

FLY FLY AWAY

MIDWEST EXPRESS AND THE WISCONSIN ANNOYANCE TAX

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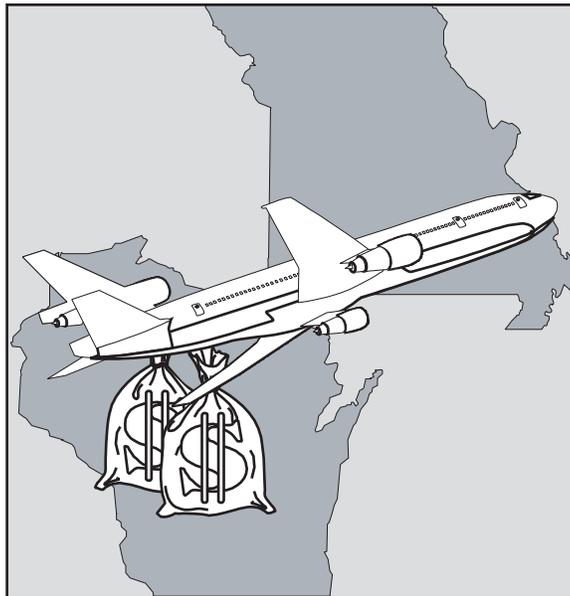
On April 25, 2001, Midwest Express airlines held its annual stockholders' meeting.

Basking in positive national media coverage and with a \$1 billion expansion plan in the works, Wisconsin's biggest airline had reasons to feel bullish.

The host city's business community feted airline executives. Local political officials made it clear how much they appreciated the airline's presence and continued expansion there. Two days earlier Midwest Express began daily service to New Orleans, building on its commitment to make the city into a major hub. Only a month earlier the airline had purchased naming rights to a portion of the baseball stadium so that fans "will recognize Midwest Express as a supporter of the hometown team as well."

The hometown, however, was not Milwaukee. It was Kansas City.

As a signal to Wisconsin's political class, the event could hardly have been fraught with more meaning. For two consecutive legislative sessions, the airline's pleas for minor tax relief had been ignored, the victim of political gamesmanship. Even as Midwest Express held



its first stockholder's meeting in Kansas City, legislation to help the airline was mired in political gridlock in Madison. Meanwhile, the airline continued to make critical long term decisions about whether it would expand its operations in Wisconsin — or whether it would look elsewhere.

Back To The Future

In the mid-1980s, the decision by Kimberly-Clark to move its corporate headquarters out of Wisconsin shocked the state's political community into addressing the state's increasingly hostile business climate. The company's criticism of the state's environment for business and subsequent decision to seek friendlier pastures elsewhere contributed substantially to the defeat of Democrat Tony Earl by challenger Tommy Thompson in 1986 and, at least for the time, changed the political landscape for business.

Nearly 20 years later, the state's treatment of Midwest Express promises to re-ignite the

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same concerns, with equally wide-ranging consequences. Some politicians seem to forget that the airline began life as a subsidiary of Kimberly-Clark. Even though Midwest Express was spun off from its parent in the mid-1990s, the corporate tradition is not merely a matter of historical interest. It is a powerful cautionary note to state leaders. Kimberly Clark is long gone and airplanes are, if anything, far more easily moved than the assets of most businesses.

Senate Majority Leader Chuck Chvala says publicly that he favors the tax break, but he has also made it clear that Midwest Express has become a bargaining chip in the legislative battles over the state budget. Chvala has played similar high stakes games with the Brewers, even with legislation to help the Packers renovate Lambeau Field.

But his handling of Midwest Express might not be business as usual. The legislative drama is being widely watched, not simply because the direct stakes are so high, but because of what Midwest Express's experience says about the prospects of other businesses who might find themselves in need of state help.

On paper, Midwest Express has done everything right. It is an outstanding company, which has won national recognition in a highly competitive business. The company is well liked, a generous corporate citizen, extremely popular among travelers, politically modest, cautious and diligent. The airline bill has emerged as the top legislative priority for the Metropolitan Milwaukee Association of Commerce, which calls the legislation "an investment in the infrastructure that supports our economy."

The tax break Midwest Express is seeking would cost the state little money, would increase the chances that the airline will create thousands of jobs here and instantly add new cities served by non-stop flights.

And yet it finds itself stuck in Wisconsin's political limbo.

Success, Wisconsin-Style

With its extra-wide seats, exceptional food, chocolate chip cookies, and attention to customer service, Midwest Express has become a traveling industry phenomenon. Midwest Express and its subsidiary, Skyway, now account for about one-third of all the flights through Milwaukee's General Mitchell International Airport, but it has also won national plaudits. In 2000, *Travel & Leisure* named Midwest Express Airlines the "Best Domestic Airline" for the third time in four years. That same year readers of *Condé Nast Traveler* magazine rated Midwest Express as the #1 U.S. Airline for the sixth year in a row. In 1998, *Aviation Week & Space Technology* named Midwest Express Airlines "Best-Managed National Airline."

And just weeks before the company's annual meeting in Kansas City the airline was once again singled out by Zagat as the country's best domestic airline. Compared with international airlines, Zagat rated Midwest Express second only to Singapore airlines, which received only a single point higher rating in the survey of 31,500 frequent flyers.

Quality sells and it has driven the company's growth. Several years ago, Midwest Express announced plans for a \$1 billion expansion, nearly doubling the size of its air fleet over the next six years. Coincidentally, the state's other major airline, Air Wisconsin announced that it too was planning a \$1 billion expansion, buying as many as 150 new regional jets. Officials from both companies said they wanted to keep much of that growth in Wisconsin.

Leaders of the business community applauded the planned expansion.

"Milwaukee's economy and its growing e-commerce presence is ever more dependent on good air service and links, not less," says Tim Sheehy, the president of the Metropolitan Association of Commerce. "The new economy needs great air service. Milwaukee and the region and state would be sucking wind with-

out the advantage of a hubbing airline like Midwest Express; it is one of our competitive advantages.”

A major stumbling block to staying here, however, was Wisconsin’s tax code.

The Annoyance Tax

Wisconsin’s system of taxing airplanes is unusually Byzantine even by Wisconsin’s convoluted standards. Most businesses no longer pay property taxes on their machinery and equipment. The exception is airplanes. A Rube Goldberg tax is assessed against the planes based on the number of origination and destination miles — but the bottom line is that it penalizes air carriers who expand their service in Wisconsin.

Clearly, the tax laws were written at a time when the prospects were remote that a major national airline would locate its headquarters in the state. The success of both Midwest Express and Air Wisconsin has changed that; but the tax code remains in place, even though it now jeopardizes billions of dollars of investment, thousands of jobs and the advantages of having easy non-stop travel. According to the Commerce Association’s analysis, Midwest Express’s presence in the state generates more than 10,600 jobs and more than \$266 million in personal earnings. In 1998, business revenue associated with the airlines amounted to \$459 million, while supported state and local tax revenue topped \$50 million a year.

In contrast, the tax on airplanes generated little meaningful revenue. The total price tag on the tax break is a mere \$2.5 million — of which \$1.7 million would go to Midwest Express.

The tax on the airlines had become a classic WAT — a Wisconsin Annoyance Tax: a tax

which generates a piddly amount of revenue, grossly disproportionate to the economic disincentives it creates. Seldom had so much been at stake for so little.

Beginning in the late 1990s, the airlines began pushing for a level playing field. Simply put: they wanted their airplanes to be exempted from taxation just as other businesses were able to exempt their machinery and equipment. The reform would bring Wisconsin’s tax policy into line with other surrounding states, many of them eager to have the airlines expand operations in their states.

The competition is very real. Air Wisconsin’s plans for new jets includes plans

to develop a new maintenance base, which could be in Milwaukee or Madison — or in one of a number of non-Wisconsin cities already vying for the plum. Air Wisconsin officials have said that airports in Moline, Illinois, and Gary and Fort Wayne, Indiana are being considered.

Midwest Express hopes to add 1,200 employees to the 2,700 workers it now employs.

Neighboring states which covet those same jobs would not force Midwest Express to pay property taxes on any new equipment it purchases — in stark contrast to Wisconsin’s punitive tax code.

Underlining this point, Carol Skornicka, the airline’s senior vice president, said that it would be “five to seven times” more expensive for Midwest Express to expand here than in other states. Soft-pedaling any direct threat, Skornicka was nevertheless clear about the implications of the tax vote. While Midwest Express would like “as much as that is possible” to double its fleet here in Wisconsin, “There are opportunities all over the country for us to grow that do not involve Milwaukee or Wisconsin.”

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The numbers are striking. A state-by-state comparison by the Metropolitan Milwaukee Association of Commerce concluded that Midwest Express would pay \$19 million more in income and property taxes in Wisconsin than it would in Minnesota; and \$30 million more than it would in Illinois over the next six years.

Held Hostage

On its merits alone, the tax relief bill should have encountered little trouble. Indeed, in the State Assembly opposition has shrunk to about a dozen "progressives" who no longer can attract even a handful of their more moderate colleagues.

Support for the measure comes from across the political spectrum, from both parties in both houses of the legislature. By most accounts, the airlines have done virtually everything right; lobbied aggressively, built support, answered the concerns of their critics. Early objections to the tax breaks had come from small private airport operators, who feared that they would receive less state aid if the revenue were cut. Those concerns were addressed, with assurances that the smaller airports would not lose out if the tax break were enacted.

Despite those efforts, Senate Majority Leader Chuck Chvala quietly killed the tax relief last year without ever allowing it to come to a vote. It was the second consecutive session in which the bill had died.

Independent observers have noted Midwest Express's frustration.

"For two years, Midwest Express has worked diligently to get the break enacted," wrote *Milwaukee Journal Sentinel* columnist Avrum Lank. "Airline officials have learned and followed legislative, lobbying, and political rules almost as Byzantine as those the airlines use to set fares.

"They showed up in the right places at the right times to get their lawmaking baggage cleared and ticket punched. As a result, most

government officials, from the governor on down, have said they endorse the bill."

Filings with the state indicated that the two airlines spent a combined \$209,439 lobbying the legislature on the tax bill in just the first six months of 2000. Midwest Express itself reported spending 780 hours lobbying for the bill. Ultimately the company gave up its high-priced contract lobbyists and turned the issue over to the Milwaukee Metropolitan Association of Commerce, which made the legislation its top legislative priority.

Still, they found themselves stalled.

Signals

Midwest Express has avoided making threats or issuing ultimatums. It has, however, given out signals.

- In May 2000, Midwest Express asked for permission to begin two daily flights between Indianapolis and Washington, D.C. The significance of the request was not lost on the *Milwaukee Journal Sentinel*, which noted that the airline was "continuing its trend of adding new service away from its Milwaukee hub."
- In September 2000, Midwest Express announced it would open a hub in Kansas City. Airline CEO Timothy Hoeksema said that the move to expand in KC "reflects a long-term commitment to providing Kansas City travelers the best care in air." The airline immediately announced 22 weekday departures to 11 non-stop destinations.

Especially notable for Milwaukee travelers was the announcement that the new KC service would include a daily roundtrip to San Francisco — service the airline has not yet offered on a year-round basis from Milwaukee. Sheehy issued an ominous warning: "The future of Midwest Express's expansion plans in Wisconsin remains in doubt until the Legislature reforms the current tax code. With three hubs, we believe Milwaukee will now compete with Midwest Express's other hubs for any expansion of resources."

"This is a direct blow for Milwaukee," said State Representative Jeff Stone (R-Greenfield). "It's opportunity lost for Milwaukee."

Midwest Express VP Carol Skornicka tried to dampen the blow, saying that the decision to open the third hub was "a combination of things." The tax bill "was a factor, but not determinative."

- In March 2001, the airlines announced a deal with the Kansas City Royals baseball team for the airline to provide in-stadium sponsorship beginning with this season. In addition to signs around Kauffman Stadium, Midwest Express also bought naming rights for an exclusive premium seating area that will henceforth be known as the Midwest Express Crown Club. "Our sponsorship with the Kansas City Royals underscores our sincere commitment to the market, and allows us to reach potential customers in the emotional environment of Kauffman Stadium," said James J. Reichart, director of advertising and brand for Midwest Express. "Fans of the Royals will recognize Midwest Express as a supporter of the hometown team, as well." The press release announcing the naming deal noted that Midwest Express has been recognized by *Ingram's* as Kansas City's preferred airline.

- Finally, Midwest Express Holdings announced that for the first time, its annual shareholder meeting would not be held in Milwaukee. Instead, it would be held April 25 at the Hyatt Regency Crown Center — in Kansas City. A spokesman for the airline downplayed any link to the tax issue, but stressed: "We really wanted to show our commitment to the [Kansas City] community." In choosing Kansas City, the company bypassed Milwaukee's own Midwest Express Center.

Business As Bargaining Chips

In March, the State Assembly voted once again to approve the relief bill — this time by a margin of 80-15. Led by Representative Tim Carpenter (D-Milwaukee) a handful of Democratic legislators delayed final passage by a week. Carpenter charged that the bill amounted to "corporate welfare," but he got few takers, even on his own side of the aisle.

Republican Speaker Scott Jensen said: "These are jobs for the people of Wisconsin, good paying jobs. They are buying the planes no matter what. The billion dollar decision is where they will put them." Democrat Antonio Riley (D-Milwaukee) echoed Jensen: "This is a question of economic growth."

Instead of acting on the legislation, Senate Leader Chuck Chvala once again indicated that he intends to hold it up until the entire state budget is deliberated sometime later in 2001. In Madison political-speak that means that Midwest Express has become a pawn in a larger political game. Chvala has made it clear that he intends to

use the urgent and popular airline bill as leverage to win concessions from Republicans. In the meantime, the airline continues to make decisions about its future.

Midwest Express CEO Hoeksema's rhetoric has also been increasingly explicit. "We made decisions last year with respect to *not growing in Wisconsin*," he said late in March. "We made decisions this year with respect to *not growing in Wisconsin*. We continue to grow. . . . The growth is just not occurring in Wisconsin. So I think the timing is the sooner the better for the taxpayers of Wisconsin."

As the airline twists in the political winds, the story is being watched closely by other

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businesses. Inevitably they have to ask themselves what their own chances would be, seeing the way the state's politicians treated a company as successful, popular, and important as Midwest Express.

Given the state's deep-seated progressivism, there is always a danger of a re-emergence of anti-business politics. But business in Wisconsin now faces a new and equally dangerous threat: becoming collateral damage in bitter political wrangles in which they are

mere bystanders. Political uncertainty imposes its own risks, increasing the cost of doing business in Wisconsin.

That is certainly the case for the state's airlines. Significantly, if the airline bill dies again, it will not be because of policy differences, or even ideological opposition.

It will simply be because Midwest Express found itself in the wrong state at the wrong time. That lesson will not be lost on the airline — or any other business.