Airline Position Report (APR)

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Abstract

The airline business is parlous at the best of times. Airlines have to make huge investments in aircraft, they are at the mercy of fluctuating oil prices and profit margins are stiff. The industry at the moment is going through one of its most torrid periods ever; its problems commenced when the global economy hit the buffers over a year ago and dramatically worsened after the September 11 attacks.

Airline Position Report

Introduction

The nation's aviation system, one of the US economy's bedrock industries, is confronting its worst crisis in its 70 years of boom-and-bust cycles. And this is before a war commences. Experts inform that fuel prices, already almost twice as high as a year ago, are expected to spike, while passenger travel slackens to a trickle. That combination could debilitate already struggling carriers like United and could drive them into liquidation. A bill introduced on Capitol Hill would provide loan guarantees to cover increased fuel costs. But many lawmakers are skeptical about giving the airlines a bailout similar to the $15 billion in loan guarantees and grants they provided after Sept. 11.

September 11 – Doom's day for the airline industry

September 11, 2001 (abbreviated as 9/11) will forever be considered a turning point in the history of America. Terrorist attacks in New York City and Washington D.C. with aircrafts, were proved to be a major calamity for American as well as world airline industry. The North American airspace was entirely shut down for four days and the airline industry confronted an unprecedented decline in demand for air travel instantly after the attack. This had a cascading impact and the airline companies started facing deterioration in their fiscal positions and the number of flights. The current market for airline industry hasn't amply recovered since that time.

Economic Impact – Post September 11 Scenario

The airline industry is one of the adversely impacted industries by the September11, 2001 disaster. Immediately after the daring attack, nation's aviation system was shut down and produced a cash "burn rate' for the industry in excess of $330 million per day for the duration of the stoppage. It has been estimated that just in the first week after the tragedy the US airline industry lost between $1 billion and $ 2 billion [Goodrich, 2002]. The impact of 9/11 attacks persists to damage the industry significantly to this day. The fears of reoccurrence of 9/11-tragedy cause public avoid the air travel. The stringent security checks, random searches and new airline ticket fees induce more individuals take road trips, which again preclude the recovery of the demand. The enactment of enhanced security policies incurs supplemental cost. Declined passenger demand results compounded with the increased cost lead the industry to face accumulated net losses.

Ripple effect

The airlines' loss has in turn had taken its toll in the U.S. economy, especially the industries that depend on air travel. Tourism has become a major causality and Washington can be quoted as an instructive example. It is apparent that anything that creates concern of a possible terrorist attack will hurt tourism and therefore the District's economy particularly. Records reveal that during the last quarter of 2001, the city's tourism and hospitality industry took an estimated $1.2 billion hit. Hotel occupancy rates dropped to as low as 25 percent immediately after the attacks, while restaurants posted huge drops in business.

The Airline Deregulation Act of 1978

Until 1978, the U.S. government, through the Civil Aeronautics Board (CAB), governed many areas of commercial aviation such as fares, routes, and schedules. The Airline Deregulation Act of 1978, however, got rid of many of these controls, thus altering the face of civil aviation in the United States. After deregulation, unfettered free competition ushered in a new era in passenger air travel.The CAB furnishes many comparisons of the industry before and after deregulation and uses those data to test the various hypotheses that scholars and politicians have advanced about how markets would behave if regulation were removed. Its findings provide information on both the demand and the cost side that will be important in molding the long-run equilibrium of the industry, and it discusses how quickly the industry is moving toward that equilibrium.

Deregulation and Its Consequences

Unfortunately for the airline industry, fuel costs, economic recession, and wanton overexpansion in the wake of deregulation began to have grievous negative imports. The airlines recorded a net operating loss of $421 million as early as 1981, when the number of passengers drastically fell to 286 million. The problems were compounded by the nationwide strike of the Professional Air Traffic Controllers Organization (PATCO) in 1981. One airline, Braniff, collapsed completely in 1982 (although the airline operated from 1984 under new ownership before entering bankruptcy once again in 1989). Other airlines continued to expand in the face of economic problems, putting them at great jeopardy.

Impact of Policies on Competition

Since the airline industry is a complex mix of a competitive and regulated industry, several policy choices could impact its level of competition. A central policy choice is the mechanism for apportioning airport boarding gates and facilities. Many airport commissions bank on non-market mechanisms to allocate these scarce resources. Alterations in policies by these commissions to allow for competitive bidding for boarding gates and landing rights might encourage competition among airlines, and it also might encourage airport authorities to increase supply when bid values are higher than costs.

Antitrust policy also may impact the level of competition. A little over a year ago, United announced plans to acquire US Airways. These plans were later vacated after the government decided to take exception to the merger. Most observers anticipate that future merger attempts are likely. There is significant statistical evidence that airfares increase as market concentration increments, thereby harming consumers. However, concentrated markets also benefit some consumers by creating bigger networks with more frequent and convenient flights. Moreover, mergers also allow incentives for efficient managerial skills and business practices to dominate. In that mergers lead to concentrated markets, antitrust policies must balance these conflicting needs when deciding whether to approve a merger.A third significant policy issue involves restrictions on substantial foreign ownership of airlines and on domestic flights by foreign-owned airlines. Allowing foreign ownership of airlines could step-up the level of competition for both international and domestic flights. As foreign airlines already fly to the United States, they are subject to U.S. safety and security regulations. However, while the current open-skies agreement between Canada and the United States allows Canadian carriers to pick up passengers in the United States, it does not permit Canadian carriers to pick up passengers in Portland and drop them off in Seattle; rather, they can only pick up passengers in Portland and drop them off in Vancouver. This confines the ability of a Canadian carrier to gain the hub-and-spoke economies of scale that might improve its competitive edge on the Portland to Vancouver market or the Seattle to Vancouver market, and also potentially on the Portland to Seattle market.

Is Airline Industry's a White Elephant?

The highest sustained jet fuel prices since 1990 are jeopardizing both the airlines' nascent earnings recovery and the low airfares that consumers increasingly favor. Fuel prices on the spot market have soared 20% since October to nearly $1 a gallon. The Air Transport Association (ATA), the industry's trade group, says each 1-cent rise in price adds $180 million to the industry's annual costs. Energy analysts don't expect the prices to fall much soon and it will be very difficult for the airline industry of breaking even this year. Airline analysts anticipate one or more airlines soon to renew attempts to increase fuel surcharges on tickets.

Airlines have imposed curb on services and amenities, airports are guarded by a new federal agency, the Transportation Security Administration, and passengers are rowdier and ruder than ever. Many once-robust mainline carriers are on the verge of bankruptcy or liquidation. The list of troubled airlines includes American Airlines, Delta Air Lines and United Airlines, which is already in bankruptcy. US Airways isn't expected to survive the year. And most airline industry executives, already burdened with crushing debt loads, aren't expecting more loans. They'd instead like to see the government annul a variety of taxes and fees. That's forcing some significant restructuring that many airline experts say is long overdue. Bankrupt US Airways and United are leading the way. They've already slashed capacity, cut back some routes, and are negotiating reductions in labor costs, their highest expense.

But some economists consider the airlines created their own problems by racking up huge debts and high fixed costs during the booming '90s, and say they should be left to the competitive market. That's sparked talk of nationalizing some airline routes, particularly to small cities. Others see a less dramatic outcome. Once labor costs are brought in line, airlines will reduce the differential between business and leisure fares. Super-cheap fares will disappear, but so will outrageously high walk-up ones.

Conclusions

The airline industry today operates in an environment where firms set prices and domestic routes given market conditions, but where access to some key inputs, such as airport boarding gates, are fixed by non-market mechanisms. While profits have fluctuated a great deal, the industry in the U.S. has been qualified by steady growth, falling prices, and moderate concentration, suggesting a positive impact of deregulation. Policies to allocate some key inputs on a market basis may yield even more efficient consequences.

September 11, 2001 has altered the situation of airline industry dramatically. The airline industry has taken aggressive cost-cutting method to reduce the cost in every potential segment. However the plunging revenue and new additional cost associated with security impact adversely the airline industry and offset all these efforts. So the airline industry is still facing steep losses and in a hard time due to plunging revenue caused by weak demand. To attract the passengers back, the airlines lose pricing power, thus leads to lowest fares in two decades. Also, the new events such as Iraq war, SARS preclude passenger from the air travel, worsening the situation. These problems make very hard for airline industry to restore to profitability.

Before September 11, the focus for the airport industry was on abridging congestion and flight delays. Today, flights are being canceled for lack of business, two major air carriers are in bankruptcy, and focus has shifted from increasing the capacity of the national airspace system to enhancing aviation security. Furthermore, as the federal budget deficit has increased, competition for federal resources has intensified, and the costs of airport capital development are growing, especially with the new requirements for security.

The interrelationships between many of the problems outlined above – revenue generation, cost structures and productivity, operational delays and stringent security requirements – mean that there is no single answer to the current industry crisis. The inability to generate adequate revenues from high-yield business travelers is due at least in part to uncertainty about security and to service quality cutbacks by the network airlines, both of which dilute product differentiation by reinforcing perceptions of poor service quality and thus increasing the attractiveness of the low-fare airline alternative. At the same time, the inability to achieve meaningful labor cost reductions and/or productivity improvements have left network airlines with little choice but to cut service quality and try to compete with low-fare airlines on price alone.

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