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# To Regulate or Not: That is the Question

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**FORUM**

## *TO REGULATE OR NOT: THAT IS THE QUESTION*

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In some ways the discussion over whether an industry should be re-regulated is an academic discussion. With over 30 years of operating as a deregulated aviation industry, it would be a herculean task to change directions and re-regulate an industry without a significant industrial event or obvious disadvantageous economic trend which with to react. Not to mention, the political will and functions would have to be present, as well as the supporting government resources available in the budget, which just is not the case at this time. In short, the airplane hangar is open and the planes have taken off; re-regulation is not only a figment of some's imagination or dream, but also an unwise economic direction for the industry.

For this paper's purpose, regulation is defined as the directing of consumer pricing, route systems, entry into a market by a producer, mergers between producers, and subsidies for service. Aviation safety, licensing, equipment policies and air space regulation are not deregulated and not in the scope of this discussion. In fact, most of the discussion of re-regulating the aviation industry focuses on airfares and route competition.

### Regulation is Deadweight Loss

Regulating industries is a common way to manipulate the market economy towards the predetermined amount of production and consumption of goods that otherwise would not take place. Typically, regulation is an attempt to avoid market inefficiencies caused by monopolies, public goods, or externalities. In any event, regulating an industry essentially moves the industry away from a free market operation that is equilibrium, and by definition, efficient, and introduces inefficiencies into an industry that economists define as a deadweight loss. The deadweight loss is economic value lost in the economy as consumers pay higher prices, and less efficient producers are supplying the product or service at higher costs (Arnold, 2011). The theory is that regulation can limit the deadweight loss from market inefficiencies, but never quite allows the market to be fully freely operating in pursuit of greater social values or benefits.

Schofield (2008) presents the argument that the airline industry should revert back to regulation because it is the government's responsibility to protect consumers and ensure the health of the industry. However, if one goes to the original political and economic document of the U.S., the U.S. Constitution, nowhere does this document task the government with ensuring the health of an industry (United States, 1998). Article 1, Section 8 of the U.S. Constitution details the powers of Congress that includes economic regulatory activities and the implication that the government is responsible for healthy industries is clearly not included.

The government is tasked with stability and economic growth which is typically reflected in a country's Gross Domestic Product (GDP) in aggregate. Since GDP is a coincident indicator of airline industry's performance, when the country experiences a stable and healthy GDP, the airline industry should also benefit without necessitating specific and market interrupting economic regulation (Aerospace industry report 2011). The government is not responsible for picking specific economic winners and losers within an industry as Dempsey & Goetz (1992) and Schofield (2008) seem to advocate as the benefits of regulation. The health of an industry and its participants is beyond the scope of the purpose of regulation. Otherwise, by extension of the argument, wouldn't the government be tasked with the health of every grocery store, nail salon and accounting company that fails due to market competition?

The timing of Schofield's argument is suspect as the U.S. economy entered a recession in 2008 and had experienced a few years of significantly higher oil prices. The airline industry was feeling the pain from the macroeconomic events in the U.S. economy, not routing and pricing issues. No amount of deregulation would reverse those affects without large subsidies to entice consumers to fly and cushion the impact of record high fuel costs. In fact, a sure way to compound the recession and the pain from the macroeconomic effects in the airline industry would be to re-introduce regulation that limits competition and drive prices up. Demand for products and services are inversely related to prices (Arnold, 2011). As prices climb, consumer demand would go down; not the direction the airlines want for their future activity.

## Benefits of Competition

The airline industry was no longer an infant industry by 1978, needing regulation for protection in order to grow and become stable. After deregulation, economic indicators for the airlines improved in aggregate. Since deregulation, contestability of the markets pushed the cost of travel by almost 50% for the consumer and the average cost of production due to increased carriage has decreased by 28%. Airfares did not increase after a period of time as Dempsey & Goetz (1992) projected would happen. This is the reversal of the economic deadweight loss incurred with deregulation. Consumers have more money to spend on more travel or other goods and the airlines are providing more of their services (May, 2008; Wilson, 2008).

One of the complaints about the industry that deregulation is proposed as a solution is the frequent congestion at various high volume airports. The solution to the congestion at these airports is not regulation, but actually to harness the free market to solve the problem. Safety and orderly operation should dictate the capacity of the airfields. The current fee structure that charges fees based on airplane weights actually work against the congestion problem (May, 2008). Government safety regulators should enact a fee structure that gives airlines incentives to not congest airports. Government intervention by regulation that forces the free market to enact costs in high demand areas and lower costs in low demand areas would move the industry to a more freely competitive and well-functioning industry rather than a sheltered, protected regulated industry.
Safety has not been compromised under deregulation, in fact it got better (May, 2008).

## Let Competition Run

Competition in any industry is beneficial, not destructive because it yields efficiency and lower prices for consumers, as well as industry innovation. Competition is only destructive if the airline in question is the one that refuses to innovate or become more efficient. In fact, competition pushed airlines to innovate to become more efficient in their reaction to macroeconomic shocks, which in turn benefits the consumers through lower prices and more traveling options (Tom, 2009). Innovations that may not have been realized under a regulated system include hedging fuel costs (SWA), more efficient equipment (Boeing 787), increasing capacity utilization by shrinking fleet structures, and scrutinizing the weight of airplanes to maximize fuel consumption (AA). By allowing the market to operate freely, especially when faced with low margins, the industry is induced to be creative to find new sources of revenue and new ways to operate efficiently.

## Conclusion

To re-regulate the airlines would stifle the growth and increase the deadweight loss to society and the economy. Additionally, it would mean another government agency along with infrastructure and employees and other additional costs that come along with a regulatory body would be incurred. The U.S. budget hardly needs another government agency to support an anticompetitive initiative that would take more away from consumers and further constrain the contribution the airline industry has in the growth of GDP.

"Ding! After the business select passengers board, we will begin boarding numbers A1-30 for the last minute $59 deal to Key West." Without deregulation, sweet words such as those may never have reached the U.S. consumer. The hangar is open and the planes have taken off. The airfield should stay that way.✈



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