

ECONOMIC NEWS UPDATE

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Fewer Flights, Crowded Planes, and Soaring Profits

It is the best of times, it is the worst of times -- best of times for America's airlines, worst of times for the passengers they are cramming into their airplanes. Not as good for the carriers as the wonderful days when regulation guaranteed them a quiet, profitable life, nor as bad for the passengers as when regulation prevented fares from dropping to competitive levels. But close, in both cases.

In the US, airlines are making money despite delays and horrible service. US Air, United, Delta, American Airlines and Jet Blue have all reported hefty increases in profits. The reason: after a wave of chastening bankruptcies, they have cut capacity, bringing the number of available seats more into line with demand, and reducing the scramble to peddle empty seats at any price above the almost zero cost of carrying an additional passenger. This past summer, carriers operated at around 86 percent load factors (percent of seats filled), which is good for the carriers, but not so good for travelers

wedged into middle seats or hoping to cadge a seat on some frequent-flyer program. Still, there are bargains available for anyone willing to take to the air on the slow travel days during the holiday season, a gift to the traveling public from Alfred Kahn, the Cornell economist who pushed through deregulation when chairing the now-defunct regulatory agency, and this month was toasted by his former students and colleagues at a 90th birthday celebration. Travelers might also hoist a glass.

The generally tight supply situation is unlikely to change for the next several months, as holiday traffic picks up. Indeed, with the weak dollar making overseas travel eye-wateringly expensive, those Americans not committed to visiting grandma in Florida are more likely to find New York and Hawaii more affordable destinations than London and the south of France.

But the cost of overseas travel might, just might, drop in the New Year. Not because the dollar will recover: it

won't. But because effective competition might finally be coming to transatlantic travel.

New carriers are already wooing business-class customers on the London-New York route with lower fares, avoiding the nightmare of London's overcrowded and poorly managed Heathrow Airport by flying to and from less crowded terminals. Even more important is the liberalized regime that will become effective in March.

Under a deal struck between the US and the EU after years of wrangling, any American or European airline will be free to fly anywhere between the US and Europe. Delta and Air France have already announced a deal for the Atlanta-based carrier to get three of Air France's Heathrow slots, reducing British Airways' dominance of that terminal. The two carriers will offer 19 flights every day from the US to London and France. Other carriers are sure to enter the fray.

The bad news for passengers is that there seems to be little relief in sight from long lines at check-in desks and at security checkpoints. Years ago, when I was at Harvard's John F. Kennedy School of Government, a colleague explained why.

Professor William Hogan is a giant of a man, physically and intellectually. For the past 30 years he has been teaching economics, statistics and, most important, good common sense at the Kennedy School. One day, when I was puzzling over how to regulate where necessary and deregulate where possible, he solved most of my problem. "Get the incentives right," he said, "and much of the rest will take care of itself."

Which brings us to Washington's Dulles, London's Heathrow, and other

airports around the world. If lines lengthen at security check points no one has an incentive to add staff, open more lanes, or do anything to relieve passengers' plight. By contrast, such a situation at Whole Foods, Giant or any respectable supermarket results in the opening of more check-out lines to relieve congestion. Store managers have an incentive to prevent customers from taking their business elsewhere; airport managers don't, or think they don't. Indeed, they have every incentive to keep costs down and profits up, even if that means providing a miserable service. Imagine what life would be like in an airport in which security personnel, or at least the managers, had their pay cut every time lines lengthened beyond some target limit, and the power to correct the situation.

Now consider the world's airlines' roles in all of this. They have by and large acted as if their customers' experience in airports is none of their concern. Yes, some have set up fast-track security lanes for their best customers, but most have left their passengers at the mercy of a security system in which the operators have little reason to worry about passenger convenience. And most airlines view with equanimity the long lines of passengers waiting to check luggage and get boarding passes. All will be well when the passenger tunes into some great in-flight entertainment system. Unless, of course, he or she is sitting on the tarmac for a few hours, in which case the airlines are guessing that their customers are not completely up-to-date on the carriers' reluctance to fund a new air-traffic control system that might eliminate such annoyances.

On the plus side is the competition between Boeing and Airbus

to produce a next-generation aircraft that is more passenger-friendly than anything manufactured in the past. Last week Singapore Airlines put the Airbus A380 into service on the Singapore-Sydney route, and promised "to change the way you travel, forever." Which will certainly be true for those who can afford one of the double-bed, private-shower, 35-inch flat-screen-television private cabins, auctioned at \$100,000 for the eight-hour inaugural flight. Less affluent passengers -- economy class goes for around \$550 -- are promised more leg-room in all classes of service. Boeing's competitor, the 787, has hit production delays but should be available some time next year, and will also offer more comfortable seating.

Of course, none of this will matter if America's airlines do what they are signaling they intend to do: keep capacity low enough to enable them to raise fares, lower service standards, allow their fleets to age rather than order new aircraft, and use the sardine can as a model for the seating configurations of the few new planes they do order. Gordon Bethune, former CEO of Continental Airlines, once commented on reductions in the quality of service that "You can take so much cheese off the pizza that nobody will eat it." Perhaps. But for now the skimpy pizza is the only food on offer.

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