

**LEGISLATIVE COUNCIL STUDY COMMITTEE ON
TRANSPORTATION INFRASTRUCTURE**

STATEMENT OF MIDWEST AIRLINES, INC.

Wednesday, October 20, 2004

INTRODUCTION

Thank you for providing an opportunity for Midwest Airlines to discuss with the Committee issues of great importance to our airline and the customers we serve. I will begin by summarizing the current state of our business. Then I will provide some information about how airline hub facilities drive economic growth and vitality. Finally, because one purpose of this Committee is to examine Wisconsin's aviation infrastructure, I will comment on why airlines cannot and should not bear any additional financial responsibility for infrastructure costs than it is currently burdened with.

MIDWEST AIRLINES

2004 has been a significant year for Midwest Airlines. In June we celebrated our 20th anniversary as a commercial carrier. This year we discontinued all of our legacy DC-9 aircraft and added 5 new Boeing 717's, bringing that new state-of-the-art fleet to a total of 16. Our plan is to continue to add 1 new 717 in 2004, 4 in 2005 and 4 in 2006 bringing our total 717 fleet to 25, at which time we have an option to purchase an additional 25 going forward. We also have 13 MD-80 aircraft, and in our Skyway subsidiary we have 22 aircraft, bringing our total fleet to 51. We currently fly to 50 destinations coast-to-coast and carry approximately 2.8 million passengers a year. We have a total of 3,118 employees, and 2,601 of them are in Wisconsin.

Last year, 2003, we completed a comprehensive financial and operational restructuring—something that many carriers are in the midst of right now. We changed our service offering to include a high-density low fare product, called Saver Service, designed to meet the growing leisure sector of the travel market, and we still provide our classic Signature Service to primary business destinations. We worked hard to pull controllable costs out of our system, and continue to do so today, generating over \$75 million in annual cost savings. We believe we are very well positioned for the future and for growth—new aircraft, new destinations, and additional frequencies. This will be good for our employees, our customers, our business partners, and the communities we serve.

While we are optimistic that the long-range future for Midwest Airlines is rosy, the immediate future is not. Record-high fuel prices constitute a major barrier to short term success. We purchase over 80 million gallons of fuel a year, so a one-cent increase in fuel represents \$800,000 in additional cost. Our business plan to return to profitability was build on 92-cent fuel, and today we are paying \$1.74 a gallon: At this rate the increased cost attributable to fuel alone is over \$65 million a year. For a company that generates around \$380 million in annual revenue, the cost of fuel alone is a major threat to ongoing viability. In 2003, Midwest reported a net loss of \$13.3 million, the third consecutive losing year in a row.

The problem of high fuel costs impacts the entire industry. As a whole, the industry lost \$8.3 billion in 2001, \$11.3 billion in 2002 and \$3.6 billion in 2003. The projected loss for 2004 is in the range of \$4.5 – \$5 billion, according to industry analysts.

After I discuss with you the importance of a hub airline to economic development of a region or state, I will describe the contribution that taxes and fees make to this grim economic picture.

AIRLINE HUB FACILITIES DRIVE ECONOMIC DEVELOPMENT AND VITALITY

According to a white paper presented at the Wisconsin Economic Summit in late 2000, excellence in air service and a first class infrastructure to support it are critical to the economic future of Wisconsin. The Economic Summit explored the way in which the retention, expansion and attraction of job creators are greatly assisted with dependable and cost-effective air service.

The loss of manufacturing jobs in Wisconsin is a topic of considerable attention today. Back in 1996, the University of Wisconsin-Madison Bureau of Business Research surveyed 251 of Wisconsin's manufacturing executives to identify factors important to their business life in Wisconsin. "Proximity to major markets" was determined to be one of the most important factors, leading to the conclusion that when a state gains or loses a company, its attractiveness is enhanced or diminished for other businesses. J.G. Udell, *WISCONSIN'S QUALITY OF BUSINESS AND PERSONAL LIFE AS SEEN BY CHIEF EXECUTIVES (1996)*.

A 1994 report on transportation and economic development issued by the Wisconsin Department of Transportation also recognized the importance of quality air service to Wisconsin business: "[Wisconsin manufacturers'] competitive stance is enhanced by access to first class passenger air service which efficiently and quickly links corporate representatives and customers." *TRANSLINKS 21, WISCONSIN DEPARTMENT OF TRANSPORTATION, TRANSPORTATION & ECONOMIC DEVELOPMENT: A SUMMARY OF KEY ISSUES BEING EXPLORED ON TRANSPORTATION OPTIONS AND ECONOMIC DEVELOPMENT (1994)*.

Who are these manufacturers who need quality air passenger service? Over a dozen Fortune 1000 companies are headquartered in metropolitan Milwaukee and more than

fifty Fortune 1000 companies have major operations in the area. The continued presence of these companies creates significant benefits to the area and the state. These benefits include employment, capital investment, and community investment in the arts, social service organizations and non-profit organizations. The loss or diminution in non-stop air service offered by a hub airline would diminish Milwaukee's standing as a national headquarters location.

In a 1998 study of the unique value of airline hubs, non-hub airport cities were compared with the major hub cities. The report concluded that hub city benefits include more frequent flights, more direct flights, more opportunities for same day returns with no overnight, service geared to local market needs and opportunities to link to other major hubs. Hub cities enjoy a larger range of services and their high-technology sector expands faster. In fact, based on the analysis, a hub airport acts as a magnet for high-technology development. *Kenneth Burton and Roger Stough, The Benefits of Being a Hub Airport City: Convenient Travel and High-Tech Job Growth, (1998).*

But what happens to cities when, after enjoying the benefits of being a hub city for years, they lose hub quality non-stop air service? Recently, the *Charlotte Business Journal* reported on the anticipated consequences of losing US Airways' hub in Charlotte, where many businesses recently had relocated or begun, in part because of its non-stop air service to over 100 cities. University of North Carolina economist John Connaughton was quoted: "One of the major ingredients in our region's economic development strategy has been nonstop connectivity. If you lose the hub, that is gone." He added that the direct job loss and ripple effect of a US Airways failure "will clearly trim the region's economic growth" in coming years. David Mildenberg, *Business As Usual? Experts Question Charlotte's Airport Strategy, CHARLOTTE BUSINESS JOURNAL (Sept. 19, 2004).*

The experience of Lambert Field in St. Louis also bears consideration. In 2001, American Airlines spent almost a billion dollars to acquire TWA and its St. Louis hub, believing it could use the hub to expand its east-west operations. That plan failed, and American decided to "de-hub" St. Louis. A University of Illinois Institute of Government & Public Affairs report observed that job losses resulting from the "de-hubbing" of Lambert Field extended far beyond the airport itself:

Part of these losses will come from multiplier effects due to lower spending by the laid-off airline workers. But additional losses will arise from the reduction in airline service quality, which will hurt the business climate for local firms that rely heavily on air transportation. . . . [I]n the long-run, the de-hubbing of Lambert Field will cost the St. Louis metro area nearly 50,000 jobs.

The report explained the loss to the business climate that stems from the connection between the quality of airline service and a metro area's business climate.

A large hub airport, with its frequent, convenient flights to a host of business destinations, provides unsurpassed service quality and thus offers a powerful enhancement to the business climate. Cities fortunate enough to have such a hub are then able to compete vigorously for business investment in industries whose employees are intensive users of the air transport system. Such industries represent all the knowledge-intensive sectors of the economy, where exchange of information (often on a face-to-face basis) is a crucial part of the productive enterprise.

Jan K. Brueckner, *The Economic Impact of Flight Cutbacks at the St. Louis Airport: A Calculation of Job Losses*, UNIV. OF ILLINOIS, INST. OF GOV'T. & PUB. AFFAIRS.

AIRLINES CANNOT SUPPORT ADDITIONAL INFRASTRUCTURE DEMANDS

As the Study Committee examines Wisconsin's aviation infrastructure, it is essential to understand the severe limitations airlines confront in providing any increment of additional support for infrastructure growth.

As airlines face ever increasing fuel costs and struggle to return to profitability, which will enable investment and growth, they also face growing taxes and fees imposed or enabled by the federal government. The rate of increase in these costs is breathtaking. It outpaces inflation and any growth in fares. For example, taxes and fees imposed or approved on a \$200 ticket purchased in 1992 were 15% or \$29; today they are 26% or \$52. On a \$300 ticket, taxes were \$38 in 1992 and today they are \$59. Federally imposed or approved aviation taxes and fees will generate over \$14 billion in 2004, the year the industry is projected to lose \$4.5 to \$5 billion.

Most interestingly, a significant portion of this money funds airport improvements. A portion of these fees goes directly to local airports in the form of passenger facility charges, and another portion goes into the FAA Airport and Airway Trust Fund. In fact, 98% of these trust fund revenues come from the commercial aviation sector (and less than 2% comes from the general aviation community). While the portion of Wisconsin aviation infrastructure costs funded from this source varies over the years, it is clearly and consistently a major source of funds for infrastructure improvements here.

Midwest Airlines appreciates the relief granted by the legislature from state-imposed taxes. This has come in the form of a volume discount on PECFA fees and the *ad valorem* tax exemption that we are currently defending from attack by Northwest Airlines in the Wisconsin Court of Appeals. We remain optimistic that the exemption will prevail, and this will significantly support our plans to grow our airline here.

Clearly, any new or additional taxes or fees on commercial aviation in Wisconsin would be distinctly counterproductive to the positive steps taken by the state to advance economic development by stimulating airline investment in Wisconsin. Diminished air

service or the loss of an airline hub would have long term adverse economic consequences that would far exceed any additional revenues that could be generated.

CONCLUSION

A strong aviation infrastructure is essential for continued economic growth and vitality. State government should adopt policies that encourage airline investment and promote the growth of air service here, including particularly the growth of an airline hub which is known to drive economic development, the location and expansion of businesses, the placement of corporate headquarters, and the creation of jobs--particularly high tech jobs. Currently, Midwest Airlines is positioned to grow its high quality, reliable non-stop service to major business destinations across the country. We want the state to be our ally.