

## The Economic Case against a Second Airline Payroll Bailout

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Like many industries affected by the COVID-19 pandemic, airlines have seen significant drops in revenue. In a first effort to help airlines weather the storm, Congress created a bailout package for US commercial airlines in April 2020 as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Congress structured the bailout in three parts: \$25 billion in payroll support, \$25 billion in subsidized loans, and suspension of certain taxes.

In exchange for payroll support funds, airlines agreed not to furlough workers and not to eliminate service to any of the cities they fly to (without a waiver from the US Department of Transportation) until September 30, 2020.<sup>1</sup>

Now that the airlines' obligations not to eliminate service or furlough workers are expiring, the airlines are seeking a "clean extension" of CARES Act payroll support—specifically, another \$25 billion in exchange for continued promises not to furlough workers or suspend operations to destinations served.

This policy brief is the second of two explaining why further subsidization of US airlines by American taxpayers would be misguided.<sup>2</sup>

Despite the initial infusion of \$50 billion, airlines continue to see reduced revenues, as many pandemic restrictions on travel remain in place. The industry is already supported by significant subsidies and has continuing access to private capital markets, though, so as a whole it is not in jeopardy. Furthermore, additional subsidies would be unlikely to help workers, as the greatest share of these subsidies would flow to creditors and shareholders. Another six-month infusion would not help keep pilots attached permanently. And large and long-drawn-out support for

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passenger airlines is not necessary to maintain capacity for cargo airlines, which will be needed anyway for rapid dispersion of a COVID-19 vaccine, when one is ready.

## **THE ECONOMIC CASE AGAINST A BAILOUT OF THE AIRLINE INDUSTRY**

As we explained in detail in our original brief on the issue in March 2020, a bailout of the airline industry, like a bailout of any industry, is misguided. Moreover, we argued that airlines have options and steps they can take to solve their problems on their own, rather than with support from taxpayers.<sup>3</sup> These options and steps are as follows.

First, the airlines, with plenty of access to private capital markets, should continue to seek private financing. They own significant amounts of durable assets that they can sell or use as collateral to get additional financing. Indeed, airlines have been able to secure substantial private capital since the beginning of the pandemic, and they continue to have access to the financial market. On September 17, 2020, Delta Air Lines announced that it had successfully raised \$9 billion in new liquidity secured by revenue from its SkyMiles frequent flyer program.<sup>4</sup> It had originally planned to raise \$6.5 billion, but the offering was oversubscribed at a blended average rate of 4.75 percent.<sup>5</sup> United Airlines was also able to raise \$6.8 billion against its frequent flyer program, an offering that was also oversubscribed.<sup>6</sup>

Second, if private financing were to prove insufficient, some airlines could—and should—do what they have done in the past when in such a predicament: declare bankruptcy. Past bankruptcies by Delta Air Lines, United Airlines, and American Airlines (and of corporate predecessors Northwest Airlines, Continental Airlines, and US Airways) show that airlines can continue flying safely even during bankruptcy, so declaring bankruptcy poses no systemic risk to the economy. If an individual airline were to shrink in bankruptcy, that would benefit the industry as a whole, allowing other airlines to recover more quickly.

Even if airlines did not have such options before the first bailout, there are reasons to oppose bailouts per se anyway. First, bailouts beget more bailouts and create bad incentives to prepare for the next emergency. Second, in the current context bailouts are almost guaranteed to be a waste of taxpayers' money. As we explained in March, unless the worries around the COVID-19 virus were to quickly disappear and consumers were willing to fly the friendly skies once again, the bailout would merely postpone layoffs to October. Airlines' demand for another bailout in order to prevent employee furloughs confirms this prediction.

Bailing out airlines the first time was a bad idea; doing it again would be even more counterproductive. For one thing, airlines still have all the options laid out earlier, and they should use them. Moreover, a second bailout would only further delay the inevitable furloughing of airline employees, this time to April 1, 2021. In the following section we explain why.

## **BAD ARGUMENTS FOR BAILOUT NUMBER TWO**

Advocates of a second bailout argue that a \$25 billion “clean extension” of airline payroll support is needed to prevent airlines from furloughing airline workers over the next six months. Before the pandemic, about 620,000 people were employed by US commercial airlines. Despite accepting payroll subsidies, airlines have reduced their headcount by encouraging employee early retirements and leaves. Based on separate airlines’ announcements, one of us estimates that the number of employees at risk of being furloughed in October is around 35,000.<sup>7</sup> The breakdown among the largest US airlines is as follows (numbers are approximate):

- American Airlines: 19,000
- United Airlines: 13,000
- Delta Air Lines: 1,700 (though Delta will defer this action to November 1, 2020, hoping to mitigate any furloughs even without government aid)<sup>8</sup>
- Southwest: 0

## **DO THE MATH: BAILOUT NUMBER TWO ISN’T ABOUT WORKERS**

First, it is worth noting that in spite of the first bailout, the largest carriers have already separated from 30 percent of their nonunion staff. This new bailout will do nothing to bring these jobs back and, therefore, isn’t about preserving old employment levels.

Second, if 35,000 US commercial airline jobs are indeed at risk, then a bailout of \$25 billion works out to about \$715,000 per job saved for six months, an annualized run rate of over \$1.4 million per airline job.

Third, the math does not support a claim that the bailout is about job support. If one were to assume that the 35,000 workers have annualized salaries of \$100,000, then supporting their wages for six months would require only \$1.75 billion, not \$25 billion. In other words, the airlines are demanding more than 10 times more than is necessary to support 35,000 employees.

Furthermore, as mentioned, Southwest Airlines has announced that it won’t be furloughing any employees, at least through the end of the year. However, under this second bailout, that airline would receive another \$3.3 billion.<sup>9</sup>

The only significant commercial airline furloughs are coming from American Airlines (19,000) and United Airlines (13,000). These carriers are the two largest and the weakest financially, which was true even before the pandemic. Credit default swap markets have indicated that American Airlines is at an elevated risk of default on its unsecured debt. Now, therefore, is the time for American Airlines to address its long-term issue, rather than delay the inevitable with a bailout that won’t change its overall situation or resolve the need to restructure.

Some argue that the bailout wouldn't be beneficial just to the workers about to get furloughed; it would also grant support and protection against termination for workers currently on leave. This argument is incorrect. First, there is no indication that airlines plan to furlough these workers, even without a CARES Act extension. The reason these employees went on leave was to avoid being furloughed in the first place. Also, the WARN Act requires advance notice of any furloughs, and such warning hasn't been given, indicating that airlines are not planning to furlough those workers currently on leave. Second, a CARES Act extension wouldn't require airlines to pay workers on leave any more than the CARES Act itself does. Finally, if the concern were that airlines might make additional, yet-to-be-announced furloughs, that concern would be an even more powerful reason not to support payrolls, since it implies that a recovery in air travel demand is even further in the future. It is also a reason to wait before deciding to provide payroll support, since the no-furlough requirement would last only until March 31, 2021, but any need for furloughs would come later.

These circumstances suggest that the proposed bailout would benefit largely shareholders and creditors, despite its ostensible purpose to help workers.

### **PULLING OUT OF CITIES**

American Airlines was the first major carrier to announce that it would suspend service to some smaller cities after the expiration of CARES Act restrictions. Its initial plan involved elimination of flights to 15 cities in 14 states, though it has since walked back plans in four of those cases, since the airlines had failed to factor in its obligations under the Essential Air Service program. These obligations include service to Sioux City, Iowa, and Joplin, Missouri, as well as transporting mechanics to Roswell, New Mexico, to service aircraft stored there. In addition, American Airlines has since committed to continued service to Stillwater, Oklahoma, in exchange for political support for subsidies from three members of Congress.<sup>10</sup>

Airlines will want to adjust their route networks in light of consumer demand. Already they have done so, with air travel hovering at around 30 percent of prepandemic levels, according to Transportation Security Administration checkpoint data.<sup>11</sup> Decreased air travel often translates into fewer flights at a given airport; or, if an airline stops service entirely, it means leaving its flights to be provided by other airlines.

In a few limited cases, such events may mean an airport loses commercial service entirely, which occurs naturally. Dozens of commercial airports have lost service over time, such as Gary/Chicago International Airport and Oxnard Airport in California. Frequently, suitable and even more attractive alternatives are within driving distance for travelers.

While the Essential Air Service program, a program that subsidizes half-empty flights to little-used airports, has been a disaster (for taxpayers, for the environment, and for airlines), it is ironically still

a better policy than the bailout for extending service to certain airports, which appears to be the real goal of many members of Congress supporting the second bailout.<sup>12</sup> Some airlines, such as American Airlines, have announced that they will drop service to some of the airports within the congressional districts of members serving on the House Committee on Transportation and Infrastructure. Some committee members have responded to this strategy by supporting the second bailout. But if the goal were to maintain service to airports in the committee members' districts, then it would be cheaper just to continue subsidizing that service through the Essential Air Service program; a \$25 billion bailout would be much more expensive and would maintain the service for only six months.

### **SUPPORT OF THE ECONOMY**

Airlines for America, a trade group representing major US airlines, reports that passenger volumes remain down approximately 70 percent.<sup>13</sup> In addition, a third of the US fleet remains idled, and the industry continues to lose \$5 billion in cash per month.<sup>14</sup> Further, the market is signaling that the airline industry won't be operating at prepandemic levels for at least the next few years. Some analysts are even more pessimistic: The International Air Transport Association says that full demand for air transport will not return until 2024.<sup>15</sup> United Airlines says that it will remain at its current reduced schedules until there is widespread acceptance of a COVID-19 vaccine, likely at the end of next year.<sup>16</sup>

In other words, this six-month payroll support will not be enough and will simply push airlines' workforce adjustments back to April 1, 2021. Without another bailout then, furloughs will take place. If analysts are correct and it takes another three years for air transport demand to return to prepandemic levels, taxpayers would ultimately need to extend up to \$175 billion in payroll support funds to the airlines.

Under these conditions, the airlines *should* be furloughing workers. That is unfortunate for workers, of course. But keeping unnecessary workers will not support the economy. Spending billions of dollars to hire workers who aren't currently needed prevents them from moving into areas of the economy where they can be more productive. Subsidies are therefore both fiscally irresponsible and economically inefficient.

The government funds used to support these unneeded airline workers come out of the economy elsewhere, either through more borrowing or more taxes. These costs are less obvious than the visible benefit of jobs being created or sustained. It is important to keep these less visible costs in mind, though, as a recent review of the academic literature on the economic return to government spending reveals that, for every dollar government spends, the economy experiences much less than a dollar in growth.<sup>17</sup>

It would be better for airline employees whose jobs are not needed anymore to transition into other industries where there is demand and where the workers can be productive (for example,

the number of advertising jobs available is greater than the number of pilots being furloughed,<sup>18</sup> and mechanics working for cargo carriers have many job options). Market participants also have voluntary ways of saving costs (and saving jobs). For example, Singapore Airlines workers agreed to temporary pay cuts of up to 28.5 percent in exchange for keeping their jobs through the pandemic.<sup>19</sup> There is no reason why US airlines cannot follow a similar model.

Airlines are certainly an important part of the economy, facilitating business connections and delivering leisure travelers to vacation destinations, but only to the extent that consumers demand these services. Nevertheless, some advocates of a second bailout argue that airline employees need to remain connected to their jobs, just to be ready to resume providing these services when demand rematerializes.

But even without payroll support, airlines understand the need to be ready for increased air transport demand. Although airlines have shed, in some cases, up to 30 percent of management jobs and reduced other groups of employees through early retirement (which payroll support will not reverse), US carriers have been reluctant to let go of pilots and cockpit crew members. Even United Airlines and American Airlines, which plan to furlough pilots at the beginning of October 2020, are keeping more cockpit crew on payroll than are needed to operate current flights, hoping to resume and expand their schedules next summer (summer is generally a period of high demand).<sup>20</sup> But the CARES Act has no relevance to this goal. The period of time that the CARES Act payroll support extension would keep employees attached to airlines is traditionally *the low point for airline demand*, outside of peak holiday travel dates. A requirement not to furlough employees for another six months, expiring April 1, 2021, will not keep employees on board for schedule growth next summer, let alone for when demand is projected to fully return, in 2024.

Some bailout advocates have suggested that subsidizing capacity now is necessary to be prepared for vaccine distribution. It is not apparent that domestic vaccine distribution will be done largely by air rather than by rail or truck. The most remote US airports, generally in Alaska, receive service guarantees through the Essential Air Service program. Airlines will be important to bring manufactured vaccines and vaccine supplies around the world. American Airlines “leads with cargo” as it determines whether to add flights to its schedule during the pandemic.<sup>21</sup> According to American Airlines President Robert Isom, the company has been making preparations and is ready to deliver vaccines. There’s no reason to expect this distribution to be anything other than profitable to airlines.

## CONCLUSION

Bailing out airlines the first time around was a bad idea; doing it again would be even more counterproductive. It only delays the inevitable. Adapting to less demand is not only a necessity; it should be welcomed. Airlines should be more flexible to adapt to emergencies, even if doing so

will never be painless or ideal. In addition, the current assumption that one of the airlines going under could mean the end of all airlines in America is just fearmongering. The academic literature in fact shows that productivity growth is driven largely by the disappearance of old or ineffective companies and the emergence of new ones.<sup>22</sup> That fact is apparent in the airline industry: in the past, airlines have gone under and disappeared only to be replaced by newcomers with innovative business models, all to the benefit of consumers and the economy.

## ABOUT THE AUTHORS

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