

Departures

Opinions On Current Issues In Aviation

The Hub Premium Myth

By Robert J. Gordon and Darryl Jenkins

There is little in aviation that has caused more consternation — and media attention — than the pricing policies of major network airlines at their hubs. Despite the acknowledged benefits of deregulation over the past 20 years, enormous criticism has been leveled at network carriers because of the perceived difference between fares they charge at hub cities and those charged elsewhere. This perceived fare differential is known as the “hub premium.”

The essence of the “hub premium” argument is that since a network carrier controls the major share of traffic at its hub, it exploits its so-called monopoly power by charging hub residents higher fares for travel originating or terminating at the hub than it charges passengers elsewhere in its system. By contrast, virtually everyone agrees that consumers on one-stop flights enjoy the full benefits of competition.

If passengers traveling from Newark to Los Angeles are willing to include a stop, they have a choice of flying perhaps seven or eight different airlines, including all major carriers. Because of the rich array of choices, they can be confident to receive a competitive fare. When the industry collectively lost \$13 billion in the early '90s, the hub premium theory received scant attention. But when the industry returned to profitability several years ago, the theory was readily accepted as dogma — too readily, in our opinion.

The problem was, no one had done a valid study using extensive proprietary data for a multi-year test period. As researchers who closely follow the industry, we believed the hub premium theory was overblown. We concluded that if we could compare a major carrier's nonstop hub fares to one-stop fares through its hubs, we could test the “hub premium” hypothesis. Because the premium is claimed to be large in Minneapolis/St. Paul, where Northwest has 62% of the origin-and-destination traffic, Northwest was a likely study candidate.

We approached Northwest and it agreed to provide us with uncensored access to a complete

data set of its prices for all three hubs — Minneapolis/St. Paul, Detroit and Memphis — from 1996 through 1998. It also agreed to defray the cost of our work. Of critical importance to us, Northwest agreed to give complete academic freedom to analyze the data and formulate our conclusions without direction or interference. After completing the initial portion of what will be a longer, more detailed examination of major airline hub pricing, we concluded:

- Using the database of fares and fare classifications for the Northwest domestic system for 1996-98, we are unable to find evidence of a “hub premium.” The “hub premium” theory is a myth. Instead, we find there is a hub discount of about 4% when trip length and major fare categories are held constant.
- Our finding of a modest hub discount is absolute, not relative. It makes no allowance for the lower quality of connecting service compared to nonstop travel.
- Some specific fare categories exhibit a slight hub premium, but this is canceled out by other categories that exhibit a slight hub discount. There is no Northwest hub pricing policy that makes these fares consistently higher than connecting fares of similar mileage.
- Other researchers who identified a hub premium have in actuality identified and measured little more than unique buying patterns that exist in different cities; that is, the different mix of full-fare and excursion travel from one city versus another.

In addition, we find that prior DOT and General Accounting Office studies that found a “hub premium” are wholly invalid because they rely on “average fares.” Average fares cannot be used for this purpose. They produce results that are severely skewed by the purchasing patterns of relatively few passengers.

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