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COMMERCIAL AVIATION

Legacy Airlines Must Further Reduce Costs to Restore Profitability

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Highlights

Highlights of GAO-04-836, a report to congressional committees

Why GAO Did This Study

Since 2001, the U.S. airline industry has confronted financial losses of previously unseen proportions. From 2001 to 2003, the industry lost $23 billion, and two of the nation's biggest airlines have gone into bankruptcy. To assist airlines, the Congress provided U.S. airlines with $7 billion of direct financial assistance—most recently in the form of $2.4 billion of financial assistance under the 2003 Emergency Wartime Supplemental Appropriations Act. Under the Act and its accompanying conference report, the conferees directed GAO to review measures taken by airlines to reduce costs, improve revenues and profits, and strengthen their balance sheets. The Congress also tasked airlines receiving assistance to report their cost-cutting plans to GAO. GAO was also required to report on the financial condition of the U.S. airline industry by Vision 100—Century of Aviation Reauthorization Act, which became law in January 2004. In consultation with the Congress, GAO agreed to satisfy these directives and report to the Congress on (1) the major challenges to the airline industry since 1998, (2) measures airlines report taking to remain financially viable, (3) the current financial and operating condition of the industry, and (4) how the competitiveness of the domestic airline industry has changed since 1998.

GAO is making no recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-04-836.

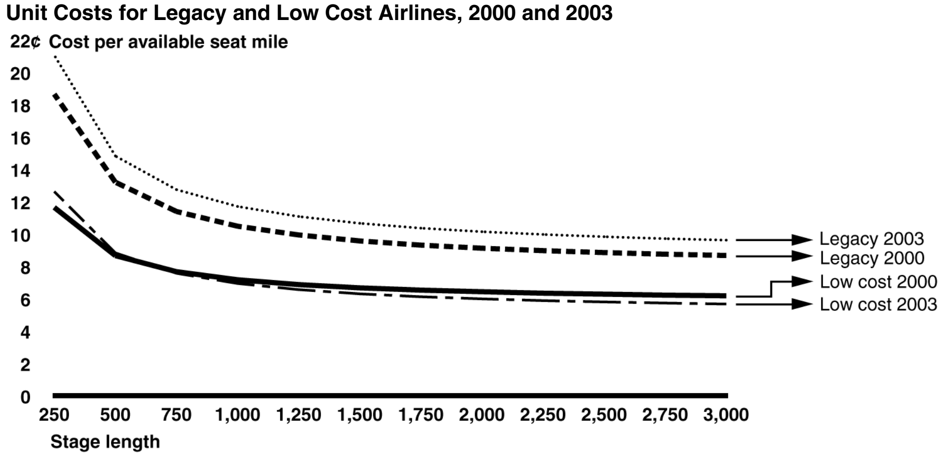
To view the full product, including the scope and methodology, click on the link above. For more information, contact JayEtta Z. Hecker at (202) 512-2834 or heckerj@gao.gov.

What GAO Found

U.S. airlines, particularly major network or "legacy" airlines, have faced an unprecedented set of challenges since 1998 that are reshaping the industry and demand for air travel. The decline in business travel, followed by the September 11, 2001, attacks, caused a significant loss of operating revenue for many airlines. In response to these new challenges, the legacy airlines reported a goal of $19.5 billion in cost-cutting measures to restore their profitability through 2003. As a group, legacy airlines actually reduced their operating costs by $12.7 billion over the last 2 years. For legacy airlines, cost cutting was greatest in labor and commission costs. Meanwhile, low cost airlines, which as a group grew 26.1 percent during the last 2 years, reported little cost cutting.

Since 2000, legacy airlines financial performance has deteriorated significantly, while low cost airlines have used their comparative cost advantage to expand their market share. Low cost airlines maintained their unit cost advantage over legacy airlines between 2000 and 2003, despite concerted cost cutting efforts by legacy airlines (see fig. below). For several of the legacy airlines, their weakened financial condition combined with significant future financial obligations makes their recovery uncertain.

Unit Costs for Legacy and Low Cost Airlines, 2000 and 2003



Source: Unisys R2A, Transportation Management Consultants, based on data reported by airlines to DOT.

Competition in the domestic airline industry has increased since 1998, primarily owing to the growth and expansion of low cost airlines. Between 1998 and 2003, low cost airlines expanded their presence from 1,594 to 2,304 of the top 5,000 domestic markets and now have a presence in markets that serve about 85 percent of passengers. Legacy airlines, despite financial problems and reduced capacity, continued to serve nearly all of the markets in 2003 as in 1998, but carried fewer passengers as they lost market share to low cost airlines.