

Analysis

Aid to Airlines and other Critical Industries During Crises

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Original post [here](#).

The [air transportation industry across the globe has been dramatically affected](#) by the outbreak of COVID-19. Government-issued travel bans and warnings to self-quarantine have forced the cancellation of trips. Passengers are [down](#) more than 90%. Airplane manufacturers, such as Boeing in the US, are [facing assembly line shutdowns](#) and possible delays of ordered planes. Related businesses such as suppliers, airports, and duty-free stores are also facing serious impacts.

Since February, several countries have provided support to help their airlines absorb the economic impacts. These actions include: direct cash subsidies ([China](#)), tax rebates and forgiveness (Australia), loan guarantees ([Sweden](#), [Finland](#)), exemption from airport fees ([Taiwan](#)), loss support, and direct aid to cover employee wages ([Denmark](#)). Several countries offer a combination of interventions, such as [South Korea](#) and the [US](#).

We consider the recent actions in the context of past assistance to airlines and other critical industries and discuss what other countries might consider in providing such assistance.

Critical Industries

Airlines are critical industries that play key roles in transportation and supply chains for passengers and cargo. Yet, they are characterized by high fixed costs and variable income streams. The ability to adjust current expenses does not directly align with drops in revenue creating cash flow challenges and making them especially vulnerable to economic shocks. ([Nolan, Ritchie and Rowcroft 2004](#)). The terrorist attacks of 9/11, in which the US closed its airspace, showed that the industry may need state aid to avoid bankruptcy and restore operations to pre-shock levels. ([Nolan, Ritchie and Rowcroft 2004](#)). With credit markets drying up, private liquidity was difficult to come by, [layoffs began](#), leading the government to provide assistance in the form of direct grants and loan guarantees through the [Air Transportation Safety and System Stabilization Act](#) (ATSSA). Similar economic factors justified the government's facilitating mergers to stabilize the industry in the 1980s.

Other modes of transportation have also been deemed critical industries. During the current COVID-19 pandemic, [the UK has temporarily nationalized its railways](#) in a preemptive move to “provide stability and certainty” and ensure that they are available for essential travel. Contractors will continue to operate their routes, but the government will collect all revenues and take on all risk. In the [US](#), the government provided \$1 billion in grants to its government-owned passenger railroad, Amtrak, 50% of the company's 2020 budget.

Beyond transportation, governments have assisted other nonfinancial industries whose failure might pose a systemic risk to the economy. During the global financial crisis (GFC) of 2007-09, the US rescued two of its “Big Three” auto manufacturers, General Motors (GM) and Chrysler. Factors cited in the decision to provide aid in those cases were the size of the firms; the

concentration of the industries within a specific region; the potential job losses; the potential knock-on effects to suppliers in the highly integrated industry that might destabilize other manufacturers; and the broader economic impacts in the midst of the financial crisis.

France, Russia, and Sweden also provided assistance to their auto industries during the GFC. France provided a package of loans to manufacturers (Renault and Peugeot/Citroen), auto finance companies, and suppliers. Russia provided a one-year interest-free loan and facilitated the refinancing of investment projects. Sweden guaranteed significant loans.

Tools Available

Once a government decides to assist a critical industry, it needs to consider what tools it has available, and how and when it will use them. Possible tools include loans, equity or warrant purchases, loan guarantees, or some combination of these, to provide the necessary capital for companies to maintain or achieve solvency. Equity can be especially useful to protect taxpayers, although governments are often reluctant to take over the management of private companies, as noted below.

In general, approaches appear to fall into three loose categories: (i) short-term liquidity relief, where the aim is to provide liquidity and support wages; (ii) mid-term aid, which focuses on providing liquidity relief for longer periods and or in larger quantities, through loans or loan guarantees; and (iii) longer term aid, which provides sustained support and protects companies' solvency through operational recovery and structural reform. Example of this last tool include the multifaceted packages implemented by South Korea, the US, and Italy, which [re-nationalized Alitalia](#) after efforts to find a buyer failed.

The COVID-19 pandemic is unique in that the economic shock has been largely government-induced. Countries quickly deployed targeted relief focused on the airline industry. Their earliest responses included:

- Direct cash subsidies or grants ([China](#) and [US](#))
- Suspension or refund of taxes and or fees (Australia, [South Korea](#), Taiwan)
- Direct absorption of losses
- Grants for payment of wages ([Denmark](#)).

Because the air travel industry is highly taxed, waiving, refunding or reducing some or all of these taxes is a particularly quick way to funnel cash to the industry amidst the sudden drop in ridership. Tax relief can be quickly implemented because it requires minimal administrative start-up costs. Once airlines recover, taxes and fees can be reinstated gradually to provide a soft cushion for recovery efforts.

Given the unique factors of the pandemic, other first-wave support has taken the form of grants to support the continuation of wages for air industry workers or financial support for furloughed workers. These may be in narrow targeted efforts (as in the case of the [US](#)) or as broad-based plans that also apply beyond the industry (as [Denmark](#) has provided).

Governments also use loans or loan guarantees have to provide longer term and more substantial support. Loans can also be used to “buy time” for private funding sources to recover, to bridge temporary distortions to cash flows. Several countries made loans to industries

affected by 9/11. The US and France provided loans to the auto industry during the GFC. The US used [bridge loans to keep Chrysler and GM](#) afloat during a presidential transition in 2008; the government used the transition period to assess if the companies would need further assistance.

In extending loans, governments must decide:

- Amount of loan
- Interest rates
- Collateral
- Maturity
- Other commitments such as reporting, governance restrictions

Loans can be flexible, subject to the government's capacity, and easily tailored, extended, or increased as circumstances change.

Loan guarantees represent a commitment rather than an actual loan. They allow governments to leverage their resources to extend more funding than they can directly. However, loan guarantees depend on there being private lenders willing to lend. This may not always be the case if banks are also distressed, as during the GFC. When there is no financial crisis, a guarantee may help a distressed industry get the funds it needs.

Loans and loan guarantees may also be bundled with other forms of assistance and are often a step-up from initial actions. In the current crisis, for example, Denmark first provided support for wages, and then later announced (along with Sweden) up to \$302 million in credit guarantees for Scandinavian Airlines.

South Korea has also bundled the availability of loans into [a comprehensive package of airline industry support measures](#). Relief has been in place for Korea-China routes since early February. In mid-February, the government made a major announcement—up to 300 billion won in emergency loans, deferred fees for three months with gradual restart, guarantees to replace aircraft lease deposits, and support in reestablishing business. In March the government announced [additional supports](#) relating to the waiver of airport fees and assistance to terminal operations for 3-6 months. The combined supports are designed not only to offset the cost of lost passengers but also to promote a quick return to operating and rebuilding capacity. It is formally divided into three phases: (i) emergency damage support, (ii) support for securing a new market, and (iii) management stabilization support.

The [US coronavirus rescue](#) legislation provides \$78 billion to the airlines in the form of direct cash grants, loans, and loan guarantees available through March 2022. The bill also temporarily suspends excise tax and kerosene taxes for air carriers through January 1, 2021. In return for financial assistance, air carriers may not put employees on temporary furlough status, engage in share buybacks, or issue dividends. Also, highly compensated employees are subject to restrictions on their pay.

The current US assistance is similar in form but far surpasses the assistance provided to airlines in the wake of the 9/11 attacks the US, when the government closed all US airspace. ([Lewinsohn 2005](#)). At that time, the government provided aid for airlines through the Air Transport Safety and System Stabilization Act of 2001. That act provided \$5 billion in direct grants for

compensation for federal actions and subsequent losses related to the attacks and the subsequent shut down of air travel, and up to \$10 billion in loan guarantees. Eligible airlines used approximately 10% of the available guarantees. Although there were still airline bankruptcies in the years that followed, some commenters believe that the assistance [was successful in that it prevented immediate bankruptcies](#) during an economic downturn. (Lewensohn 2005).

Even if a crisis is short-lived, companies will need a period in which to recover to pre-crisis levels. The assistance packages and loans offered by Korea and the US seem to acknowledge this and anticipate challenges even after the epidemic subsides. Another example is [Singapore Airlines](#) which, in response to the COVID-19 crisis, announced that it had secured a loan of S\$4 billion from DBS Bank to cover its near-term liquidity needs. It also planned to raise S\$14 billion from its existing shareholders through a rights offering (to purchase shares and bonds) underwritten by its majority shareholder, the sovereign investment fund, Temasek Holdings. This would provide capital that would not only help it weather the pandemic but would also strengthen its return to operations after.

Should a crisis extend for longer than expected, governments may have to extend or increase aid to forestall the further decline of weakened companies. In such instances, tools that may be utilized include:

- additional or longer-term loans
- capital injections
- restructuring
- bankruptcy
- nationalization.

Some of these solutions, such as extended loans, are quicker to put in place than others, i.e., capital injections and restructuring. However, restructurings, whether through bankruptcy or not may require additional funding directly from the government or from private sources, potentially with further government guarantees. The availability and ease of implementation of these later solutions usually depend on what standing powers the government has. In other contexts, additional legislation may be needed, which would be more time consuming.

It should also be noted that there is always the possibility that the effects of a crisis may reveal preexisting fundamental financial weaknesses that would need to be addressed upfront if companies are going to be saved from collapse. Sometimes these are revealed upfront, as in the case of [Italy--which in response to the COVID-19 pandemic, has re-nationalized Alitalia](#); the airline had been attempting to sell itself for a year and was thought to be unable to weather the pandemic without assistance.

There are several types of nationalization. Governments can take control of a company or industry e. through government fiat, using existing authority or new legislation; capital injections; or as the result of providing funding for a restructuring. Italy nationalized Alitalia by government fiat. The country had previously used a similar strategy in the aid provided to Parmalat, an Italian dairy company, when the Italian government [issued an emergency decree](#) to allow Parmalat to file for bankruptcy to receive financial aid and undergo intensive

restructuring. During the GFC, the US took control of GM as a result of funding its bankruptcy and receiving equity in the company.

Taxpayer Protection

Another important issue for governments to consider is how to structure the intervention to ensure repayment and protect taxpayer funds. Several elements can address this:

- Rates and fees that incentivize repayment once private funding is available
- Loan provisions that restrict share buybacks and paying dividends
- Loan provisions that affect desired policies
- Restrictions on executive compensation
- Collateral that secures the loan
- An equity interest for the government

A simple protection for lent funds would be to set the rate and terms of loans to incentivize payoff when private credit avenues are again available. In accordance with Bagehot's dictum to lend at a penalty rate, setting a rate above the usual market rate will incent borrowers to pay off or refinance the loan from private sources when the market recovers. Restrictive loan terms, such as those relating to buyback of shares and payment of dividends, prohibit the firm from misappropriating government funds. Terms may also require heightened government oversight and reporting, which a firm may find burdensome, incentivizing accelerated repayment.

In the US, during the GFC and since, the payment of executive compensation at firms receiving government assistance has been a controversial issue. Aid provided under the [Troubled Asset Relief Program \(TARP\)](#) during the GFC was subject to these types of restrictions. There is some evidence that these restrictions created incentives for companies to repay the government early. Terms of the aid offered in the current COVID-19 programs also restrict certain executive pay.

Loan terms have also been used as a means to interject industrial policy into a situation such as during the GFC, when the restructuring of GM and Chrysler were conditioned on lowering labor costs and producing energy efficient autos.

Loans may also be secured by collateral; however, this is not always available. A firm or industry may be highly leveraged, having already granted security interests on much of its assets. In this case, receiving equity interests may be an alternative that provides some potential upside to taxpayers.

The theory behind equity interests is that the taxpayers can share in the company's recovery, which their assistance funded. This can be achieved through the grant of warrants that provide the opportunity to purchase shares at a nominal price, preferred shares that are convertible into common shares, or an outright purchase or grant of common shares.

US Treasury Secretary Mnuchin said that rather than make outright grants, the [Treasury intends to take equity stakes](#) in airlines in exchange for the cash grants (which must be used for employee wages, salaries, and benefits) contemplated by the COVID-19 assistance. Equity stakes are common in government bailouts. Such "equity stakes" would in theory permit taxpayers to

benefit from the financial recovery of the firm. At this time, it remains unclear in what form this equity interest would take.

In the GFC, the government received warrants to purchase stock (GM) and convertible preferred stock (AIG). Another example is the actions of the New Zealand government which utilized equity purchases as a means of cash injection when [refinancing Air New Zealand](#) after the 9/11 attacks. Another successful example, not during a financial crisis, was the utilization of a combination of loan warrants and guarantees in the [aid provided to Chrysler in 1980](#), which resulted in a net profit for the US government.

Developing countries may rely on [sovereign wealth funds](#), which store capital in investment funds during high-income times to fund government policies in low-income times. Other rescues rely on private sector solutions, such as the [formation of a lifeboat fund via private banks](#) for the rescue of Pan Electric Corporation in Singapore. With the global demand shock progressing rapidly through various industries almost simultaneously, a private sector solution may not be the most effective in the current economic environment.

Some commenters have critiqued the [use of warrants](#) as financial injections for poorly managed firms. Another sees the possibility of bankruptcies as necessary to prevent moral hazard if only cash grants or loan programs are offered. ([Casey and Posner 2015](#)). Another critic argues that one-off and full bailouts from the state are inefficient and should not be utilized; standard bankruptcies, perhaps with government assistance, are preferred. (Couwenberg and Lubben 2018). Consistent with this argument, [the Congressional Oversight Panel](#) found that the use of bankruptcy in the aid provided for GM and Chrysler [prevented moral hazard](#) as the companies faced disincentives to apply for aid. The panel estimated that up to 1.1 million auto-related jobs would have been lost if the companies had failed.

Conclusion

Various tools are available to countries that may need to provide assistance to critical industries that experience distress in a crisis. The COVID-19 crisis has shown that direct grants and industry-specific remedies such as the suspension or refund of taxes may be readily available as a first response to quickly provide liquidity. However, as the crisis persists, additional assistance may be needed to sustain companies. Loans and loan guarantees have often been applied at this juncture. A prolonged crisis or the existence of fundamentally weak organizations pose a risk that solvency issues may appear, requiring more intensive measures such as capital injections and restructurings, with or without government assistance, if firms are to recover from the crisis and avoid collapse.