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Leaving on a deregulated jet plane, maybe

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Leaving on a Deregulated Jet Plane, Maybe

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Introduction

In the past few years, there have been major changes in the airline industry. These changes have come about because of the Deregulation Act of 1978. The industry had been regulated almost since its inception. In 1938 the Civil Aeronautics Board was established to economically regulate the industry. CAB had control over authorizing new carriers, new routes, and fares. Since deregulation, the carriers have control over setting their own fares, and there are no longer barriers to entry or exit. In looking at the effects of deregulation it is important to first get an understanding of the theory of market organization for the airline industry and then an understanding of what it was like during regulation. After regulation, a look at the major provisions of the Deregulation Act of 1978 and the theory behind it will be done. The next step will be the early effects of deregulation and then the trends of the industry in the past couple of years. Finally, a verdict on deregulation will be given, followed by a look into the future of the industry.

Theory of Market Organization

Before starting a discussion of the market organization of the airline industry, it would be helpful to define a few terms. A revenue passenger mile or RPM is one revenue passenger transported one mile. The load factor is the percentage of seating capacity that is actually sold and utilized. The formula for the load factor is the RPM divided by available seat miles. Frequency refers to how often or how many flights to a particular point an airline offers. These three terms will be used throughout this discussion of the airline industry.

The airline industry is a very cyclical industry heavily influenced by the business cycle. The cycle, which is also influenced by the capital intensive nature of the industry, repeats itself about every five to ten years. It is about this length of time that the airlines need to think about making large capital outlays to update their fleet and phase out the obsolete aircraft. The airline industry follows the business cycle very closely since for many people flying is a luxury. Therefore, when the economy is doing well the airlines do well, and when the economy is in a recession the airlines do poorly. Equilibrium is achieved in the market when the fares equal the average cost of producing service. When the industry was operating under fixed fares and the airline had excess profits on a route, they would raise the level of service on that route until they no longer had excess profits. Then when revenues were too low they would lower the level of service until they were back at equilibrium. In analyzing load factors the airline is in equilibrium when the actual load factor equals the break even load factor. Therefore, when the actual load factor is greater than the break even load factor the airline has two choices to reach equilibrium. It can decrease frequency, or it can raise its fares.

Before deregulation, the airline industry was characterized by subsidization. Internal cross subsidization occurred because the airlines were not free to exit unprofitable routes and were required to serve small markets as well as large markets. The per mile operating costs of an airline decrease with the length of the haul. Therefore, the short haul routes are not as profitable as the long haul routes. The airlines used the excess profits made on long haul routes to subsidize the short haul routes. They also subsidized their financially weak routes with stronger ones. This cross subsidization does not give any incentives for efficiency. External subsidization occurs when the airlines are paid by the government to keep servicing small communities. The government makes subsidy payments to the airlines so that they do not lose money while servicing the small communities.

Regulation

Until the late 1930's, the airline industry had no real clear direction or regulation. Then in the late 1930's a five man Federal Aviation committee made a study to recommend future aviation policy. The recommendation they came up with was the creation of a separate agency to oversee the economic regulation of the airline industry. It was determined that legislation was needed to provide control of competition and to assure the amount of carrier operation needed to stabilize the industry financially. This led to the birth of the Civil Aeronautics Board (CAB) in 1938. CAB was an independent federal agency which consisted of five members appointed for a six year term by the President with the approval of the Senate. The theory behind the regulation of the airline industry was that common carrier transportation is a public utility, and regulation is needed to make sure that the public is adequately served.

The most important objectives of the Civil Aeronautics Act of 1938 that CAB was to implement are as follows:

> "The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discrimination, undue preferences or advantages, or unfair or destructive competitive practices. Competition to the extent necessary to assure the sound development of an air transportation system properly adapted to the needs of the foreign and domestic commerce of the United States."[1]

These objectives required CAB to perform a balancing act between the two. They needed to make sure there was enough competition to offer consumers a choice, but not so much as to undermine the industry. One way CAB regulated the industry was through its policies on fares. The carriers were required to file tariffs showing all of their rates, fares, and charges for air transportation. They were then not allowed to charge fares that were different from their tariff. If the carrier wished to change its fare, it had to file a thirty day notice with CAB. This regulation made it hard for the airlines to compete on the basis of price. This led to them all charging basically the same fares and competing on the basis of service.

Another way that CAB regulated the industry was through its control over entry and the route structure. Its main tool for controlling entry was the certificate of public convenience and necessity. Airlines were required to obtain a certificate before they were allowed to operate. Once a carrier received a certificate they were only allowed to operate on the routes specified in their certificate. The objective was to provide the public with the benefit of competition while protecting existing carriers from excessive competition. The criteria CAB used to determine whether or not to grant new routes or an extension of already existing routes were as follows:

1. Does a public need exist that will be served usefully by the applicant's service?
2. Can this need be fulfilled adequately by the existing carriers?

3. Will the service proposed by the applicant jeopardize the operations of the existing carriers contrary to the public interest?
4. Does the cost of the proposed service exceed the benefit?
5. Does the financial and economic need of the applicant carrier justify the award?"[2]

These criteria and the certificate provided an effective barrier to entry into the industry. Monopoly route awards were granted to carriers that were in weak financial positions in order to strengthen and maintain the stability of the industry. Not only was entry into the industry controlled, but CAB also established barriers to exit. Before an airline could stop service on a route, they had to file an application, go through proceedings with CAB, and then get approval.

One final policy of CAB was the imposition of public service obligations on the carriers. They had to serve large and small communities and large and small markets. They were required to do this unless relieved by CAB. This led to subsidization of the carrier by the government. This policy made sure that the public was served even in small communities.

Mergers and acquisitions have been a part of American business almost since the beginning. Almost every industry has seen mergers between companies within the industry. The reasons for airlines to merge in the regulated environment are numerous. One reason is to become more efficient and to serve their markets more effectively. Another reason is to avoid bankruptcy. Financially weak carriers would merge with stronger ones in order to avoid disrupting the industry by going bankrupt. Airlines also merged to diversify, eliminate competition, and to avoid seasonality problems. They would try to obtain routes that would provide traffic in their off seasons. Under regulation though the most important reason a carrier merged with another was to get a whole network of routes at once instead of applying for them one at a time.

In order for a merger to be accomplished CAB had to approve it. One of the factors that they looked at was the effects on competition. If the merger would substantially lessen competition, they would deny the merger unless other factors outweighed that effect. Other factors they looked at were the diversion of traffic from the other carriers and the level of services offered. Finally they considered the effects on the industry structure and market conduct. Section 408 of the Civil Aeronautics Act of 1938 prohibits CAB from approving mergers that create a monopoly, restrain competition, or jeopardize another carrier. To get around the anti-monopoly prohibition, CAB used the failing business doctrine. The failing business doctrine allowed a merger even if it created a monopoly if the carrier being acquired was going into bankruptcy. This was the most common reason for mergers in the 1970's. In addition to CAB being involved with the approval of mergers, the Department of Transportation could intervene in the proceedings and make recommendations to CAB. The Department of Justice also was allowed to participate in the proceedings and enforce the anti-monopoly, antitrust laws.

1978 Act of Deregulation

Since the establishment of CAB in 1938, the costs and benefits of regulation have been debated. In his book Regulation and Its Reform, Stephen Breyer discusses the "mismatch" between excessive competition and airline regulation. He says "classical regulation should not be used to control excessive competition. Deregulation and reliance upon antitrust are more suitable."[3] He states three arguments to support his conclusion that price and entry regulation applied to a complex industry, such as the airline industry, is a mismatch. First he states that regulation produces unnecessary anticompetitive harms. Second he argues that it is difficult for regulators to apply cost of service rate making to an industry with many firms. His final argument is that the rationale underlying regulation is weak. He finds classical regulation to be inappropriate because of the highly competitive, highly volatile nature of the airline industry, and because of the complex cost structure. The proponents of deregulation base their support on the theory that airlines are not public utilities, but are like any other business, "the theories hold that these businesses are also of importance to the public, are not governmentally controlled, and yet their services and products are forthcoming at reasonable prices in an atmosphere where the absence of economic regulation and the interplay of free-market forces allows for maximum efficiencies and allocations of resources."[4]

The hypothesis for deregulation is that with open entry and unrestricted fares equilibrium will be achieved through the market forces. Supporters of deregulation say that the public "wants" low cost travel even if it results in a lower quality of service. Deregulation was also supposed to eliminate the monopolies held by certain carriers in some markets, and result in lower fares. Internal cross-subsidization would be eliminated since airlines could exit from unprofitable routes. The small community markets were there was not enough traffic to make it profitable for major carriers would be served by commuter carriers. Finally, deregulation would reduce overcapacity and raise the load factor.

The opponents of deregulation were the ones that benefited under regulation. The major certificated air carriers did not have to worry about competition under regulation. Employees of the industry benefited from the suppressed competition in the form of higher wages and fringe benefits. The small communities benefited because they had air carrier service under regulation. Airport operators also benefited under regulation. The few airlines that supported deregulation did so because they were being limited by regulation. The opponents of deregulation predicted that deregulation would produce gross inefficiency in the industry. Another prediction was that the markets would be dominated by a few carriers. They also thought service to the small communities would disappear. Another fear was that there would be insecurity for the employees if the new carriers used nonunion employees. They also predicted that safety would be endangered while the airlines struggled to cut costs to keep up with the competition. Another argument was that the airlines would have a diminished ability to finance their capital requirements. The banks would not be as willing to lend money because there would be more risk of the airline failing.

On October 14, 1978, the Deregulation Act was enacted. The major changes that Congress implemented through the Act went a long way in deregulating the industry while still easing into it gradually. One of the biggest changes made was the abolition of CAB. Congress phased out CAB gradually to allow time for the industry to adjust. On January 1, 1982, CAB lost almost all power to control entry by new carriers on entry into new markets. On January 1, 1983, they lost their power over passenger fares, and their authority over mergers was transferred to the Department of Justice. On January 1, 1984, CAB was to report to Congress on the progress of and the effects of deregulation. Finally on January 1, 1985, CAB was to be phased out completely if changes were not made.

Other major changes occurred in route entry and exit controls. The certificate of public necessity and convenience is still technically required, but is freely given if the applicant is fit. In regards to route exit, the carrier is allowed to terminate services at a community after giving 90 days advance notice. Congress did put restrictions on a carrier's exit rights at small communities. During the ten year transition period CAB and then the Department of Transportation were given the power to require the last airline serving a particular community to maintain air service until a replacement could be found. The airline would be paid compensation for any losses they incurred during the period of their stay beyond the termination date. Therefore, the barriers to entry and exit were substantially reduced. Along with the change in route entry and exit was the change in service obligations. There were no longer any obligations on the airline to continue services.

The Deregulation Act completely deregulated rates and fares. Each airline could set their prices at whatever level they wanted. This gave the airlines greater freedom for discount pricing.

One final provision of the Deregulation Act was the express federal preemption provision. It states that no state or other governmental unit can enforce any laws or regulations concerning rates, routes or services of any carrier that is entitled to provide interstate air transportation.

The Early Effects of Deregulation

The early effects of the Deregulation Act of 1978 were clouded by the economic environment in which it was begun. The economy was plagued by high inflation and rising fuel costs in 1979. The inflation plus the rising cost of fuel made things difficult for the industry. It also made the determination of what effects deregulation had difficult. In 1978, the year in which deregulation was activated, the airline industry had record profits. Then in the third and fourth quarters of 1979 the industry had a slump, and there were losses for many carriers. The increase in fuel costs and the recession were major causes of the slump in 1979. The rising fuel prices had two major system wide effects. First of all, it encouraged the transfer of short haul routes in low density markets from jet carriers to the commuters. By eliminating the exit barriers deregulation made this easier to accomplish. It was more fuel efficient for the commuters to serve these markets with their small planes than for the major carriers. The second system wide effect of the rising fuel costs was that almost 1/4 of the jet industry's capacity became obsolete faster than it normally would have. Therefore, the airlines were faced with the problem of replacing them.

With the beginning of deregulation, the airlines faced many new challenges and problems. Management had to learn how to plan new strategies, and consider factors, such as fares, that they had no control over before. Deregulation allowed the carriers to compete on the basis of fares for the first time. Supporters of deregulation thought that all fares across the board would be lowered. Instead, management decided to develop discount fares, and limit them so that fares were changed on a selective basis. Regulation had created much excess capacity in the industry. The average load factor at the beginning of deregulation was 53%. The airlines strategy was to increase revenues at little extra cost by offering discounts to people who normally would not consider flying, and thus get rid of excess capacity. They limited the discounts in such a way that it would be hard for the business travellers to use them, since the businessman would be travelling anyways. They could do this at little extra cost because the largest costs of the flights were fuel, labor, and airport usage. They would already be incurring these costs anyway, but with the added passengers the costs could be spread over more people. Also with the freedom of fare selection the airlines were able to offer a variety of price and quality combinations to appeal to a variety of people.

Another factor that management had to contend with was increased competition from new airlines. Many new airlines were born after the entry barriers to the industry were lifted. Some of the new airlines were Midway, People Express and New York Air. The emergence of these new carriers made it difficult for the already established major carriers. The new carriers were able to achieve lower costs and thereby charge lower fares. The difference in costs can be attributed in part to the use of nonunionized workers. The use of nonunion labor enabled the new carriers to have lower labor costs. The new carriers also achieved greater productivity from the work force. People Express is a good example of greater productivity from the work force. People Express made their employees feel like they were owners of the airline. The employees all had stock in the company, and helped out in other areas of the company besides their own. Another difference is that the new carriers use their planes more intensively. Frequently, they only have one type of plane. Also they fly into and out of the less congested airports thereby avoiding direct competition with the majors. These differences in costs resulted in the new carriers having cost levels 25 to 30 % below that of the established carriers. The lower costs enabled the new carriers to offer low discount fares. People Express offered "no frills," low fare service. Besides the competition from new carriers, the major carriers also had to deal with the local service airlines that started to expand their networks.

The actual and threatened competitive entry by new carriers, and the expansion of established carriers into new routes provided strong incentives to the carriers to be more efficient. Not only did deregulation provide the incentive to improve efficiency and productivity, it also provided the means to accomplish it by giving management more freedom and control. Improvement could be seen in the 1970's through such factors as seat miles flown and traffic volume. The average number of hours a plane spent in the air each day increased from 8.3 hours in 1974-75 to 9.3 hours in 1979. This improved airplane utilization reduces capital expenditures without sacrificing load factors. Since 1976, seating density has increased. During the 1979 slowdown in traffic, the airlines offset 32% of input price hikes through increased efficiency and productivity, whereas before deregulation input price hikes were passed through to the consumer. Before deregulation, the industry had been unable to keep up with the growth of potential capacity. After deregulation the industry exploited potential capacity with increased intensity. The increase in output and the decrease in costs eliminated the slack created by regulatory policies.

Another new experience or freedom for management was the ability to enter new routes or exit from the routes they had. This opened the way to a new level of strategic planning for the managers. There are many route strategies available for the airlines to pursue. Each airline has to judge what their strengths and weaknesses are and assess the competitive and economic environments to determine which strategy or strategies to follow and at what rate to adopt it.

One strategic option available to the airlines is hub strengthening. Hub strengthening is based on the hub and spoke networks most airlines utilize. Hub and spoke networks offer the advantage of having a central location for maintenance and operations with the spokes providing feeder traffic. Another strategy is called "longer and stronger." This strategy is based on a serial route structure. Under this strategy the object is to strengthen the airline by achieving longer routes. Network extension is another route strategy that the airlines can use. Network extension can be accomplished through internal growth or through internal growth or through mergers. Regional rationalization provides a strong regional identity for the airline. It is mainly implemented by local service carriers and commuter carriers. Another strategic option is seasonality reduction. The final option available to the airlines is opting out. If the airline finds that it cannot operate in a deregulated environment, it can minimize financial harm to the owners by utilizing this strategy. The following table summarizes the strategies used by the airlines and at which rate they adopted it for the period 1976-1979.

Airlines Grouped by Principal Strategy, 1976–1979

Principal Strategy	*Airline*	*Rate*	*Minor Strategy*
Trunk Airlines			
Hub Strengthening	Delta	Medium	
	Eastern	Medium	Network extension (transcontinental)
Longer and Stronger	Continental	Medium	
	National	High	
	United	Low	Network extension
	Western	Low	Network extension
Network Extension	American	Low-Medium	
	Braniff	High	
	Northwest	Low-Medium	Longer and stronger
	TWA	Medium-High	
Local Service Airlines			
Network Extension	Hughes	High	Pruning multiple stops (regional rationalization)
	Frontier	High	Regional pruning
	North Central (internal and acquisition)	High	
	Ozark	High	
	Piedmont	Medium-High	Pruning multiple stops
	Texas International	High	Longer and Stronger (regional pruning)
Hub Strengthening	Allegheny	Low	
Regional Rationalization	Southern	Medium-High	Longer and stronger

Taken from Airline Deregulation: The Early Experience p. 111

Other occurrences in relation to routes after deregulation are the modification and diversification of routes. In modifying their route network the airlines added longer haul routes and deleted short haul routes. Their reason for this was that longer haul routes are more profitable for them. They diversified their routes to reduce seasonality, improve their market traffic mix base, and improve their fleet utilization. Small intrastate and commuter carriers expanded their service into new and major routes, providing competition for the trunk carriers.

In the first few years after the deregulation Act of 1978, the market share of the major trunk carriers decreased, and there were more competitors in each market offering more choices to the consumer. This can be directly attributed to deregulation and the lifting of the barriers to entry. Deregulation allowed new carriers to be formed and existing carriers to expand into new routes.

One concern that the opponents of deregulation had was that service to small communities would be hurt. They argued that with the ease of entry and exit the airlines would leave the small communities for high density markets. From July 1, 1968 to October 24, 1978, 75 terminations of service were allowed. After deregulation the number of terminations filed increased rapidly. From October 24, 1978 to June 30, 1979, 134 terminations were filed. The peak month of terminations was November 1978. The termination points filed then were the ones that the airlines had been wanting to get rid of for a while. The communities that are classified as nonhubs, less than .049% of the national total of passengers, as a group were no worse off under deregulation than they had been before. The group average of departures per week was 7.1% more in 1979 than it had been in 1978. There was s shift away from flights between two nonhubs. The small hubs, .05% to .249% of the national total of passengers, had their service change from multistop to one stop and nonstop. Some of the small communities were hurt by terminations and lost services, but many others were either not affected or ended up with better service. In part the small communities did not suffer because of the regulation making the airline stay until a replacement had been found. Another factor is the commuter carriers taking the place of the air carriers that terminate service. Overall deregulation had not harmed small communities in its first phase, and there was a net decrease in subsidy payments.

Another factor that was affected by deregulation was the growth of airlines through mergers. Deregulation changed the importance management placed on the reasons for mergers discussed earlier. The carriers no longer needed to merge with another carrier to obtain new routes, but still a great number of mergers took place after deregulation. The carriers now were merging to acquire planes, gate space, and landing slots. Since carriers could now expand easily, they did. Gate spaces and landing slots became scarce resources. Another reason for mergers before deregulation was to avoid large changes in industry structure caused by carrier failures. The industry suffered a shakeout of unhealthy carriers thereby achieving greater efficiency. In his book Airlines in Transition, Nawal Taneja sums up what will happen through this industry shakeout. "The survivors in the industry will be the airlines that not only control costs and tailor capacity acquisition to financial ability, but also attempt to find an optimal solution to the balance among the investment decision, the financing decision, and the dividend decision."[5] Policies for approval of mergers also changed bringing them closer to the standards used in other industries. Proposed mergers were looked at in relation to the Sherman and Clayton Antitrust Acts. Generally in the early phases of deregulation mergers that were parallel in character were not approved. Parallel in character means that the two airlines flew the same routes. A merger between them would effectively limit competition. End to end mergers, on the other hand, were approved. With end to end mergers, there is not a lessening of competition since the merger would complete routes. The failing business doctrine was still used in cases were one of the carries was near bankruptcy. These then are the early effects of deregulation.

Recent Trends

Lately there has been quite a lot of activity in the airline industry. Airlines are announcing lower fares, mergers, failures, and problems with labor. Fare wars have been occurring frequently as airlines try to compete and gain market share. Fare wars first started when new discount carriers such as People Express started competing for market share with the major carriers. At first, the airlines did not lower their fares to match those of the discount carriers, but when they started losing market share they quickly followed suit. Since that time, fare wars have usually been in evidence. During the summer of 1986, fare wars were still going strong even after the failure of People Express. Carriers, such as American Airlines and United Airlines, were trying to attract customers away from competitors and could afford to keep cutting prices. The 1986 summer fare wars caused the airlines to lose profits that they could have made since fuel and labor costs were down. In late September and early October of 1986, People Express was desperately trying to attract customers by offering half-price fares on domestic flights. In October of 1986, the major air carriers tried to raise fares on average of more than 5%. Alfred Kahn, former chairman of CAB said "As the industry gets more concentrated, price competition will diminish. To some extent that is inevitable because everybody is losing money and so the present program of fares is not sustainable."[6] In November 1986, fare wares again broke out as Continental lowered its fares out of Chicago. Delta also started fare battles in trying to promote its new hub in Cincinnati. Continental can effectively lower its fares because it has lower costs than the other major airlines. The lower fares hurt the other carriers more. Fare wars continued into 1987 as Texas Air started cutting its fares. Texas Air has proven to be a price leader in recent months, as it can afford to lower its price because of lower costs. Airlines that try to raise fares find it difficult because the other airlines will not always go along.

At first airlines lowered their fares to compete with the discount carriers, but as the discount carriers faded way there were still fare wars. Carriers then were lowering fares to promote new identities after mergers and fill empty seats. The airlines attracted the consumers who otherwise would not fly, and are finding out that raising fares loses these consumers. The fare wars caused lost profits for many airlines, and caused some to fail. Many travellers are traveling while the fares are low and will not be travelling later in the summer of 1987 when airlines want to raise fares. In a Wall Street Journal article dated June 26, 1986, a reason for fare wars is given. "The Machiavellian view is that big carriers want weaker rivals to continue losing money so they can buy them later at bargain prices."[7]

Although fare wars are continuing, there are now more restrictions on discount fares. In February, Texas Air introduced Max Saver fares. One feature of these discount fares was nonrefundability. If the customer does not use the ticket, he does not get his money back. Other restrictions that the airlines are trying to implement are having to buy the tickets in advance. Because competition has been reduced in some markets, overall fares have increased somewhat. The bargain fares are harder to get and are not offered everywhere. Heavily competitive areas still have low fares. The airlines are offering higher unrestricted fares and more restricted discount fares.

Fare wars have helped contribute to the industry shakeout. When deregulation first began, many new airlines were born and existing carriers started to expand. Local service and commuter airlines started competing with the major carriers. Frank Lorenzo from Texas Air demonstrates this expansion. He started out with Jet Capital Corporation and then took over Trans Texas airlines and became Texas International. It is now Texas Air and since deregulation has acquired Continental, Frontier, People Express, New York Air, and Eastern giving Lornezo control of the nation's biggest airline network. Texas and its acquisitions are examples of the merger mania in the past two years. Airlines are trying to expand as rapidly as possible in the deregulated environment. Through mergers, they can get the routes they want, aircraft, and scarce resources such as landing slots, gates, and airport facilities. Some of the airlines that are acquiring other carriers are finding it tough to merge their empire together. They have to fit one carrier with another. In the process of doing this, their service goes down. Many consumers have been complaining of lower quality service. Baggage is lost, flights are delayed, and flights are overbooked. Airlines say that service problems will be worked out in the long run, but the problem is losing their passengers now that may never come back. Northwest Airlines and Eastern are two of the airlines that have been having problems. Lawmakers are getting upset when they fly and have problems. This might result in new legislation.

One of the decreases in service that has everybody complaining and the airlines making excuses is flight delays. The airlines blame them on the FAA, and the FAA blames it on the airlines, and everybody blames the weather. Consumer complaints rose 43% in the first three months of 1987, with more than a third being prompted by flight delays and cancellations.

The reason that DOT gives for delays is that the airlines "fudge" their schedules. The airlines say that the delays are the result of the air-traffic control system being obsolete and understaffed. Part of the problem is that the airlines schedule a lot of flights at peak rush hour times in order to get bookings. These rush hours are in the morning and early evening when business travellers are trying to go to a meeting or work and then coming home. There is not enough airport capacity to support so many flights. In April of 1987, the FAA scheduled talks between the airlines to discuss juggling schedules to cut down on delays. Adjustments were made but not enough to cut out all delays.

Now that deregulation has been around for a few years some airlines new and old are finding it tough to continue making profits. Many airlines are failing or being bought out by stronger carriers. People Express sold out to Texas Air. Presidential Air sold its ten gates at Dulles Airport to Texas Air. Deregulation has done its job in weeding out the inefficient, weak carriers. The new carriers that were born after deregulation have either expanded too rapidly or tried to compete directly against the majors. The new airlines did well when they were not directly, they started losing. The same changes that gave birth to them eventually killed them. Before deregulation, commuters had no competition. After deregulation, when the majors pulled out of small communities, the commuters filled the void and started to flourish. Then, they started to get competition from the majors. The major airlines started to either buy up the commuters or make a joint market venture with them. The other commuters see their traffic fall and are either forced to sell out or quit. The major carriers are using the commuters as feeder lines for their hubs. There are now 27% fewer commuters than there were five years ago.

Merger mania has not only caused decreases in services and chaos for airlines, but it is also a primary factor in the problems airlines have been having with labor. American is having problems with their stewardesses and the two tier pay scale which they implemented. United recently received a proposal from its pilots to buy out the airline. UAL's pilots feel that the airline is being neglected, in the drive to expand into other travel fields, such as car rentals and hotels. United's unions also stopped United from acquiring Frontier. The problems exist because the airlines are trying to cut costs, and so try to cut labor costs. During regulation employee's salaries rose quite high. Now the airlines are trying to compete with new airlines who do not have as high of labor costs because they are nonunion. Of course the unions do not want to have their pay cut, even if they are way over the industry average. Unions try to stop mergers from going through because of how it will affect them. They might end up with lower pay if them. They might end up with lower pay if the other airline is nonunion or has lower pay scales.

In approving mergers, the Justice Department and Transportation Department have different standards. The Justice Department has recommended disapproval of three major mergers in the past two years which have been approved by the Department of Transportation (DOT). The Deregulation Act of 1978 gave DOT the final authority to approve mergers until 1989. DOT has been approving mergers, despite what the Justice Department says because they feel that with deregulation there are no barriers to new entrants in the market so there is potential for competition. The Justice Department and quite a few other people have realized that there are barriers to entrants in the form of scarce resources. Before a new carrier can enter a market, it needs to have airport facilities. The hub and spoke system prevents a new carrier from entering the major carrier hub. The Justice Department uses tougher anticompetitive standards than DOT. Alfred , Former chairman of CAB, "also criticized the Reagan administration for what he asserted were "severe derelictions" in enforcing federal antitrust laws with regard to airline mergers."[8] Lawmakers are presently trying to transfer final authority over merger approvals to the

Justice Department.

Another recent development in the airline industry is luxury airlines. In November of 1986, McClain Airlines started operations. Another luxury airline planned to start operations in April of 1987. The luxury airlines are going after business travellers but offering them luxury at reasonable prices. In the past luxury airlines have not worked. Midway started out as coach carrier, switched to luxury, and then in November of 1979 went back to all coach. Air One filed bankruptcy in October of 1984. Air Atlanta, established in February of 1984, may soon show a profit. The owners of the two new luxury airlines say that they have learned from the past mistakes of others. The biggest risk for budget luxury is a first class war fare with the major carriers.

Verdict on Deregulation

Now that deregulation has been in effect for about nine years it is time to take a look and see how it is working. Good and bad has come out of deregulation, and it did not produce the great increase in competition that supporters had said it would. However, deregulation has increased the nation's Gross National Product by $8 billion in 1977 dollars which equals a permanent .4% increase in GNP. The benefits of deregulation come from three factors. The first is greater operating efficiency. With more flexibility in setting fares and in expanding their route structure, the airline industry has managed to fill the excess capacity they had before deregulation. In the new environment if they were not operating at peak efficiency, they would be beaten by all the new competitors. The second factor is the increase in competitors. This increase gave more choices to the public and spurred on the other carriers. The third factor is deflating wages. Under regulation wages had increased quite rapidly. There was no competition really so the airlines could afford to pay more out. Princeton University economist David Card estimates that inflation adjusted wages have fallen about 5% for airline mechanics.

Another positive aspect of deregulation is the decrease in fares. Fares have decreased 13% since deregulation. There are more choices in price-quality combinations. People who never would have flown have been able to take advantage of the lower fares. The businessmen however have not been able to take advantage of the discounts because of restrictions, but there are frequent flier programs which can benefit them.

After the surge of new competition in the first few years of deregulation, the market has become more concentrated. The commuters are joining the big carriers, a lot of the new airlines did not make it, and weaker carriers have been merged with stronger ones. The problem is that new competitors cannot effectively compete against the established carriers. Large airlines dominate airports by using the hub and spoke network. The captive traffic the airline then has creates great economies for that airline and prevent others from entering that hub. Also there are not enough landing slots at the major airports. The administration at first kept control over the slots and then gave them to airlines already suing them. This gives new entrants no chance. Part of the problem of concentration in the market also is due to DOT's policy of approving mergers. They have not been applying strict enough standards to judge whether a proposed merger was in violation of antitrust laws.

There has been a change in public attitudes towards deregulation because it has not produced the results in competition that were predicted. The people who worry about the lack of competition have joined with the groups that have been hurt to go back to regulation. The groups that have been hurt, of course, want to go back to the way things were because they were better off. These are the people who have not done well under competition. The verdict on deregulation of the chief executives who make up the Dun's Business Month's President's Panel is that deregulation has been a success. Some of the CEO's feel that we are now going through a transitional period and will be better off when the airlines get used to the new rules.

Deregulation has not worked out exactly like it was predicted, but overall it has been a success. Fares are lower, and more choices are being offered. There has been a lessening of monopoly routes. Nine hundred former monopoly routes now are being served by competing carriers. Carriers have been forced to operate more efficiently. The hub network makes the economy more efficient. Yes, there have been problems with deregulation, but the economy is still better off than before, and with the legislation pending that will transfer merger authority to the Justice Department the problems are on their way to being solved. As the industry adjusts to deregulation and the recent mergers, the problems with service will end.

Conclusion: Future in Airline Industry

In the future, there will probably be a push for reregulation. Hopefully, they will not go back to the way it was before, but just fix the problems. The Justice Department should soon have control over merger approval which will cut down on mergers in the future. Fare wars will continue as long as some of the airlines, such as Texas Air, do not go along with the increase in fares.

The airlines will continue to restrict the discount fares and try to limit the fares to people who normally would not fly to fill their empty seats. The airlines and the FAA will keep trying to deal with the problem of flight delays, and probably still keep on blaming each other. The carriers will keep on trying to cut labor costs and will probably succeed in reducing the costs. The unions will keep protesting and pushing or reregulation. The industry probably will still have mergers, but this should slow down as the standards will be tougher, and the remaining airlines will be strong enough to make it on their own.

To increase competition and decrease entry barriers legislation might be passed to make access to hubs easier for new carriers. Also they should come up with a new way to distribute scarce airport facilities or build more. In the long run, as the industry adjusts to deregulation the problems shoutld be ironed out, and the market will not become so concentrated as to be a monopoly. There should still be enough competition to stimulate the industry.

Endnotes

[1]Meyer, Oster, Berman, and Strassman, Airline Deregulation: The Early Experience (Boston, Massachusetts: Auburn House Publishing Company, 1981), p. 18.

[2] Nawal K. Taneja, The Commercial Airline Industry (Lexington, Massachusetts: Lexington Books, 1976), p. 122.

[3]Stephen Breyer, Regulation and its Reform (Cambridge, Massachusetts: Harvard Universtiy Press, 1982), p. 195.

[4]George W. James, Airline Economics (Lexington, Massachusetts: Lexington Books, 1982), pp. 170-171.

[5]Nawal K. Taneja, Airlines in Transition, (Lexington, Massachusetts: Lexington Books, 1981), p. 189.

[6]John Koten, "Major Airlines Plan Fare Hike Later in Month," Wall Street Journaal, Midwest Edition, October 14, 1986, p. 39.

[7]Linda Sandler, "Fare Wars Are Likely to Remain, Analysts Say Even if People Express Puts Itself Up For Sale." Wall Street Journal, Midwest Edition, June 26, 1986.

[8]Andy Pasztor, "Justice Department Control of Mergers of Airlines Sought." Wall Street Journal, Midwest Edition, March 26, 1987, p 36

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