Energy and Mineral Resources Subcommittee
Committee on Natural Resources
U.S. House of Representatives

Statement of
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May 19, 2005

Thank you, Mr. Chairman for inviting me to talk about the incredibly harmful effect of high oil prices on U.S. air carriers and their employees. Clearly, air carriers are among the sectors of the economy most affected by the soaring price of oil and while our members and the manufactures of their aircraft have made remarkable gains in energy efficiency it has proven impossible for technology to outpace the growth in the price of a barrel of oil. And unlike many industries, we have no alternative fuel source.

The Air Transport Association is the trade association for the leading U.S. airlines. ATA members transport more than 90 percent of all passengers and cargo traffic in the United States.

Anyone who follows the news these days knows that all U.S. airlines are facing an extremely challenging commercial and policy environment, with few signs of material improvement anytime soon. Over the last four years, the industry – in total – has recorded over $32 billion in losses (including federal reimbursements for the shutdown and a portion of our security costs). We are projecting additional losses of at least $5 billion in 2005.

These losses have led us to borrow huge sums to survive, with few assets left to pledge as collateral. For the nine largest airlines, including Southwest Airlines, net debt stood at $81.3 billion at the end of 2004, resulting in a staggering net debt to capital ratio of 110.1%. Compare this to $64.2 billion and 71.7% at the end of 2000. Eleven of the 12 passenger airlines rated by Standard & Poor’s are considered “speculative” investments, also known as “junk bond” quality. Only Southwest Airlines is considered investment grade.

Meanwhile, fares are running at late 1980s levels – a fourth of all domestic passengers now pay $200 or less including taxes for a roundtrip ticket; two-thirds pay $300 or less. Airline passenger revenue has plummeted from its historical average of 0.95% to 0.70% of U.S. GDP – a gap of $29.3 billion based on today’s $11.7 trillion economy.

It couldn’t get any worse, could it? Yet it has. In January 2001, the price of jet fuel on the spot markets averaged 85.8 cents per gallon. For the first 2 weeks of May, we faced an average of $1.60 – an 87 percent increase. In 2004, the industry paid $21.4 billion for jet fuel. That tab would have been $5.5 billion lower at 2003 jet fuel prices and a whopping $8.0 billion lower at 2002 jet fuel prices. It is not unreasonable to argue that without the doubling of oil prices over the past three years the industry would not be in the economic crisis we find ourselves. But the future doesn’t look any brighter. Our forecast shows that we will pay $6.8 billion more for fuel in 2005 than in 2004. If these projections prove accurate the industry will have faced a 91 percent increase in its fuel costs from 2001 ($14.8 billion) to 2005 ($28.2 billion). When you understand that the industry has been hit with more than $28 billion in additional fuel costs and $15 billion in taxes, fees and unfunded mandates for security since 9/11, and compare those uncontrollable costs to the $32 billion the industry has lost over that period, it easy to see where the problems lie.

Earlier this week, the 12-month forward curve of future prices averaged $51 a barrel. The corresponding price of Gulf Coast jet fuel – a conservative benchmark –showed $1.55 per gallon. Now keep in mind that this industry consumed 18.6 billions gallons of jet fuel last year. That means that every penny increase in the price of a gallon increases our annual operating expenses by $186 million. Viewed from an employee perspective, every $1 increase in the price of a barrel of crude puts another 5,500 airline jobs at risk. Indeed, the airlines have shed 137,000 jobs from the payrolls since August 2001. That’s a loss of 1 out of 6 employees and more cuts are on the way.

When people say to me, “But every time I fly the plane is full.” I respond, “They’re full, alright. Full of cheap fares and expensive fuel.” At today’s fares and jet fuel prices, the average breakeven load factor for the industry – including all the low-cost carriers, is estimated at 80%. Compare that to 65% in the mid-90s. That means that every single flight on average must be at least 80% full of paying passengers to avoid losing money – not to make a fortune!

So how are we coping? First, we are obviously taking all possible steps to reduce or mitigate fuel consumption. From 2001 to 2004 alone, thanks to newer fleets, single-engine taxi, lower cruise speeds, onboard weight reduction, access to more

ATC lanes in the sky, and a host of other measures, our fuel efficiency jumped 18% to 45 passenger miles per gallon.

Meanwhile, we are using our human capital more effectively. Airline productivity has risen 17% since 2000, up to 2.2 million available seat miles per full-time employee. And we are parking airplanes. The “Big 6” passenger airlines have reduced their operating fleets by 502 airplanes from December 2000 to December 2004.

For this same group capital expenditures fell from $13.1 billion in 2000 to $3.1 billion in 2004 (up slightly from $2.7 billion in 2003), while unit operating costs excluding fuel fell 6.2% from 10.36 cents per available seat mile (ASM) in 2002 to 9.72 cents per ASM in 2004.

I think that’s pretty impressive. But you don’t have to believe me. As Gary Chase of Lehman Brothers observed on March 15:

“The airline industry has moved aggressively to reduce costs in the face of unprecedented challenges… On a non-fuel basis, operating profitability…is as good as it was in the late 1990s. While these facts are exciting…, they may also be totally moot if oil prices do not return to [historical norms]… [W]e see a materially greater chance for oil prices above $50 than below $40 over the next several years. Unfortunately, high fuel prices are consuming what would otherwise be an upcycle for the industry.”

I’m often asked, “Why don’t your members just raise fares and pass through high oil prices?” Well, it’s this simple – if we could we would. To cover the costs of fuel increases from 2003 to 2004 passenger would have to pay, on average, an additional $21 per ticket. Yet prices during this period continued to fall because of the intensely competitive nature of the industry. Indeed, only recently have carriers had even modest successes in raising fares in certain markets, but this is hardly enough to cover the cost of crude oil rising from $26 a barrel in 2002 to over $50 in 2005. And as Standard & Poor’s Phil Baggaley testified before the House Aviation Subcommittee this past June:

“Fuel represents a roughly comparable proportion of expenses for railroads and many trucking companies…, but they have not been hurt by higher fuel prices to nearly the same degree… Part of the difference is due to more active hedging programs by these freight transportation companies, but most is due to the fact that many of their contracts with corporate customers allow them to pass through higher fuel costs in the form of surcharges. Airlines have tried repeatedly to raise fares in response to high fuel costs, but with little success. [T]he problem comes back to a lack of pricing power in a very competitive market.”

The unfortunate truth for most airlines today is that the economic principles of supply and demand still apply. If we could raise prices to cover the soaring cost of jet fuel or the many new taxes and fees that have been placed on the industry in recent years we would. But what many of our customers discovered in the post-9/11 world is that they don’t have to fly. Business travelers chose teleconferences or e-mail instead of a face-to-face meeting if they aren’t able to find a rock-bottom fare. Families will vacation near home as opposed to flying to Florida’s beaches, Colorado’s ski slopes or grandma’s house. For short-haul flights the addition of the TSA “hassle factor” has made taking the car a more viable option. It’s important to remember, airlines don’t just compete against each other. They compete against movie theaters, e-mail, video conferencing, automobiles, trains, corporate jets and even the local amusement park…anything that can substitute for a vacation or a face-to-face sales call.

So where does that leave U.S. air carriers? Frankly, we will remain at the mercy of OPEC and the federal government. If oil stays high and our taxes with it I expect more jobs lost, more flights cut and more airlines in crisis. And in the international arena, our global competitiveness will continue to suffer because our airlines are paying disproportionately more than their foreign flag competitors due to the relative weakness of the dollar. My CEO’s will continue to find ways to wring costs from those areas they can, and that includes further fuel conservation. But you can only be so efficient. As I said when I started, my industry is one of the most severely hurt by the soaring price of oil. And airplanes will be burning refined oil long after other modes of transportation have moved beyond it. Not because we want to but because the principles of aircraft design rule out our alternatives.

So, will oil stay above $50? For business planning purposes it is prudent to assume that it will. There appear to be no short term solutions. This is a problem of our own creation that’s been some time in the making.

My solution to the problem is to do more…more of everything. And by more I mean more conservation and more production, including here at home. I am proud of the efficiency gains that the aviation sector has made over the past 30 years. If other industries throughout the world had kept pace we would not face nearly the crisis we face today. Yet conservation and efficiency are only half the equation. We must find and produce more oil in the U.S. and overseas. The rapid economic expansion in countries like China and India will demand more and more oil and keep pushing prices higher. The “more of everything” approach can work there, too. The United States should encourage those nations to find and produce more of their own energy as well as help them use it more efficiently by providing them with technologies to reduce waste.

More of everything also means that as a nation we must be willing to produce more of our own energy and be willing to refine it here, too. I know that this issue is outside of this Committee's jurisdiction, but our nation's stagnant refining capacity is creating a bottleneck in the distribution chain that further increases prices. More and more jet fuel, gasoline and other refined products are being imported because of limited production capacity in the U.S. and this is further exacerbating the price run up. Steps must be taken to expand refining capacity so we do not become as dependent on foreign refined oil as we are foreign crude oil.

Also, I encourage Congress and the administration to ensure that forces are not working within western energy markets to unnaturally inflate prices. There are simply too many unnatural influences in global oil markets to allow market speculators to contribute to the problem. I encourage Congress and the appropriate federal regulatory bodies to exercise their oversight responsibilities to ensure that markets are driven by consumers demand and not speculation. The other day Representatives Walden and Rothman called on the Government Accountability Office (GAO) to examine the CFTC's oversight of domestic petroleum trading. I would echo this call.

Some have attacked the airline industry for not being fast enough to adapt to market changes. I strongly disagree with this view and point the past three years of aggressive cost saving moves taken by all airlines to stay competitive. I also point to the past 30 years of aggressive efforts by the industry to save fuel and improve efficiency. We have been and will continue to be leaders in each of these areas.

To conclude, in order for my "more of everything" approach to have prevented the crisis that the airlines and their employees now face I would have had to have made this appeal to the 89th or 99th Congress, not the 109th. Since I can't roll back the clock I challenge the world to follow the example of my industry in improving fuel efficiency and I challenge this Congress to avoid the mistakes of the past and recognize that more efficiency must be matched with more production. Let's do more.

Thank you.