ATA TESTIMONY

# *"CFTC Energy Markets Oil Futures Contracts Oversight"*

**Statement of James C. May**
**President and CEO**
**Air Transport Association of America, Inc.**
**before the**
**Senate Committee on Agriculture, Nutrition and Forestry and the**
**Senate Appropriations Subcommittee on Financial Services and General Government**

**June 17, 2008**

AIR TRANSPORT ASSOCIATION

Chairman Harkin, Chairman Durbin and members of the committees, I welcome your leadership – in particular, Senator Durbin's – in examining the catastrophic impact of high fuel prices on the airline industry and the nation's economy. I hope that the unusual nature of this combined Agriculture Committee and Appropriations Subcommittee hearing is an indication that Congress will move swiftly to find a solution.

My task today is to deliver what I consider to be an extremely disturbing report on the state of the nation's airline industry. Today, we are revising our forecast: this country's airlines expect to lose in the range of **$10 billion this year –** a loss equal to or greater than the worst year in this industry's history.

**High fuel prices are the sole reason.** This year, we will spend more than $60 billion on fuel, at least $20 billion more than last year and slightly more than our combined fuel bill for the first four years of this decade.

Sadly, 2008 could turn out to be the worst year in the industry's history. Unlike the temporary revenue hits from SARS, 9/11 and other one-time demand shocks, the airlines now are facing a massive structural increase – with no end in sight – in a virtually uncontrollable cost. Moreover, there is little low-hanging fruit left to harvest. Unfortunately, not even Chapter 11 can lower the price of fuel.

To many members of Congress, $10 billion is not a lot of money. Let me try to add some context. More than 14,000 airline jobs have been cut so far this year, and that is just the tip of the iceberg. It is not unrealistic to think that by cutting capacity, more than 200 communities could lose all commercial air service by early next year. Orders for new planes have been slashed and hundreds of older, less efficient planes have been taken out of service. We are burning through cash at unprecedented rates, barely surviving from month to month. The nation's airlines will not ever fully recover from this economic blow, and more airlines – in addition to the eight that have already filed for bankruptcy or stopped operating – may simply shut down. That means even more job losses and untold harm to families and the economy.

I assure you that airlines are not gouging passengers with higher fares. As of June 1, analysts [Boyd Group] estimate the average gross fare, including all fees and taxes and all recent fare hikes, is $191.00. Eliminating fees and taxes brings it to $166. At current jet fuel prices, the cost of fuel per passenger is $138.80. That leaves only $27.37 to pay for every other cost – labor, airport fees, insurance and facilities, to name but a few.

Committee members and Congress, for that matter, may ask why the country should care that its airlines are on the brink of financial disaster and – some would say – about to implode. The answer is simple: this nation's economy is inextricably linked to the viability of its air transportation system. If the airlines continue to spiral downward, so will the economy. Aviation contributes $690 billion to the U.S. GDP – that's equal to heating oil costs for 376 million households for one winter, 24 million new cars and 10 million new jobs.

If Congress does not turn things around very soon, the impact on the country's economy will be even worse. Analysts are predicting that a 20 percent reduction in capacity may not be enough to save the industry. If 200-plus communities lose all service, airline hubs will be decimated, tens of thousands more jobs will be eliminated and tourist destinations will be devastated by huge cuts in the number of flights. Realistically, rural areas will be hit the hardest by the cuts, leaving thousands of square miles without air service.

This is NOT what we want to happen in this country. Ask any local chamber of commerce and they will tell you that convenient air service is absolutely critical to economic growth. Without it, businesses are isolated, communities fade away because they never recover from staggering job losses.

Mr. Chairmen, Congress has a choice: stay with the status quo or make the hard decisions. The status quo means continuing to blame high oil prices on the weak dollar and growing demand from China and India. Status quo means forming yet another commission or task force to study the problem and report back in six months. The airlines won't be around much longer if the status quo wins the day.

I am not an expert in the trading of energy commodity futures. In addition to the supply-side solutions where relief is on the long-term horizon, leading commodities experts believe that crude oil prices today are unnecessarily high due, in large part, to excessive market manipulation for which there are short-term solutions. As these experts tell us:

> The proper range for oil prices should be "somewhere between $35 and $65 a barrel." – **John Hofmeister, President of Shell Oil Co.**
>
> There may now be upwards of $25 to $30 of speculation in the price of crude, which continues to soar despite soaring stockpiles in the U.S. **MF Global Energy Risk Management Group**
>
> The increasing prevalence of futures contracts has transformed the nature of oil markets. It is no longer only about the value of oil as an energy commodity, but also…oil as a financial asset. **Goldman Sachs**
>
> If the crude oil market is not physically tight now, there is at least a belief on the part of a bullish speculator that it will become so later. What has driven the market so far, so far, in our view, is that such a high percentage of the speculative trade has become aligned in one direction. **Tim Evans, Citi Futures Perspective**
>
> It also seems hard to dispute that the growth in the size of futures and options trade has something to do with the price movement... [W]e believe that growth in NYMEX trade has certainly made it more dominant relative to the physical market in setting prices than in the past. **Tim Evans, Citi Futures Perspective**

Mr. Chairmen, this country does not need another Enron scandal. Enron destroyed its pensions, its investors and its employees. One of the most disturbing aspects of the current energy market is that studies have shown that the airline and other transportation industries such as trucking have been victimized by loopholes in the law. We have to restore CFTC's authority to prevent improper and excess speculation in the energy sector. Foreign exchanges, such as ICE are allowed to accept energy trades from persons in the United States, and elsewhere, and "to operate with no regulatory oversight, no obligation to ensure its products are traded in a fair and orderly manner, and no obligation to prevent excessive speculation." **Mr. Chairman, that quote is from the Senate Permanent Subcommittee on Investigations.** Some aspects of problems caused by the Enron Loophole were addressed in the farm bill – and those reforms are a good step forward – but more legislative changes are needed.

Mr. Chairmen, all we are seeking are common-sense measures to ensure transparency and an even footing between traders and speculators. I defer to your insight on ways to increase transparency and fairness in the energy commodity futures market – to reel back the overwhelming odds now favoring speculators and institutional investors, particularly those trading on foreign exchanges.

We need action, not more studies or expert commissions. Many have suggested a way forward: totally close the loopholes that permit large institutional traders to avoid any real oversight or financial requirements; curtail extremely risky investments by pension funds that jeopardize savings for employees across the country; eliminate trading advantages for the huge speculative traders over those who plan to use the products they buy rather than trading them over and over again for unbelievable profits; and make the commodity market true to supply-and-demand fundamentals.

As the Permanent Subcommittee on Investigations of the Senate Homeland Security and Government Affairs Committee found:

> Congress needs to "level the regulatory playing field between the NYMEX and the ICE exchanges, increase energy price transparency, and strengthen the ability of CFTC to analyze market transactions and police U.S. energy commodity markets.
>
> It is "essential" that CFTC have "access to daily reports of large trades of energy commodities … to deter and detect price manipulation."
>
> ***CFTC*** **"**surveillance tools have not matched the subsequent growth in commodity trading, electronic trading and speculative trading, especially for energy products."
> "The energy futures market is really about whether families will be able to afford to heat their homes and fill up at the pump."
> **"**More and more trading occurs on electronic markets without oversight…"

Mr. Chairmen and committee members, your leadership and insight are greatly appreciated.

As I said at the beginning of my remarks, if Congress does not act soon, this country will not have a viable airline industry. Thank you.