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Highlights

Highlights of GAO-05-834T, a testimony before the Committee on Commerce, Science, and Transportation, Subcommittee on Aviation, U.S. Senate

COMMERCIAL AVIATION

Structural Costs Continue to Challenge Legacy Airlines' Financial Performance

Why GAO Did This Study

Since 2001, the U.S. airline industry has confronted unprecedented financial losses. Two of the nation's largest airlines—United Airlines and US Airways–went into bankruptcy, terminating their pension plans and passing the unfunded liability to the Pension Benefit Guaranty Corporation (PBGC). PBGC's unfunded liability was $9.6 billion; plan participants lost $5.2 billion in benefits.

Considerable debate has ensued over airlines' use of bankruptcy protection as a means to continue operations, often for years. Many in the industry and elsewhere have maintained that airlines' use of this approach is harmful to the industry, in that it allows inefficient carriers to reduce ticket prices below those of their competitors. This debate has received even sharper focus with pension defaults. Critics argue that by not having to meet their pension obligations, airlines in bankruptcy have an advantage that may encourage other companies to take the same approach.

GAO is completing a report for the Committee due later this year. Today's testimony presents preliminary observations in three areas: (1) the continued financial difficulties faced by legacy airlines, (2) the effect of bankruptcy on the industry and competitors, and (3) the effect of airline pension underfunding on employees, airlines, and the PBGC.

www.gao.gov/cgi-bin/getrpt?GAO-05-834T.

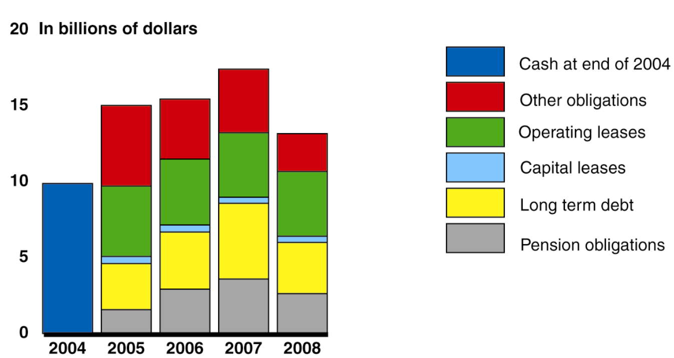
To view the full product, including the scope and methodology, click on the link above. For more information, contact JayEtta Z. Hecker, (202) 512-2834 or heckerj@gao.gov.

What GAO Found

U.S. legacy airlines have not been able to reduce their costs sufficiently to profitably compete with low cost airlines that continue to capture market share. Internal and external challenges have fundamentally changed the nature of the industry and forced legacy airlines to restructure themselves financially. The changing demand for air travel and the growth of low cost airlines has kept fares low, forcing these airlines to reduce their costs. They have struggled to do so, however, especially as the cost of jet fuel has jumped. So far, they have been unable to reduce costs to a level with their low-cost rivals. As a result, legacy airlines have continued to lose money--$28 billion since 2001.

Although some industry observers have asserted that airlines undergoing bankruptcy reorganization contribute to the industry's financial problems, GAO found no clear evidence that historically airlines in bankruptcy have financially harmed competing airlines. Bankruptcy is endemic to the industry; 160 airlines filed for bankruptcy since deregulation in 1978, including 20 since 2000. Most airlines that entered bankruptcy have not survived. Moreover, despite assertions to the contrary, available evidence does not suggest that airlines in bankruptcy contribute to industry overcapacity or that bankrupt airlines harm competitors by reducing fares below what other airlines are charging.

While bankruptcy may not be detrimental to rival airlines, it is detrimental for pension plan participants and the PBGC. The remaining legacy airlines with defined benefit pension plans face over $60 billion in fixed obligations over the next 4 years, including $10.4 billion in pension obligations -- more than some of these airlines may be able to afford given continued losses (see figure). While cash from operations can help fund some of these obligations, continued losses and the size of these obligations put these airlines in a sizable liquidity bind. Moreover, legacy airlines still face considerable restructuring before they become competitive with low cost airlines.



Source: PBGC and SEC filings.