for airline passengers since deregulation. The analysis we are presenting today is based on our recent assessment of the financial condition of the airline industry and on the work we have done over the past three years, much of which has been reported to you in a series of reports and testimonies, on competition in the airline industry.

Overall, our work suggests the following:

-- First, the airline industry has developed over the past decade some serious long-term problems that weaken the financial position of some carriers. Chief among these problems are (1) the high levels of debt that some carriers have incurred and (2) the operating and marketing practices that some carriers have adopted that prevent other carriers from competing effectively. More recently, the industry has also been hit by two severe short-term problems--the ongoing recession and high fuel prices resulting from the Iraqi invasion of Kuwait. The short-term problems have exacerbated the financial weakness that has been building up over the past decade. Future investment demands, for repairing aging aircraft and meeting more stringent noise standards, will increase the financial burdens on the industry.

-- Second, financial problems threaten the survival of several carriers. Eastern and Braniff have already ceased operations within the past two years; if the recession is prolonged, several additional carriers could fail.

-- Third, if several airlines do fail to survive the recession, competition could be adversely affected. Many routes are served by only two or three carriers, so the loss of a single airline could significantly reduce competition. If carriers do cease operations, careful monitoring of sales of assets by the Department of Transportation (DOT) and the Department of Justice can help to mitigate reductions in competition by encouraging the sale of assets to carriers that did not previously offer service on the affected routes.

-- Fourth, the potential reduction in competition that could result if several carriers cease operations lends greater urgency to the need to take further action to enhance the industry's competitive balance. In our previous testimony before this Subcommittee, we discussed a number of policy initiatives to promote competition in the airline industry.[1] One of these, passenger facility charges at airports, was authorized last year by the Congress. It should help provide revenues to airports to expand capacity without needing the approval of airlines. Other policies we discussed, such as reducing the anticompetitive impact of computerized reservation systems, have been subjected to prolonged review by DOT. These policies would both improve the financial health of carriers whose survival is threatened and help to mitigate any loss of competition resulting from carriers ceasing operations. While these policies would enhance the competitive strength

[1]Barriers to Competition in the Airline Industry (GAO/T-RCED-89-66, Sept. 21, 1989).

of the smaller carriers in the industry, the long-term problem of excessive debt in the industry would remain.

-- Fifth, the urgent need of some carriers for additional capital has led to calls for legislation to allow foreign firms more opportunity to invest in U.S. carriers. Insofar as such action goes beyond the policy changes recently announced by the Secretary of Transportation, it could lead to greater control of U.S. carriers by foreign interests, and would require careful review for its impacts on national defense and our bilateral negotiating strategy. Any general opening of the U.S. market to foreign interests should take place as part of a reciprocal process which allows U.S. carriers more access to foreign markets.

-- Sixth, more far-reaching policy options, such as reregulation of fares or federal financial assistance for the industry, pose serious problems that would require extensive analysis before they could be considered for implementation. These approaches are at odds with the policy expressed in the Airline Deregulation Act of 1978, which emphasizes competition as the primary regulator of airline fares.

HIGH DEBT LEVELS AND OBSTACLES TO COMPETITION HAVE WEAKENED THE FINANCIAL HEALTH OF SOME CARRIERS

Debt Levels Have Increased Substantially For Some Carriers

Debt levels increased substantially for some carriers during the 1980's, either as a result of leveraged buyouts or to finance expansion. This debt was taken on under the assumption that the demand for airline travel would grow at a sufficiently steady pace to generate the revenues to pay the debt service. These assumptions are now proving to have been overly optimistic. The increase in debt increases fixed charges for interest payments and makes these carriers much more vulnerable to a short-run decrease in demand due to a recession or a short-run increase in costs.

One standard measure of debt levels is long-term debt as a percentage of total capitalization. Between 1980 and 1989, this percentage rose from 62 percent to 273 percent at Pan Am, from 62 percent to 115 percent at TWA, and from 62 percent to 96 percent at Continental. (See attachment I.) The debt to capitalization ratio at Eastern rose from 79 percent in 1980 to 473 percent in 1988.[2] America West raised its debt level from 45 percent to 85 percent between 1983 and 1989, while Midway's went up from 52 percent to 78 percent.[3] By contrast, despite a vigorous expansion program, American Airlines actually reduced its debt ratio during this period to 34 percent, while United, USAir, Southwest, Delta, and Northwest all held their debt ratios under 60 percent.

These data include capitalized leases (that is, leases for the lifetime of the asset), but may not include other long-term leases. Some analysts believe all long-term leases should be included as part of debt, which would make these debt ratios higher. One estimate for American and United places their debt ratios at 70 percent and 75 percent, respectively, including long-term leases and short-term debt.

Industry Operating and Marketing Practices Limit Competition

At the same time, as we have reported previously, some operating and marketing practices used in the airline industry limit competition and make it more difficult for some carriers to

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[2]1989 data for Eastern are not comparable due to Eastern's bankruptcy.

[3]America West is a relatively new airline that only began reporting in 1983. Midway began reporting in 1982.

compete.[4] These practices limit access to airports and limit the ability of new carriers on a route to market their services.

Some Practices Limit Access to Airports

Airport access is limited by the practice of leasing airport gates and other facilities to airlines on long-term exclusive-use leases. These leases give control of these facilities to airlines and make it possible for them to exclude other airlines from the use of the facilities. At some airports, most of the facilities at the airport are controlled by a single airline. Another practice that limits access to airports is the majority-in-interest clause. This provision in the airport use agreement typically gives the airlines providing a majority of the operations at an airport the right to disapprove expansions in capacity by the airport which would alter the airlines' financial commitment to the airport. These clauses thus potentially prevent capacity expansions that could accommodate another carrier. Our analysis showed that carriers charge significantly higher fares on routes to airports where they control a large portion of the gates or where a majority-in-interest clause is in effect. Last October the Congress passed legislation authorizing airports to levy Passenger Facility Charges. These charges, by giving the airports a source of revenues independent of the airlines, should help the airports to expand capacity without seeking airline approval.

Another factor limiting airport access is the Federal Aviation Administration's (FAA) High Density Rule, which restricts access to takeoff and landing "slots" at National Airport in Washington, LaGuardia and JFK Airports in New York, and O'Hare Airport in Chicago. Our analysis showed that carriers charge higher fares on routes where slot controls are in effect. While these practices

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[4] Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990).

enhance the revenues of carriers who have established positions at these airports, they make it more difficult for other carriers to compete and earn an adequate profit.

Marketing Practices Limit the Ability of Airlines Entering New Markets to Compete

Airline marketing practices also limit competition. Over two years ago, we testified before this Subcommittee on the competitive impacts of computerized reservation systems (CRS).[5] Because each carrier must, as a practical matter, have its flights listed on each of the four CRSs in order to market its flights successfully, each carrier is forced to pay the booking fees charged by the other airlines that own the CRSs. These booking fees far exceed the costs of providing the service, and hence transfer hundreds of millions of dollars in revenues from carriers that do not own CRSs to those that do. Even a carrier that owns a CRS loses money if it pays out more in booking fees for flights booked on other systems than it receives from other carriers' flights booked on its system. Because of restrictive contract provisions between CRS vendors and travel agents, it is virtually impossible for a new CRS to be established or for a small CRS to expand its market share. While most of the major carriers are now part-owners in CRSs, most of the benefits of these systems go to the two majority owners of the two dominant systems, American and United. We calculated that the lack of effective competition in the CRS industry allows American and United each to receive over $300 million per year in excess of the costs of the service provided (including a reasonable profit) from other carriers in the industry, most of which are financially weaker.

Frequent flyer plans may also have a significant effect in reinforcing the market power of dominant carriers. Our survey of

[5]Competition in the Airline Computerized Reservation System Industry (GAO/T-RCED-88-62, Sept. 14, 1988).

travel agents indicated that business flyers often choose their carrier based on frequent flyer plans, which generally favor the larger carriers in each market. Travel agent commission overrides (bonus commissions paid to travel agents to encourage booking on a particular carrier) may also restrict competition, but their effect is less clear.

Code-sharing agreements (cooperative marketing agreements between jet carriers and commuter carriers) appear to strengthen the position of carriers with such agreements, especially at their hubs. In doing so, these agreements prevent other carriers from competing effectively. Code-sharing agreements might also reduce the long-run competitiveness of the industry by making regional carriers less independent and preventing them from potentially offering a competitive challenge to larger carriers in some markets.

The Recession and High Fuel Prices Have Worsened Carriers' Financial Problems

Airline industry profitability has been low for several years. The industry lost money in 4 out of the 10 years from 1980 to 1989. Passenger airlines earned a profit of $1.2 billion in 1988, but have become increasingly distressed since then.[6] They lost $20.7 million in 1989 and appear headed for a record loss of over $2 billion in 1990. (See attachment II.) The recent decline in profitability is due primarily to the decline in the health of the economy and to the rise in the price of fuel.

Capacity is Up, But Demand Is Flat

The demand for airline service tends to rise and fall with the overall level of national income. Gross national income grew very

[6]Our analysis includes the eleven major airlines and Midway.

slowly in 1990, rising 1.0 percent during the first three quarters before dropping 0.5 percent in the fourth quarter. Meanwhile, domestic airline industry capacity in 1990 grew faster than demand, rising by 5.5 percent over 1989 capacity. Fares rose slightly, but less than the increase in operating costs.

Fuel Prices Are Up

The domestic cost of jet fuel rose 97 percent during the first months of the Persian Gulf Crisis, from $.56 per gallon in July to a peak of $1.11 in October. Our preliminary analysis indicates that the increase in fuel costs from July to October pushed up total operating costs up by more than 10 percent. By January 30th, the price of fuel had fallen to $.70, a decline of 37 percent from the October peak. While there is no organized futures market for jet fuel, futures prices for other refined petroleum products suggest that prices are expected to fall further over the course of the year.

Reduced Profits Have Weakened Carriers' Ability to Service Their Debt

As profits have declined, carriers have been less able to service their debt. Earnings before interest and taxes in the 3rd quarter of 1990 were less than interest charges for 6 of the 11 major carriers (America West, Continental, Delta, Eastern, Pan Am, and USAir), and almost certainly declined further in the 4th quarter.

FUTURE INVESTMENT DEMANDS WILL IMPOSE FURTHER FINANCIAL STRAINS ON THE INDUSTRY

Investment demands for replacing and renovating aircraft will continue to be heavy due to increasingly stringent FAA airworthiness directives and new federal requirements to phase out older, noisier jets. The FAA recently issued new airworthiness directives for aging aircraft requiring repairs and modifications to about 1,400 of the 4,100 aircraft in the U.S. fleet, at a cost of about $500 million per year over the next 4 years. Moreover, the recently enacted Aviation Noise and Capacity Act of 1990 requires that all aircraft meet stringent "stage 3" noise standards by the year 2000. We estimated that this will require the retrofitting or early replacement of over 2,000 aircraft over the next 10 years at a cost of about $2.2 billion. These changes are essential to meet compelling safety and noise abatement objectives, but they will place a substantial financial burden on the industry.

THESE FINANCIAL PROBLEMS THREATEN THE SURVIVAL OF SEVERAL CARRIERS

Several carriers, including Pan Am, Continental, and TWA, have been plagued by high debt and low profits. Pan Am and Continental have both filed for protection from their creditors under Chapter 11 of the bankruptcy code. Midway also has a high level of debt (though less than these other three carriers), and lost money in both 1989 and 1990. America West made a profit in 1989, but lost money in 1990 and also has a high debt level. USAir has a low debt level, but lost money in both 1989 and 1990. These carriers are all, to varying degrees, threatened by the declining financial fortunes of the industry. For the stronger carriers in the industry, on the other hand, the recent decline in profitability will probably cause temporary financial distress but should not lead to any long-term problems. American, Delta, Northwest, Southwest, and United all have reasonably low debt levels and turned a profit in 1989. The likelihood of any particular carrier surviving depends on the strength of various elements of its balance sheet, its ability to compete effectively, the level of fuel costs, and the length of the recession. A carrier's balance sheet evolves continuously as it takes out additional loans and acquires new assets. We are not prepared to assess the prospects of survival of any particular carrier, but clearly several carriers are threatened.

COMPETITION COULD BE HARMED IF ADDITIONAL CARRIERS CEASE OPERATIONS

If additional carriers cease operations, the decline in the number of competing carriers will probably harm competition. The four carriers in the weakest financial condition (including Eastern) collectively carried about 27 percent of the industry's traffic last year. (See attachment III.) Our analysis of industry pricing demonstrates that carriers are able to charge higher prices on routes where they have higher market shares. Our analysis indicates that doubling a carrier's market share on a route, e.g., from 10 percent to 20 percent, is associated on average with an increase in prices of almost 9 percent. As carriers cease operations, we would expect the market shares and fares of the remaining carriers to rise.

Before it ceased operations, Eastern had at least a 10-percent market share on 10 percent of the nation's routes. Continental and TWA have such shares on 14 percent and 12 percent of the nation's routes, respectively. Pan Am, by contrast, is primarily an international carrier and has at least a 10-percent share on less than 1 percent of the nation's domestic routes. (See attachment IV.)

It has been suggested that the survival of four or five carriers would be enough to achieve effective competition. This would be true _if_ several carriers served most routes. However, about 76 percent of all passengers nationwide fly on routes served by three or fewer carriers, and 45 percent fly on routes served by only one or two carriers. On these routes, the loss of a single carrier could have a serious adverse effect on competition.

The nature of the competitive outcome would depend, of course, on how other carriers responded to the failing carrier's exit. If a failing carrier were able to sell its hub operation to another carrier that did not already provide service on its routes, then competition might not be adversely affected, because market shares would be no higher than before. However, the acquiring carrier will probably have been providing service already on some of the routes acquired from the failing carrier, and competition would be adversely affected on those routes. The exit of one carrier would probably make the remaining carriers on its routes stronger. The ultimate outcome is uncertain, but the potential loss of competition could significantly raise fares.

The loss of competition when a carrier ceases operations can be reduced if the DOT and the Department of Justice monitor sales by the failing carrier of its geographically fixed assets, such as gates and slots, to ensure that these sales do not result in avoidable losses of competition. As the Subcommittee is aware, review of competitive impacts by DOT has sometimes been cursory in the past, when mergers were assumed to have no impact because of the role of "potential competition."[7] DOT and Justice have stated that they are currently monitoring asset sales by Eastern Air Lines, and Justice has recently requested additional information concerning proposed sales of Eastern's assets. The sale of Eastern's gates in Atlanta to Delta Air Lines, which already dominates routes from Atlanta, would significantly reduce competition in the Atlanta market, where fares since deregulation have already increased more on average than in any other major hub market.[8]

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[7]See our report, Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, June 28, 1989).

[8]See our report, Airline Competition: DOT and Justice Oversight of Eastern Air Lines' Bankruptcy (GAO/RCED-90-79, Feb. 23, 1990).

POLICY INITIATIVES TO PROMOTE COMPETITION SHOULD ALSO PROMOTE FINANCIAL HEALTH

The declining financial health of several carriers has led to numerous suggestions for policy initiatives to improve their financial condition. Some of these suggestions deal with the short-run problems of the industry. These include forcing down the price of jet fuel, either through federal government pressure on oil companies or through release of petroleum from the Strategic Petroleum Reserve, and allowing airlines to retain for a time the revenues from the airline ticket tax. Other suggestions are addressed to the long-term problems of the industry, such as proposals to set a floor on airline fares so as to increase revenues and to ease the rules that restrict investments by foreign entities in U.S. carriers. We believe that a more effective and appropriate approach would focus on policies to enhance competition--such as revised rules on slot allocation and computerized reservation systems--that we have discussed in previous testimony before this Subcommittee. This would both enhance the financial conditions of threatened carriers and mitigate any reduction in competition that would occur if additional carriers ceased operations.

Short-run Policy Approaches

Reducing the Price of Jet Fuel

The price of jet fuel has already fallen considerably from the peak levels reached this fall. Prices are still higher than the levels being paid in July; however, the early achievement of air superiority in the Persian Gulf War, coupled with the President's decision to release petroleum from the Strategic Petroleum Reserve, has created expectations that prices will fall even further. A prolonged war could, of course, reverse these expectations. In any case, reducing fuel prices will not solve the more fundamental problems, such as limited access to airports and restrictive marketing practices, that limit the competitiveness of the airline industry.

Allowing Airlines to Retain Revenues From the Airline Ticket Tax

Airlines collect a 10-percent excise tax on the price of airline tickets, which they remit to the federal government for deposit in the Airport and Airway Trust Fund. Allowing airlines to retain revenues from the airline ticket tax would be an indirect form of federal financial assistance for the industry. The airlines would increase their cash flow and reduce their need to borrow, but these savings would come at the expense of the federal government, which would have to borrow more to replace the lost cash flow and incur increased interest charges. Moreover, such financial assistance would be at odds with one of the purposes of the Airline Deregulation Act of 1978, to reduce the role of the federal government in the airline industry.

GAO has had extensive experience with previous bailouts, including those for Conrail, Lockheed, Chrysler, and New York City (the Comptroller General served on the boards that oversaw the financial assistance provided to Conrail and Chrysler). In a previous report, GAO reviewed the experience with these bailouts and set out a series of guidelines that should be followed before any additional such bailouts are authorized.[9] These guidelines are that the problem should be clearly identified, the national interest should be clearly established, the objectives of the bailout should be clear and consistent, and the government's financial interests should be protected. Given the dramatic increase in federal budget deficits since these other bailouts were authorized, it is especially important that any proposal for

[9] Guidelines for Rescuing Large Failing Firms and Municipalities (GAO/GGD-84-34, March 29, 1984).

financial assistance to the airline industry address the national interest to be served by rescuing any individual airline and how such a bailout could be structured to protect the government's financial interests. Finally, and more fundamentally, other steps to enhance the competitiveness of the airline industry should be taken before financial assistance is considered.

Long-run Policy Approaches

Reregulation of Fares

Reregulation of fares would reverse the pro-competitive policy established by the Congress in 1978, would be cumbersome to implement, and might well be ineffective in halting the slide in airline profits. Carriers with weak reputations for passenger service quality might be able to compete effectively only by offering lower fares than their competitors. Forcing them to charge the same fares as their competitors might reduce their traffic levels and hasten their exit from the industry, rather than retard it. Reregulation of fares would also be extremely cumbersome administratively. Carriers vary the number of seats they sell at each fare level on each flight. A regulator would need either to regulate the number of seats sold at each fare level on each flight, which would be extremely cumbersome, or to reduce the airlines' freedom to vary their fares, which would probably reduce, rather than increase, their revenues. Given the current size of airline fleets, discount airfares are needed to fill the seats, and the airlines can much better assess the level of pricing that will maximize their revenues from that capacity than the federal government can. Eliminating discount seats would also exclude price-sensitive passengers who could not afford to fly at higher fares.

Opening U.S. Airlines to More Foreign Investment

Improving access of poorly financed carriers to capital might reduce their cost of capital and enhance their ability to survive. One option for the Congress to consider would therefore be easing the rules that restrict investments by foreign entities in U.S. carriers. The Secretary of Transportation recently relaxed these rules so as to allow unlimited access to debt capital from foreign sources and access to non-voting foreign equity capital up to 49 percent of an airline's total equity. The 25-percent limit on voting foreign equity, which is fixed by statute, of course remains in effect.

The unlimited access to foreign debt capital is subject to the condition that the loan not provide "special rights" to the debt holder that might imply control. While the order does not specify what kinds of special rights are meant, the rights that have concerned DOT in the past include the foreign creditor's right to name a management advisory committee and its right to enter into exclusive marketing agreements with the U.S. carrier. We would also be concerned with what rights of recourse the foreign creditor has in the event of default.

Increasing this access significantly beyond what the Secretary has already announced could effectively give control of U.S. carriers to foreign entities. We would therefore urge caution in authorizing such access. If foreign carriers were allowed to buy effective control of U.S. carriers, we would in effect be giving these foreign carriers cabotage rights (i.e., the right to provide domestic service) in the United States. This would raise legitimate concerns. For example, foreign control of U.S. carriers might compromise their key national defense role. Under the Civil Reserve Air Fleet program, they are required to make available certain aircraft for military airlift. This airlift has been a critical part of the mobilization for the Persian Gulf war. Also, allowing foreign ownership of U.S. carriers would complicate the bargaining strategy of the U.S. government in negotiating international route rights. Finally, many foreign carriers are government owned and subsidized. Allowing such carriers to compete in the U.S. market could distort the competitive process. We are currently investigating these issues at the request of the Senate Commerce Committee.

The creation of a single market in Europe in 1992 is likely to lead to efforts to renegotiate bilateral agreements governing access by U.S. carriers to Europe. Any action to allow foreign ownership of U.S. carriers or access by foreign carriers to U.S. domestic markets should be part of a reciprocal arrangement that allows U.S. carriers greater access to foreign markets.

Improving Financial Health by Promoting Competition

The government's interest in the survival of threatened carriers is primarily one of ensuring that enough carriers survive to provide effective competition. At the same time, the goal of federal competition policy is to protect competition, not to protect competitors. A policy that protected inefficient competitors (for example, through some kind of subsidy) could injure, not protect, competition. Ultimately, the only way to ensure the survival of enough firms to maintain competition is to ensure that the industry remains open to market entry. The government's interest is to ensure that a "level playing field" exists so that the weaker carriers still in business can provide safe and cost-effective service in competition with the stronger carriers.

In our previous reports and in testimony before this Subcommittee, we discussed several policies that could enhance the financial health of the weaker carriers while also promoting competition.[10] While some of the stronger carriers might lose some control over their markets if these policies were implemented, we believe that the weaker carriers would, in general, gain, and that the competitive balance of the industry would improve.

Improving Access to Airports

Our previous testimony focused on two policy objectives--easing access to airports and reducing the marketing advantages of dominant carriers. The recent passage of legislation authorizing passenger facility charges is one step toward easing access to airports. It should allow airports to expand their facilities without seeking approval from dominant airlines. An additional step in this direction would be to encourage the use of preferential-use leases (rather than exclusive-use leases) of airport facilities to airlines. Preferential-use leases allow carriers other than the primary lessee to use gates and other facilities when they are not needed by the primary carrier.

Revisions to the slot rule could ease access to the four slot-controlled airports and enhance the competitive status of carriers like America West and Midwest Express that currently have very limited access to these airports. Such revisions are currently under consideration by the DOT. DOT has been considering such changes for over two years. Although a proposed rule has been drafted, the review process at the Office of Management and Budget may delay its issuance for a few months, and a final rule would come at least several months after that.

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[10]For example, Barriers to Competition in the Airline Industry (GAO/T-RCED-89-66, Sept. 21, 1989) and Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990).

Reducing Barriers Resulting From Marketing Practices

We testified before this Subcommittee over two years ago on ways of revising DOT's rules governing computerized reservation systems (CRSs) so as to improve their competitive impact.[11] Options to remedy this problem include eliminating booking fees, establishing a common CRS governed by a consortium of airlines, and eliminating minimum-use clauses and minimum 5-year terms from contracts between CRS vendors and travel agents. As with the slot rule, DOT has been considering revision of its CRS rules for more than a year; it has prepared a draft proposed rule that will not be issued for at least several more months.

Frequent flyer plans also have a substantial potential to limit competition. Policies that would restrict these plans might enhance competition and strengthen weaker carriers.

CONCLUSIONS

The protracted financial distress of the airline industry threatens the survival of several carriers. An industry with four or five carriers might, as has been suggested, be effectively competitive if several carriers served most routes. But given the barriers to market entry that exist, there is no assurance that new carriers would enter existing routes to replace carriers that ceased operations. Action should therefore be taken now to ensure that the structural conditions exist for effective competition in the airline industry. The need for action on this problem has been apparent for at least the past two years. The failing financial health of several carriers makes this need even more urgent. DOT has been considering new rulemakings on slots and CRSs for over a year, and even proposed rules still appear to be months away.

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[11] Competition in the Airline Computerized Reservation System Industry (GAO/T-RCED-88-62, Sept. 14, 1988).

Continued delay by DOT may result in these reforms taking effect so late that they will no longer be effective in preserving competition. Other action, to encourage use of preferential-use gate leases at airports and to restrict frequent flyer plans, should also be considered. While opening the U.S. market to foreign competition might offer some long-run hope for improved competition, such changes would be most appropriate in the context of a reciprocal agreement for improved access to foreign markets.

Deregulation of the airline industry has generally brought lower fares and better service to most Americans. But the benefits of deregulation could be lost if the industry collapses into a tight oligopoly, controlled by a handful of firms, into which new entry is effectively precluded. Even an improvement in the competitive environment within which the industry operates will be to no avail, however, if firms continue to burden themselves with excessive debt.

That concludes my statement. We would be happy to respond to any questions you might have.

LONG-TERM DEBT AS A PERCENTAGE OF TOTAL CAPITALIZATION, 1980-1989

Airline	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Pan Am Corp.	62.0	58.8	77.3	71.9	82.2	60.5	99.0	132.3	151.1	272.9
Eastern	78.5	83.8	89.0	93.2	87.6	84.0	90.7	97.3	473.3	(52.9)[a]
TWA[b]	61.8	66.6	70.3	65.4	66.7	75.5	94.2	89.8	101.3	114.8
Continental[c]	62.3	53.7	92.6	308.9	123.9	95.9	97.3	85.4	96.3	96.3
America West	--	--	--	44.7	75.7	65.9	81.5	89.0	86.9	84.5
Midway	--	--	57.2	52.0	62.3	44.1	34.9	50.8	46.5	78.0
UAL Corp.	45.2	48.2	58.3	41.5	31.1	56.7	45.8	32.7	62.7	46.1
Air Wisconsin	71.2	49.9	35.1	46.6	48.2	54.5	51.4	47.5	39.9	41.8
Alaska	--	--	39.9	40.0	48.2	54.0	56.6	39.5	32.7	37.1
AMR Corp.	63.4	66.4	64.2	51.2	47.2	43.7	45.1	45.0	41.0	33.5
USAir[d]	44.0	42.6	37.9	31.8	31.7	27.7	24.8	44.5	35.6	44.8
Southwest	38.0	22.2	27.2	29.6	25.7	40.3	35.3	29.5	35.6	33.4
Delta[e]	10.6	12.4	20.2	45.0	30.4	22.0	33.4	28.7	21.0	18.3
NWA Inc.[f]	5.4	1.1	0.0	8.2	7.9	29.3	50.8	34.4	32.1	--
Industry Average	53.5	54.8	60.3	57.3	52.5	52.6	56.8	54.6	53.6	56.2

Source: Salomon Brothers Stock Research, The Financial Condition of the U.S. Airline Industry at Year-End 1989, by Julius Maldutis, Ph.D., July 1990, Figure 10, p. 7. Data are drawn from company reports.

[a]1989 data for Eastern are not comparable with previous years' data due to Eastern's bankruptcy.

[b]TWA's data for 1986 and subsequent years reflects its acquisition of Ozark on September 15, 1986.

[c]Prior to December 31, 1986, $653.9 million in liabilities was subject to Chapter 11 reorganization proceedings. Financial ratios and data for 1983, 1984 and 1985 do not include any of the liabilities subject to reorganization proceedings.

[d]USAir's data for 1987 and subsequent years reflects its acquisition of Piedmont on November 5, 1987.

[e]Delta's data for 1987 and subsequent years reflects its acquisition of Western on December 18, 1986.

ATTACHMENT I

[f]NWA Inc. was acquired by Wings Acquisition, Inc. on August 4, 1989. Consequently, company reports for NWA Inc. are not available for 1989. NWA's data for 1986 and subsequent years reflects its acquisition of Republic on August 12, 1986.

NET PROFIT (LOSS) BY AIRLINE

Millions of dollars

Airline	Full year 1988[a]	Full year 1989[a]	First quarter 1990[b]	Second quarter 1990[b]	Third quarter 1990[b]	Fourth quarter 1990[c]
America West	9.4	20.0	(2.6)	6.1	(22.0)	--
American	449.4	423.1	(30.7)	120.0	54.1	(215.1)
Continental	(315.5)	3.1	21.3	96.8	(55.1)	--
Delta	344.5	473.2	31.3	74.1	(51.6)	(207.8)
Eastern	(335.4)	(852.3)	(136.5)	(35.6)	(252.8)	--
Midway	6.5	(21.7)	(22.9)	(11.4)	(18.7)	--
Northwest	162.8	355.2	(39.3)	59.6	90.7	--
Pan American	(118.3)	(414.7)	(184.7)	(46.9)	(25.8)	--
Southwest	57.4	71.4	5.1	23.5	23.0	(4.6)
Trans World	249.7	(298.5)	(143.0)	103.4	(14.7)	--
United	589.2	358.1	(35.7)	149.7	105.7	(123.5)
USAir	76.2	(137.7)	(66.9)	(24.7)	(111.1)	(221.1)
Total	1,196.0	(20.7)	(604.6)	514.6	(278.3)	(772.1)

[a]Full year data on net income (loss) for 1988 and 1989 were provided by the Air Transport Association (ATA) for its member and associate airlines.

[b]Data on net income (loss) for the first three quarters of 1990 were taken from the Form 41 data filed with the Department of Transportation.

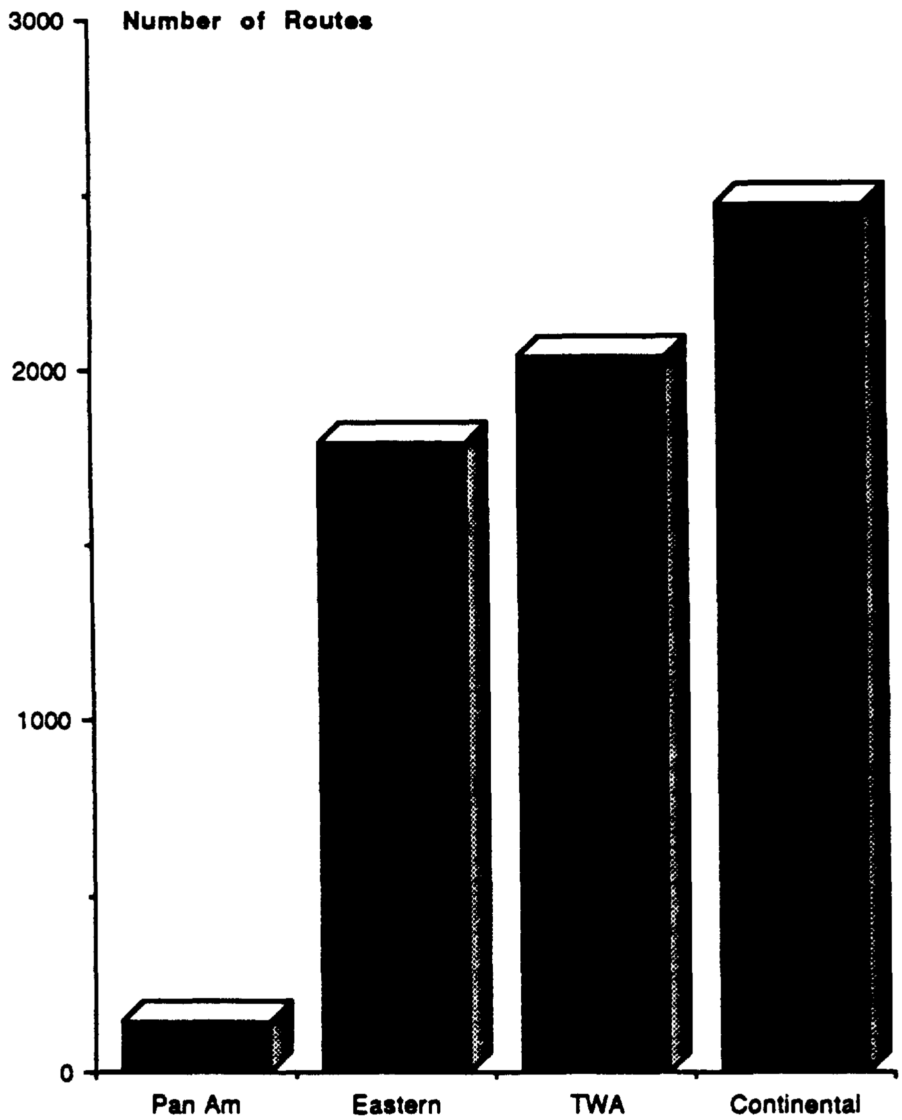
[c]Data on net income (loss) for the fourth quarter of 1990 are taken from preliminary results provided by ATA for its member and associate airlines. Fourth quarter data are not yet available for all airlines. Total shown is for airlines that have reported so far. ATA projects the total loss for the fourth quarter to be approximately $1.7 billion and the total loss for 1990 to be at least $2 billion.

U.S. MAJOR AIRLINES MARKET SHARE, CALENDAR YEAR 1990

Airline	Revenue passenger miles in thousands	Market share percent
American	76,998,599	17.467
United	75,945,637	17.228
Delta	58,983,900	13.380
Northwest	51,491,064	11.681
Continental	39,173,562	8.886
USAir	35,550,516	8.065
TWA	34,236,500	7.767
Pan American	30,676,000	6.959
Eastern	16,692,131	3.787
America West	11,114,444	2.521
Southwest	9,958,940	2.259

Source: Aviation Daily, January 23, 1991, p. 149.

ROUTES WHERE FINANCIALLY TROUBLED AIRLINES HAVE AT LEAST 10 PERCENT OF THE MARKET



Note: Represents the number of routes where the named airline had at least 10 percent of the market. The results are based on analysis of 17,645 routes using Data Base Products O&D Plus Data Base.

Eastern ceased operations on January 18, 1991.

Period: 3rd quarter 1989 through the 2nd quarter of 1990.