Remarks of
Read C. Van de Water
Assistant Secretary of Transportation
for Aviation and International Affairs
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Good morning. As the title of this conference indicates, these are indeed extraordinary times for the airline industry. Significant challenges are occurring virtually every day. My boss, Secretary Norm Mineta, and other members of the Administration are working hard to keep up with these developments and assess their implications.

We now know that the predictions for large losses during 2002 were correct, and Wall Street analysts, even before the war in Iraq, had changed their loss predictions for 2003 from the range of $2.5 to $3.0 billion to about $6.5 billion. The large network airlines that today account for a major part of our domestic passenger air transportation system account for most of these losses. The war in Iraq may both reduce their revenue and increase their losses in 2003.

This industry has proven to be remarkably resilient over the years though, and it is important to note that the news is not all bad. Despite heavy losses for the industry overall, a cadre of low-fare airlines has remained profitable and have been expanding their operations despite the downturn in demand.

Individual network airlines are also making progress in controlling their costs. US Airways has emerged from bankruptcy, and American has thus far avoided it, in part by substantially reducing their labor costs and overhauling their business plans. Other airlines have had similar success.

Many issues are now at play--structural issues that emerged before September 11, the aftermath of the September 11 terrorist attacks, the sluggishness of the return of air travel demand, and the war in Iraq. How all of this is resolved will have major consequences for the airline industry and related industries, and, indeed, our economy for many years to come.

A basic reason for the emergence of the low-fare airlines is that this was the only effective response to the powerful networks that were quickly built by the pre-deregulation airlines. Low costs allowed the new carriers to charge such low fares that they could profitably serve a demand sector that was mostly unserved by the large network airlines. While these airlines, other than Southwest, struggled for years to establish a competitive toehold, several have now done so. Almost ironically, while the low-cost strategy was initially pursued as a vehicle for coexisting with the larger, dominant network airlines, the success of this strategy now poses a serious threat to the continuing viability of the larger airlines unless they too are successful in their own efforts to control costs.

But both types of operation are vital components of our nation’s air transportation system. Low-cost airlines are an increasingly important element of our commercial air travel system. Their substantially lower costs enable them to provide capacity for price sensitive passengers, and to price compete for time sensitive passengers who are otherwise faced with substantially higher prices. But the traditional “major” airlines, though their feeder systems, serve an unmatched variety of markets – including a great many smaller communities that would not be on the aviation map without them. Over the course of many decades our largest airlines have established critical international franchises as well – links to foreign markets that are essential to trade and economic growth.

The simple truth is that this country needs the diversity of airlines that we enjoy in the market today, and any suggestion that we can do with just one category or the other is silly. That is why we cannot be cavalier about any part of the industry, and why the Administration is watching developments so closely.

The long period of record profits for the airline industry seen in the late 1990s abruptly came to an end well before the September 11 terrorist attacks. This is evidenced by trends both in unit revenues, or operating revenues per available seat mile, known as RASM, and in unit costs, or operating expenses per available seat mile, known as CASM. For several years the costs, or CASM, increased very slightly, compared with much larger increases in airline revenues, or RASM. These trends portray a period of solid revenue growth and cost control underpinning continual profitable operations, indeed several years of record profits. But the combination of increasing costs beginning in 1999, and declining demand starting in early 2001, turned record profits into losses. Indeed, the decline in industry profitability for the year ended June 30, 2001, compared with a year earlier, was the largest year-over-year decline ever – before September 11. The losses for the year ended June 30, 2001, were not record losses, but that too changed abruptly with the terrorist attacks.

The large network carriers collectively have sustained operating losses approaching $10 billion for each of the past two years. However, the group of low-fare carriers has continued to earn profits during this same time, and this is not just attributable to Southwest. Of six low-fare carriers – JetBlue, Frontier, AirTran, Spirit, American Trans Air, and Southwest, five earned profits in 2001, and half of them earned profits in 2002, while two of the other three were close to break even. However, the last profitable quarter for the large network carriers was the third quarter of 2000, and these carriers continued to suffer sizeable losses throughout 2002. It is especially important to note that these carriers' losses have accelerated since the second quarter, including the third quarter, which is normally their best quarter of the year. Despite the disastrous losses during the last two quarters of 2001, total losses for calendar 2002 approach the same levels. Indeed, in reality, 2002 losses were even greater given that these six large network carriers' operations were considerably smaller.

In addition to the financial information the airlines file with the Department every quarter, they also file preliminary data on a monthly basis. While this information is subject to change, we believe it can be relied upon to reveal general tendencies. Our review of this information suggests that the financial trends

I just spoke of using quarterly data throughout 2002 are continuing into 2003. Indeed, the results for the large network carriers in January 2003, or 16 months after the September 11 terrorist attacks, are no better than a year earlier, despite the fact that travel demand was still severely depressed at that time.

So where does this leave us? Many airlines, including the large network airlines that now provide the bulk of airline service in the U.S., have consistently suffered large losses for more than two years, they are heavily leveraged, and now, once again, they see air travel demand in steep decline for some unknown period. Does this mean that the airline industry as we know it today is doomed to fail? No, but there will be change. Airlines that are in trouble are all working hard at what they must do to survive and eventually return as viable competitors. How quickly and to what extent they recover will depend largely on three factors: how much they are able to reduce their costs, the recovery of travel demand, and the extent to which carriers reduce capacity in light of the now-diminished level of demand.

While my focus here today is the financial state of the airline industry, this painful process affects everyone in the aviation industry: aircraft lessors and investors, aviation vendors, airports and their concessionaries, and – more than anyone else – airline employees. Since September 11, more than 100,000 airline employees have lost their jobs. Just in the past few weeks, airlines have announced an additional 10,000 layoffs. The aircraft industry has also been hard hit. Of the 7,525 jet aircraft available for service today, 971 are either stored or temporarily inactive.

We are going to get through this. I am confident that when we do, the industry will be more cost-effective, more competitive, and more robust. While it is critical that the industry conquer its current financial troubles, it is also just as important that we not lose sight of the future demands on our air transportation system. We must plan for the return of the demand we saw in the summer of 2000, just three short years ago, when our skies, runways, and airports, were filled to the brim.

As many of you know, the Administration has recently unveiled its proposal, the Centennial of

Flight Aviation Authorization Act, of FLIGHT-100, as a successor of AIR-21, which expires at the end of this fiscal year. A lot of people at the FAA and in the Office of the Secretary have spent a lot of time over the past year developing that proposal, and we are proud of it. The Administration's proposal would promote the industry's growth and vitality while retaining safety as our top priority. We plan to reinforce our commitment to safety by making substantial investments in National Airspace System infrastructure and ensuring that our highly trained controller workforce is fully capable of sustaining its high levels of performance over the course of the next reauthorization period and beyond.

Our proposal will ensure that we are prepared for the demand levels predicted in the FAA's recent industry forecast by continuing to fund airport capacity enhancements at record levels and restructuring Airport Improvement Program formulas and set-asides. When the traffic returns and the industry recovers, we must and will be ready.

Thank you for inviting me to speak today. I can now take a few questions.