

Airline Regulation and Deregulation

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1. Airline Regulation

- a. Form of regulation (short; reference existing literature):
 - Industry-wide price setting (formulaic by end: nonlinear in distance)
 - Entry restrictions at route (airport or city pair) level, CAB allocation
 - Route assignments based (in part) on financial “need”/“cross-subsidies”
 - No service level (flights) restriction within route
 - Douglas and Miller non-price competition and ratchet effect
- b. Outcomes:
 - Entry:
 - Little (regional) /no (national/trunk) entry of new firms over history of CAB regulation
 - Growth of capacity, service frequency on routes served
 - Network shape
 - Prices/Revenues:
 - Relatively high (esp. compared to intra-state travel in CA, TX)
 - Very simple price structure (1st and coach fares, some student/sr)
 - Low Rev/ASM in mid-70s due to capacity glut/low load factor, not low fares
 - Compare to international ops: limited capacity through bilateral agreements.
 - Profits: no evidence of substantial excess rents to firms
 - Labor:
 - Mixed evidence of impact on labor(e.g. Card).
 - Mutual aid pact in dealing with strikes/labor constrained union power?

2. Deregulation and its effects

- a. Political economy/Process (very short, reference literature)
 - Led by administrative reform at CAB (Kahn), firms/labor came in late
 - Phase-out of price, then entry restrictions
 - “Economically less intrusive” regulations
 - Consumer protection (e.g., denied boarding compensation, CRS bias, delay stats)
 - Revisions to slot control process for congested airports
 - Antitrust processes—role during transition, maturation of process?
 - Not entirely? (Service to small communities)
- b. Impact
 - Price competition: price level and structure effects
 - Lower prices, continued declines in real dollars (time path)
 - Substantial price dispersion; time path of price structure
 - Traffic expansion
 - Strategic product differentiation.
 - FFPs/loyalty programs/alliances

- Entry:
 - Network restructuring
 - Flight frequency/interline benefits for consumers
 - De novo entry by firms
 - entry/exit/merger waves
 - “Low cost carriers”
 - Capacity
- Labor
- Productivity effects

3. Current challenges and issues:

- a. Capacity/price/profit cycles: is there a “core” to game?
 - Growth of discount carriers
 - Impact of bankruptcies
 - Government “bailout” policies/calls for intervention
- b. Pricing complexity/structure and price discrimination
 - Interaction with distribution channels (online)
- c. Labor:
 - Interaction with competition / rent-sharing
 - Pension “puts”
- d. Quality of service:
 - Flight service quality (delays, cancellations, baggage, etc.)
- e. Role of antitrust/regulation:
 - Mergers/alliances/code-sharing
 - International ownership restrictions
 - Strategic market power (e.g. use of loyalty programs)
 - Supporting infrastructure and related industries
 - Airport congestion/allocation (slot controls?)
 - Air Traffic Control system/privatization issues?
 - Airline taxes/fees
 - Continued regulation of international air service/cabotage

4. Conclusions: but NO POLICY CONCLUSIONS per NBER policy

NOTES FOR DISCUSSION:

This outline is quite US-centric, for several reasons:

- Formal regulation (state ownership was substitute in many other markets)
- Earliest to deregulate/liberalize
- Historically largest integrated air market
- And of substantial practical importance, most heavily-researched (largely data availability)

Would there be significant pay-offs to trying to incorporate other air markets (given up-front costs of setting up differences in their structure/history /institutions, and relatively limited empirical economics research upon which we could draw)?

The outline largely ignores safety regulation by the FAA, in principle unchanged by the economic regulatory reforms and elimination of the CAB (though some have argued that economic regulation interacts with safety investments/monitoring/etc.—no clear evidence on this). Does this decision seem sensible?