Airline Deregulation and Market Performance: The Economic Basis for Regulatory Reform and Lessons from the US Experience*

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I INTRODUCTION

Ever since airline deregulation was first proposed for the United States, it has been the cause of controversy. Proponents have seen little but benefits from it, yet opponents have found much to criticise. The purpose of this paper is to survey the evidence from the United States with the following set of questions in mind.

First, what were the analytical motivations for passenger airline deregulation in the United States, as expressed by its advocates before it occurred? This question is of more than historical interest, because the issues that were relevant to the decision to deregulate in the United States are still relevant in Western Europe today. To the extent that conceptual advances in economics have changed arguments affecting air deregulation, such changes should obviously also be considered.

Second, to what extent has airline deregulation met the expectations of its advocates in the United States over the past 11 years? Whatever theoretical motivations there maybe for airline deregulation, the proof is in the degree of success of the outcome. To the extent that airline deregulation has failed to live up to the expecta-

*This paper benefited from support from the Institute of Transportation Studies at the University of California, Berkeley. It has also benefited from the assistance of Melanie Mauldin and the comments of Marjorie Nathanson Keeler, Philip A. Viton, Michael Levine and Clifford Winston.

D. Banister et al. (eds.), Transport in a Free Market Economy
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tions of its advocates, is that due to deregulation itself, or to extraneous factors?

Third, what (if any) unanticipated policy problems have occurred in the United States as a result of air deregulation and, to the extent that they have happened, what lessons can be learned by those who would deregulate elsewhere?

Fourth, what are the implications of all this evidence for airline deregulation in Western Europe? Should it be done and, if it is, are there specific policies needed to avoid potential pitfalls, such as those experienced in the United States.

Finally, what are the implications of all these matters for future research in the economics of air transportation?

In line with these questions, Section II of this paper discusses the conceptual motivations for airline deregulation in the United States, both as it was originally conceived and as it has been subsequently revised with experience and conceptual improvements in economics over the past decade. The third section discusses some of the prior concerns which sceptics had about airline deregulation.

Section IV reviews the evidence on the economic effects of the Airline Deregulation Act of 1978, as it relates to a variety of economic and social criteria, including fares, service quality, service to small communities, factor use and returns and, finally, the question as to whether air deregulation has met the expectations, theoretical and practical, of its advocates.

The fifth section of the paper addresses current policy problems faced under deregulation, including airports and airways, safety regulation and anti-trust policy. The final section summarises the evidence compiled through the paper, discusses its implications for policy in Western Europe and suggests directions for further research.

II INDUSTRY STRUCTURE AND THE MOTIVATION FOR AIRLINE DeregULATION

As all students of microeconomic theory know, there are several reasons why markets can fail, and they therefore require regulation. They include natural monopoly, externalities, immobility of factor markets, imperfect information, a belief on the part of the policy-maker that consumer sovereignty does not apply, or issues relating to income distribution and macroeconomic stabilisation of which the