

The 2020 Bailouts Left Airlines, the Economy, and the Federal Budget in Worse Shape Than Before

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The arguments for bailing out the airlines during the COVID-19 pandemic included the claim that without the subsidies, airlines would fail and that subsidies were needed to keep the industry's labor force at the ready for when the pandemic ended. Bailouts were paid to the tune of \$54 billion, and airlines received other benefits, employees were paid to stay home, and financial aid was dispensed to airports.¹

Nevertheless, travel by air became a nightmare for many in summer 2022 as passenger demand returned. Mass cancellations and delays occurred with regularity, and each instance cascaded into further delays as crew and planes were caught out of position. The major carriers have canceled a significant portion of their flights in the past few months, creating chaos at major airports, especially during high-traffic periods. The problem is not unique to domestic travel; it affects also international flights and airlines around the world.

Numerous factors have been blamed for the current wave of delays and cancellations, including pandemic recovery, COVID-19 deaths, early retirement, and the heavy burden of occupational licensing for pilots. Each of these explanations makes some sense. Yet stakeholders have also used each to distract from the question of whether government should have bailed out airlines in the first place.

This brief is the third installment of the series that looks at airline bailouts. The first makes the case that there were no valid reasons to bail out airlines, at least before they used all the means at their disposal to address the challenges of the pandemic.² These means included tapping into private capital markets (which were flush with cash from the Federal Reserve), using as collateral

the significant amounts of durable assets (planes, spare parts, gates, slots, and real estate) the airlines have at their disposal. In addition, if private financing failed, some airlines could and should have done what they did in the past in such a predicament: declare chapter 11 bankruptcy. History shows that airlines can continue flying safely, even during bankruptcy, so there is no systemic risk posed to the economy at large by doing so.

The second brief examines the labor argument made to justify further bailouts.³ Even if airlines would have had to furlough 35,000 workers during the pandemic and the resulting period of drastically low demand, the bailouts were grossly oversized. In fact, the bailouts were large enough to cover a substantial share of airlines' other expenses in addition to the cost of retaining furloughed workers.

In this brief we consider the reasons advanced to bail out the airlines and how well the bailouts have delivered on the promises made. Although the bailouts are not the reasons for the mess in 2022, the arguments used to get the bailouts were proved to be flimsy. No major US airline has gone bankrupt during the pandemic (though later we discuss the case of ExpressJet Airlines, 49 percent of which had been owned by United Airlines, and which just declared bankruptcy), but that is not much of an accomplishment, considering that bankruptcy is not a death warrant for an airline and provides an opportunity to restructure and recover. Therefore, these bailouts may have left airlines more fragile by creating a false sense of financial safety for their management teams and, thus, muting airlines' incentives to be as good as possible. If that is the case, bailouts will have only postponed bankruptcy rather than prevent it. Also, to the extent that the bailouts were intended to keep airlines ready to fly when passengers returned, they have failed.

HOW BIG WERE THE BAILOUTS?

Throughout the pandemic, via three separate statutes, the 10 major US passenger airlines together received more than \$54 billion in direct payments (\$25 billion, \$15 billion, and \$14 billion). Congress also appropriated another \$25 billion in subsidized loans from the US Department of the Treasury (only a fraction of which airlines have used) and suspended the 7.5 percent excise tax on domestic air travel as well as payments to airports and contractors.⁴

In exchange, the airlines had relatively few requirements. They had to use the funds for payroll and had to maintain a minimum level of air service along existing routes. In addition, they could not furlough workers involuntarily or reduce pay or benefits, and they could not buy back shares of their stock or pay shareholder dividends. They also had to limit executive compensation. And the airlines will be required to repay—years down the road—only a small portion of the money they have received.

These bailouts were significantly larger than anything the airlines had received in the past. In the wake of the 9/11 terrorist attacks, Congress quickly passed the bipartisan Air Transportation

Safety and System Stabilization Act. Airlines were bailed out to the tune of \$5 billion in cash and \$10 billion in loan guarantees.⁵

THE RESULTS OF THE 2020 AIRLINE BAILOUTS

The results of the bailout are mixed. On the one hand, no major US airline so far has gone into bankruptcy or been forced to close shop (though some of them are facing real financial headwinds). In addition, disruptions to travel during and after the pandemic would have likely been much worse than they have been so far without the first bailout (though the second and third bailouts accomplished little). On the other hand, the main arguments for the bailouts were not that airlines would avoid bankruptcy in the short term or that travels would be less disrupted than otherwise; they were that without bailouts, airlines would disappear and would not be travel ready once the economy reopened.

Were the Airlines Able to Avoid Bankruptcy?

On March 21, 2020, the chief executives of the nation's top carriers wrote a letter to congressional leaders urging them "to swiftly pass a bipartisan bill with worker payroll protections to ensure that we can save the jobs of our 750,000 airline professionals who are coming to work every day to serve the traveling and shipping public."⁶ According to this letter, this first COVID-19-era bailout of the US airlines was meant to keep the nation's aviation system alive through the coronavirus pandemic, given that all employees in the industry were at risk of losing their job owing to the reduction in demand.

Testifying before Senate Committee on Commerce, Science, and Transportation in December 2021, American Airlines CEO Doug Parker said that "it's not an exaggeration to say the program saved the airline industry."⁷

Parker's claim is groundless. Although American Airlines and potentially United Airlines were at risk of chapter 11 restructuring (on the basis of the price of credit default swaps at the time, one can infer that an American Airlines bankruptcy was highly likely), the airline industry was never at risk of disappearing. If some airlines were forced to cease or suspend operations indefinitely, they would be quickly replaced by new ones. In fact, few people realize that every year, many airlines around the world stop flying.⁸ Most of them are small, but there are also many examples of major airlines going under, such as Pan American World Airways or Eastern Airlines.⁹

Also, many observers equate bankruptcy with going out of business, but that perspective is far from accurate. The most common path is chapter 11 reorganization. Chapter 11 "ordinarily is used by commercial enterprises that desire to continue operating . . . and repay creditors concurrently through a court-approved plan of reorganization."¹⁰ Under more extreme circumstances, compa-

nies engage in chapter 7 liquidation proceedings, which entail “an orderly, court-supervised procedure by which a trustee takes over the assets of the debtor’s estate, reduces them to cash, and makes distributions to creditors, subject to the debtor’s right to retain certain exempt property and the rights of secured creditors.”¹¹

In other words, the principal goal of chapter 11 commercial bankruptcy, which the airlines would have likely filed for, is precisely the survival of the company. And in fact, any airline that files for bankruptcy can stage a comeback, as Delta Air Lines, United Airlines, and American Airlines have all done. Some may even come back stronger. However, if they do not come back, the supply of flights is not likely to waver. Because the aircraft, hangars, workers, landing slots, and other assets do not simply vanish when an airline goes out of business, another airline will quickly replace the defunct one.

Bailouts may have prevented the bankruptcy of major airlines so far, but the net outcome is unlikely to be positive in the long run. These bailouts cost taxpayers and add to the country’s already outsized public debt. In addition, bailouts create all sorts of perverse incentives. They also prevent airlines from getting a shot at a restructuring—shareholders may not like the idea of bankruptcy, but it would be healthier in the longer term. In fact, whereas bailouts may have prevented bankruptcy during the pandemic, it may have simply postponed the inevitable for some of the airlines. For instance, ExpressJet Airlines, an airline that had been 49 percent owned by United Airlines, has filed for chapter 11 bankruptcy and ceased all flight operations.¹² The company was in trouble already, and the bailout may have given it a lease on life for a while. Now that reprieve is over.

Moreover, bailouts are unfair. Why one industry gets bailouts while others do not is mostly determined by political connections and the perception of saliency rather than by real systemic risks to the economy or other economic factors.¹³ There are no systemic risks to the economy from airline failures. However, airlines have long benefited from a preferred status with the political class, which explains why they almost always get bailed out.

This situation creates moral hazard, meaning that airlines, their creditors, and their shareholders soon learn that they need not plan for emergencies, because in times of crises their political friends will not let them fail. Indeed, when the pandemic hit, airlines were coming off a remarkable 10-year run.¹⁴ For instance, in 2019, Delta Air Lines CEO Ed Bastian noted that “2019 was a truly outstanding year on all fronts—the best in Delta’s history operationally, financially and for our customers.”¹⁵ Airlines were doing so well that American Airlines CEO Doug Parker told investors in 2017, “I don’t think we’re ever going to lose money again.”¹⁶ And yet, as soon as demand for their services dropped, the airlines ran to Congress for help as common paupers, instead of letting their shareholders take a hit, selling any of their assets, or fully take advantage of their access to capital and various lines of credit.

Unfortunately, that pattern will continue, as evidenced by the message that Bastian gave his investors during a speech at the Alliance Bernstein 37th Annual Strategic Decisions Conference. Bastian said, “my hope is that we’ve tested at Delta at least the proposition ‘are airlines investable’ and I think the strong answer is ‘yes they are investable.’ And even in the worst crisis imaginable we’ve proven ourselves. We’ve proven the value of what we bring to society. We’ve proven that governments will be there for us if ever needed again, hopefully never again.”¹⁷

Were the Airlines Ready for the End of the Pandemic?

Another prominent argument for bailing out airlines was that the money was needed to keep airline workers on the job so they would be ready to fly when passengers returned. As Americans now know, this plan has not worked out, in large part because the airlines—contrary to their promise—did not keep their workers. However, this failure does not mean the bailouts induced the current mess.

In large part—and unacknowledged by legislators—although a condition for the bailouts was that airlines could not fire workers, airlines induced many of their employees to leave. To understand what happened, one must break the three bailouts apart.

First was \$25 billion in cash plus \$25 billion in loans to airlines distributed as part of 2020’s Coronavirus Aid, Relief, and Economic Recovery Act. At the time, airline travel had collapsed. Under these conditions, there is little doubt that without the bailout money airlines would have had to shut down and furlough most of their employees. That would have meant a longer time to build back up. Instead, legislators extended \$50 billion to the airlines, required them to keep their staff and continue flying to all destinations. Although reduced ridership was permitted, about 90,000 people per day (down from 2 million per day) managed to travel by air during the pandemic’s height, many of whom probably would not have been able to do so otherwise.¹⁸

Was this outcome worth billions? No. Airlines had enjoyed profits for the better part of the previous decade. They were not at risk of disappearing and, owning lots of valuable assets, had tremendous access to capital markets for needed liquidity (bolstered further by the Fed). Even in the worst-case scenario, airlines could go through the bankruptcy process, continue to fly safely while doing so, and emerge healthier. Either way, the airlines’ pleas for handouts were unjustified. There was, contrary to their insistence, no systemic risk associated with closing or going bankrupt. Bailouts meant that taxpayers took a haircut rather than shareholders and creditors.

If airlines had needed more time to restart their business, passengers would have expected a reduced number of flights and a greater number of delays. Indeed, Americans were told that everything would be just like before in no time, and airlines tried to behave as if the fiction were true that airlines can go through such an economic shock with no disruption to travel whatsoever.

The second and third bailouts were also a waste of taxpayer money; they were at least 10 times larger than what was needed to cover the payroll of the workers at risk of being furloughed.¹⁹ One knows this because, during the time between the first and second payroll support programs, some airlines furloughed workers. By the time the second program was passed, demand for travel was growing, and airlines were planning increased schedules. As a result, most of the funds were used to pay workers whose jobs were never at risk, and shareholders and creditors pocketed any excess while the airlines downsized anyway. Also, although airlines continued to pay pilots, pilot training was not kept up to date, thus preventing some pilots from returning to the skies when passenger demand returned.

In addition, airlines used a brief gap in government payroll-support funding between the first and second bailouts—that gap created the specter of layoffs—to induce employees to leave voluntarily. These employees were offered buyouts—potentially with bailout money!—with termination as a possible alternative and the promise of better benefits for making their termination voluntary.

Once the second bailout passed, requiring airlines to continue employing existing workers, departed employees were discouraged from coming back to their jobs. American Airlines, for instance, emphasized that employees who had taken other jobs could not simply return to the airline's payroll.²⁰ That's the opposite of keeping employees attached to the company.

As a result, Delta Air Lines shrunk its staff by 31 percent and American Airlines shed \$500 million a year in annualized payroll by reducing its nonunionized workforce by 30 percent. American Airlines did continue paying pilots, as required, but did not keep them eligible to fly; they were paid to sit home and did not do recurrent training. The consequence was that when passengers returned, the airline lacked sufficient pilot staff to operate its published schedule.

Airlines also retired aircraft fleets, necessitating pilots to be retrained on new aircraft. Union contracts amplify the problem of pilot shortages because the determination of which pilots fly which planes is based on seniority, so the retirement of one aircraft type bumps younger pilots off of the planes they are currently flying to make room for senior pilots who previously flew the now-retired aircraft. The younger pilots then need to get retrained.

In addition, as airlines restaffed, employees lacked the experience that they used to have in running an airline. Many of the more experienced managers had left during the pandemic. These were the people who determined when to schedule maintenance on planes, built flight schedules, and had years of experience handling irregular operations. Flight attendants and reservations agents cannot simply start working with customers on their date of hire; they must go through training. These circumstances contribute to poor operational performance.

Labor shortages affect not only airlines; airports received bailouts too, which gave them the flexibility to relax requirements for concessions operators. They are now having a hard time restaffing.

A small portion of delays is also due to inadequate staffing at the Federal Aviation Administration and Transportation Security Administration. This inadequate staffing can be explained in part by the disincentives to return to work created by overly generous pieces of government spending such as stimulus checks, enhanced unemployment benefits, and more.

CONCLUSION

Airline bailouts did not cause the current problems faced by airline passengers; the pandemic and the airlines' need to adjust to the collapse in travel demand did. However, the current airline troubles should make legislators think twice next time they are asked to bail out airlines' shareholders, even if the airlines claim the bailouts will allow them to keep their employees. The airlines were not ready when passengers came back, because in spite of the bailouts, which made it a priority for airlines to keep their workers (in part to keep airlines travel ready), airlines got rid of many employees, dissuaded those employees from coming back when the economy reopened, encouraged retirements, and did not keep the pilots they retained ready to fly. In addition, airlines were never in danger of disappearing. United Airlines and American Airlines would likely have entered chapter 11 bankruptcy. But Congress instead decided to bail out their shareholders and creditors, inducing many unintended consequences for years to come while leaving the skies very unfriendly.

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NOTES

1. The \$54 billion was made up of direct cash transfers. The other benefits included \$25 billion in subsidized loans, suspension of the 7.5 percent excise tax on domestic air travel through end of 2020, and payments to airports and airline contractors, as well as Federal Reserve policy rendering debt issuance cheap—the airlines loaded up on private sector debt.
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4. The benefits included “\$25 billion for loans and loan guarantees to passenger air carriers, repair station operators certified under 14 CFR part 145, and ticket agents; up to \$4 billion for loans and loan guarantees to cargo air carriers.” “Loans to Air Carriers, Eligible Businesses, and National Security Businesses,” US Department of the Treasury, accessed August 29, 2022, <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-industry/loans-to-air-carriers-eligible-businesses-and-national-security-businesses>.
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7. Oversight of the U.S. Airline Industry, Hearing before the S. Comm. on Commerce, Science, and Transportation, 117th Cong. (2021) (statement of Doug Parker, Chairman and Chief Executive Officer, American Airlines).
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14. Leslie Josephs, “US Airlines Are Set for a 10th Year of Profits. More Than 120,000 Employees Want a Raise,” CNBC, December 26, 2019.
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16. David Koenig (Associated Press), “American Airlines’ Doug Parker Tells Analysts: ‘I Don’t Think We’re Ever Going to Lose Money Again,’” *Dallas Morning News*, September 28, 2017.
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18. “TSA Checkpoint Travel Numbers (Current Year versus Prior Year(s)/Same Weekday),” Transportation Security Administration, last updated September 1, 2022, <https://www.tsa.gov/coronavirus/passenger-throughput>.

19. De Ruyg and Leff, "The Economic Case."
20. "Such employment would be inconsistent with your availability to return to work at American and with the purpose of PSP2 to provide pay and benefits to individuals involuntarily separated from their employer and accordingly no longer receiving pay and benefits. PSP2 does not intend to provide redundant pay and benefits. If you become fully employed at any point before March 31, 2021, you must notify American so that we can discontinue the relief you are receiving from American pursuant to PSP2." American Airlines, quoted in Gary Leff, "How American Airlines Is Keeping Government Payroll Support for Itself, Not Giving It to Employees," *View from the Wing* (blog), January 13, 2021.