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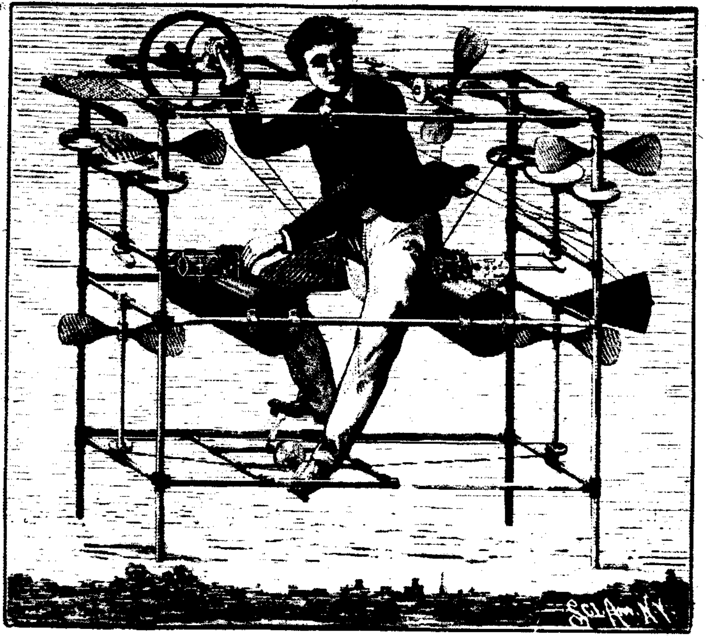

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Flights of fancy

Reregulating nation's airlines a foolish idea

By Robert J. Gordon

This week's report from the U.S. Department of Transportation suggests that some major airlines are guilty of predatory pricing practices designed to throw small rivals out of business. This is sure to throw a spotlight on critics who claim that air passengers in cities like Chicago would be better served by some reregulation of the airline industry. But a closer look at the economics of air traffic should put these criticisms to rest.

Competition drives the airline industry, and there is no more telling example of how start-up airlines promote competition than Midway Airport. Once nearly empty, today Midway serves thousands of passengers who fly on Southwest, ATA, Vanguard, Spirit or Kiwi. To remain competitive, major airlines must find ways to match the low airfares of start-ups.

While some studies indicate that average airfares are higher at hubs dominated by a single airline, this theory greatly exaggerates the importance of such hubs. In fact, large air carries can't be accused of predatory pricing because start-up airlines have successfully competed in a number of major markets.

When we count all the nation's metropolitan areas of more than 1 million people, only eight areas containing roughly 20 million people qualify as hubs dominated by single carriers. Another 33 areas containing 120 million people do not qualify because traffic is not dominated by a single carrier, because start-up carriers continue to successfully compete, or more commonly, (in 25 of the 33 areas) because low-cost Southwest Airlines serves the area.

It's true, some new carriers have failed, but that's hardly due to predatory pricing. Some start-ups underpriced their product, some lacked a sound business strategy and a number were managed poorly.

In truth, many customers choose major airlines because they want the convenience of flying on a single airline virtually anywhere in the world and they value frequent flier rewards—two very large benefits of our present deregulated air system.

Calls for a return of regulations amount to little more than griping by those who don't fully appreciate the benefits of deregulation. Since deregulation in 1978, the consumer price index has increased 150 percent, but the price of air travel has increased only 60 percent. That's because low-cost airlines continue to expand and every day new airlines enter the market.

As a result of cheap airfares, total traffic flown by non-chartered U.S. air carriers has increased since 1978 by 134 percent, more than double the increase in gross domestic product over the same interval.

Nor have airlines been pocketing monopoly profits. In fact, between 1982 and 1997 the net profit of the domestic U.S. airline industry was almost exactly zero! As good years almost exactly canceled out bad years, all the benefits of deregulation went into the pockets of consumers. Two Brookings Institute scholars estimate that airline deregulation is currently saving air travelers $20 billion per year.

Returning to the bad old days of regulation makes no sense socially or economically. As Southwest Airlines and other start-ups prove, if the major airlines fail to meet the needs of the flying public, competitors will provide an alternative. Competition, not government reregulation, should dictate the future of the airline industry.

Robert J. Gordon is a professor of economics at Northwestern University. One of the nation's leading experts on the causes and consequences of inflation and unemployment, he is the author of "Macroeconomics" and is co-editor of "The Economic of New Goods."