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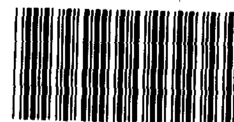
Report to Congressional Requesters

December 1992

AIRLINE COMPETITION

Impact of Changing Foreign Investment and Control Limits on U.S. Airlines



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Resources, Community, and
Economic Development Division

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December 9, 1992

The Honorable Ernest F. Hollings
Chairman
The Honorable John C. Danforth
Ranking Minority Member
Committee on Commerce, Science,
and Transportation
United States Senate

The Honorable Wendell H. Ford
Chairman
The Honorable John McCain
Ranking Minority Member
Subcommittee on Aviation
Committee on Commerce, Science,
and Transportation
United States Senate

This report, prepared at your request, provides information on the current restrictions on foreign investment in and control of U.S. airlines and an analysis of the potential impact of relaxing those restrictions.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. We will then send copies to the Chairman, House Committee on Public Works and Transportation; the Secretary of Transportation; the Secretary of Defense; the Acting Secretary of State; the Administrator, Federal Aviation Administration; and other interested parties. We will make copies available to others on request.

This work was performed under the direction of Kenneth M. Mead, Director, Transportation Issues, who can be reached at (202) 275-1000 if you or your staffs have any questions. Other major contributors are listed in appendix III.

J. Dexter Peach
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Executive Summary

Purpose

Recent bankruptcies by financially struggling U.S. airlines have raised congressional concern about the effects of industry consolidation on domestic and international competition. Foreign investment is a potential source of capital for U.S. airlines, but it is limited by law. The Chairmen and Ranking Minority Members of the Senate Committee on Commerce, Science, and Transportation and its Subcommittee on Aviation asked GAO to examine the implications of relaxing the current restrictions on foreign investment in and control of U.S. airlines. GAO assessed the impacts in five key areas—domestic and international competition, national security, airline employment, and safety. GAO also examined the Department of Transportation's (DOT) procedures for enforcing the current restrictions.

Background

Low profits in recent years have forced airlines to finance their capital needs by borrowing. But borrowing leads to higher fixed costs to repay interest and principal—obligations that can be difficult to meet if traffic or revenues decline. Since January 1991, six large U.S. airlines have declared bankruptcy and three have ceased operations. Fewer airlines could mean less competition and higher fares. Foreign investment is one alternative to borrowing, and several foreign airlines have expressed interest in investing in U.S. airlines. Federal law, however, limits foreign investment in U.S. airlines to 25 percent of the voting stock and limits foreign investors' ability to elect members of boards of directors and other key officers. Also, DOT interprets the law as requiring that decision-making control of an airline remain with U.S. citizens. Even 25 percent of voting stock might constitute effective control if there is no other large voting bloc and the stock is broadly held by many small shareholders. Proposals to relax the restrictions range from increasing the limits to 35 percent of the voting stock to eliminating the restrictions entirely.

Results in Brief

Relaxing the statutory limits on foreign investment and control could potentially give U.S. airlines, particularly those in financial difficulty, greater access to needed capital, thus enhancing their domestic competitive position. Foreign airlines are the most likely source of investment because they can benefit from integrating their international service with that of U.S. airlines. However, unless foreign investors can exercise control commensurate with the amount of voting stock held, they may not want to invest in U.S. airlines. While foreign investment has potential benefits for U.S. airlines, it is not a panacea for preserving competition in the U.S. airline industry, because other factors—such as airline control over gates and other facilities at major U.S. airports—affect

airline competition. These issues have been addressed in previous GAO reports.

The impact of increased foreign investment on international competition depends, in part, on existing bilateral aviation agreements. These agreements set the conditions under which U.S. and foreign airlines operate and compete, and can restrict competition by limiting the service that can be offered. There may be opportunities for relaxing operating restrictions in some bilateral agreements in exchange for relaxing restrictions on foreign investment in U.S. airlines. Eligibility to invest in U.S. airlines could be restricted to airlines from nations that allow greater access to their aviation markets or do not subsidize their airlines.

Relaxing foreign investment and control restrictions also could affect national security, employment, and safety oversight. U.S. airlines, through their voluntary participation in the Civil Reserve Air Fleet (CRAF) program, provide the Department of Defense (DOD) with supplemental airlift capacity in emergencies. DOD is concerned that foreign investors might discourage continued participation in CRAF. Increased foreign investment could put jobs—those of pilots and crew on international routes, for example—at risk, but it could also help stabilize U.S. airline employment by strengthening financially weak airlines. Increased foreign investment could place additional burdens on the Federal Aviation Administration's (FAA) safety oversight responsibilities if foreign aircraft are transferred to U.S. registry.

DOT currently reviews airlines' financing and management, among other things, before granting the airlines authority to operate. As part of this review, known as a fitness review, DOT ensures that U.S. airlines are controlled by U.S. citizens. DOT does not have to complete its review before the investment is made final. If foreign investment and control restrictions are relaxed, the timing and extent of DOT's review would require change to ensure that DOT reviews investments before they are made final and, in conjunction with DOD and the Department of Justice, reviews the impact of investments on a broader range of factors. These factors would include the potential impact on international competition and national security.

GAO's Analysis

Potential Impact on Domestic and International Competition

An airline that cannot pay its debt can be forced into bankruptcy. Access to new sources of capital could allow weaker U.S. airlines to reduce debt costs, invest in new aircraft, and compete more effectively with the dominant airlines. However, current control restrictions limit foreign investors' ability to influence the management decisions that affect the value of their investments. Therefore, foreign investment is not likely to increase substantially under the current system. Furthermore, bilateral agreements often restrict competition by limiting the number of airlines that can serve a route. Therefore, determining the impact on competition of changing restrictions will depend not only on the terms of a proposed investment, but also on the terms of the aviation bilateral agreement between the United States and the foreign investor's home country. In addition, factors such as airport congestion may limit an airline's ability to exercise the rights obtained in bilateral negotiations. Finally, some foreign airlines are subsidized by their governments. If these airlines invested in a U.S. airline and passed on the subsidies to the U.S. airline, the U.S. airline would have an unfair advantage in U.S. domestic markets. While subsidies could benefit consumers in the short run, they run counter to the United States' policy of relying on market forces to set fares.

Potential Impact on U.S. Airlines' Role in the National Security System

DOD relies on U.S. airlines' voluntary participation in CRAF to supplement its airlift capability in military emergencies. U.S. airlines participating in CRAF agree to supply crew members who can obtain security clearances as well as the long-range aircraft critical to DOD. While foreign investment could allow a U.S. airline to expand or upgrade its fleet and thus be better able to meet DOD's needs, DOD is concerned that U.S. airlines could be pressured by foreign investors to limit or discontinue their participation in CRAF. If voluntary participation fell short of projected needs, the CRAF program would have to be changed to preserve DOD's access to civilian aircraft and crews.

Potential Impact on Airline Employment and Safety

Some U.S. jobs on international routes could be at risk if foreign investment and control restrictions are relaxed. Representatives of airline employees are concerned that a foreign airline investor might discourage the U.S. airline from serving international routes it also serves. However, there are legal and practical limits to substituting foreign workers for U.S.

employees that would limit job loss in the United States. Also, if foreign investment reinvigorates financially ailing U.S. airlines, the net impact of foreign investment on domestic airline employment could be positive. U.S. airline safety should not be affected, regardless of the amount of foreign investment, because any airline offering domestic service in the United States would still be subject to FAA's safety regulations. However, if cross-border investments increase the number of aircraft transferred between U.S. and foreign registry, the work load of FAA's safety inspectors and engineers could increase.

DOT's Investment Approval Process

During its fitness review, DOT reviews changes in the financing and management of U.S. airlines, including investments from foreign sources. GAO found two aspects of DOT's current review authority that could become important if foreign investment and control restrictions were relaxed. First, investors are not required to obtain DOT approval before completing the investment, although some investors elect to submit the proposal for early review. The British Air investment in USAir is being reviewed by DOT, but the parties could choose to consummate the deal before the review is finished. If investments are completed before DOT's review is finished, it can be difficult to undo these complex corporate investment transactions. Second, DOT does not review an investment for the purpose of determining its potential effect on competition in international aviation markets or its impact on national security. To ensure that foreign investments do not reduce international competition or limit CRAF participation, each investment needs a careful, case-by-case review.

Matters for Congressional Consideration

GAO recognizes that foreign investment in and control of U.S. airlines is a complex and controversial issue. Changing the current limits has both benefits and potential risks. Legislation has been proposed to change the limits. If the Congress chooses to relax the limits on foreign control of U.S. airlines, it may wish to consider

- modifying DOT's fitness review authority so that DOT can review investments before they are made final;
- expanding the review to consider the potential impact of foreign investments on national security;
- requiring DOT, in conjunction with its fitness review, to make explicit determinations under its separate statutory authority[1] with respect to international aviation competition; and

[1] 49 U.S.C. app. section 1159b.

- limiting eligibility for greater investment and control to investors from countries willing to exchange improved access to their aviation markets for greater opportunities to invest in U.S. airlines.

Agency Comments

As requested, GAO did not obtain written agency comments on this report. GAO discussed the report with officials at DOT's Office of the Assistant Secretary for Policy and International Affairs, DOD's Assistant Secretary of Defense (Production and Logistics), and the State Department's Office of Aviation Programs and Policy. These officials generally agreed with GAO's presentation of the key issues involved in relaxing foreign investment and control restrictions. Their comments have been incorporated where appropriate.

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Abbreviations

AFL-CIO	American Federation of Labor and Congress of Industrial Organizations
ATA	Air Transport Association
CAB	Civil Aeronautics Board
CFIUS	Committee on Foreign Investment in the United States
CRAF	Civil Reserve Air Fleet
DOD	Department of Defense
DOT	Department of Transportation
EAS	Essential Air Service
EC	European Community
FAA	Federal Trade Commission
FTC	Federal Trade Commission
GAO	General Accounting Office
IATA	International Air Transport Association
ICAO	International Civil Aviation Organization
KLM	KLM Royal Dutch Airlines
LOT	LOT Polish Airlines
SAS	Scandinavian Airlines System
UPS	United Parcel Service
USA-BIAS	U.S. Airports for Better International Service
UTA	Union de Transports Aeriens

Introduction

Foreign investment is becoming an increasingly important source of capital for many U.S. industries. However, foreign investment in U.S. airlines is limited by federal law enacted more than 60 years ago. We reviewed the reasons for the restrictions on foreign investment and control of U.S. airlines to see whether they continue to be relevant. Foreign investment in U.S. airlines is reviewed by both the Department of Transportation (DOT) and the Department of Justice. DOT's review is designed to ensure that foreign investment does not exceed the prescribed limits, while Justice is responsible for determining competitive impacts.

Foreign Investment Plays an Important Role in the U.S. Economy

According to an August 1991 Commerce Department report on foreign investment in the U.S. economy,[1] foreign direct investment (i.e., ownership by a foreign person or business of 10 percent or more of the voting stock of a firm located in the United States) grew rapidly during the 1980s. This increased foreign investment was the result of relatively high interest rates in the United States. Falling rates in the United States in the 1990s and rising rates elsewhere led to a sharp decline in the growth of foreign investment in the U.S. economy. Foreign investment continues to account for a smaller part of the U.S. economy than that of any other major industrial country except Japan. Nevertheless, foreign investment in the United States has provided some important benefits, including the 4.4 million jobs provided by U.S. affiliates of foreign companies in 1989, the latest year for which data are available. The Department of Commerce estimates that the net benefit to the U.S. economy of foreign investment in 1989 was between $48 billion and $150 billion, depending on the assumptions made about productivity rates and the relationship between economic growth and capital.[2]

Current Restrictions on Airline Ownership and Control Have Historical Basis

The restrictions on the ownership and control of U.S. airlines were first enacted in 1926. Industry analysts point to four primary reasons why limits were placed on foreign investment and control of U.S. airlines. These include (1) protection of the heavily subsidized fledgling airline industry, (2) regulation of international air service through bilateral agreements negotiated with foreign governments, (3) concern about allowing foreign

[1] Foreign Direct Investment in the United States, U.S. Department of Commerce, Economics and Statistics Administration, Office of the Chief Economist (Washington, D.C.: Aug. 1991).

[2] In a March 1992 report, GAO criticized Commerce's report for not discussing the possible costs related to the economy's dependence on foreign capital, such as possible limitations on the U.S. government's freedom to decide monetary and foreign policies resulting from the need to obtain and hold high levels of foreign financing. See Foreign Direct Investment: Assessment of Commerce's Annual Report and Data Improvement Efforts (GAO/NSIAD-92-107, Mar. 18, 1992).

aircraft access to U.S. airspace, and (4) military reliance on civilian airlines to supplement airlift capacity.

Federal Law and DOT's Current Interpretation

Federal law currently limits foreign investment in U.S. airlines. To obtain or hold the authorization necessary to operate as a U.S. airline, an airline must meet two statutory tests to ensure that control of the airline is held by U.S. citizens.[3] First, at least 75 percent of the airline's voting stock must be held by U.S. citizens. Second, the airline's president and at least two-thirds of its board of directors and key management officials must be U.S. citizens. The law does not specify any limits on foreign investment in nonvoting stock or limits on the provision of debt financing. Furthermore, DOT interprets the law as requiring that effective control also be in U.S. hands. Effective control means that the U.S. citizen owners and managers of the airline must have the independence to make decisions, even if those decisions would not coincide with the best interests of a particular foreign investor. These requirements apply to all U.S. airlines.

To attract additional equity investment, the Secretary of Transportation announced in January 1991 that DOT would now interpret the law to allow a foreign investor to hold as much as 49 percent of a U.S. airline's total equity, as long as foreign investment did not exceed the statutory limit of 25 percent of the airline's voting stock. Subsequently, in June 1991, the Secretary also proposed allowing foreign investment in up to 49 percent of an airline's voting stock, a change that would require legislative action. These policy changes, according to DOT officials, were in response to two events. First, U.S. airlines had suffered heavy losses in 1990 and 1991. Several airlines were operating under bankruptcy court protection or had ceased operating during the period. Second, DOT had gained experience in structuring foreign investment to maintain U.S. citizen control by working with two major U.S. airlines, Northwest and Continental, and their foreign investors.[4] However, the Secretary did not propose any changes to the citizen control requirements.

[3]An airline must be a U.S. "citizen" as defined in 49 U.S.C. app. sec. 1301(16) before it can obtain authority to engage in air transportation under 49 U.S.C. app. sec. 1371(a).

[4]Ch. 2 discusses four cases, including those of Northwest and Continental airlines, in which DOT reviewed foreign investments in U.S. airlines for their control implications.

Federal Subsidy and Regulation of Airline Industry

Ownership and control of U.S. airlines was historically reserved to U.S. citizens so that federal subsidies would not flow to foreign citizens or foreign governments. When the Congress established citizenship requirements in the Air Commerce Act of 1926,[5] commercial aviation was in its infancy, and the airlines depended heavily on subsidies from government mail contracts. However, the airline industry has changed greatly since that time. Just before deregulation in 1977, federal subsidies had declined to less than one-half of 1 percent of the industry's revenues. When the Congress deregulated the domestic airline routes and fares in 1978,[6] it also established the Essential Air Service (EAS) program, to help support service to small communities. EAS, the only remaining direct federal subsidy of air service, provides payments that amount to only one-twentieth of 1 percent of the airline industry's revenues.

Bilateral Aviation Agreements

International air service has been regulated since the Paris Convention of 1919.[7] Early scheduled international air services between two countries required special permission from the nations involved and were based on reciprocal trading of services of equal value.[8] In 1944, the United States hosted an international civil aviation conference in Chicago, inviting representatives from allied and neutral nations to create a framework for international aviation. The countries did not agree on the open economic regime the United States preferred, but chose instead to rely on bilateral agreements between nations to decide routes, fares, and capacity. Therefore, two nations negotiate the air transport services between them and award to their airlines the rights to offer those services. These bilateral agreements require that the airline on whose behalf a government is negotiating be controlled by citizens of that country. The Chicago Convention also reserves to each country the right to prevent foreign airlines from operating domestic air services within their home countries.

Airspace Sovereignty

Concern about foreign airlines' access to the nation's airspace is another historic rationale for requiring U.S. citizen control. The Chicago Convention continued to limit access to a country's airspace, a principle

[5]P.L. 69-254, 44 stat. 568 (1926).

[6]The Airline Deregulation Act of 1978, 49 U.S.C. app. sec. 1302.

[7]The Convention on the Regulation of Aerial Navigation of 1919 (known as the Paris Convention) was signed but not ratified by the United States.

[8]Ramon de Murias, The Economic Regulation of International Air Transport (North Carolina: McFarland & Company, Inc., 1989).

first agreed to in the Paris Convention. Both conventions reserve "complete and exclusive sovereignty over the air space above its territory" to each signatory country. Governments wanted to limit access to the airspace over their countries to prevent activities such as unauthorized photographing of military installations. Today, the presence of foreign commercial aircraft in U.S. airspace is of less concern for two reasons. First, the Federal Aviation Administration's (FAA) air traffic control system regulates all aircraft while they are in U.S. airspace, and these aircraft are kept away from militarily sensitive areas. Second, many U.S. cities are served by foreign airlines, including many cities in the U.S. interior, so that foreign aircraft already have extensive access to U.S. airspace. Finally, satellites and high-resolution photography have made aerial photography less important.

Military Reliance on Civilian Airlift

The Department of Defense (DOD) relies on U.S. commercial airlines to supplement its own airlift capacity for both peacetime and emergency airlift and considers the airlines a vital tool for maintaining national security. The major link between U.S. airlines and the military is the voluntary Civil Reserve Air Fleet (CRAF) program.[9] The primary incentive for the airlines to participate voluntarily in CRAF is access to peacetime military charter business, which is distributed among the airlines that sign CRAF contracts. Through CRAF, DOD has access to approximately 500 passenger and cargo aircraft without the economic burden of purchasing, maintaining, and staffing the equipment.[10] The participating airlines sign contracts promising to deliver aircraft to the Air Mobility Command (formerly the Military Airlift Command) when CRAF is activated. In addition, for each aircraft committed to CRAF, the airlines must supply four crews. Crew members must be U.S. citizens, because they must be eligible for security clearances. During the recent Middle-East conflict, civilian airlines, operating through CRAF, carried 63 percent of the passengers and 25 percent of the cargo transported by air to the Persian Gulf.

[9]GAO's National Security and International Affairs Division is currently conducting a detailed review of the operation of the CRAF program during its first-ever activation for Desert Shield/Storm.

[10]April 1992 DOD Air Mobility Command data showed 501 aircraft committed to CRAF. DOD officials noted that the number of aircraft committed to CRAF fluctuates but is usually in the range of 485 to 525 aircraft.

DOT Reviews Airlines' Financing and Management to Determine Fitness to Hold Operating Authority

When an airline first applies for operating authority, requests a change in the type of authority it holds (e.g., a change from nonscheduled service to scheduled service), or undergoes significant changes in its financing, ownership, or management, DOT's Air Carrier Fitness Division conducts a "fitness review." For example, a fitness review could be triggered by an airline's filing for Chapter 11 bankruptcy court protection or by a significant change in the ownership of voting stock. The purpose of the review is to determine whether the airline should be allowed to begin or continue offering service. As part of the fitness review, DOT must determine whether an airline meets the statutory requirements for authorization, including U.S.-citizen control. When the ownership or control of an airline changes, DOT undertakes a fitness review, but the review may not be completed before the changes are made final. For antitrust purposes, the Department of Justice also reviews certain changes in the ownership and control of U.S. airlines. The Federal Trade Commission (FTC) has review authority for other industries. Comparison of the processes and criteria used by Justice and FTC with those used by DOT show that all three agencies consider the same factors to determine control, but there are important differences in their procedures.

To find an airline "fit" (i.e., eligible for authorization), DOT uses a three-part test that reconciles the policy of encouraging market entry with concern for safety and consumer protection. Specifically, DOT must find that the airline will (1) have the managerial skills and technical ability to conduct the proposed operations, (2) have access to resources sufficient to conduct operations, and (3) comply with laws and regulations imposed by federal and state agencies. In addition, DOT must find that the airline will be controlled by U.S. citizens.

DOT Determines Whether U.S. Airlines Are Controlled by U.S. Citizens

DOT's determination of the "citizenship" of an airline confirms that the airline meets the statutory requirements for authorization. Initially, DOT analysts review the formal structure of the airline and its management team. For a corporation, this review would include the identity of the major stockholders, amounts of voting stock held by shareholders, composition of the board of directors, and background of key management personnel. If the airline meets the statutory tests for formal control, DOT then analyzes the structure of the airline and—when ownership and control of an airline change—of the proposed transaction for indications that U.S. citizens have effective or decision-making control. To analyze effective control, DOT examines such factors as the business

and personal relationships between the U.S. directors and managers and foreign investors, if any.

Many factors besides the citizenship of investors affect the control of an airline. These factors include the distribution of shares, the composition of the board of directors and key management personnel, the ability to appoint directors and key managers, and the sources and terms of debt financing. In general, investors are given stock that carries voting rights in return for their investment.[11] Voting stock usually entitles investors to a degree of control over the corporation's decisions directly related to their share of the voting stock. The shareholders vote for the members of the board of directors, who, in turn, select key management personnel. Thus, major investors have the ability to protect their investment by electing directors who reflect their interests. However, in the airline industry, the effective control requirement means that foreign investors are not able to use their votes to influence management decisions to the same degree as domestic investors.

Competitive Impacts of Foreign Investments in U.S. Airlines Are Reviewed by Justice but Not DOT

Under current policy, both DOT and Justice review investments in airlines, but the reviews serve different purposes. DOT's fitness review does not encompass an investment's potential effect on competition. According to DOT officials, because the fitness review does not address competition issues, DOT cannot order a U.S. airline to divest itself of an international route as a condition for approval of financing and management changes. However, investments in U.S. airlines and sales of airline assets may be subject to antitrust review by the Justice Department. Under the Hart-Scott-Rodino Act, Justice analyzes the potential anticompetitive effects of certain proposed investments and sales of assets in the airline industry as part of a review that must be completed before the transaction can be made final.[12] Justice can consider whether an investment by a foreign airline would tend to reduce competition in markets in which the U.S. and foreign airlines compete and could order the U.S. airline to divest itself of international routes. Unlike the Justice review, DOT's review

[11]The rights of various types or classes of shareholders are defined in a corporation's bylaws. Owners of common stock almost always have voting rights, while holders of preferred stock may or may not receive voting rights.

[12]Under the Hart-Scott-Rodino Antitrust Improvement Act (1976), the parties to an acquisition of voting stock or assets of an airline must notify the Justice Department before completing the transaction when one of the parties has $100 million or more in total assets or net sales and the other has $10 million or more in total assets or net sales. The responsible federal agency then performs a pre-merger review of the transaction to determine if it is likely to have anticompetitive effects.

cannot delay a transaction, and investments can be made final before the review is completed.

DOT has the authority to examine and eliminate foreign anticompetitive aviation practices. If the Department exercises its authority under the International Air Transportation Fair Competitive Practices Act of 1974, as amended, it may determine whether a foreign government or instrumentality, including a foreign airline, has unreasonably placed restrictions on or is practicing discrimination against U.S. airlines in international markets. Should DOT make such a determination, it may take such action as it deems to be in the public interest to eliminate these restrictions or practices, including disapproving a transaction it is reviewing.

International routes are currently awarded to U.S. airlines through an administrative process overseen by DOT's Office of International Aviation. International routes on which entry is limited (i.e., the number of U.S. airlines that can offer service or the number of flights that can be operated are limited) are awarded for a period of 5 years. When a new route becomes available or an existing route is up for renewal, airlines submit applications to DOT detailing their service proposals. In selecting which U.S. airline will receive authority, DOT considers, among other factors, which proposal will generate the most competition among the airlines in the market.

Subject to DOT review, U.S. airlines are free to sell their routes to another U.S. airline. DOT considers the effect of the transfer on competition between U.S. airlines and between U.S. and foreign airlines, and the impact on the trade position of the United States in the international air transportation market. However, DOT policy is ". . . not to delay transactions . . . when the contracting parties believe that [the transfer] will result in a more efficient operation of international routes, and when [DOT has] found that they will not injure the public interest.[13]

Finally, when U.S. airlines enter into agreements with foreign airlines lasting more than 60 days that allow them to serve international routes with the foreign airline's aircraft and crews, the airlines must receive DOT's approval before the agreements can be implemented. Such agreements give U.S. airlines flexibility in how they serve international markets. For example, an airline may not have an appropriate long-range aircraft to use

[13]DOT Order 91-4-47, Final Order in the Joint Application of American Airlines, Inc., and Trans World Airlines, Inc., for Approval of Transfer of Certificates Under Section 401(h) of the Federal Aviation Act, as Amended (U.S.-London routes), Apr. 24, 1991, p.25.

in an international market. Instead of withdrawing service from a profitable market or risking the loss of any of its international route authority, a U.S. airline may decide to enter into an agreement with a foreign airline also serving the market. On international routes for which these agreements are in place, an airline may carry passengers for another airline as well as carrying its own passengers. DOT reviews the agreements to ensure that foreign airlines do not gain opportunities to serve international markets unless U.S. airlines are allowed to perform similar operations in the foreign airline's country. In addition, DOT considers the competitive impact of these interairline agreements and ensures that both airlines have the necessary international route authority.

Committee on Foreign Investment in the United States Reviews Investments

Foreign investments in U.S. firms, including U.S. airlines, are subject to review by the Committee on Foreign Investment in the United States (CFIUS), which is chaired by the Secretary of the Treasury.[14] CFIUS reviews such factors as the domestic production needed for national defense, the capacity of domestic industries to meet national security requirements, and foreign control of domestic industries as it affects national security requirements. The CFIUS review is an attempt to assess the potential for future action by a foreign investor that would present national security problems, according to Treasury Department officials. CFIUS reviews of foreign investments must be completed within 45 days, by which time CFIUS must have sent its report to the President. The President, who has an additional 15 days to decide whether or not to block the investment, has the authority to suspend or prohibit the acquisition of all or a part of a U.S. business by a foreign investor under certain conditions. According to Treasury officials, this process achieves the goal of protecting national security without discouraging foreign investment.

Objectives, Scope, and Methodology

The Chairmen and Ranking Minority Members of the Senate Committee on Commerce, Science, and Transportation and of its Subcommittee on Aviation requested that we examine the implications of relaxing restrictions on foreign investment in and control of U.S. airlines. We assessed the impacts in five key areas—domestic and international competition, national security, airline employment, and safety. GAO also examined DOT's procedures for enforcing the current restrictions and whether changes might be needed.

[14]CFIUS was established in 1975 by executive order. The President's authority to block investments was added by the Defense Production Act in 1988. The Committee consists of representatives from the Departments of Treasury, Commerce, Defense, State, and Justice, as well as the Office of Management and Budget, the U.S. Trade Representative's Office, and the Council of Economic Advisers.

To gather information on the historical rationale for the current statutory limits on foreign investment and control, we reviewed relevant legislation and related reports. To assess DOT's enforcement of the current limits, we talked to officials of DOT's Air Carrier Fitness Division (the Division responsible for enforcing the foreign investment and control restrictions), examined four relevant DOT cases, and contacted some of the airlines involved. The four cases we selected involved DOT reviews of foreign investments in U.S. airlines. These cases included the two most recent cases involving major U.S. airlines that had been completed at the time of our review, the attempted start-up of a regional airline backed with foreign investment, and the sale of a small, operating cargo airline to foreign investors. We did not review all foreign investment cases involving U.S. airlines. For example, we did not review the 1987 investment in America West by the parent company of Ansett Airlines of Australia; the 1988 investment in Hawaiian by a subsidiary of Japan Air Lines; or the 1989 three-way alliance between Delta, Swissair, and Singapore Airlines, in which each airline owns up to 5 percent of the voting stock of the other two. For comparison, we examined the processes the Department of Justice and the Federal Trade Commission (FTC) use to determine when an investor has gained control over a company. We also met with officials of the Offices of Premerger Notification and Special Projects at the FTC and the Transportation, Energy, and Agriculture Section of the Justice Department.

We identified five key areas of potential impact—domestic competition, international competition, national security, airline employment, and airline safety.[15] We discussed the potential impact on domestic and international competition with officials of DOT's offices of the General Counsel for International Law and Air Carrier Fitness Division, and the Office of International Aviation. We also met with officials of Justice's Transportation, Energy, and Agriculture Section, and officials of the Office of Aviation Negotiations and Policy at the Department of State. We discussed the national security implications of increased foreign investment and foreign control with officials of the Directorate for Transportation Policy at DOD and the Office of Emergency Transportation at DOT. To assess the potential impact on airline employees, we met with the Air Line Pilots Association, the Allied Pilots Association, the Association of Flight Attendants, and the International Association of Machinists and Aerospace Workers. To assess the potential impact on airline safety, we met with FAA's Deputy Associate Administrator of the

[15]We did not examine whether increasing levels of cross-border investments would have any impact on aircraft purchase decisions.

Office of Regulation and Certification. We also had an official of FAA's Flight Standards Service review the draft section on safety in this report. Finally, we discussed all of the above issues with representatives of major U.S. and foreign airlines, trade associations, and other industry analysts. (See app. I for a list of the organizations contacted during our work.)

As requested, we did not obtain written agency comments on this report. However, we discussed our results with agency officials at the Departments of Transportation, Defense, and State—including officials from the Office of the Assistant Secretary for Policy and International Affairs at DOT, the Office of the Assistant Secretary of Defense (Production and Logistics) and the Transportation Command (liaison for the Air Mobility Command) at DOD, and the Office of Aviation Programs and Policy at State. These officials generally agreed with our identification and presentation of the key issues involved in relaxing foreign investment and control restrictions. Their comments have been incorporated where appropriate. Our work was performed between March 1991 and August 1992 in accordance with generally accepted government auditing standards.

DOT Administers the Current Foreign Investment and Control Restrictions in the Airline Industry

Federal law requires DOT authorization before airlines may engage in air transportation. To be granted authority by DOT, an airline must be a "citizen" under the law, which limits foreign investment and control of U.S. airlines. The law limits foreign ownership of voting stock to 25 percent. DOT generally interprets the law as limiting total equity (voting and nonvoting stock) to a maximum of 49 percent. Debt from foreign sources is not limited, unless the debt instrument contains unusual provisions that could give the lender effective control of the airline, such as the ability to shut down the airline by withdrawing all of its aircraft. DOT's current review process, known as a fitness review, confirms that U.S. airlines meet these requirements. The current process, however, does not require investors to obtain preapproval from DOT, so that if it ultimately finds them in violation of the foreign investment restrictions, DOT must either require that the transaction be undone or find a way to make the investment acceptable.

How DOT Assesses and Enforces Citizen Control Requirement

If a foreign investment does not conform to the current law, DOT works with the airline to restructure the investment, rather than revoking or withholding the airline's authorization. DOT officials said that as long as the airline is making a good faith effort to bring its management and financial structure into conformity with the law, DOT will allow an authorized airline to continue to operate. These officials told us the public interest is better served by keeping a competitor in the industry than by suspending or revoking the airline's authorization. However, an airline will not receive or retain authorization if it does not ultimately meet the statutory requirements.

DOT considers the relevant factors when it reviews airline financing and ownership to determine whether U.S. airlines are substantially owned and effectively controlled by U.S. citizens. Before 1989, DOT reviewed airline investments for their competitive effects as part of its premerger approval authority. This authority ended in 1989 and Justice now reviews airline transactions under the antitrust laws. Because DOT no longer has preapproval authority, the Department uses a less formal process than the processes used by Justice and FTC in their reviews of the antitrust implications of mergers and acquisitions.[1] Justice and FTC focus on the antitrust implications of transactions, i.e., whether the transactions are likely to reduce competition in the relevant markets. Neither agency tries

[1]The Hart-Scott-Rodino Antitrust Improvement Act, passed in 1976, requires premerger review. Hart-Scott-Rodino works in conjunction with sec. 7 of the Clayton Act, which prohibits the acquisition of another company if the effect of the transaction may be "substantially to lessen competition" or to "tend to create a monopoly."

to determine the "citizenship" of the resulting enterprise. We found that DOT reviews the same general factors and business relationships that Justice and FTC investigate to determine control. However, DOT must determine whether the airline continues to qualify as a U.S. citizen.

Four Recent Cases Show How DOT Interprets and Enforces Foreign Investment and Control Restrictions

We reviewed four recent cases involving foreign investment to determine how DOT was carrying out its responsibility to ensure continued citizen control. We found that DOT took remedial action when it discerned problems.

DOT Attached Conditions to Two Foreign Investments in Major Airlines

In June 1989, Northwest Airlines' parent company, NWA, Inc., announced that it was being acquired in a leveraged buyout by Wings Acquisition, Inc.[2] About 57 percent of the total equity of Northwest's new owner, Wings, was provided by KLM Royal Dutch Airlines. KLM's investment in Wings represented about 5 percent of the voting common stock, with the majority of KLM's investment in the form of nonvoting preferred stock. KLM also was to have the right to appoint 1 member of Wings' 12-member Board of Directors and to form a financial advisory committee of three representatives to advise Wings on the management of Northwest. In addition, other foreign investors held about 15 percent of Wings' voting common stock, bringing the total voting stock held by foreign investors to about 20 percent of Wings' voting stock.

In a September 1989 consent order issued by DOT, Northwest and Wings agreed to significantly reduce KLM's investment. Until this could be accomplished, the excess of KLM's holdings over 25 percent of total equity was to be placed in a voting trust, administered by a U.S. trustee approved by DOT.[3] In addition, Northwest and Wings agreed to (1) terminate KLM's right to appoint a financial advisory committee and (2) disqualify KLM's representative on Wings' Board of Directors from participating in all decisions on competitive and international aviation matters. DOT subsequently granted two extensions of the time allotted for the

[2]In a leveraged buyout, the acquiring firm buys a controlling interest in the target firm, financing the purchase with debt securities. The firm's assets are used as security for the new debt securities—i.e., the assets are leveraged.

[3]Since most of KLM's investment is in the form of nonvoting preferred stock, the independent voting trust contains nonvoting stock.

divestiture because of developments in the airline industry, such as the heavy losses suffered by U.S. airlines in 1990, and concern about harming Northwest's financial condition by requiring divestiture at that time. Ultimately, in January 1991, DOT allowed KLM to retain its interest, with the excess over 49 percent of total equity remaining in an independent voting trust. DOT also expanded KLM's representation on Wings' board when the number of directors was increased and continued the disqualification provision regarding decisions on competitive and international issues. However, the order stated that appointment of foreign representatives to key positions on Wings' board, especially the position of chairman, would be "cause for us to review the citizenship of the affected air carrier." Finally, the DOT order pointed out that the modifications to the original consent order were being made in the context of a "liberalized aviation relationship" between the United States and the Netherlands, KLM's homeland.

DOT also attached a number of conditions to foreign investment in Continental Airlines. In October 1988, Scandinavian Airlines System (SAS) purchased about 10 percent of Continental's parent company on the open market. Subsequently, in August 1990, SAS purchased additional stock in Continental's parent company, essentially buying out the interest of Frank Lorenzo, who was Chairman of the Board of Directors.[4] This second investment resulted in SAS' holding about 18 percent of the voting stock of Continental's parent company. In September 1990, DOT issued an order setting out the agreements and conditions pertaining to SAS' investment in Continental. For example, SAS agreed to appoint only 3 of the 15 members of Continental Holdings' Board of Directors and only one member of its Executive Committee, which performs the functions of the full board when the board is not in session. In addition, SAS agreed that none of its representatives would serve as chairman of the board and that these representatives would disqualify themselves from decisions on competition, aviation negotiations, or any other transactions in which SAS has a material interest.

Thus, in the Northwest/KLM and Continental/SAS cases, DOT ordered modifications to the original investments and attached conditions to its approval to ensure that the U.S. airlines retained their decision-making independence from their foreign airline investors. In each case, DOT placed limitations on the number and activities of the directors that KLM and SAS, respectively, could appoint to the U.S. airlines' boards of directors. These

[4]At the time of SAS' first investment, Continental's parent company was Texas Air, which also owned Eastern Airlines. Because of Eastern's bankruptcy, Texas Air was dissolved and Continental's new parent company, Continental Holdings, was formed.

conditions were designed to ensure that effective, as well as formal, control of Northwest and Continental remained in the hands of U.S. citizens.

DOT Fitness Reviews Found Foreign Control Problems at Two Smaller Airlines

In a case involving Discovery Airlines, DOT granted the small start-up airline temporary operating authority in December 1989, with the understanding that Discovery would come into compliance with the citizen control requirements. In July 1990, DOT cancelled Discovery's temporary authority after finding that the airline failed to meet the criterion for effective citizen control. DOT found that Discovery's U.S.-citizen directors and managers were not able to exercise decision-making authority independent of foreign interests. Discovery's two largest shareholders were an American citizen who was considered a foreign national by DOT because of his affiliation with a foreign company, and a foreign national. In this case, DOT determined that debt was also a potential source of control because there were unusual terms and conditions in Discovery's aircraft leases that gave a foreign lender (British Aerospace) the ability to exert control over the airline's operations.

Finally, in the case of Hutchinson, the small cargo airline's owner sold 51 percent of the airline's stock to foreign investors in February 1990. By October 1990, Japanese investors held all of the airline's voting stock and replaced the former owner and other board members with their own nominees. In August 1991, DOT determined that the airline, as structured, failed the citizenship criterion and that the situation represented effective and formal foreign control of the airline. DOT issued an order that granted Hutchinson a 90-day period to restructure its ownership to meet the citizenship requirement. If the airline had failed to do so, DOT would have revoked Hutchinson's operating authority. Before the 90-day period expired, DOT was notified that the foreign investors had sold their stock in Hutchinson to U.S. citizens. Therefore, DOT stayed the revocation of Hutchinson's operating authority and, after examining information on Hutchinson's new ownership, determined in May 1992 that the airline met the citizenship criterion and could retain its authority.

Another Major Airline Has Recently Announced a Foreign Investment

In late July 1992, British Airways announced it would invest $750 million in USAir. The proposed investment would give USAir new equity capital and representation on British Airways' Board of Directors. In exchange, British Airways would receive about 44 percent of USAir's total equity, 21 percent of USAir's voting stock, and representation on USAir's Board of Directors.

The two airlines plan to integrate their services so that their jointly operated services will be competitive with other airlines' stand-alone services.

The proposed investment has other benefits for the two airlines as well. It would give British Airways a secure partnership with a U.S. airline that can feed U.S. passengers to its international flights. In addition, the agreement would allow USAir, an airline with a very small international route system, to "catch up" with American, Delta, and United—airlines that have greatly expanded their international route systems over the last few years by purchasing international route authority from struggling U.S. airlines.

However, the investment agreement between USAir and British Airways must be approved by both the U.S. and U.K. governments. British Air attached some important conditions to its investment, including one that would give it significant influence over major investment decisions by USAir. The agreement will be nullified if completion of the investment would cause either airline to violate the conditions of its domestic operating authority. Both DOT and Justice would be expected to examine the investment—DOT to determine whether USAir will continue to meet the fitness requirements for U.S. certification, and Justice to determine whether the investment would have anticompetitive effects. Opponents believe that, on the basis of previous cases reviewed by DOT, the final form of the investment agreement may need to be altered to ensure that USAir remains in compliance with the fitness requirements.

Timing of DOT's Review May Need Modification If Restrictions Are Relaxed

DOT no longer has the authority to require preapproval changes in airline ownership since, under provisions of the CAB Sunset Act, DOT's premerger approval authority terminated at the end of 1988. According to DOT, most prudent investors confer with DOT before transactions involving foreign investment are made final. For example, in the Continental, Northwest, and USAir cases, DOT was contacted before the transactions were made final. However, investors are not required to contact DOT before a transaction is final or await DOT's approval before implementing changes to an airline's ownership and control.

Because of the complexity of corporate structures and DOT's limited resources, reviews of airline transactions normally last from several months to a year. DOT officials do not believe that preapprovals could be done any faster, given the agency's current resources. Consequently, DOT

officials believe that some deals that would be beneficial to U.S. airlines and would meet the current requirements would not be made because of the length of time required for a complete review. However, under the current system, DOT has had to attach conditions to foreign investments to ensure that the U.S. airlines remain under the effective control of U.S. citizens. These conditions limit a foreign investor's ability to exercise ownership rights to the same degree as domestic investors. For example, in both the Northwest and Continental cases, the foreign airline investors are not able to appoint directors to key positions on the U.S. airlines' boards.

Although DOT officials acknowledged that a form of early review such as that used by Justice and the FTC might be possible under DOT's current statutory authority, DOT is reluctant to require filing of information on airline investments before transactions are made final. According to officials at the Air Carrier Fitness Division, such a requirement could be interpreted as attempting to revive DOT's premerger approval authority through administrative rulemaking. In addition, they said that DOT does not have the resources to preapprove airline investments and management changes.

While we agree with DOT officials that performing preapproval reviews at DOT's current pace could discourage beneficial investment in existing U.S. airlines, we also agree with Justice and the FTC that it is far easier to prevent a transaction than to "unscramble the eggs" afterwards. For example, in the KLM/Northwest case, the investment was made final before DOT could fully analyze whether the transaction met existing requirements, according to DOT officials. However, if DOT were to develop an early review procedure, the agency would still not have the authority to prevent or stay completion of an investment. Moreover, additional resources might be required to perform even an early review within the limited time allowed—for example, for Justice and the FTC to perform reviews under Hart-Scott-Rodino.

Conclusions

DOT's review process ultimately ensures that U.S. airlines are controlled by U.S. citizens. Because investors are not required to obtain approval of changes in financing or management that may violate the citizenship requirements before the transaction is made final, DOT's lack of authority to review investments before they are final could create pressure for DOT to approve marginal transactions. However, changing the timing of DOT's fitness review to allow the agency to prevent transactions will require

changing or clarifying DOT's review authority. Early review of foreign investments in U.S. airlines to determine whether the investment raises substantive control issues is not likely to delay the completion of airline investments as long as the review is completed within the same time period that Justice performs its antitrust review. The two reviews could be conducted simultaneously. Likewise, the authority to conduct a preliminary review before investments can be made final could help reduce some of the uncertainty for investors inherent in the present process. In addition, if the restrictions on foreign investment and control are relaxed, DOT's review will become critical to ensuring that investments in U.S. airlines meet any eligibility criteria that are included in the legislation authorizing increased foreign investment or control.

Impact on Domestic Competition of Changing the Foreign Investment and Control Restrictions

Recent developments in the domestic airline industry, including the bankruptcies and mergers of airlines with heavy debt burdens, have prompted a reexamination of limits on the foreign investment that could be a source of needed capital for U.S. airlines, especially those that are financially ailing. Investments from foreign airlines offer an alternative to the borrowing that has undermined the financial health of some airlines. However, under the current law that limits foreign control of U.S. airlines, foreign investors are unable to exercise sufficient control to protect the value of their investments. Thus, U.S. airlines, especially the smaller or weaker ones, have generally not been able to attract meaningful amounts of additional foreign investment. Relaxing the current limits to permit greater foreign investment and control could result in additional investments between U.S. and foreign airlines. However, careful review by the Justice Department and DOT of foreign investments will be needed to prevent alliances that threaten competition.

Bankruptcies and Mergers Have Resulted in Industry Consolidation

The continuing consolidation of the U.S. domestic airline industry over the last 3 years has prompted interest in reexamining the current limits on foreign investment and control. During that 3-year period, six well-known airlines have declared bankruptcy and three have ceased operations. Yet, U.S. airlines will have to raise billions of dollars to renovate and upgrade their fleets to meet safety and noise regulations. Bills have been introduced in both the Senate and the House to change the current restrictions on foreign investment and control, and DOT has proposed relaxing the restriction on foreign ownership of voting stock. Officials of two major airlines and one smaller start-up airline attempting to locate additional financing reported that, while U.S. financing was not available, more foreign investment was available to them than the law allowed them to accept.[1]

The consolidation of the domestic airline industry has led to congressional concern that consumers will face higher airline fares and reduced service. Since 1987, domestic airline industry concentration has increased significantly as a result of mergers and bankruptcies. (See table 3.1.) At the end of 1987, there were 11 major and 7 national airlines with a significant market share—at least 0.5 percent—offering scheduled passenger service. By January 1992, two major airlines (Eastern and Pan American) and two

[1]There are three categories of airlines. A major airline is an airline with annual operating revenues of over $1 billion. A national airline has revenues between $100 million and $1 billion, and a regional airline has revenues of less than $100 million.

national airlines (Braniff and Midway) had ceased operations,[2] three more major airlines (Continental, America West, and Trans World) were being reorganized under bankruptcy court protection, and another six airlines had been merged into surviving major airlines. These changes leave only nine major airlines and one national airline with significant shares of the scheduled passenger market. Our 1991 analysis of airline fares showed that increased concentration correlates with higher fares, and the current round of industry consolidation may not have run its course.[3]

Table 3.1: U.S. Major and National Airlines That Have Ceased Operating or Declared Bankruptcy Since 1986

Airline	Carrier group	Current status
Air California	National	Merged with American
America West	Major	Operating in bankruptcy
Braniff	National	Ceased operations; bankrupt
Continental	Major	Operating in bankruptcy
Eastern	Major	Ceased operations; bankrupt
Jet America	National	Merged with Alaska Airlines
Midway	National	Ceased operations; bankrupt
Pacific Southwest	National	Merged with USAir
Pan American	Major	Ceased operations; bankrupt
Piedmont	Major	Merged with USAir
Muse (Transtar)	National	Merged with Southwest
Trans World	Major	Operating in bankruptcy
Western	Major	Merged with Delta

Source: Compiled by GAO.

Moreover, the largest airlines are increasing their share of the air travel market. In 1991, the three largest and financially strongest airlines carried 51 percent of the passenger traffic, compared with 41 percent in 1987. (See table 3.2.) The three weakest surviving major airlines saw their market shares fall more than one-third, from about 28 percent to about 18 percent. The ultimate fate of the three major airlines currently reorganizing under bankruptcy court protection is uncertain. Among the national airlines, Hawaiian Airlines has been struggling to survive and the Trump Shuttle has entered into an agreement with USAir transferring the shuttle to USAir for a period up to 10 years. Air Wisconsin has merged with United and has ceased to be an independent airline.

[2]"Braniff" refers here to the second of three airlines to use the Braniff name, all of which have gone bankrupt and ceased operations. The first airline to use the name Braniff ceased operations in 1982, the second in 1989, and the third in 1992.

[3]Airline Competition: Effects of Airline Market Concentration and Barriers to Entry on Airfares (GAO/RCED-91-101, Apr. 26, 1991).

Table 3.2: U.S. Major and National Airline Market Shares, 1987 and 1991

Airline[b]	Carrier group[c]	Market share[a] (percent) 1987	1991
United	Major	16.39	18.16
American	Major	14.03	18.02
Delta	Major	10.83	14.79
Northwest	Major	9.78	11.81
Continental	Major	9.80	9.20
USAir	Major	3.23	7.62
Trans World	Major	8.12	6.22
Pan American[d]	Major	6.45	4.71
America West	Major	1.43	2.86
Southwest	Major	1.67	2.48
Alaska	National	0.73	1.09
Midway[e]	National	0.63	0.85
Hawaiian	National	0.72	0.44
Eastern[f]	Major	8.93	0.38
Tower Air	National	0.20	0.32
Aloha	National	0.10	0.15
American Trans Air	National	0.04	0.13
Air Wisconsin	National	0.08	0.11
Total—all major airlines		**91.04**	**96.24**
Total—all national airlines		**8.02**	**3.54**
Total—others		**0.94**	**0.22**

[a]Market shares are based on scheduled revenue passenger miles for the total system (international and domestic) for the full year. A revenue passenger mile is the transportation of one paying passenger for one mile.

[b]Only airlines that were operating in both 1987 and 1991 are included in the individual airline section of this table. For example, the Trump Shuttle, which began operations in 1989, and Piedmont, which was acquired by USAir in 1987, are not included. Market share totals, however, include all scheduled airlines operating in 1987 and 1991, respectively.

[c]The carrier group column reflects each airline's classification by DOT for reporting purposes in 1991.

[d]Pan American ceased operations in December 1991.

[e]Midway ceased operations in November 1991.

[f]Eastern ceased operations in January 1991.

Source: Compiled by GAO.

Increased Foreign Investment Could Benefit U.S. Airlines

Profit margins in the U.S. airline industry have been about half those of the average U.S. company in other industries for more than a decade, according to the Air Transport Association (ATA).[4] U.S. airlines will need to improve their financial condition if they are to finance large capital investments for modifying or replacing aircraft and for adding aircraft to expand service. Airlines also face requirements to inspect and repair aging aircraft. ATA estimates that U.S. airlines will need to spend $130 billion over the next decade to replace aging aircraft and expand their fleets. Industry analysts believe that all but the strongest U.S. airlines will continue to have difficulty financing these requirements.

Whether U.S. airlines would benefit from changes in the restrictions on foreign investment and control (and which airlines would be most likely to benefit) depends on the nature of the changes. Normally, the more equity an investor provides, the more control that investor has in the form of voting rights, the ability to appoint company directors, and influence over hiring or retention of managers. At present, foreign investors are limited both in the amount of voting stock (25 percent) they are permitted to hold and in the amount of control they may exercise. If restrictions on investment are relaxed without changing the requirements for U.S. citizen control, well-run airlines that do not yet have substantial international operations could benefit. For airlines perceived as poorly managed, significant investment is not likely to occur as long as investors cannot exercise control commensurate with the amount of their investment.

Improving access to world capital markets for U.S. airlines by relaxing the current restrictions on foreign investment and control could help airlines fund the investments they need to remain viable competitors. While 5 out of the 11 major airlines had a cumulative net profit for 1987 through 1991, only 2 had net profits in 1991. (See table 3.3.) The major airlines as a whole lost $3.8 billion in 1990 and an additional $1.8 billion in 1991. Eastern and Pan Am, airlines that have ceased operations, recorded net losses every year between 1987 and 1991. Likewise, Continental had net losses in 4 of those 5 years. These three airlines had combined losses of more than $6.3 billion during that period. After absorbing such losses, airlines, especially those constrained by high debt and/or poor credit ratings, could find it difficult to raise the capital needed to meet new safety and noise regulations, much less the capital needed to finance service expansion. Officials of Pan Am, Continental, America West, and USAir all told us that the statutory 25-percent limit on foreign voting stock limited their ability

[4]The Air Transport Association is a trade association representing most of the major and national U.S. airlines.

to attract foreign investment in the amounts they need because the limit hinders a potential investor's ability to exercise the control that would normally accompany an investment.

Table 3.3: Yearly and Cumulative Net Income/Losses of Major U.S. Airlines, 1987-91

Dollars in millions

	Net Income					
Airline	**1987**	**1988**	**1989**	**1990**	**1991**	**1987-91 total[a]**
America West	$ (45.7)	$ 9.4	$ 20.0	$ (74.7)	$ (213.8)	$ (304.8)
American	207.6	449.5	423.1	(76.8)	(239.9)	763.4
Continental	(258.0)	(315.5)	3.1	(1,236.4)	(305.7)	(2,112.5)
Delta	217.5	344.5	473.2	(154.0)	(239.5)	641.7
Eastern	(181.7)	(335.4)	(852.3)	(1,115.9)	[b]	(2,485.3)
Northwest	140.7	162.8	355.2	(10.4)	(3.1)	645.2
Pan Am	(274.6)	(118.3)	(414.7)	(638.1)	(283.1)[c]	(1,728.8)
Southwest	3.8	57.4	71.4	47.1	26.9	206.6
Trans World	106.2	249.7	(298.5)	(237.6)	48.2[d]	(132.0)
United	33.3	589.2	358.1	95.8	(331.9)	744.5
USAir	238.6	217.2	2.1	(410.7)	(305.3)	(258.2)
Total[a]	**$187.9**	**$1,310.5**	**$ 140.6**	**$(3,811.8)**	**$(1,847.2)**	**$(4,020.0)**

Note: Losses are in parentheses.

[a]Totals may not add due to rounding.

[b]No data available. Eastern ceased operations in January 1991.

[c]Pan Am ceased operations in December 1991. Because full-year 1991 data are not available, 1991 data reflect January through September results.

[d]Trans World had an operating loss of $353.5 million during 1991. Its net profit, therefore, can be attributed to the sale of three of its transatlantic routes to American Airlines for $445 million.

Source: Compiled by GAO from data supplied by the Air Transport Association.

Most Major Airlines Are Building Global Route Networks

Officials at most of the major airlines believe that the competitive airlines of the future will be those that can offer the widest range of services.[5] These officials and other industry analysts told us that a traveler who wishes to go to London, Paris, and Seoul, for example, will prefer to fly on the airline that can offer service to all of those cities, rather than flying on

[5]Southwest, the only exception, provides frequent, low-cost service between domestic cities. It does not have any international routes or, according to Southwest officials, any plans to expand into international service at this time.

several airlines to make the trip. There are two ways to achieve this "global reach." One is for each airline to build its own global system; the other is for two or more airlines to create such a system through marketing and equity partnerships.[6] Thus, while financially strong airlines—such as American—may choose to build their own global networks, other airlines—such as Continental and Swissair—are seeking to build cooperative networks.

The stronger U.S. airlines are expanding their international route networks through purchases of routes from the weaker airlines, especially those selling assets during bankruptcy reorganization. The stronger U.S. airlines have little incentive to merge with the struggling U.S. airlines for two reasons. First, a merger would mean the assumption of the other airline's liabilities—underfunded pension plans, for example—as well as its assets. Second, the U.S. airlines that could finance such an acquisition are usually already the largest, so those mergers would be more likely to be challenged by Justice for antitrust reasons than would purchases of specific assets. For example, Justice challenged United's attempt to purchase Eastern's Washington National Airport facilities because United already held a large share of the facilities at nearby Dulles International Airport. However, Justice did not challenge Midway's purchase of Eastern's Philadelphia operations because Midway had only a small market share there.

Airlines that cannot afford to build independent route networks are, instead, building cooperative networks. Officials of several major U.S. airlines told us that marketing agreements are an important strategic tool for exploring new international routes and for serving international destinations that the airline could not otherwise serve because, for example, it does not have appropriate aircraft available. Thus, airline officials maintain that marketing agreements, such as code-sharing,[7] between U.S. and foreign airlines enhance international competition by allowing airlines that could not otherwise do so to enter the market in competition with the airlines already serving that market.

[6] Marketing partnerships between airlines can include almost any aspect of delivering service to passengers, such as ticketing, baggage handling, advertising, and promotion of special fares, as well as providing the flight itself.

[7] Code-sharing refers to the practice of one airline using another airline's two-letter code in flight listings in computerized reservation systems. This practice allows a flight jointly operated by two airlines to be displayed on the screen near flights offered by a single airline for the same pair of cities, making the jointly operated flight easier for travel agents to find.

While we found that code-sharing may reduce competition in the domestic market,[8] marketing agreements in international service are fundamentally different from the code-sharing agreements common in the domestic market. Code-sharing in international markets generally consists of two airlines coordinating marketing activities and ticketing on a particular route or group of routes. However, only one of the airlines actually operates an aircraft and provides baggage handling and airport facilities on each segment of the code-shared flight. Airlines will frequently have international code-sharing agreements with several foreign airlines, each pertaining to a different international market. Domestic code-sharing agreements, on the other hand, almost always commit a regional airline to an exclusive relationship with a single major airline.[9] The regional airline often depends on its code-sharing partner to provide airport facilities and operating rights and, consequently, may be forced to cease operations if its code-sharing partner ceases operations, as happened to regional airline partners of Pan Am and Eastern. Also, many regional airlines are now owned by their larger code-sharing partners. Because most current international code-sharing agreements are more limited in scope than domestic code-sharing agreements and do not entail the same degree of interdependence between the two airlines, they are less likely to be anticompetitive than domestic code-sharing agreements.[10]

Airline officials told us that marketing agreements cemented with equity investment signal to employees, travel agents, and customers that the airlines are committed to a long-term relationship. Therefore, equity investments between airlines can strengthen marketing alliances, making them a more reliable vehicle for building an extended route network. While most major U.S. airlines have marketing alliances with one or more foreign airlines, not all of these alliances involve equity investments between the marketing partners. The need to strengthen an alliance with equity investment varies, depending on how integral the alliance is to the airline's strategic plans. In addition, marketing agreements lasting more than 60 days between U.S. and foreign airlines generally must be approved by DOT, which requires that both airlines have the necessary authority to serve the route in question and that the agreement not harm competition.

[8]Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990), pp. 66-68.

[9]Of the top 40 U.S. regional airlines, accounting for more than 90 percent of regional airline passenger enplanements, 38 had code-sharing agreements and only 2 had code-sharing agreements with more than one major or national airline in 1990.

[10]We will examine code-sharing and other marketing agreements between U.S. and foreign airlines in more depth in forthcoming work in our series on international aviation issues.

Thus, effective regulation of international code-sharing by DOT could prevent airline combinations that substantially reduce competition in relevant markets. With proper regulation, international code-sharing may enhance competition by giving airlines that would not otherwise be able to do so the opportunity to serve an international destination and offer consumers greater choice.

Financial analysts and industry officials agree that investments in airlines historically do not earn as much as investments in other U.S. industries. Because of their low returns and the shortage of available investment funds in the United States, the weaker U.S. airlines are not likely to attract much additional equity investment from U.S. sources. According to airline officials and industry analysts, the most likely investors in U.S. airlines are foreign airlines, because another airline can capitalize on operating synergies between the two airlines (something nonairline investors could not do). Investing in a U.S. airline can give a foreign airline more secure access to U.S. passengers for their international routes than marketing alliances, such as code-sharing, alone. Investments by government-owned foreign airlines should not present any practical problems solely because of foreign government ownership, according to Justice officials, since the airlines' activities would be subject to all of the antitrust regulations that govern airlines operating in the United States. However, because some foreign airlines are still subsidized by their home governments, a foreign airline could potentially pass subsidies on to a U.S. airline partner. Since U.S. airlines are privately owned, if one competitor were able to use subsidies to price below cost, for example, competitors could sustain losses to meet that price, adversely affecting domestic competition in the long run. Airline passengers could benefit in the short run from subsidized fares, but in the longer term, subsidies run counter to the goal of deregulation: relying on market forces to determine airline fares and services.

Foreign Investments Represent Practical Alternative to Cabotage

Equity investments may be a more practical alternative for promoting and preserving competition than permitting cabotage,[11] which would allow foreign airlines to serve U.S. domestic markets. Cabotage has occasionally been proposed as a way of introducing new competitors into the domestic U.S. airline industry. However, cabotage presents several practical problems. First, prime domestic hub sites in the U.S. have already been

[11]Cabotage is the right to offer transportation between two points within a country. Therefore, cabotage would allow a foreign airline to offer domestic service between two points within the United States. For example, if cabotage were permitted, the Spanish airline Iberia would be able to operate between two U.S. cities, such as Houston and Pittsburgh, if it wished to do so.

developed by the major U.S. airlines, which have long-term leases on most of the facilities at those airports. Additional access to prime hub sites and to most of the nation's largest airports is limited. Second, the U.S. domestic market is the largest single aviation market in the world. Therefore, granting cabotage on a reciprocal basis with any other single country could raise questions of fairness, because no other trade bloc of similar size (such as the European Community) is yet ready to negotiate for access on a multilateral basis. Third, Europe and Japan already face severe problems with airport and air traffic control capacity, making them unlikely to be able to accommodate major service expansions by U.S. airlines. Finally, because each country regulates air transport safety for its own airlines, foreign airlines engaged in cabotage in the United States would not necessarily be subject to the same safety regulations that cover U.S. airlines. (See ch. 5 for a more detailed discussion of the related aviation safety issues.)

Investment Restrictions Potentially Affect U.S. Airlines' Financial Condition

Because restrictions on foreign investment and control limit U.S. airlines' ability to accept equity capital from foreign investors, airlines are encouraged to use forms of financing that are not similarly restricted, such as long-term aircraft leases and debt financing, to meet their capital needs. For example, many U.S. airlines finance acquisition of aircraft and engines through foreign sources, according to airline officials. The disadvantage of these types of financing is that they increase fixed charges for interest and lease payments. In a cyclical industry like the airline industry, revenues available to cover fixed charges may fluctuate widely, making it difficult to cover fixed charges during cyclical downturns. One indicator of a firm's ability to cover its interest expense is pretax interest coverage, which measures how many times the interest expense in one period could be paid from pretax income. Delta, one of the strongest U.S. airlines, had net gains in all but 2 years during the 1980s. However, Delta's pretax income failed to cover its interest expense in three of those years, even though it had one of the lowest debt burdens among major airlines.

During the past decade, debt levels have increased substantially for some airlines, either to finance expansion or as a result of leveraged buyouts. (See app. II for data on airline debt levels.) The airlines in financial trouble in 1990—America West, Continental, Eastern, Midway, Pan Am, and Trans World—all experienced substantial increases in their debt ratios (i.e., long-term debt as a percentage of total capitalization) during the 1980s. All of those airlines had average debt ratios over 80 percent, with the exception of Midway. In contrast, the stronger airlines in the

industry—American, Delta, Northwest, Southwest, United, and USAir—all held their debt ratios under 65 percent and most held their average debt ratios below 50 percent in 1985-89.

While the financially weakest U.S. airlines were experiencing substantial increases in their debt ratios, available U.S. capital was falling short of the country's capital investment needs. At the same time, the U.S. airline industry's low returns were making it difficult for airlines to attract equity investment. As noted previously, most of the U.S. economy met that shortfall through an influx of foreign investment. Whether any particular airline would have been able to attract foreign equity investment as an alternative to increasing its long-term debt during this period is not known, but the restrictions on foreign investment and foreign control limited the amount of foreign equity U.S. airlines could accept.

Conclusions

A financially strong, competitive airline industry is the surest way to protect consumers from excessively high fares and/or reduced service. When financially weak airlines are forced to decrease the size of their operations or sell international routes or other assets, they become less competitive or may cease operations altogether. Thus, improving access to world capital markets for U.S. airlines by relaxing the current restrictions on foreign investment and control could help preserve the consumer benefits of deregulation by allowing U.S. airlines to fund the capital investments and build the strong route networks needed if they are to remain viable competitors.

However, investments between U.S. and foreign airlines could have an adverse affect on competition if the dominant airlines in a market form such partnerships. In addition, if a government-subsidized foreign airline were allowed to invest in a U.S. airline, it could potentially pass subsidies through to its U.S. airline partner. Such subsidies could adversely affect domestic competition if other U.S. airlines were forced to sustain losses, not covered by government subsidy, that weakened their financial condition.

Effective review of airline investments is key to ensuring that partnerships between U.S. and foreign airlines do not impair domestic competition and, as discussed in the next chapter, that these partnerships do not diminish international competition. If the restrictions on foreign control and investment are modified, the reviews performed by DOT and Justice are likely to take on an even greater significance.

Impact on International Competition of Changing the Foreign Investment and Control Restrictions

The international aviation industry, like the domestic industry, has been changing in ways that raise concerns about the future competitive environment. Many industry officials and analysts believe that the current consolidation of the U.S. aviation industry is the precursor of a global trend, leading to the eventual domination of worldwide aviation by a handful of mega-carriers. U.S. and foreign airlines have been developing networks of equity and marketing alliances to improve access to each others' international and domestic markets and thereby improve their chances of surviving the expected restructuring.

Equity investments can strengthen marketing alliances, open new markets to U.S. airlines, and allow the smaller or weaker airlines to bond together into networks large enough to compete with emerging mega-carriers. On the other hand, equity investments between airlines could weaken competition if the dominant airlines serving an international market are permitted to form alliances. Some industry analysts believe that the system of bilateral air services agreements that currently restrains international aviation will be replaced by a more open, competition-oriented system. Investments between airlines of different countries, which complicate the operation of the bilateral system, may provide incentives for changing the bilateral system. However, the exact nature and timing of the changes to the bilateral system, if any, are yet to be determined.

Developments in International Aviation Raise Concerns About Competition

The competitive environment in international aviation has been changing over the last few years. As growth in the U.S. domestic market has slowed, U.S. airlines have begun to focus greater attention on expanding their international operations. United expanded its international route network through purchases of Pan Am's routes to the Pacific (1986), London Heathrow (1990), and Latin America (1992). American purchased Eastern's Latin American routes (1989) and three of Trans World's London Heathrow routes (1990). Delta purchased Pan Am's Frankfurt hub, European routes, and remaining worldwide route authority (1991). (See table 4.1.) In response to this international expansion by the strongest U.S. airlines, other major U.S. airlines have sought new or expanded alliances with foreign airlines as a means of building competing networks.

Table 4.1: Selected International Route Sales Between Major U.S. Airlines, 1986-92

Dollars in millions

Buyer	Seller	Route	Price[a]
American[b]	Eastern	Latin American system	$471
	Trans World	3 U.S.-London routes	445
Delta	Pan Am	European routes	526
	Pan Am	New York-Mexico City	25
Northwest[c]	America West	Honolulu-Nagoya, Japan	15
	Hawaiian	Pacific routes	9
USAir[b]	Trans World	2 U.S.-London routes	50
United[b]	Pan Am	Pacific routes	716
	Pan Am	U.S.-London	400
	Pan Am	Latin American system, Los Angeles-Mexico City	148

[a]Prices were verified with the airlines that bought the routes. In some cases, the prices include related facilities and assets as well as international route authority.

[b]Price given includes related facilities and assets.

[c]Price given does not include related facilities and assets.

Source: Compiled by GAO.

Many airline officials and industry analysts in the U.S. and Europe believe that the global industry will be dominated by a few extremely large and powerful airlines. Most industry analysts believe that each of the major aviation markets—Europe, the Pacific, and North America—will eventually be dominated by a few such giants. Thus, these analysts predict that the smaller and weaker airlines will have to either find distinctive market niches or form coordinated networks through mergers, investments, or marketing alliances in order to remain viable competitors. In the European Community (EC), airlines are forging mergers and alliances in preparation for the opening of their home markets to greater competition from other EC airlines beginning in 1993.[1] For example, Air France has purchased its two primary competitors in France, AirInter and UTA (Union de Transports Aériens), and has agreed to invest in the Belgian airline Sabena. SAS, Swissair, and Austrian Airlines have formed the European Quality Alliance. Finally, British Airways had made overtures to both Sabena and KLM to form alliances that would have given it access to a continental airport to set up a hub operation.

[1]We are currently preparing a report on EC integration. That report will discuss in depth the potential impact of EC integration and intra-EC cabotage on U.S. airlines.

Another trend in international aviation is away from government ownership and toward more private ownership, as is the case in the United States. Traditionally, airlines outside the United States have been government-owned. Among the 16 leading European airlines, 4 are wholly owned by their governments, 11 are partially government-owned, and only 1 is privately owned. (Table 4.2 provides information on government ownership of selected foreign airlines.) However, airlines require large amounts of capital, requirements that have become increasingly difficult for governments to finance in the face of many airlines' poor financial performance and the competing demands of their citizens for government services. Therefore, many governments throughout the world have begun to privatize their flag airlines or, at least, to explore that option.[2] According to DOT, as of January 1992, privatization of 26 government-owned airlines were completed or in progress—including AeroMexico, British Airways, Japan Airlines, and Lufthansa. In addition, foreign governments had proposed privatizing another 20 airlines, including Australia's Qantas and Israel's El Al. Privatization moves an airline from the direct ownership and control of a foreign government to ownership by private interests, and can open the door to foreign investment.

[2]Other reasons for privatizing government-owned airlines include improving productivity and giving an airline's employees a financial stake in the airline's performance.

Table 4.2: Government Ownership of Selected Foreign Airline Corporations

Airline corporations	Home country	Percentage of government ownership
Iberia	Spain	100
Aer Lingus	Ireland	100
Saudia	Saudi Arabia	100
TAP Air Portugal	Portugal	100
Qantas	Australia	100
Olympic	Greece	100
Thai Airways, Inc.	Thailand	100
Air France Group	France	99
Sabena	Belgium	88
Alitalia	Italy	85
Finnair	Finland	70
Luxair	Luxembourg	69
Lufthansa	Germany	59
Singapore Airlines	Singapore	54
Austrian Airlines	Austria	52
SAS Group	Sweden, Norway, and Denmark	50
KLM Royal Dutch Airlines	Netherlands	38
Swissair	Switzerland	20
Cathay Pacific	Hong Kong	13
Air Canada	Canada	0
All Nippon Airways	Japan	0
British Airways	United Kingdom	0
Icelandair	Iceland	0
Japan Airlines	Japan	0
Korean Air	South Korea	0

Source: Airline Business, Feb. 1992, pp. 40-45.

International Aviation Is Regulated by Bilateral Agreements

Opportunities for the world's airlines to engage in open competition are currently limited by a network of bilateral air services agreements negotiated between governments. Negotiations are held whenever one country requests new aviation rights, such as new routes, or to resolve disputes arising under a bilateral agreement. The United States has 72 bilateral agreements covering air services with 95 countries around the

world.[3] While U.S. policy is to pursue agreements that allow free competition, many of the current agreements continue to limit the amount and type of competition permitted on routes between the two countries involved. For example, the U.S. agreement with France allows for a temporary capacity limit (i.e., a restriction on the number of seats U.S. airlines can offer passengers),[4] while the agreement with the United Kingdom strictly limits access to congested London Heathrow airport. Agreements can also restrict the number of airlines allowed to offer service on a given route and the airlines' freedom to change fares or offer discount fares.

In addition, all of the bilateral agreements between the United States and other countries contain provisions requiring that the airlines designated by each country to exercise the rights awarded under an agreement must be substantially owned or controlled by citizens of the designating country. Officials of KLM told us that this requirement is the main reason the Dutch government retains a stake in the airline. DOT and State Department officials acknowledged that if U.S. law were changed to allow greater foreign investment in or foreign control of U.S. airlines, other countries could potentially deny access to U.S.-designated airlines that were not "substantially owned and controlled" by U.S. citizens. However, DOT and State Department officials believe that the value of access to the U.S. market—the largest single market in the world—would probably prevent such a denial on the part of the United States' major trading partners.

Changes in ownership provisions in existing bilateral agreements can be a negotiating tool to gain new benefits for U.S. air travellers, airlines, and investors. For example, the United Kingdom used the substitution of American and United for Trans World and Pan Am, respectively, at London's Heathrow airport as an opportunity to gain additional benefits for its airlines. Similarly, the United States could agree to the EC's changes in ownership rules in exchange for the EC's recognizing changes to the U.S. ownership rules.[5] Occasions when changes are being made can also be used to increase opportunities for U.S. investors to invest in foreign airlines, according to State Department officials. However, at present, the

[3]Some countries are covered by the bilateral agreement between the U.S. and their former colonial rulers.

[4]France renounced its bilateral agreement with the United States on May 4, 1992, after negotiations between the two countries failed to resolve their disagreement over capacity limits. The agreement will continue in force for one year after the renunciation while negotiations on a new agreement continue.

[5]The EC proposes to allow the airlines of member states to be owned by citizens of any member of the Community. Therefore, the airlines of the EC member states might not be controlled by citizens of those states as specified in their bilateral agreements with the United States.

EC lacks authority to negotiate external aviation matters on behalf of member states. At the same time, when foreign negotiators raise the issue of increasing opportunities to invest in U.S. airlines during bilateral negotiations, State Department officials are faced with the fact that the limits on foreign investment in U.S. airlines are set by statute, and these officials cannot guarantee that a proposal to change those limits will be made or, if made, will be adopted.[6]

Changes in International Aviation May Weaken Airlines' Support of the Bilateral System

Changes in international aviation regulations that allow airlines to behave more like other businesses may weaken airlines' incentives to support the bilateral system. Many U.S. airline officials we spoke with believe that cross-border investments provide another incentive for foreign airlines to press for changes to the bilateral system when it limits their ability to respond to market forces. An equity investment allows the investor airline to participate in the target airline's profits or losses. In conjunction with a marketing agreement, such an investment can give the investor airline access to additional passenger traffic for international routes that both airlines are authorized to serve. If U.S. and foreign airlines in equity partnerships are to reap the full benefits of those relationships, they need to identify the synergies between the airlines and have the flexibility to pursue them, as U.S. airlines already do in the domestic market.

Because foreign airlines have traditionally been owned by their governments, some airline officials say that many foreign airline managers have had little experience operating in a competitive environment. These officials think that cross-border investments and marketing agreements may help make foreign airline managers familiar with the advantages of operating in a less-restricted environment. For example, if domestic traffic between Pittsburgh and Oklahoma City increases, U.S. airlines can increase service or initiate new service on that route without the need for cumbersome regulatory approval of the changes. In contrast, if a bilateral agreement allows only daily service between Paris and Boston, for instance, an airline serving that route would not be able to add additional flights and additional airlines would not be able to begin service without a change in the agreement, regardless of how much demand for service on that route has grown.[7] Thus, to the extent that countries have only one

[6]As noted earlier, the Secretary of Transportation has proposed increasing the limit on foreign investment from 25 percent of a U.S. airline's voting stock to 49 percent.

[7]A change in a bilateral agreement must be negotiated between the two signatory countries in the same way that a new agreement is negotiated. The complexity of the issues to be resolved and the degree of compatibility between the two countries' positions determine how long it takes to reach accord on a new or changed bilateral agreement.

airline, governments may favor the interests of that airline, even if it is privately owned. However, foreign airlines will only be able to fully use the synergies of cooperative marketing agreements if restrictions governing competition in international markets are made more liberal.

Cross-Border Investment May Provide Incentives to Change Bilateral System

Cross-border investments may provide additional incentives for governments to change the bilateral system, but they may also complicate administration of that system in the interim. First, as cross-border investments become more common, it will become more difficult for governments to analyze the distribution of benefits accruing to their own country from bilateral agreements. Second, cross-border investments can complicate the development of a nation's negotiating strategy, if negotiations involve the home countries of airlines linked by cross-border investments. Finally, cross-border investment can complicate the assessment of the competitive aspects of awarding scarce international routes among competing airlines.

Cross-border investments make it harder for governments to analyze the benefits of bilateral agreements and may eventually reduce the governments' incentive to preserve restrictions on international markets. Because international competition is constrained by bilateral agreements, an underlying premise of U.S. aviation policy is that the United States receive a "balance of benefits" in any air services agreement it signs. The law requires that U.S. negotiators seek to gain as much for the United States (i.e., its airlines and citizens) as they grant to the airlines and citizens of the other country in bilateral negotiations.[8] Because the U.S. aviation market is much larger than most other countries' internal markets, part of this balance is often made up of "soft" rights (such as an agreement to allow more flexibility in selling and marketing airline service), rather than consisting exclusively of "hard" rights (such as the right to fly between two specific cities). Thus, if the U.S. airline asking for additional rights under a bilateral agreement were partially owned or controlled by the flag airline of another country, analysis of the comparative gains from a new bilateral agreement becomes more difficult for both the United States and the other country. As more foreign airlines become privately owned and as cross-border investments between airlines increase, governments may begin to focus their analysis of the balance of benefits in bilateral agreements more on the benefits that flow to their countries' economies and consumers than on the benefits for a specific

[8] 49 U.S.C. app. sec. 1302(a)(12) and sec. 1502(b).

airline. Therefore, governments may become more willing to grant greater access to their aviation markets.

Cross-Border Investments Can Complicate Bilateral Negotiating Strategy

U.S. bilateral negotiating strategy is developed by DOT and State Department officials in consultation with interested U.S. airlines, airports, labor representatives, and industry groups. The U.S. negotiating teams gather information about such things as interest in new or expanded operating rights, problems in implementing the current bilateral agreement, and reactions to issues expected to be raised by the other country's representatives. DOT and State Department officials prepare strategies for the bilateral negotiations and provide instructions to the U.S. negotiating teams. The delegations are led by State Department officials and include representatives from both DOT and various airline, labor, and airport organizations,[9] who keep their constituents informed on the progress of the negotiations.

Because U.S. airlines actively participate in formulating U.S. negotiating strategy and receive information about planned and ongoing negotiating sessions, foreign investment that resulted in the majority ownership or control of a U.S. airline by a foreign airline could complicate negotiations. In a hypothetical case, if a French airline were to own or control a U.S. airline, the U.S. airline could potentially reveal U.S. strategy to the French airline, which could pass it on to the French negotiating team. However, DOT's Assistant General Counsel for International Law told us there are several methods that could be used to restrict the flow of strategic information in such a situation. These methods range from prohibiting the U.S. airline from participating in the relevant industry meetings and receiving strategic information to allowing the airline to contribute to the strategy without receiving information on the strategy adopted for the negotiations. A State Department official told us that the methods outlined by DOT would be workable but said airlines are not given sensitive strategic information in any case. Thus, there is usually little need to protect the information that is made available to U.S. airlines.

Foreign Investment Also Complicates Awarding of International Routes

Foreign investment could complicate the awarding of routes if a U.S. airline applying for a specific route has received an investment from a foreign airline designated by its own government to operate in the same market. The primary concern would be the impact of the investment on

[9]These organizations include the Air Transport Association and the National Air Carrier Association, trade associations representing most of the major and national U.S. airlines; the Airports Association Council International; and the AFL-CIO.

competition on that particular route. However, because not all investment from that foreign country would raise the same competitive questions, investments in U.S. airlines would need to be carefully analyzed so that investments that would enhance competition are allowed while those that would reduce competition are prevented. Investment by a foreign airline from a country that does not compete in the market would have little anticompetitive impact, while investment by an airline that already offers service in the market would have greater potential for limiting competition on a route.

The potential for foreign investment to diminish competition on particular routes also depends on the timing of the investment. If the investment is made before the route is awarded to a U.S. airline, the likely impact of the investment on competition on the route and in the relevant market will be considered during the selection decision. If the investment occurs after the U.S. airline has been awarded a route, Justice—not DOT—would examine the competitive aspects of the transaction. Under its fitness review authority, DOT reviews investments only to ensure that an airline continues to meet the requirements for authorization. The review does not encompass the investment's potential effect on competition.

According to DOT officials, because the current fitness review does not address competition issues, DOT cannot order the airline to divest itself of an international route as a condition for its approval of financing and management changes. However, DOT officials said the Department could adopt new policies to respond to the competitive implications of foreign investment, such as withdrawing the route at the end of the 5-year authorization period or instituting a formal revocation proceeding, if such policies were needed in the future. Finally, if the U.S. airline should suspend service on the route, DOT would be able to reallocate that route to another U.S. airline.

Relaxing Restrictions May Affect International Competition

Equity investment could strengthen marketing alliances, open new markets to U.S. airlines, and allow the smaller or weaker airlines to bond together into networks large enough to compete with emerging mega-carriers. On the other hand, equity investments between airlines could weaken competition if the dominant airlines serving an international market are permitted to form alliances. Although allied U.S. and foreign airlines would have little incentive to compete with each other on routes that both airlines have authority to serve, neither airline should have an incentive to try to restrict its partner from serving international

destinations it does not have authority to serve, because the objective of the alliance is to enhance the airlines' combined route network. Thus, whether such investments help competition will depend on effective review of the proposed investments' potential impact on competition so that investments that would reduce competition can be prevented. From 1979 until the end of 1988, airline mergers were reviewed by DOT or its predecessor, the Civil Aeronautics Board (CAB). In a June 1989 report, we criticized DOT's implementation of its merger authority, finding that the Department had not revised the assumptions underlying its merger analysis to take into account fundamental changes in the airline industry.[10] Justice, the agency that now reviews airline mergers, applies assumptions to airline mergers that take those industry developments into account.

Investment in a U.S. airline by a foreign airline could promote competition on international routes in two ways. First, as discussed in chapter 3, the additional equity investment may allow a U.S. airline to invest in the equipment, facilities, and marketing strategies necessary to successfully compete in the U.S. domestic market. That U.S. airline may then be able to compete internationally either by continuing, starting, or expanding its own international service or by cooperating with its foreign airline partner to offer international service. Second, a foreign airline partner can offer support beyond its financial contribution. An official from Delta told us that one reason Delta entered into its stock-swaps with Swissair and Singapore Airlines was to gain insight into operating in those airlines' home markets. An official at Continental told us that one advantage of its investment from SAS is the opportunity to improve its customer service by sending its employees to a training facility jointly run with SAS, a European airline with a reputation for high-quality service.[11]

Certain equity investments are subject to antitrust scrutiny by the Department of Justice. If alliances between airlines that dominate markets are allowed, such combinations could undermine competition. For example, the KLM investment in Northwest was not challenged, according to Justice officials, because neither airline had a dominant position in the relevant North Atlantic markets. On the other hand, if the proposed 1989 British Airways investment in United had gone forward, that transaction would more likely have been challenged because the combined shares of those two airlines would have been quite large. Justice officials also told

[10] Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, June 28, 1989).

[11] Continental has improved its performance from 3.29 complaints per 100,000 passengers in 1989 (the year SAS initially invested in Continental) to only 1.21 complaints per 100,000 passengers in 1991, according to DOT consumer complaint statistics.

us that investments by and activities of foreign airlines in the U.S. market would be subject to the same antitrust review and enforcement as those of U.S. airlines. The fact that some foreign airlines are owned or controlled by a foreign government would not exempt them from compliance with U.S. antitrust regulations for any operations conducted in the United States or between the United States and foreign countries.

If restrictions on foreign investments in U.S. airlines were relaxed, controlling the effect on competition of investments by foreign airlines ultimately would depend on careful review by the federal government.

Conclusions

International air service is regulated by bilateral agreements that allow varying levels of competition. Equity investments between airlines complicate the bilateral system and may, eventually, provide incentives to change or replace it. Foreign airlines that invest in U.S. airlines will only be able to fully use the synergies of cooperative marketing agreements if restrictions governing competition in international markets are made more liberal. Thus, investments between U.S. and foreign airlines could help build pressure for changes to the bilateral system. While the bilateral system may be changed to accommodate more competition or be replaced with a market-oriented system, for the present, the system constrains international competition.

If the United States allows increased foreign investment or control, it may wish to do so only in the context of a bilateral agreement under which another country could be offered enhanced investment opportunities only if, in exchange, it grants more open access to its markets. However, because not all foreign investments would have the same impact, controlling the effect on competition of foreign airline investments ultimately depends on a careful case-by-case review by Justice and DOT. If DOT's fitness review authority were broadened, the review could consider the specific terms of the relevant bilateral agreements and determine whether the investment would help promote international competition.

Impact on National Security, Airline Labor, and Airline Safety of Changing the Foreign Investment and Control Restrictions

Relaxing restrictions on foreign investment has potential implications for national security, airline employment, and airline safety. DOD is concerned about maintaining access to civilian aircraft in national emergencies. At the same time, further consolidation of the industry could reduce the number of experienced crews and overall capacity. Airline labor unions have expressed concern about future pay and employment prospects for their members. If increased foreign investment in U.S. airlines increased the shifting of aircraft between U.S. and foreign registry, the already heavy work load of FAA's safety engineers and inspectors could increase.

DOD Is Concerned About Continued Participation in CRAF by U.S. Airlines

DOD officials are concerned about the effect of increasing foreign investment on the willingness of U.S. airlines to continue participating in the CRAF program, especially if foreign control were to be allowed. These concerns center on the financial and political relationships between foreign airlines and their home governments and the motivations behind the airlines' participation in CRAF.

Close Links Between Foreign Governments and Their Airlines Raise Potential Problems

The relationships between foreign airlines and their home governments are often fundamentally different from the relationship between U.S. airlines and the U.S. government. Unlike the United States, most countries have very few airlines, and most have only one international airline. In contrast, all but one of the nine major U.S. airlines offer international service, as do several of the smaller airlines.[1] In addition, while there is a trend toward privatizing foreign airlines, many still have at least some direct government participation, if only to ensure compliance with the terms of bilateral agreements. Thus, the close links between foreign airlines and their governments raise the possibility that some international airlines may act, at times, as instruments for their governments' policies. To the extent that other governments have interests that do not coincide with U.S. interests and those political interests influence the behavior of foreign investors, U.S. airlines with substantial foreign investments could feel constrained to limit their involvement in the CRAF program.

DOD can solicit additional airlift from allied foreign governments and, in fact, did so during the 1990-91 Desert Shield/Storm operations. While this method was used successfully during the Middle East operations, foreign airlines only flew about 2 percent of CRAF missions. DOD was not able to

[1]Among major U.S. airlines, only Southwest has no international service. In addition, smaller airlines such as Alaska and Tower also offer international service.

contract for any additional airlift with foreign airlines.[2] While DOD also made use of supplemental foreign sealift, some foreign ships refused to make deliveries to some ports or to carry certain types of cargo, limiting their usefulness. DOD officials are concerned that the factors that limited the usefulness of foreign ships for supplemental sealift could be indicative of the kinds of problems DOD would face if it had to rely on foreign aircraft for airlift.

Potential Impact of Increased Foreign Investment on CRAF Depends on Reasons U.S. Airlines Participate

Airline and DOD officials generally agreed on the reasons U.S. airlines participate in CRAF, but ranked the importance of those reasons differently. Although one airline's representative stated that his airline was proud of its role in Desert Shield/Storm, airline officials consistently characterized the decision to participate in CRAF as primarily economic, based on an assessment of potential benefits (peacetime business awarded on the basis of CRAF participation) versus potential risks (activation). DOD officials emphasized patriotism as a motivating factor more than the airlines did. DOD and DOT officials also stressed that the laws allowing seizure of aircraft under certain conditions motivate airlines to voluntarily sign and deliver on CRAF contracts. Airline representatives, on the other hand, appear to view those powers as methods of enforcing the CRAF contracts should an airline ever default on its commitment rather than as reasons for participating in the program.

Airline executives also told us that the economic incentives to participate are not limited to peacetime charter business. They believe that any emergency severe enough to require activation of CRAF aircraft would be accompanied by a significant drop in commercial traffic, especially passenger traffic. During the Persian Gulf crisis, passenger traffic on some North Atlantic routes dropped well below normal levels, and insurance coverage in some Middle East markets was either unavailable or so expensive that flights became uneconomical. Thus, according to airline officials, CRAF missions were also an economic incentive because they allowed airlines whose aircraft were underutilized to earn revenues. For example, in February 1991 when the Chairman of Hawaiian Air Lines testified before the Senate, he said "Hawaiian is scrambling to survive .... We are very grateful for the military charter work to the Gulf. ... Without it, Hawaiian would have no hope."[3] Before CRAF was activated in support of

[2]The reasons for DOD's inability to contract directly with foreign airlines during the Persian Gulf crisis are outside the scope of this review.

[3]Statement of J. Thomas Talbot, Chairman and Chief Executive Officer, Hawaiian Air Lines, Inc., before the Senate Committee on Commerce, Science, and Transportation, Subcommittee on Aviation, Feb. 19, 1991.

Desert Shield/Storm operations, U.S. airlines had already volunteered more than 30 aircraft and flown more than 100 passenger and cargo missions.[4]

The different emphasis DOD and the airlines place on the reasons U.S. airlines now participate in CRAF is reflected in their views on whether increased foreign investment or foreign control of U.S. airlines would affect their willingness to participate in CRAF. In general, since U.S. airline officials characterize CRAF participation as an economic decision, they believe that foreign investors would not attempt to preclude U.S. airline participation in CRAF as long as the economic benefits of participation outweigh the economic risks. Conversely, DOD believes that foreign investors might discourage or prohibit a foreign-owned U.S. airline from participating in CRAF because of the close links between foreign airlines and their governments.

In addition, DOD officials are concerned that a foreign-controlled U.S. airline might withhold aircraft enrolled in CRAF during a crisis because of fear of terrorist reprisals against the foreign airline if its U.S. partner supplied DOD with aircraft for airlift during military operations. A representative of a foreign airline with an investment in a U.S. airline, however, told us he believes that foreign investment would not affect U.S. airlines' CRAF participation for two reasons. First, any increased risk of terrorist activity against the foreign airline would result from the alliance with the U.S. airline, regardless of whether the U.S. airline participates in CRAF. Second, a U.S. airline, even one with substantial foreign equity investment, has direct access to the U.S. domestic market. If approval of the foreign investment were conditioned on the airline's continued participation in CRAF, a failure to meet contractual obligations could result in the airline's loss of its U.S. authorization and its right to operate in the domestic market. Because the incentive for investing in a U.S. airline is to gain direct access to the U.S. domestic market, the foreign airline would not want to risk losing that access by failing to meet a CRAF commitment. State Department officials agree with the foreign airline representative's view that the need to maintain a U.S. airline partner's authority to operate in the U.S. domestic market would lessen the potential for a foreign investor to oppose CRAF participation.

[4]Review of Strategic Mobility Programs, Volume 2: Civil Reserve Air Fleet, Report PL023R2, Logistics Management Institute (Bethesda, Maryland: May 1991). This report was prepared under contract with DOD. Volume 2 focuses on the experience of DOD and the commercial airlines in satisfying the strategic airlift requirements of the Persian Gulf crisis.

Domestic Industry Consolidation May Affect Participation in CRAF

Continued consolidation of the industry already constitutes a long-term threat to DOD's ability to attract voluntary participation in CRAF, especially from scheduled airlines. Consolidation resulting from mergers and bankruptcies reduces the number of airlines, aircraft, and licensed crew members available to participate in CRAF.[5] These changes have occurred in the absence of any changes to the limits on foreign investment and control and could eventually lead to diminished willingness or ability of U.S. airlines to fulfill the role currently assigned to them. The three airlines that have ceased operations since January 1991—Eastern, Midway, and Pan Am—operated a total of 400 aircraft at the end of 1990. According to a Salomon Brothers report, only about 26 percent of these aircraft have been returned to service with other U.S. airlines.[6] In addition, the 13 largest U.S. airlines' fleet fell by 230 aircraft between year-end 1990 and 1991. The report concludes that because of age, corrosion, or economics, the majority of these grounded aircraft are unlikely to fly again. The three defunct airlines also had over 44,000 employees in 1991. While some of those employees have been hired by other U.S. airlines, many others have not.

Thus, if relaxing foreign investment restrictions helps slow or prevent further consolidation by improving some airlines' financial condition, it may also help DOD maintain access to U.S.-operated aircraft and experienced crews. However, DOD officials continue to be concerned that U.S. airlines could face pressure from foreign investors or owners that would limit their willingness to participate in the CRAF program, especially if a particular U.S. military action were not supported by the foreign investors' home government. DOD officials told us that, although the President can seize aircraft in wartime, preserving the CRAF program is the most efficient means of ensuring that the military has access to civilian aircraft when they are needed.

In addition, the airlines enrolled in CRAF can potentially suffer competitive setbacks during an activation. Some scheduled-service airline officials have expressed concern that they will have a difficult time rebuilding market share on routes on which they had to reduce service during the CRAF activation. Recovery could be especially difficult in international and domestic markets in which the airlines' competitors did not have to reduce service. DOT analyzed the potential impact of CRAF activation on the total

[5] Airline industry consolidation is not only due to problems in the competitive environment but may also reflect overcapacity or poor management.

[6] Julius Maldutis, The U.S. Airline Industry, 1991-98, Aircraft Fleet Analysis, Salomon Brothers (New York: Mar. 1992).

long-range cargo fleet of U.S. airlines. If CRAF activation had moved fully into a second stage during the Persian Gulf crisis, DOT estimated that 15 percent of the total U.S. long-range cargo fleet would have been delivered to DOD. The DOT study showed that the impact on individual participating airlines would have ranged from 7 percent (4 of 56 aircraft) at United Parcel Service (UPS) to 40 percent (2 of 5 aircraft) at Air Transport International. Even when the effect on two CRAF participants with similar size cargo fleets are compared—UPS with 56 aircraft and Federal Express with 51 aircraft—a full stage-two activation would have had very different results. UPS would have lost the use of 7 percent of its fleet, while Federal Express would have lost the use of 27 percent.

Thus, the competitive consequences of disrupting service may be high enough to discourage some airlines from participating in CRAF if their major competitors do not. Airline officials almost unanimously attributed their decision to participate in CRAF to a comparison of the expected costs and benefits of participation. Among the costs to be considered, they listed the opportunity costs associated with removing aircraft from scheduled service while competitors sustain service, the costs of rebuilding market share in markets in which service has been interrupted, and the probability of CRAF activation. The benefits they cited include revenues from peacetime charter operations, reimbursement for CRAF missions, and pride in being good citizens. The components of this cost-benefit equation will, of course, be modified to reflect each airline's experience during the recent CRAF activation.

New foreign investment in financially stressed U.S. airlines could provide funds for the replacement or renovation of their fleets. In December 1990, over 30 percent of the total U.S. fleet was being operated by the six major airlines that were in the greatest financial distress. Three of these airlines, accounting for about 11 percent of the fleet, have already ceased operations. The other three, still reorganizing under bankruptcy court protection, were operating a total of 606 aircraft at the end of 1991, 41 fewer aircraft than they operated in 1990. In a May 1991 report,[7] we found a strong relationship between the airlines' financial health and the extent of their progress toward compliance with regulations requiring inspection and repair of aging aircraft. The financially weaker airlines tend to have older fleets, on average, than the financially stronger airlines and have made less progress toward compliance. (See table 5.1.) Additional foreign

[7]Aircraft Maintenance: Additional FAA Oversight Needed of Aging Aircraft Repairs (Vol. I), (GAO/RCED-91-91A, May 24, 1991).

equity investments could help some airlines upgrade their fleets, giving the CRAF program access to newer, more efficient aircraft.

Table 5.1: Average Age of Aircraft for Selected U.S. Airlines as of February 1992 (except as noted)

	Aircraft in CRAF[a]		
Airlines by type of service	Number of aircraft	Percentage of all CRAF aircraft[b]	Average age (in years)[c]
All cargo airlines			
Evergreen[d]	31	6.0	22.9
United Parcel Service[d]	19	3.7	19.6
Federal Express[d]	32	6.2	19.0
Scheduled passenger airlines			
Ceased operations in 1991			
Pan American[d]	50	9.7	16.4
Midway[d]	[e]	[e]	15.7
Eastern[f]	7	[e]	14.2
Operating in bankruptcy			
Trans World[g]	38	7.4	17.5
Continental[g]	26	5.0	13.5
America West[g]	3	0.6	6.0
Others			
Northwest[g]	60	11.7	15.5
United[g]	59	11.5	11.2
USAir[g]	4	0.8	9.0
American[g]	42	8.2	8.9
Delta[g]	4	0.8	9.2
Southwest[g]	[e]	[e]	6.6

[a]The number and percentage of aircraft in CRAF are calculated on the basis of October 1, 1991, data obtained from DOD. The October listing does not include the seven aircraft Eastern had committed to the program at the time it ceased operations in January 1991.

[b]The percentage column does not add to 100 percent because not all CRAF participants are included.

[c]This column shows the average age of all aircraft operated by each airline, not only the aircraft committed to the CRAF program.

[d]Data on the average age of aircraft are for the third quarter of 1991 and were compiled by AVITAS and published in the Feb. 26, 1992, issue of Aviation Daily.

[e]Not applicable.

[f]Based on full-year 1990 data.

[g]The average ages of aircraft are based on full-year 1991 data and were taken from Julius Maldutis, The U.S. Airline Industry, 1991-98, Aircraft Fleet Analysis, Salomon Brothers (New York: Mar. 1992).

Source: GAO analysis of data from DOD, AVITAS Aviation, and Salomon Brothers.

In January 1991, the six most financially troubled airlines had 132 aircraft committed to the CRAF program, representing 25 percent of the CRAF fleet. Two of the three airlines that have ceased operations, Eastern and Pan Am, had 7 and 55 aircraft, respectively, committed to CRAF at the time they ceased operations. When an airline ceases operations, its aircraft are lost to CRAF, because the contract between the airline and DOD is for the provision of a service—air transportation—that the airline can no longer supply. According to DOD, subsequent purchasers or lessors of the aircraft are under no obligation to keep the aircraft enrolled in CRAF. Evergreen and Delta, the current owners of some of the aircraft formerly leased to Pan Am and committed to CRAF by that airline, have agreed to keep some of the aircraft in CRAF, although they are not legally required to do so.

Several Strategies Could Protect Military Access to Civilian Aircraft

If the Congress decides to permit greater foreign investment and/or foreign control of U.S. airlines and DOD determines that voluntary participation in the CRAF program falls short of projected military needs, the way airlines currently interact with DOD could be modified. While the strategies discussed in this section are not meant to be exhaustive, they indicate possible ways of providing military access to emergency civilian airlift capacity.[8] Each strategy has advantages and disadvantages. Alternatives include making the CRAF program mandatory for all airlines, making continued participation a condition for approval of foreign investments, and changing or increasing the incentives for participation.

Making Participation Mandatory

Making CRAF participation mandatory for all airlines holding U.S. authorization would achieve several goals. Since all U.S. airlines would be participating, a mandatory program would affect all of the airlines equally and would ensure DOD's access to a portion of the aircraft and crews operated by each airline. As previously noted, under the current voluntary program, airlines participating in CRAF could suffer adverse effects on competition during a CRAF activation. Thus, an airline might deem CRAF participation too risky, particularly if its primary domestic competitor has declined to join the CRAF program. However, a mandatory CRAF program would require careful analysis. In a national emergency, not only the projected needs of DOD but also the needs of other essential federal government functions and the private sector must be met. On the other hand, according to State Department officials, the President's ability to

[8]We did not attempt to assess whether the CRAF program should be modified in the absence of changes to the foreign investment and control limits.

invoke emergency powers limits the need for converting CRAF to a mandatory program.[9]

Making Approval of Foreign Investments Conditional on Participation

Requiring continued CRAF participation as a condition of approval for foreign investment would be less intrusive than conversion to a mandatory CRAF program. Participation in CRAF would be mandatory only for U.S. airlines accepting additional foreign investment. However, while this alternative would ensure DOD's access to aircraft enrolled in CRAF at the time approval is sought for new foreign investment, it might not ensure DOD's future access. Airlines subject to this condition might not have to enroll new aircraft in CRAF or continue their commitment beyond the current contract. In addition, new airlines and airlines not seeking approval of a new foreign investment would be exempt. Thus, this strategy might have the unintended effect of causing airlines interested in securing future foreign investment but currently enrolled in CRAF to decide not to renew CRAF contracts in order to avoid a mandatory commitment that their competitors do not share.

Increasing or Changing Incentives

No change to the current CRAF program is required unless voluntary participation falls below DOD's projected needs. If actual participation in the CRAF program fell, DOD could increase or change the incentives it offers to make participation more economically attractive. This alternative would resolve the problem of DOD's access to aircraft, if participation is purely an economic decision for the airlines, regardless of the level of foreign investment. However, if foreign investors were reluctant to participate because of perceived political pressure in their home countries or fear of terrorism, DOD's concern that it would not have access to sufficient capacity could be realized. In addition, changes to the amount or distribution of incentives designed to make the program more attractive to airlines would probably raise the cost of the CRAF program for DOD.

DOD Could Provide Insights on Whether Proposed Investments Would Affect National Security

DOD has begun to seek a stronger voice in formulating U.S. policy on foreign investment in U.S. airlines. According to DOD officials, DOT's reinterpretation of its foreign investment and control policy in 1991 and the Secretary of Transportation's subsequent proposal to increase the limit on foreign ownership of voting stock to 49 percent have prompted DOD to request a revision of the memorandum of understanding that underlies coordination between DOD and DOT on the CRAF program. Ideally, DOD

[9]For example, 50 U.S.C. sec. 9742 gives the President authority to take control of "all or part of any system of transportation" in time of war for the transportation of troops, war material, equipment, or other purposes related to the emergency.

would like to be notified whenever DOT reviews foreign investment and control questions concerning U.S. airlines that operate the long-range aircraft that are critical to the CRAF mission.

According to DOT officials, they currently do not request DOD's views on foreign investment cases because they do not believe that any of the transactions they have reviewed thus far have been a cause for concern, and because they are not required to assess the national security implications of the transactions. DOT officials said that DOD was given the opportunity to comment on these issues in meetings of a working group of DOT's Transportation Policy Advisory Council that has been examining the issues involved in foreign investment in U.S. airlines. Although DOT can not deny or revoke an airline's authorization on national security grounds, DOT officials told us the Department would probably be able to make an adverse finding under one of the existing fitness criteria in any case that could pose a substantial risk to national security.

DOD officials told us they have never been notified of or consulted by DOT about specific cases involving foreign investments in U.S. airlines. DOD officials believe that they should be part of the formal process for reviewing foreign investments in U.S. airlines to ensure that national security concerns are adequately considered in DOT's final decisions. DOD officials can, however, file comments in a fitness review case, in the same way that other interested parties, such as labor unions, do. Finally, State Department officials told us that DOD, as a member of the Committee on Foreign Investment in the United States (CFIUS), could have airline investments reviewed by CFIUS, which can recommend that the President block a transaction. DOD officials acknowledge their role in CFIUS but would like to have a consultative role in DOT's reviews as well.

Relaxing Restrictions Could Have Implications for U.S. Airline Employees

Airline labor representatives have expressed concern about allowing increased foreign investment in or foreign control of U.S. airlines. The major areas of concern about the potential effects of foreign investment and control centered on (1) U.S.-based jobs, (2) labor union bargaining power, and (3) U.S. jobs on international routes. However, it is difficult to predict the potential impact of increased foreign investment or foreign control on U.S. employment.

Potential Impact on U.S.-Based Jobs

In the view of labor union representatives, a U.S. airline substantially owned or controlled by a foreign airline might not behave the same as

U.S.-owned and -controlled airlines do. These representatives believe that the foreign airline would restructure the U.S. airline to concentrate on "feeding" passengers to the foreign airline's international routes, drop service to many U.S. destinations, and reduce the number of U.S.-based jobs. They also believe that a foreign-owned or -controlled U.S. airline could receive virtually unlimited subsidies from the foreign airline partner's government. Subsidies would allow the airline to set fares below cost, thus driving privately owned U.S. airlines from the market and also reducing U.S.-based jobs.

Because it is impossible to predict the potential market behavior of investing firms, whether they are foreign airlines or new U.S. investors, it is unclear if these events would occur as a result of foreign investment. Nevertheless, there are clearly factors that would make transferring U.S. domestic jobs to foreign workers difficult. For example, U.S. immigration law limits a firm's ability to bring in foreign workers when qualified U.S. citizens are available. Unlike manufactured goods, air transportation cannot be produced in a foreign country and imported into the United States for domestic consumption. Thus, the aircraft, crews, ground staff, and maintenance staff must be located in the United States and the aircraft must be staffed with appropriately licensed and qualified U.S. citizens if they are available. In addition, if a foreign-owned or -controlled U.S. airline were to discontinue operations to some U.S. destinations, other U.S. airlines would likely offer the service if the market were economically viable. DOT and airline officials told us that dismantling the domestic route network of the U.S. airline partner would be counterproductive, because access to the domestic traffic generated by that route system is what underlies the investment.

Finally, some industry analysts told us that additional foreign equity investment could help preserve or expand airline industry jobs in the United States. The three airlines that ceased operations last year employed over 44,000 people, and the three major airlines that continue to operate under bankruptcy court protection employ more than 78,000. While there is no guarantee that any of the surviving airlines would attract additional equity investment if the restrictions on foreign investment were relaxed, they would have another avenue to explore to refinance their operations and emerge from bankruptcy as viable competitors. Thus, foreign investment could help to preserve jobs at financially troubled airlines.

Potential Impact on Union Bargaining Power

Labor union representatives told us that they believe it would be more difficult to negotiate with U.S. airlines that had substantial foreign

investment or control. They said they believe that bargaining units for U.S. workers at foreign airlines' operations based in the U.S. have difficulty negotiating contracts as favorable as those negotiated with U.S. airlines. These representatives also believe that some foreign airlines would be less willing than U.S. airlines to negotiate with U.S. labor unions.

While management attitudes toward labor unions vary, most foreign airlines are unionized—as are most U.S. airlines—and are accustomed to working with unions. In addition, the rights and protections for U.S. airline employees under the Railway Labor Act apply to the U.S.-based employees of foreign airlines.[10] Those guarantees would not change if the restrictions on foreign investment and control were relaxed. Unions might have difficulty negotiating with a foreign airline whose U.S. operations are only a small part of its overall operation. However, a U.S. airline that was controlled by a foreign airline would be likely to have substantial operations in the United States. Thus, the employees would represent a larger share of the airline's overall work force than the U.S. employees of foreign airlines currently do. Consequently, they should have substantially more bargaining power than the small groups of foreign airline employees in the United States now have.

Potential Impact on Jobs on International Routes

According to some union officials, some jobs on international routes could be shifted from U.S. employees to foreign employees. The employees most likely to be affected would be cockpit and cabin crews, although some jobs in aircraft maintenance could also be affected. These officials believe that international routes would be operated by the foreign airline partner if investment and control restrictions were relaxed. They further believe that the U.S. airline partner would be constrained from operating on international routes.

However, there are practical limits to the number of jobs that can be shifted from U.S. to foreign workers. First, in order to offer service on an international route, an airline must have bilateral route authority. Therefore, for jobs to be shifted to a foreign airline partner on an international route, both the U.S. and the foreign airline must have bilateral authority for the proposed operation. While international routes held by U.S. airlines can be transferred to another U.S. airline with DOT's

[10]The Railway Labor Act established procedures governing union representation and union security issues, contract application and administration, collective bargaining, and the right to strike. One major objective of the act is to ensure that all efforts to settle differences without disruption of the transportation system have been exhausted before the parties can resort to economic action, i.e., strikes or lockouts.

approval, they cannot be transferred to a non-U.S. airline. In addition, U.S. airlines cannot suspend operations on limited-entry international routes without risking the loss of the route authority. Second, while these officials believe it would be logical to consolidate the services offered by the two airlines on international routes that both airlines have the authority to serve, the foreign airline would have little incentive to deter the U.S. airline from serving international destinations that the foreign airline is not authorized to serve. However, because FAA regulations allow maintenance on U.S.-registered aircraft to be performed in non-U.S. facilities, cross-border investments that lead to consolidation of maintenance services between U.S. and foreign airlines could increase the proportion of aircraft maintenance performed outside the United States.

Our discussions with DOT and industry analysts indicate that U.S. employees have some advantages that make them attractive relative to foreign employees. For example, U.S. airlines and their employees are generally viewed as more productive than their foreign competitors. U.S. airline employees are cost-competitive with most European and Japanese airline employees. The International Labor Organization compared 1988 labor costs at North American, European, Asian, African, and South American airlines in a 1990 report. They found that North American (U.S. and Canadian) airlines had the lowest ratio of labor costs to operating revenues, showing that North American airlines generate more revenue per unit of labor cost than airlines elsewhere in the world.

Staffing on international routes interacts with the previously discussed national security issues because airlines participating in CRAF contract to supply crews as well as aircraft to DOD. The availability of a sufficient number of U.S. crews certified for the long-range aircraft crucial to DOD's ability to move troops and equipment is also necessary if U.S. airlines are to fulfill their commitments to DOD under the CRAF program. For aircraft to fly into the military theater of operations, the crews on CRAF mission flights need access to security devices capable of encoding and decoding messages. Because access to these security codes must be limited, the crews provided by U.S. airlines for CRAF missions into the theater of operations must be eligible for secret security clearances. Since foreign nationals cannot meet these eligibility requirements, the types of flights foreign airlines can provide for DOD in the CRAF program are limited. For example, a foreign airline from an allied country could more easily be used to move cargo from a U.S. base to a European base closer to the theater of operations than to deliver cargo directly into the theater of operations.

Finally, even if a U.S. airline does not have any foreign investment, international routes can already be served by U.S. airlines through agreements with foreign airlines without using U.S. crews or U.S.-registered aircraft. However, when such agreements last more than 60 days, DOT must review the agreement for its implications for competition on the routes in question. This review includes proceedings that allow for comment from interested parties, including labor representatives. On one hand, increased foreign investment could result in some international operations being shifted to a foreign airline partner. On the other hand, increased foreign investment could provide financing for expansion of international service staffed with U.S. crews and flown with U.S.-registered aircraft. Therefore, the overall effect of foreign investment on employment on international routes would depend on many factors, such as each airline's access to the necessary bilateral route authority, the availability of appropriate aircraft and licensed crews, and the terms of each airline's union contracts. Union contracts generally require staffing assignments to be made from the union seniority list. Thus, it is difficult to predict how allowing increased foreign control would affect the staffing on international routes served by U.S. airlines without individual analysis of each proposed investment.

Relaxing Restrictions Could Have Implications for FAA's Safety Engineers and Inspectors

FAA's authority to oversee airlines operating in the U.S. depends on where the airline is certificated.[11] Any airline holding a U.S. certificate is subject to FAA's safety regulations for both its domestic and international services. Currently, in order to offer U.S. domestic service, an airline must hold a U.S. certificate. As long as that requirement is not changed, relaxing foreign investment restrictions, even to the extent of allowing foreign control, would not diminish FAA's authority to ensure the safety of U.S. airlines, according to FAA. Neither would it diminish FAA's responsibility for ensuring airline safety.

Foreign airlines operating international routes into the U.S. are not covered by most of FAA's safety regulations but are subject to oversight by their home country's equivalent agency. To operate in the U.S., a foreign airline needs (1) bilateral route authority from its home country, (2) economic authorization from DOT, and (3) operational authority from FAA. FAA's grant of operational authority to a foreign airline is based on FAA's

[11]Airlines that receive either a certificate of public convenience and necessity or authorization from DOT to operate domestic service (depending on the nature of the operations the airline wishes to offer) are referred to in this section as U.S.-certificated airlines. This distinguishes them from foreign-flag airlines granted authority under bilateral agreements to operate international service to and from the United States.

review of the safety oversight capability of the airline's home country. The foreign airline must comply with the international standards and procedures of the International Civil Aviation Organization (ICAO) to get operational certification from FAA. ICAO standards are broad, generalized guidelines that are implemented by each country's set of detailed regulations. Thus, any airline complying with ICAO standards would have licensed crews, but the regulations detailing the procedures and qualifications for licensing could differ from country to country. However, according to the FAA's Deputy Associate Administrator for Regulation and Certification, there is little potential for safety problems with airlines from developed countries, but there is a potential for problems with airlines from less-developed countries. FAA has begun to take steps to alleviate this potential gap in safety oversight of foreign airlines operating in the United States and is working with foreign governments to design or improve their safety oversight processes.[12]

According to FAA officials, if foreign investment limits were relaxed, airlines holding U.S. certification would continue to be under FAA's jurisdiction. Conversely, granting cabotage to foreign airlines could allow airlines from countries with less stringent enforcement of safety regulations to offer U.S. domestic air service. Currently, the regulations governing foreign airline operations in the U.S. are separate from those governing the operations of U.S. airlines. While it would be possible to bring foreign airlines operating in the U.S. under FAA's safety oversight, such a strategy could cause problems for U.S. airlines operating overseas. For example, because each airline is currently subject to the safety oversight of its own country, an airline has one set of technical guidelines to meet. Changing the system to extend U.S. safety oversight to foreign airlines might subject U.S. airlines to the safety guidelines of the foreign countries they serve, creating potential conflicts.

Finally, investments between U.S. and foreign airlines could lead to an increase in the number of aircraft transferred between foreign and U.S. registry (for example, to allow the airlines to use their existing aircraft more efficiently). Foreign aircraft maintenance and inspection records are not necessarily kept in the same format or language as records for U.S.-registered aircraft. The translation of those records and matching of foreign maintenance requirements to U.S. procedures, as well as the certification of work done at foreign repair stations, have been difficult for FAA. Thus, if shifting of aircraft between U.S. and foreign registry expanded

[12]See Airline Safety: Increased Oversight of Foreign Carriers Needed (GAO/RCED-93-42, Nov. 20, 1992).

significantly, it would create additional burdens for FAA's already thinly stretched engineering and inspection work force.

Conclusions

Because of the important role that U.S. airlines play in meeting emergency military airlift requirements, DOT may need authority to consider the national security implications of foreign investments in U.S. airlines that operate long-range aircraft if the current U.S. restrictions on foreign control are relaxed. Because DOT's current review authority does not allow the Department to use a national security criterion to deny or revoke a U.S. airline's authority, DOT cannot directly address comments from DOD about potential national security impacts. However, CFIUS—of which DOD is a permanent member—already reviews the national security implications of airline investments and can recommend that the President block the transaction. Nevertheless, if the restrictions on foreign investment and control are relaxed, DOT may need to consult with DOD on foreign investments that result in foreign control of U.S. airlines operating long-range aircraft to ensure that the military continues to have access to the civilian aircraft and crews on which it relies.

Airline employees have certain rights under U.S. law that are not affected when the ownership of an airline changes, regardless of the nationality of the new investors or owners. Relaxing the restrictions on foreign investment and control could result in some jobs on international routes and in aircraft maintenance being shifted overseas. However, foreign investments in U.S. airlines could also result in jobs at financially distressed airlines being saved. Furthermore, if the investment is used to finance domestic or international service expansion, new jobs could be created. Nevertheless, the overall impact of increasing foreign investment on airline employees is difficult to predict.

Relaxing the foreign investment and control restrictions would not change FAA's authority to oversee aviation safety in the United States. Because aircraft registration could be shifted from abroad to the United States, however, such an action could lead to an increased work load for FAA's safety engineers and inspectors.

Policy Options for Relaxing the Foreign Investment and Control Restrictions

Changing the existing restrictions on foreign investment and control of U.S. airlines will improve U.S. airlines' access to foreign capital and could help strengthen some of the financially weak U.S. airlines. This, in turn, could benefit domestic competition and, if foreign investment helps to keep an airline from going out of business, could help preserve domestic airline jobs. Relaxing the restrictions on foreign investment is not a panacea for the problems facing competition in the domestic airline industry, nor is it the only way to address competition problems. There are potential risks that must be guarded against if the Congress chooses to relax the restrictions. This chapter offers a framework for considering three basic approaches to foreign investment in U.S. airlines.

Three Approaches for Addressing Limits

While the Congress could consider a variety of options with regard to changing the limits on foreign investment and control of U.S. airlines, these options can be summarized in three categories. First, the Congress could choose to maintain the current limits on investment and control. Second, the Congress could opt to relax the voting stock limits but continue to require that effective control reside with U.S. citizens. This second alternative has been proposed in both the House and the Senate. Finally, the Congress could choose to relax both the investment and control limits, so that foreign investors could influence the corporate decisions of U.S. airlines commensurate with the size of their investment. Because relaxation of both the investment and control restrictions carries with it the most potential benefits, as well as the most potential risks, this chapter discusses ways of maximizing competitive potential and minimizing potential risks in some detail.

Continuing Current Restrictions or Modifying Only Voting Stock Ownership Limits Will Likely Have Little Impact

Retaining the current restrictions on foreign equity financing and foreign control will not mitigate the financial problems facing U.S. airlines or prevent further industry consolidation.[1] Fewer airlines ultimately means fewer competitors on individual airline routes, and less competition can lead to higher fares.[2] Even if some weaker U.S. airlines survive, limited access to domestic capital could force them to scale back operations and reduce employment. Maintaining the current restrictions prevents airlines

[1]Although USAir and British Airways recently announced an investment agreement, that investment can be withdrawn by British Airways if the parties cannot come to an agreement with DOT that will both allow British Airways to protect the value of its investment and allow USAir to retain its U.S. authorization. DOT is currently reviewing that investment agreement.

[2]Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990); Airline Competition: Effects of Airline Market Concentration and Barriers to Entry on Airfares (GAO/RCED-91-101, Apr. 26, 1991).

from exploring one possible source of funds that could help some airlines continue operating and become more effective competitors. Continuing the current restrictions on foreign investment and control limits U.S. negotiators' ability to gain access to foreign airlines' home markets in exchange for opportunities to improve foreign airlines' access to U.S. markets. The principal benefit of maintaining the status quo is that it does not raise additional questions about the continued participation by U.S. airlines in the CRAF program or increase the likelihood of jobs being shifted overseas.

Relaxing the restrictions on foreign investment in voting stock alone might improve U.S. airlines' ability to gain access to world capital markets. However, the inability of foreign investors to exercise control commensurate with their investment would likely continue to limit the amounts that foreign investors would be willing to invest. This option allows the United States to wait to see whether the EC's proposal for changing investment restrictions actually occurs before the United States changes its own ownership barriers. Because this option does not allow foreign control, new equity investments are likely to be limited and useful primarily for cementing marketing agreements. To prevent such investments from having an anticompetitive impact, the relationships between U.S. and foreign airlines would have to be considered when DOT is awarding scarce international routes.

Relaxing limits only on voting stock but not control should not have much impact on either safety or U.S. airline employment. This option would not likely affect the willingness of U.S. airlines to join the CRAF program, because foreign nationals would not be able to influence U.S. airline decisions to participate in CRAF.

It is probably unrealistic to expect foreign airlines to invest significant amounts in financially weak U.S. airlines without allowing them to have some influence over what happens to their investment. Allowing foreign airlines to purchase up to 49 percent of the voting stock but denying them the right to exercise control commensurate with such an investment will likely attract few investors. Voting stock loses its essential characteristic when it is stripped of the right to influence the entity in which the investment is made. Investments to cement marketing alliances could proceed, but it is not clear that a foreign investor would need to invest more than the current limit to cement such an alliance.

Potential Effects of Relaxing the Restrictions on Both Investment and Control

The greatest opportunities for enhancing domestic competition lie in relaxing the restrictions on both foreign investment in voting stock and foreign control. Because foreign investors would be able to influence corporate decisions and minimize the risk to their investments, this option would more likely spur increased investment activity. While such a change would make it possible for a foreign investor to substantially influence the affairs of a U.S. airline, this option would also present the greatest opportunities for the smaller and weaker airlines to gain access to foreign capital. Allowing significant equity linkages between U.S. and foreign airlines also might give U.S. airlines greater opportunities to expand overseas, help keep smaller domestic and foreign airlines in the market, and provide effective competition to the mega-carriers. However, since some foreign airlines are still subsidized by their governments, a foreign airline could potentially pass subsidies on to a U.S. airline in which it had invested, adversely affecting domestic competition. While this result could have short-term benefits for U.S. passengers, it is fundamentally at odds with U.S. deregulation policy. Deregulation is predicated on a reliance on market forces and minimum government involvement in airline fares and service.

Increasing the current limits for both investment and control could provide U.S. negotiators with an important bargaining tool. Because the U.S. domestic market is large, it represents valuable "feed" traffic for international flights. To provide U.S. negotiators with an effective negotiating tool, the restrictions on foreign investment and control could be relaxed while incorporating guidelines for eligibility. Eligibility for the enhanced investment opportunities could be reserved for investors from countries that are willing to grant U.S. airlines improved access to their markets. If the restrictions on foreign investment and control were eliminated unconditionally, there is a risk that other nations would not grant more open access to their aviation markets or allow more international competition.

Allowing increased foreign investment and control could help the smaller and weaker U.S. airlines to maintain or expand service, which might increase total U.S. airline employment. However, allowing greater foreign influence raises the possibility that some cockpit and crew jobs on international routes could be shifted to a foreign airline partner. If the protection offered by the immigration laws that limit a firm's ability to bring in foreign workers when qualified U.S. citizens are available were deemed insufficient, the U.S. airline could be required to include a plan for staffing and operating international routes that its foreign airline partner

also has authority to operate. Such a requirement could help ensure that U.S. employees have a chance to directly share in the benefits of international expansion by all U.S. airlines, even those with foreign investment or control.

Allowing foreign investors greater influence over the operations of U.S. airlines increases the likelihood that the relationship between the military and U.S. airlines would need modification in order to ensure that DOD has adequate access to civilian aircraft for emergency airlift. If foreign control were allowed, DOT's review of the investment could include consultation with DOD on the national security implications. The desirability of a particular foreign investment, especially if control would pass to investors from foreign countries, would depend on how similar the foreign government's political and economic views were to those of the United States.

To ensure that relaxing ownership restrictions does not reduce competition in international markets, DOT could exercise its authority over discriminatory or unfair international trade practices. Careful scrutiny by the Department of Justice in its antitrust review also could prevent anticompetitive behavior. Also, investments in U.S. airlines would still have to be reviewed by DOT to ensure that the airline continues to meet fitness requirements. DOT could be required to consider proposed investments in light of the aviation trade relationship between the United States and the foreign investor's home country. In addition, even after approval of an investment, financial relationships between U.S. and foreign airlines would have to be considered by DOT to ensure that the award of international routes would not diminish competition.

At a minimum, allowing a foreign airline to have substantial influence over the management decisions of a U.S. airline would probably require expanding the scope of DOT's fitness review to include consultation with DOD on any potential national security problems posed by the investment and a consideration of potential impacts on international competition in conjunction with Justice's antitrust review. Finally, DOT could be given preapproval authority to perform fitness reviews within a limited time period before investments are made final and to temporarily stay completion of investments, if necessary, for fuller investigation. Such authority would enhance DOT's ability to prevent inappropriate investments because the Department would not have to try to restructure or undo already completed transactions.

None of the three policy options envisions removing the prohibition against cabotage. Therefore, in order to offer service in the U.S. domestic market, an airline would still require authorization from DOT and be subject to continuing fitness reviews. Because holding U.S. authorization makes an airline subject to FAA's safety oversight, none of the options would change FAA's authority to ensure the safety of the domestic airline system. Conversely, allowing cabotage would permit airlines holding foreign certificates, which are subject to their home country's safety oversight, to operate domestic service in the United States and would require reaching agreement with the foreign country to resolve potential conflicts between U.S. and foreign safety regulations. Thus, allowing cabotage would mean that, while some airlines offering domestic service would be subject to FAA's oversight, others might not be. Finally, if increased foreign investment and control lead to large numbers of aircraft being transferred between U.S. and foreign registry, it would create additional work for FAA's already burdened inspection staff.

Conclusions

Retaining the current restrictions on foreign investment and control presents no new risks. But neither does that strategy help U.S. airlines gain access to more equity investment, minimize further consolidation of the U.S. airline industry, or open new opportunities abroad for U.S. airlines. Relaxing only the restrictions on foreign investment carries little risk, because it preserves U.S. citizen control. However, this approach would probably have minimal effect on the U.S. airline industry's problems of financing and competition. Such a policy change might, nevertheless, offer limited benefits and could be used as a test to see whether other countries might be more willing to open up their aviation markets to U.S. airlines. While relaxing the restrictions on foreign control offers the greatest opportunities, it also represents the most risk. If the United States goes forward with this strategy, there could be implications for national security, employment, and competition. This option offers the most potential for benefits and risks, strongly suggesting that safequards be in place to ensure that the benefits outweigh any costs.

Matters for Congressional Consideration

If the Congress chooses to relax the limits on foreign control of U.S. airlines, it may wish to consider

- limiting eligibility for greater investment and control of U.S. airlines to investors from countries that are willing to exchange improved access to their aviation markets for greater opportunities to invest in U.S. airlines;

- limiting eligibility to foreign investors that are not subsidized by foreign governments; and
- modifying the scope and timing of DOT's review process to ensure that potentially harmful investments are prevented by (1) giving DOT authority to review investments before they are made final and to prohibit investments that fail to meet the fitness criteria; (2) requiring DOT, in conjunction with its fitness review, to make explicit determinations under its separate statutory authority with respect to international aviation competition; and (3) requiring that DOT consider potential national security impacts of foreign investments in U.S. airlines in consultation with DOD.

Organizations Contacted During Our Review

Government and Trade Organizations

Air Line Pilots Association
Air Transport Association of America
Allied Pilots Association
American Association of Airport Executives
Association of Flight Attendants
AVMARK (aviation consultants)
Commission of the European Communities, Transport and Competition directorates
Department of Defense, Directorate for Transportation Policy
Department of Justice, Transportation, Energy, and Agriculture Section
Department of State, Office of Aviation Negotiations and Policy
Department of the Treasury, Committee on Foreign Investment in the United States
Department of Transportation, Air Carrier Fitness Division, Office of the General Counsel for International Law, and Office of International Aviation
Federal Aviation Administration, Office of Regulation and Certification
Federal Trade Commission, Bureau of Competition
Immigration and Naturalization Service
International Air Transport Association (IATA)
International Association of Machinists and Aerospace Workers
National Air Carrier Association, Inc.
Regional Airline Association
U.S. Airports for Better International Aviation Service (USA-BIAS)

Airlines—United States

Aloha Airlines
America West Airlines
American Airlines
Continental Airlines
Delta Air Lines
Evergreen International Airlines
Federal Express
New Eastern
Northwest Airlines
Pan American World Airways
Southwest Airlines
Trans World Airlines
United Airlines
USAir

Airlines—Foreign

Alitalia
British Airways
British Midlands Airlines
KLM Royal Dutch Airlines
Sabena
Scandinavian Airlines System (SAS)
Swissair

Long-Term Debt as a Percentage of Total Capitalization, 1986-90

Airline	1986	1987	1988	1989	1990	Average
Pan Am Corp.	99.0	132.3	151.1	272.9	[a]	131.1
Eastern	90.7	97.3	473.3	(52.9)[b]	(21.8)[b]	117.3
Continental[c]	97.3	85.4	96.3	96.3	197.2	114.5
Trans World[d]	94.2	89.8	101.3	114.8	140.6	108.1
America West	81.5	89.0	86.9	84.5	96.7	87.7
UAL Corp.	45.8	32.7	62.7	46.1	42.8	46.0
Alaska	56.6	39.5	32.7	37.1	51.5	43.5
Air Wis	51.4	47.5	39.9	41.8	36.1	43.3
USAir[e]	24.8	44.5	35.6	44.8	61.8	42.2
AMR Corp.	45.1	45.0	41.0	33.5	42.8	41.5
Southwest	35.3	29.5	35.6	33.4	31.4	33.0
Delta[f]	33.4	28.7	21.0	18.3	29.8	26.2
Midway	34.9	50.8	46.5	78.0	(144.3)	13.2
NWA, Inc.[g]	50.8	34.4	32.1			
Industry average[h]	56.8	54.6	53.6	56.2	73.6	

Note: For years for which no data appear, data were not publicly available.

[a]Pan Am's ratio of long-term debt to total capitalization was infinity in 1990.

[b]Due to Eastern's bankruptcy, 1989 and 1990 data for Eastern are not comparable with earlier data for Eastern or with data for other airlines.

[c]Before December 31, 1986, Continental had $653.9 million in liabilities subject to Chapter 11 reorganization proceedings. Financial ratios and data for 1985 do not include any of the liabilities subject to reorganization proceedings.

[d]Trans World's data for 1986 and subsequent years reflect the airline's acquisition of Ozark on September 15, 1986.

[e]USAir's data for 1987 and subsequent years reflect the airline's acquisition of Piedmont on November 5, 1987.

[f]Delta's data for 1987 and subsequent years reflect the airline's acquisition of Western on December 18, 1986.

[g]NWA, Inc., was acquired by Wings Acquisition, Inc., on August 4, 1989. Consequently, company reports for NWA, Inc., are not available for 1989. NWA's data for 1986 and subsequent years reflect the airline's acquisition of Republic on August 12, 1986.

[h]Industry average data include data for Ozark, People Express, Piedmont, Republic, and Western until their respective mergers.

Source: Julius Maldutis, The Financial Condition of the U.S. Airline Industry at Year-End 1990, Salomon Brothers (New York: June 1991), p. 8, fig. 10. Data are drawn from company reports.

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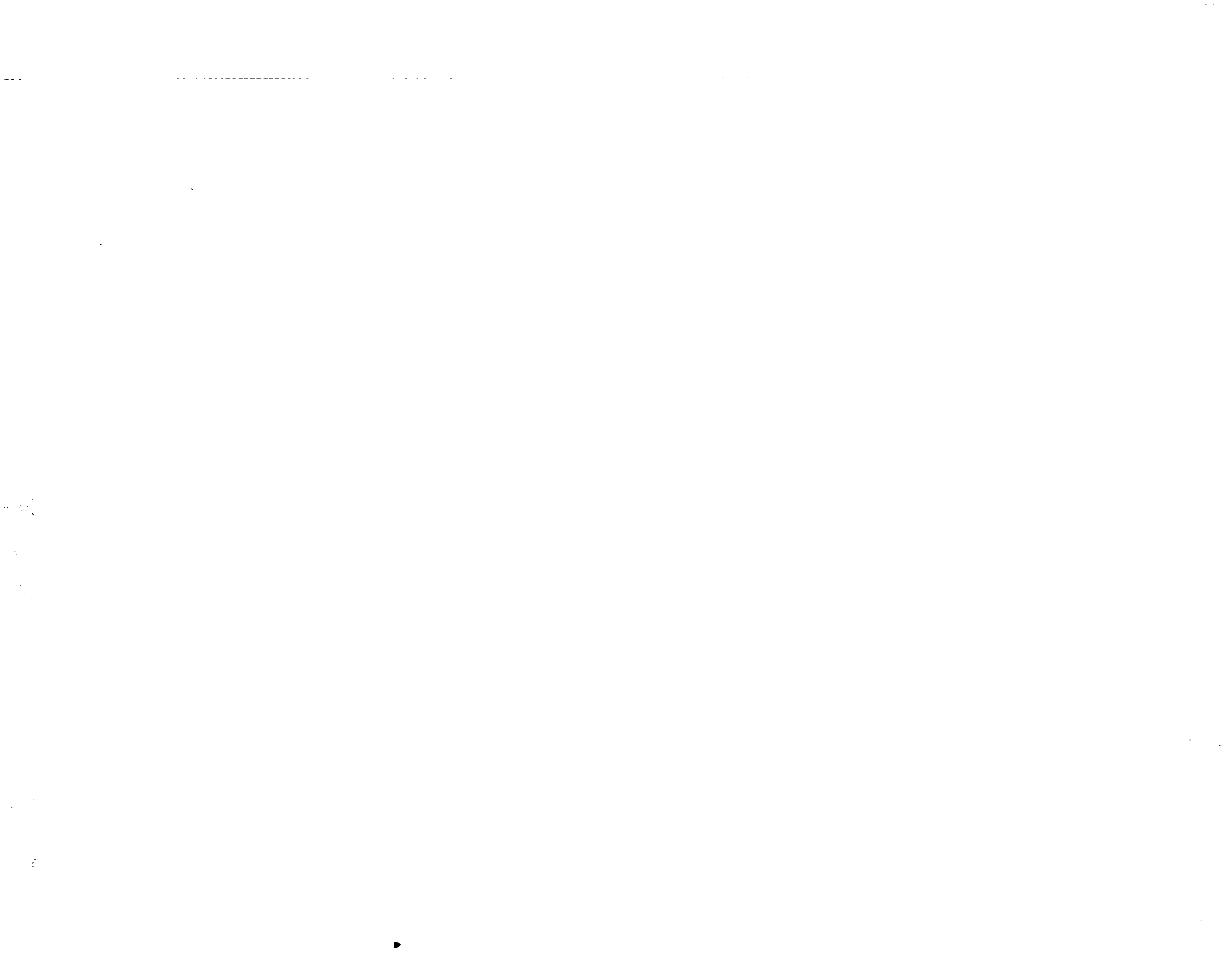

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