



SPECIAL REPORT 255

**Entry and
Competition
in the
U.S. Airline
Industry**

*Issues and
Opportunities*

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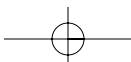
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Preface

In the 1998 Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999,¹ Congress requested a 6-month study to update a 1991 report, *Winds of Change: Domestic Air Transport Since Deregulation*.² The previous study had been completed over a 2.5-year period by a committee of experts operating under the auspices of the National Research Council's Transportation Research Board (TRB). In addition to reviewing the effects of deregulation on competition, fares, and service, the report included reviews of safety experience since deregulation and presented options for reforming the Federal Aviation Administration.

The request to update *Winds of Change* arose during debate over the U.S. Department of Transportation's (DOT's) proposed "Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry" (see Appendix A). This proposal responded to complaints from new airlines that large established carriers were engaging in highly aggressive pricing and other unfair practices, allegedly to suppress low-fare competition. In its proposal, DOT explained its intention to exercise its statutory authority to prohibit unfair competition (49 USC §41712, formerly section 411 of the Federal Aviation Act). This

¹ Section 110(g)(1)(A) of Title I, Subdivision C (Other Matters), Public Law 105-277; October 21, 1998.

² *Special Report 230: Winds of Change: Domestic Air Transport Since Deregulation*. TRB, National Research Council, Washington, D.C., 1991. 399 pp.

authority was transferred to DOT when the Civil Aeronautics Board was abolished in 1984.

Issued as a notice in the *Federal Register* on April 10, 1998, the draft proposal prompted criticism from the major airlines. Some raised concern that the policy would inhibit legitimate competition, and others questioned DOT's statutory authority to enforce the policy. Most new entrants, however, responded positively, and many advocated complementary changes—including measures easing access to major airports—to foster more competition and entry opportunities.

In the 1998 act, Congress called on DOT to reexamine its proposed guidelines for 6 months before issuing the final version. It also requested an update of the 1991 study:

The National Research Council of the National Academy of Sciences shall complete a comprehensive update of the 1991 study of airline deregulation prepared by the Transportation Research Board of the Council. The update shall include updated versions of the chapters contained in the study pertaining to competitive issues in the airline industry as well as recommendations for changes in the statutory framework under which the airline industry operates.

To conduct the study, TRB convened an 11-member committee with expertise in economics, airline operations and management, law, and public policy. Following the tradition and policy of NRC, the committee members served without compensation in the public interest. John R. Meyer, professor of economics (emeritus) at Harvard University, served as chairman. Professor Meyer also had served on the earlier *Winds of Change* committee. The committee interpreted its charge from Congress as assessing the current and emerging state of competition in the domestic airline industry and making recommendations for further government action to promote competition. As indicated in the report, the committee did not believe that enhancing airline competition would require substantial changes in the general statutory framework under which the industry has operated. However, it did believe that some additional government action would be needed to curb unfair conduct, eliminate opportunities for such conduct, and take positive steps to create an environment more conducive to airline entry and competi-

tion. Because of the compressed time frame for the study, the committee could not examine all the issues in equal depth. In examining effects on consumers, the committee chose to emphasize the trends in pricing and in flight offerings. In part because of inadequate data and in part because of the limitations of time and resources, the committee chose not to examine service quality issues such as lost baggage, overbooked flights, on-time performance, or other dimensions of customer service. The committee examined issues that, in its collective judgment, pertained to its expertise and deserved priority attention.

DOT funded the study in January 1999. The committee held three meetings between December 1998 and April 1999, followed by several committee conference calls. Two meetings included extensive sessions open to the public, during which experts from government, academia, and industry presented a variety of issues to the committee. Those who provided expert testimony included Frank Berardino, GRA, Inc; Severin Borenstein, University of California at Berkeley; Reid Detchon, Interactive Travel Services Association; Edward Faberman, Air Carriers Association of America; Richard Fahy, Trans World Airlines; Roger Fones, U.S. Department of Justice, Antitrust Division; Joseph Galloway, American Society of Travel Agents; Thorsten Hisem, Embry-Riddle University; Charles Hunnicutt, Assistant Secretary, DOT; Darryl Jenkins, George Washington University; Mark Kahan, Spirit Airlines; Daniel Kasper, Law and Economics Consulting Group; Nancy McFadden, General Counsel, DOT; Jeff MacKinney, AirTran Airways; Thomas Miller, Iowa Attorney General; Kevin Mitchell, Business Travel Coalition; Patrick Murphy, Deputy Assistant Secretary, DOT; Clinton Oster, Indiana University; David Plavin, Airport Council International/North America; Douglas Parker, America West Airlines; Paul Ruden, American Society of Travel Agents; Donald Schenk, Airline Capital Associates; Dick Spaulding, Spaulding Aviation; Bill Spitz, GRA, Inc.; John Strong, William and Mary College; and Clifford Winston, Brookings Institution.

The committee also commissioned data analyses and papers to assist in its work. Professors Martin Dresner and Robert Windle of the University of Maryland prepared a paper on resource availability and entry in the airline industry, cited and discussed in Chapter 1. Director James Craun, Deputy Director Randall Bennett, and Anita Edwards of the DOT

Office of Aviation and International Economics provided data and analyses on passenger fares and traffic and performed regression analyses (discussed in Chapter 2) according to instructions given by the committee.

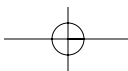
Many assisted the committee and staff during the course of the study. In addition to Craun, Deputy General Counsel Steven Okun, served as main DOT contact for the study, and responded to frequent inquiries from TRB staff and committee members. John M. Meenan of the Air Transport Association of America and Michelle M. Faust of the Air Carriers Association of America also fielded frequent questions from staff and assisted in arranging presentations before the committee from airline representatives. Earl Doolin of Database Products, Inc., Steven Casley of BACK Associates, and Fred Klein of GRA Aviation Specialists, Inc., provided the committee with aviation data and analyses, often on short notice.

The study was managed by Thomas R. Menzies, Jr., who drafted the report under the guidance of the committee and under the supervision of Stephen R. Godwin, Director of Studies and Information Services. Suzanne Schneider, Assistant Executive Director of TRB, managed the review process. The report was reviewed by individuals chosen for their diverse perspectives and technical expertise, in accordance with procedures approved by the National Research Council's Report Review Committee. The purpose of this independent review was to provide candid and critical comments to assist in making the published report as sound as possible and to ensure that it has met institutional standards for objectivity, evidence, and responsiveness to its charge. The review comments and draft manuscript remain confidential to protect the integrity of the process. Thanks are due to the following individuals for their participation in the review of this report: Robert W. Coggin, Alpine Marketing Consultants; Jeffrey H. Erickson, Scottsdale, Arizona; Alexander H. Flax, Potomac, Maryland; Lester A. Hoel, University of Virginia; Paul Joskow, Massachusetts Institute of Technology; Theodore E. Keeler, University of California, Berkeley; Edward L. Perkins, Ashland, Oregon; John E. Robson, Robertson Stephens; and Mark Schechter, Howrey & Simon.

Although the reviewers have provided constructive comments and suggestions, responsibility for the content of this report rests with the authoring committee and the institution.



The report was edited and prepared for publication under the supervision of Nancy Ackerman, Director of Reports and Editorial Services. Javy Awan edited the report. Special thanks go to Marion Johnson for assistance with computer graphics and the extensive communications with committee members, and to Frances E. Holland for assistance with meeting arrangements and the word processing of the report manuscript.



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