5

Competition and Entry in Smaller Markets

This study has focused on some of the most significant and well recognized means of enhancing airline entry and competition, especially in larger markets. However, smaller markets are promising and deserving candidates for competitive activity. The Department of Transportation (DOT) can and should take the lead in seeking creative ways to increase competitive options for travelers in the small- to medium-size communities that often serve as spoke cities for one or two carriers operating from larger hub airports. Although low traffic densities in many of these city-pair markets have made competitive jet service uneconomical, new technologies and changing market conditions are presenting new possibilities.

As noted earlier, these markets have been the subject of complaints by new entrants about aggressive and anticompetitive responses by incumbents. Startup airlines also have alleged that incumbents are offering travel agents extra commissions on ticket sales in markets challenged by smaller carriers. They also have alleged that larger carriers sometimes refuse to allow them to buy miles from frequent-flier programs to award to their customers, even when other airlines are purchasing miles. Highly selective uses of marketing advantages might require scrutiny and action by DOT; for example, possibly requiring airlines that sell miles to one airline to make similar offers to others.

Small- to medium-size cities—particularly those that are spokes for single-hub carriers—are potential battlegrounds for competition in the airline industry. Cities such as Knoxville, Tennessee, and Grand Rapids, Michigan, have nonstop jet service only to two or three hubs in their regions. Although the hubs are important destination points for travelers from these medium-size communities, traffic to other large, but more distant, nonhub cities—such as New York and Washington, D.C.—also might be considerable and capable of supporting nonstop service on smaller jet aircraft.

During the past 5 years, smaller, regional jet aircraft that can seat 35 to as many as 100 passengers have been introduced by commuter affiliates of major carriers, primarily to provide feed traffic to hubs. With their added speed and comfort, these aircraft are more popular, particularly with business travelers, than turboprop aircraft. They also have significantly greater range and potentially lower seat-mile costs on medium-length, low-density routes (i.e., flights of 400 mi or more). Some industry observers believe these aircraft will create many more competitive choices for travelers in small- and medium-size markets.[1]

The committee did not study the economics of regional jets; however, it is reasonable to assume that the new jets could increase the opportunities for some small- to medium-size cities to receive more nonstop service between more large destination cities than has been possible with mainline jet and turboprop aircraft. Regional jets are an example of how new technologies continue to affect the economics of the airline industry; they also might have implications for competition generally since regional jets could prompt incumbent airlines to compete directly with one another in more markets—for example, in serving the spoke cities

[1] Most recently, these opportunities have been discussed in Poole and Butler 1999. DOT also has prepared a white paper available on its website, profiling regional jets and their emerging roles in U.S. markets (June 1998).

of their competitors.[2] They also might provide possibilities for new entrants to develop niche markets and services. In all these cases, they would enhance service and competitive choices in moderate-size markets.

But spurring competition and service improvements in medium-size cities might require policymaking as well. For example, it will be important that limited airport and air traffic capacity do not impede the introduction and use of the new aircraft and technologies. Lifting slot controls at some key airports, promoting more gate availability, and providing more service opportunities at secondary and reliever airports—as recommended in Chapter 3—should increase competition, even in smaller markets. Some major airlines and their pilots have contractual agreements, known as “scope clauses,” that can limit the introduction and use of regional jet aircraft by the major airlines. The committee did not examine the potential institutional and contractual impediments to the use of these jets, but if the economics are right, pressures to relax these constraints will emerge.

In addition, DOT should be sure that its own policies and practices are not among the unintended impediments. For example, its economic fitness determinations for a new airline’s certification require an array of information describing the carrier’s business plan, its equipment, fares, and intended markets. The committee was not able to discern the need for this specific information, but recognized that the required public filings could help an incumbent. If some of these filing requirements are no longer necessary to ascertain fitness, they should be lifted or relaxed as vestiges of the regulated era. Competitively sensitive information should be treated as confidential.

Additional, innovative government actions also might induce more rivalry in smaller markets and more nonstop service to more varied destinations. DOT should work with small- to medium-size communities

[2] As an example, Northwest might add service between Minneapolis and Oklahoma City, now served mainly by TWA and American through their hubs in St. Louis, Chicago, and Dallas; or Delta might add service between Atlanta and Manchester, New Hampshire, now served mainly by USAirways through BWI, Philadelphia, and Pittsburgh. Retaliation by incumbent carriers to hub “poaching,” however, could dissuade major carriers from using regional jets in this competitive manner—a possibility that underlines the importance of new entrants spurring competition.

to consider positive actions for increasing competitive services. One concept worth exploring is that communities could offer airlines exclusive, but time-limited, rights to provide nonstop service in city-pair markets that have none. Brief "patents" of this kind might allay concerns that hub carriers will challenge them aggressively to protect their own hubs. Local residents also might be assured that the service will be sustained, although this might warrant local subsidies or other financial inducements, at least initially. A few communities, often with the support of local businesses, are now using subsidies to attract and retain desired airline service (see Chapter 1).

The committee is encouraged by DOT's determination to curb unfair competition in the airline industry. However, DOT also must remain alert to positive actions to encourage competition broadly, in large and small markets, long haul and short haul, and with new technologies and old.

REFERENCE

Poole, R.W., Jr., and V. Butler, 1999. Airline Deregulation: The Unfinished Revolution. *Regulation*, Vol. 22, No. 1, pp. 44–51.