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Why Consolidation Undermined the Airline Industry's Ability to Recover from the Coronavirus Crisis

By [Hubert Horan](#)

May 5, 2020



Over his long career, Hubert Horan has worked on many of the most critical issues in the field of transportation economics, including the impact of regulation and mergers on industry efficiency, and the impacts of consolidation and other industry structural changes on consumer welfare. Mr. Horan graduated from Wesleyan University in 1976 with a B.A. degree and Honors in Economics. In 1980 he graduated from Yale University's School of Management with an MPPM (MBA) degree. He is currently based in Phoenix, Arizona.

A major factor contributing to the industry's struggles during the current crisis was the loss of resiliency due to the consolidation of the airlines serving the intercontinental market. Part 1 of 4.

It is difficult to imagine how a stable, efficient, and competitive private sector airline industry could possibly emerge from the staggering post-coronavirus demand collapse. Aviation history provides many examples of far less serious crises triggered by bad corporate decisions (expansion far beyond market demand) and external shocks (major fuel price spikes, recessions, wars, terrorism). Recoveries from these smaller crises were slow and traumatic and depended on a large set of conditions that no longer exist.

In past airline crises, the most serious financial problems were limited to just a portion of the industry, and those carriers had ample liquidity, thanks to healthy demand and temporary debt relief. Legal processes and regulatory institutions were focused on protecting consumers, creditors, and longer-term economic welfare. There were still a large set of better managed/positioned carriers, so that capital markets and the bankruptcy courts could readily restructure still-viable assets. Robust competition rewarded the airlines who had not recklessly over-expanded and could readily cope with cyclical problems.

Over the last 15 years, all of the processes and conditions that had allowed commercial aviation to weather downturns and crises were systematically undermined. The largest, most politically astute carriers successfully captured existing legal processes and regulatory institutions, who abandoned the pro-consumer and pro-competitive policies of the previous 30 years, and worked aggressively to maximize the corporate value of favored incumbents.

In many of the world's most important markets, robust competition was replaced by an oligopoly/cartel of Too-Big-To-Fail airlines. Freed from competitive pressures, focus shifted from the innovations needed to drive ongoing productivity improvements to maximization of artificial short-term supra-competitive profits.

The owners of the Too-Big-To-Fail airlines aggressively extracted tens of billions of these profits into their own pockets, under the apparent belief that these companies would never ever face a serious downturn.

These changes destroyed industry resiliency. Critical liquidity was extracted, and even the huge taxpayer bailout the airlines requested is far too small to stabilize industry finances. The industry requires much more radical restructuring than anyone has ever considered before. This is not a situation where a handful of airlines need to replace failed management teams and downsize networks.

Since the cataclysmic demand collapse is likely to last for years, every sector of the worldwide industry (including manufacturers, airports, and other suppliers) is economically bankrupt in the Chapter 7 "no longer a viable going concern" sense, and must rapidly shrink to a fraction of its current size.

The owners of the Too-Big-To-Fail airlines aggressively extracted tens of billions of these profits into their own pockets, under the apparent belief that these companies would never ever face a serious downturn

The needed industry restructuring cannot happen on a private sector basis funded by at-risk capital. Near-term operations and the restructuring process can only be funded and administered by governments. This government role can only be justified if it minimizes the inevitably large number of job losses and service cuts.

Restoring a legitimate private sector industry will require that the restructuring process restores the level of competition that existed twenty years ago and ensures that competition drives the innovation needed for ongoing improvements in consumer welfare and overall industry efficiency.

Unfortunately, airlines and governments appear to be focused on protecting the managers and shareholders who created these problems, under the misguided belief that they can quickly recreating a

2019 status quo that is no longer sustainable. These airline owners and government officials spent the last fifteen years eliminating competition and ensuring that the resulting artificial short-term gains went almost exclusively to a narrow set of private shareholders who had little interest in the industry’s long-term health.

If these owners and officials control the restructuring process, there is a huge danger that it will focus on even deeper competitive cuts, bigger increases in artificial pricing power, creating even more powerful Much-Too-Big-To-Fail-Much-Less-Regulate airlines, and protecting investors from bearing their share of the pain and disruption of industry restructuring.

The Radical Post-2004 Consolidation

The radical post-2004 consolidation of international aviation is critical to understanding the depths of the current crisis, and the obstacles to solving it. None of this consolidation was due to cost efficiencies or other “market forces.” It was entirely the result of government decisions to reduce competition in order to help some of the most powerful incumbents boost near-term profits and stock prices. A major industry with a strong track record of producing significant consumer welfare gains was rapidly converted to a permanent extractive oligopoly.

In the 90s, the transatlantic (North America-Europe) airline market—the largest airline market in the world—was highly profitable and innovative, growing rapidly, and was robustly competitive. Consolidation focused on intercontinental markets because they have been the overwhelmingly largest source of airline profits and growth, and the North Atlantic was the most lucrative of them all.

	2003	2013
Concentration of US-Continental Europe top 3 market (40 million annual pax)	67%	97%
	top 5 80%	99%
Concentration of total North Atlantic market (55 million annual pax)	top 3 54%	96%
	top 5 73%	99%
Collusive Alliance share	48%	96%
North Atlantic competitors with capacity share of at least	>4% 8	3
	>2% 9	3

Beginning with 2004, the transatlantic market was converted into a permanent 3-player oligopoly/cartel that controlled 96 percent of all traffic.^[2] Those three are the collusive alliances led by Lufthansa, Air France, and British Airways, whose US partners are United, Delta, and American.

These alliances go well beyond traditional marketing alliances (where independent carriers link frequent flyer programs and lounge facilities) because the US Department of Transportation (DOT) granted them antitrust immunity (ATI) to fully collude on pricing and capacity. The antitrust immunity granted to these carriers eliminated competition just as a full merger would.

The radical consolidation of the North Atlantic directly (and by design) drove a major consolidation of the domestic US industry (the world’s second-largest market, where 4 of the largest competitors were

merged out of existence) and drove ongoing reductions of competition in the Transpacific and Latin American markets.

The idea that balanced competition between just three players could be sustained indefinitely never made any sense, given the industry's long history of cyclical downturns and market instability. Consolidation eliminated the possibility of significant price competition in international markets and eliminated any remaining possibility of new market entry. The consolidation movement allowed the now Too Big To Fail carriers to capture full control of industry oversight in Washington and Brussels. That control threatens to hugely bias, and perhaps undermine efforts to recover from the coronavirus crisis.

This article summarizes previously published analysis from journal articles and DOT and Congressional testimony that readers interested in [more exhaustive documentation](#) of the history and industry economics should refer to.

The Airline Industry's Post-2004 Consolidation Reversed 30 Years of Successful Pro-Consumer Policies

By [Hubert Horan](#)

May 5, 2020

Share

A small number of intercontinental carriers recaptured control of industry oversight in Washington and Brussels to convert the world's most important markets from robust competition to a permanent oligopoly of Too-Big-To-Fail airlines. Part 2 of 4.

As discussed in Part One of this series, there is serious doubt as to whether a stable, efficient, and competitive private sector airline industry could possibly emerge from the staggering post-coronavirus demand collapse.

Starting in 2004, a small number of intercontinental carriers led a carefully orchestrated program to recapture control of industry oversight in Washington and Brussels, reversed thirty years of successful pro-consumer and pro-competitive aviation policies, and converted the world's most important markets from robust competition to a permanent oligopoly/cartel of Too Big To Fail airlines.

That consolidation movement undermined many of the mechanisms that had allowed the industry to restructure after past crises, and it is difficult to see how those mechanisms could rapidly be restored in order to help cope with today's much larger crisis.

The 1930s-1980s Regulatory Capture

In the 1930s, strict economic regulatory controls over airlines were established because airline technology and economics were extremely immature. Decades of regulatory protections were clearly

needed to nurture an industry whose huge economic potential was still far into the future. The Civil Aeronautics Board (CAB) began managing US airline competition in 1933.

The CAB segregated markets between those served by large trunk carriers (e.g. United, Eastern), the Local Service carriers using DC-3s to feed smaller cities to the trunk carriers, and international “flag carriers.” The trunk carriers were viewed as having the greatest potential to someday become standalone commercial enterprises, but the system required elaborate cross-subsidies to ensure the politically required national network coverage.

While historically, the overwhelming majority of US airline service was domestic, outside the US, it was international. Governments worked hand-in-hand with their designated “flag carrier” (e.g. BOAC, Air France, and Alitalia) that was usually state-owned and the long-term nurturing of aviation was primarily seen as a means of advancing national trade and development policy, and not in terms of developing a future private sector industry.

The 1947 Chicago Convention established a system whereby every international market depended on bilateral treaties where the most protective government could dictate limits on competition.

The focus of the very different US and non-US systems both morphed from nurturing industry technology/economic development to cartel management, focusing more on the near-term interests of the largest, most politically organized incumbents than on longer-term industry or consumer interests. There was no mechanism that could override the interests of carriers benefiting from protections in order to force the overall industry efficiency improvements that would permit increased service and lower prices.

A prominent regulatory history summarized the US shift to incumbent protection:

“Clearly, in passing the Civil Aeronautics Act [of 1938], Congress intended to bring stability to airlines. What is not clear is whether the legislature intended to cartelize the industry. Yet this did happen. During the [next] forty years ...the overall effect of board policies tended to freeze the industry more or less in its configuration of 1938. One policy, for example, forbade price competition. [...]Charged by Congress with the duty of ascertaining whether or not ‘the public interest, convenience, and necessity’ mandated that new carriers should receive a certificate to operate, the board often ruled simply that no applicant met these tests. In fact, over the entire history of the CAB, no new trunkline carrier had been permitted to join the sixteen that existed in 1938. And those sixteen, later reduced to ten by a series of mergers, still dominated the industry in the 1970s. All these companies... developed into large companies under the protective wing of the CAB. None wanted deregulation.”^[6]

The primary beneficiaries in the US were the large trunk carriers whose “government affairs” investments (backroom negotiations with CAB staff, Congressional lobbying) had given them exclusive access to the most lucrative routes, blocked the efforts of Local Service carriers to establish more efficient networks, and prevented charter carriers from selling low price tickets to individual travelers.

The CAB authorized price and capacity levels were designed to ensure that even the most mediocre airline could survive and the CAB engineered mergers to salvage airlines that failed to achieve mediocrity. Much of the [early economic literature](#) on “regulatory capture” used the CAB as a prime

example of how regulators could become more responsive to larger, politically adept incumbents than to their obligations to the general public interest.

The 1970s: Deregulation/Liberalization

1970s academic critiques of New Deal-era regulatory regimes only gained political traction in the field of transportation. Simple examples existed, for both airlines and other modes, of how the economic logic behind the original legislation had become obsolete, how regulators were no longer attentive to the broader public interest, and how regulatory actions were directly harming economic welfare.

Critiques of the CAB noted that regulatory approaches established in the DC-3 and DC-6 eras were still being used well after the second generation of jets (e.g. 737s and 747s) had dramatically improved efficiency, and created a true mass market for air travel. Why was the CAB hurting consumers by demanding that United and Western charge \$35 for Los Angeles-San Francisco tickets, when PSA [could profitably operate](#) with \$19 fares?

The [US airline deregulation legislation](#) of the late 70s that emerged after extensive Congressional review was designed to directly address the regulatory capture problem. The objective of government oversight shifted from protecting the short-term financial interests of incumbent carriers to protecting the public's longer-term interest in dynamic, level-playing-field competition.

Level-playing field competition was seen as critical to driving ongoing innovations that would in turn increase overall industry efficiency and consumer welfare.

Antitrust rules were still seen as critical to protecting competition. "In enacting the Airline Deregulation Act, Congress directed that control of the air transportation system be returned to the marketplace. We have consistently held that a part of the return to market control is exposure of participants to the antitrust laws, as that exposure exists in unregulated industries."

The CAB's artificial rules limiting the use of integrated commuter airline feed and preventing "Local Service" carriers from developing hubs or operating long-haul routes that had been reserved for "Trunk" carriers quickly broke down, and the two categories melded into what became known as the "Legacy US hub" business model.

Meanwhile, in Europe

In Europe, there was growing recognition that flag carriers' regulatory capture of each country's industry oversight contradicted the principles that became embodied in the Single European Act of 1986. But neither Brussels nor national governments did anything to change the political position of these highly visible "national champions."

Similar to the US convergence around the "Legacy US hub" model, these flag carriers converged around the "intercontinental hub" model; every flag carrier hub in Europe (Amsterdam, Zurich, Rome, Brussels, Vienna, etc.) became a smaller version of the industry leader (Lufthansa's hub in Frankfurt).

While over half the passengers at these hubs were taking intercontinental trips, they also served a variety of regional and domestic markets. The EU recognized the consumer benefits created by US deregulation

but the increased pricing and market entry freedoms it introduced were limited to short-haul, intra-European markets.

“Deregulation” was always a misnomer, and the EU’s approach was correctly labeled “liberalization.” Governments were not abandoning industry oversight. A government policy that its industry oversight should try to maximize long-run competition and consumer welfare instead of short-term incumbent profitability is still a government policy.

In addition to antitrust, regulations regarding safety (pilot training, maintenance, aircraft licensing) financial integrity and reporting, and consumer and labor protections remained fully in place. New entry was allowed, but entrants had to meet stringent safety and financial standards. It was only after the economic and popular success of US airline “deregulation” reforms that the term was repurposed as a branding for much more radical reductions in government oversight of the financial industry.

A full accounting of 1970s/80s US/EU airline “deregulation”/liberalization is not possible here. While there were numerous shortcomings, I would argue that it achieved the vast majority of its primary objectives and was one of the most successful 20th Century US public policy initiatives focused on improving the efficiency of a major industry. It was implemented after an exhaustive and transparent public debate, based on a detailed analysis of industry economics, involving all important stakeholders, and support from a wide variety of political interests.

Congress passed public laws codifying its major objectives and rules. It led to major improvements in industry efficiency and profitability, and many of these benefits were passed on to consumers (increased service at lower prices) and workers (increased employment). Carriers certainly pursued a lot of ideas that hindsight demonstrated to be foolish and uneconomical. But because there was robust competition among a large set of competitors the worse-run airlines could not hide behind regulatory or other artificial protections.

I would also argue the biggest impact of deregulation/liberalization was that the industry didn’t just achieve a one-time service/efficiency boost from eliminating regulatory distortions but became much more dynamic over time. The industry became capable of faster growth and demonstrated it could better withstand fuel shocks and cyclical downturns.

Prior to the 1970s/80s, most airline productivity gains originated outside the airlines, primarily from improved aircraft/engine technology, but also from public investment in airport and air traffic control infrastructure. Increased competition forced airlines to become much more innovative. After deregulation, carriers aggressively restructured in order to fully exploit hub network efficiencies. Hubs established prior to deregulation (Atlanta, Chicago, Dallas-Ft. Worth) became much bigger and more efficient. New marketing freedoms led to the development of extremely sophisticated pricing and revenue management systems and customer loyalty (frequent flyer) programs.

An even bigger post-deregulation innovation was the development of the “low-cost-carrier” model. This had been originally pioneered by PSA and Southwest on intrastate routes exempt from CAB restrictions, but was finally able to demonstrate its value nationwide in the 80s. The new LCC model drove major industry growth by offering very low fares in high-volume point-to-point markets using simplified, better utilized fleets and avoiding high cost hubs.

In Europe, a different type of “low-cost-carrier” sector emerged combining new startups such as Ryanair (founded 1984), and airlines that had originated (due to previous regulatory limits) as tour-package charter operators.

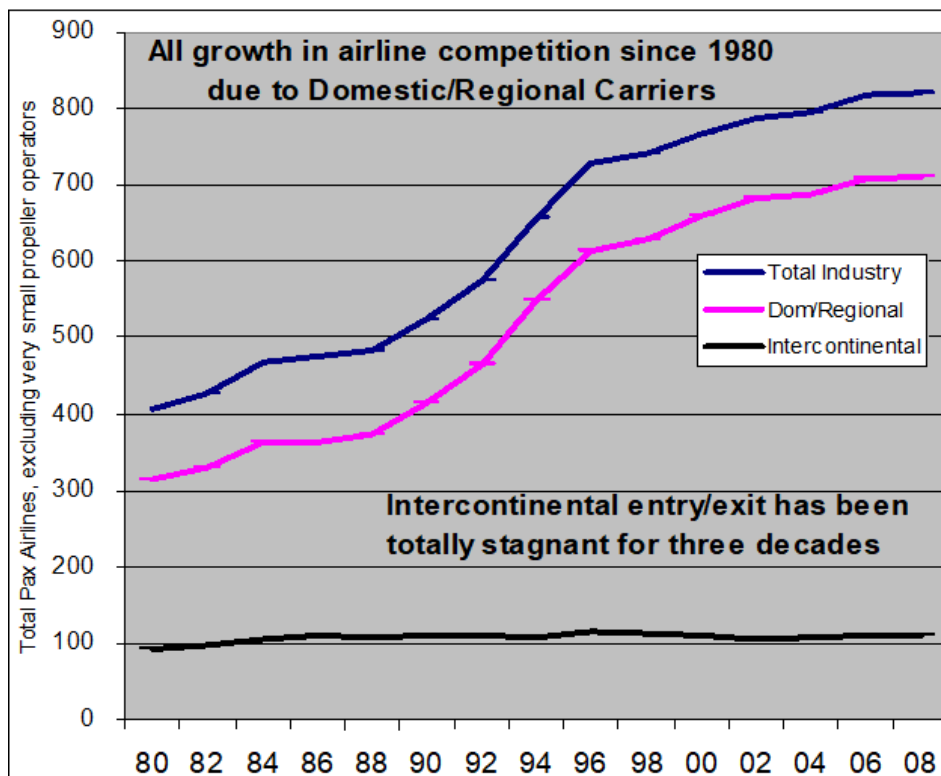
Prior to the 1970s/80s, most airline productivity gains originated from improved aircraft/engine technology. After deregulation, carriers restructured in order to exploit hub network efficiencies

A Two-Tier Industry

The separate 1930s-1970s American and European regulatory regimes had inadvertently dictated that all Legacy carriers follow a “one-size-fits-all” business model. Both models were clearly the most efficient way to serve the majority of traffic, especially in smaller markets that needed hubs and complex fleets. But they were not an efficient way to serve high-volume point-to-point markets. With the historic regulatory straitjacket removed, the industry structure in both America and Europe quickly bifurcated into a mixture of point-to-point low-cost carriers (LCC) and traditional Legacy (pre-deregulation) hub airlines.

As Exhibit 2 illustrates, the widespread perception that “deregulation”/liberalization had unleashed a torrent of new competition is highly misleading. Essentially all of the new competition in the industry after 1980 came from short-haul/narrowbody airlines. The success of Southwest and Ryanair and the vastly reduced entry barriers in short-haul markets unleashed a wave of new startups in America and Europe. Other variations of the non-hub, point-to-point “LCC” model were introduced in rapidly growing markets around the world.

Exhibit 2



Government favoritism towards their “national champions,” entry barriers, and protective bilaterals ensured that the number of intercontinental competitors remained absolutely flat. These markets remained competitive stagnant even though these markets enjoyed much stronger underlying demand growth (from increasing and global trade, labor movements, and tourism) and efficiency gains (from newer longhaul aircraft including 330s, 777s, 787s).

The Open-Skies Treaties

Two-tier airline competition (short-haul dynamic, intercontinental stagnant) remained in place despite Washington’s desire to extend [domestic level-playing field competition](#) to international markets. The first major breakthrough did not occur until 1993, using the combination of the first collusive alliance (Northwest-KLM) and the original US-Netherlands [“Open Skies” treaty](#).

The 1990s collusive alliances were an innovative solution to the problem of poor service and high fares in small secondary North Atlantic markets that neither a US airline nor a European airline could economically serve with its own aircraft.

European carriers could feed markets across Europe through their hubs to large US cities, and the smaller carriers could only economically serve the very largest cities (New York, Chicago, Los Angeles). US carriers could feed passengers from across America, but were similarly limited to flights to London, Paris, and Frankfurt.

With antitrust immunity, Northwest and KLM could offer superior schedules and a full range of discount fares to passengers not previously served by any single carrier’s online service.

These were largely double-connect markets (e.g. St. Louis to Stuttgart via Detroit and Amsterdam) where the only available services were interline connections with long layovers and higher fares. The markets that had lacked single-carrier service were individually small but accounted for over 30 percent of the total US-Europe market.

The success of the KLM-Northwest efforts led a number of other European countries to abandon protective bilaterals and sign “Open Skies” agreements. In 1995, Delta established a similar collusive alliance with Swissair and Sabena, and in 1997 United joined forces with Lufthansa and SAS.

The full consumer and industry benefits of collusive alliances had been fully realized by the end of the 90s when previously interline trips had completely shifted to superior single carrier and alliance alternatives. None of these airlines attempted to introduce this type of collusive alliance in the 1990s to transpacific or other international markets, because the problem they fixed was only found on the North Atlantic.

The original “Open Skies” treaties laid out strictly defined requirements that applicants for antitrust immunity had to meet. These including case-specific evidence that the immunity grant not only met Clayton Act tests showing that markets were fully contestable and that market power would not increase but was “required by the public interest” in order “to achieve important public benefits” that could not be created otherwise and would outweigh the risks of reduced competition.

In the case of the original 90s collusive alliances, those tests [were clearly met](#). As noted, antitrust immunity grants reduce competition just as a full merger would have, but the original three collusive alliances had only minor impacts on market concentration, grew on the basis of verifiable service/efficiency improvements, and (as Exhibit 3 illustrates) succeeded in an environment that remained robustly competitive. Combined, these three alliances only operated 42 percent of North Atlantic capacity and reduced average North Atlantic fares by 8 percent while capacity increased 54 percent (4.4 percent per year).

Non-alliance carriers continued to focus on very large local markets (British Airways at London, Air France at Paris, Continental in New York) while the alliance carriers exploited their advantages in connecting markets.

Exhibit 3		1993	1998	2003	2013
Concentration of US-Continental Europe market (40 million annual pax)	top 3	41%	55%	67%	97%
	top 5	59%	69%	80%	99%
Concentration of total North Atlantic market (55 million annual pax)	top 3	42%	48%	54%	96%
	top 5	56%	66%	73%	99%
Collusive Alliance Share		0%	42%	48%	96%
North Atlantic competitors with capacity share of at least	>4%	10	8	8	3
	>2%	15	10	9	3

As Exhibit 3 also illustrates, the competitive impact of the DOT's later (post-2004) antitrust immunity grants would be dramatically different. After the turn of the century, the successful policies focused on preventing regulatory capture and protecting level-playing field competition and maximizing consumer welfare were completely reversed.

This radical consolidation destroyed the resilience the industry needed to cope with challenges much smaller than coronavirus. The effective recapture of government oversight by the powerful oligopoly carriers and the elimination of policies designed to protect competition and consumer welfare created a huge obstacle to establishing a post-coronavirus industry that can efficiently serve the overall public interest.

How Alliances Carriers Established a Permanent Cartel

By [Hubert Horan](#)

May 5, 2020

American carriers faced the post 9/11 demand shock, while the European intercontinental flag carriers were facing increased competition in the Middle East and Asia. The consolidation movement was a reaction to these short-term problems. Part three of four.

How could a major, highly visible industry shift from robust competition to permanent cartel conditions in just a few years? How could widely supported liberal pro-competitive government policies that visibly produced major improvements in the airline industry's efficiency and consumer welfare suddenly be totally reversed?

As shown in Exhibit 1, the counter-revolution against liberal international airline competition began in 2004 with the radical consolidation of the North Atlantic market. It was almost completely in place before the 2008 economic collapse, and by 2013 the loose ends had been tied up. This program focused initially on the North Atlantic, the most lucrative intercontinental market, because these carriers knew that North Atlantic consolidation would inevitably force the consolidation of the domestic US, transpacific and [other major markets](#).

Exhibit 1

9 of 27 North Atlantic competitors eliminated 1993-2003

Northwest (1993 into KL)
Sabena (1995 into SR, later LH)
Delta (1995 into SR, later AF)
Austrian (1995 into SR, later LH)
United (1997 into LH)
SAS (1997 into LH)
British Midland (2001)
TWA (2002 into AA)
CSA
Czech (2002 into AF)

15 of 18 North Atlantic competitors eliminated since 2004

#USAir (2004 into LH then AA)
#KLM (2004 into AF)
#Air Canada (2005 into LH)
#Swissair/Swiss (2005 into LH)
LOT Polish (2005 into LH)
TAP Air Portugal (2005 into LH)
Aeroflot (2006 into AF)
Turkish (2008 into LH)
#Continental (2009 into LH)
#American (2010 into BA)
Iberia (2010 into BA)
Finnair (2010 into BA)
#Virgin Atlantic (2014 into AF)
Aeromexico (2011 into AF)
Aer Lingus (2015 into BA)

Only 3 viable North Atlantic competitors today

3 viable surviving competitors
Lufthansa (LH)-led collusive alliance
Air France (AF)-led collusive alliance
British Airways (BA)-led collusive alliance plus 2 niche carriers not seen as viable
Norwegian
Alitalia (had previously been part of AF-led alliance) #—these ten carriers had operated at least 5% of total North Atlantic capacity during this period

Part 2 of this series described the—largely successful—airline deregulation/liberalization policies that the post-2004 consolidation movement needed to reverse. Those policies had replaced the pre-1980s regime

that allowed the most powerful industry incumbents to capture the regulatory process with a regime focused on maintaining level-playing field competitive conditions. The innovations spurred by this increased competition increased both profitability and consumer welfare.

More robust competition also increased the industry's ability to support stronger growth and better withstand cyclical and external shocks. The industry's ability to recover from the coronavirus crisis has been seriously weakened because of the consolidation movement's success in shrinking many major markets into a permanent oligopoly of Too-Big-To-Fail airlines.

“Industry Consolidation” to Fix Profit Problems

The gains from these pro-competitive policies were not evenly distributed, and a two-tier industry emerged. The legacy carriers (who had predated deregulation) converged around a domestic hub model in America and an intercontinental hub model in Europe and elsewhere. These could efficiently serve most, but not all traffic, and various forms of “low-cost carriers” (LCCs) demonstrated that they could much more efficiently serve high-volume short-haul markets than the two legacy models. These short-haul/narrowbody carriers enjoyed the full benefits of the new pro-competitive policies but the intercontinental/widebody carriers had not.

Unfortunately, the legacy carriers refused to accept the fact that they now faced a huge competitive disadvantage in these serve high-volume short-haul markets.

Instead of refocusing networks on the (much larger set of) markets where they had competitive advantage, they kept investing in LCC-dominated markets which they could not serve profitably.

Margins at these companies [had also slumped](#) at the turn of the century due to dot-com era overcapacity, and the recession that began in 2000 linked to a major fuel price spike (2001 was up 40 percent over 1999).

The US carriers faced the additional burden of the short-term post-9/11 demand shock, while the European intercontinental flag carriers were facing increased competition from long-haul carriers in the Middle East and Asia.

The post-2004 consolidation movement was a reaction to these short-term profit problems.

The US carriers faced the post-9/11 demand shock, while the European intercontinental flag carriers were facing increased competition in the Middle East and Asia. The consolidation movement was a reaction to these short-term problems

Beginning with 2002, almost all of the large legacy US carriers filed for bankruptcy protection. These carriers failed to acknowledge any responsibility for any of their financial problems, claiming their descent into bankruptcy was entirely the result of the post-9/11 demand shock.

The US bankruptcy laws had always been an integral part of its competition policies, designed to protect assets that could still contribute to overall economic welfare. They did a reasonable job of fixing bad airline capital allocation problems in the 80s and 90s, because the courts welcomed competing reorganization proposals and focused on protecting these asset values in order to maximize creditor

recovery, and ensuring that restructuring burdens were equitably distributed. They failed to work in the 21st-century cases because the bankruptcy process has been “captured,” just as pre-1980s Civil Aeronautics Board industry oversight had been captured.

Instead of prioritizing asset values, creditor recovery, and the reallocation of industry resources to more efficient uses, the courts prioritized the personal interests of the senior executives who believed their past decisions had nothing to do with their company’s collapse into bankruptcy. The courts gave them exclusive control of the reorganization process and blocked all efforts to present competing plans.

As a result, airline plans failed to fix bad investment decisions or other supply/demand problems, and forced labor to suffer a disproportionate share of burdens it had not created. Since none of these plans could produce a credible business turnaround, these carriers remained bankrupt for years, and continued to operate unsustainable routes with operations funded by advance payments from the banks that issued the extremely profitable credit cards linked to their frequent flyer programs.

The senior executives who had maintained control of the process over these years inevitably ended up [enriched by tens of millions](#) in newly issued stock.



In 2004, Air France [merged](#) with KLM.

The Antitrust Immunity Applications

The post-2004 consolidation movement was entirely driven by the largest North Atlantic carriers, especially Lufthansa, Air France, United and Delta. The triggering event was the 2004 merger of Air France and KLM, which was quickly rubber-stamped by the EU.

As will be seen with every subsequent major merger, the higher cost airline took over a more efficient competitor, which in this case was the main source of price competition in European long-haul markets. Air France paid a 40 percent premium over KLM’s prior equity value, indicating how highly these reductions in competition were valued.

The Air France-KLM merger triggered multiple rounds of further consolidation. By reducing the European long-haul market to just 3 competitors (a duopoly in Continental Europe plus the British Airways hub in London), the Air France-KLM merger forced the reduction of the North Atlantic market (which then had 8 significant competitors) into a permanent 3-player oligopoly/cartel, led by the senior partners of the three collusive alliances.

Since US legacy carriers depended heavily on international traffic, and the North Atlantic was the largest international market, this meant that approval of Air France-KLM meant that three of the six US legacy carriers had no hope of surviving independently.

The second (and most important) stage of this orchestrated program was three new antitrust immunity applications to the US Department of Transportation (DOT). Delta went first, applying to merge the Delta-Air France and Northwest-KLM into a single collusive alliance that was now the largest competitor on the North Atlantic.

The original 1993 antitrust immunity (ATI) allowed Northwest and KLM to effectively “merge” into a single marketplace entity where partners could collude on pricing and all other competitive decisions. This met the stringent legal requirements governing ATI grants, as they produced readily verifiable consumer welfare gains and the combination of smaller carriers posed negligible competitive risks. DOT was now granting ATI in cases that would dramatically reduce competition.

At each step, the DOT refused to consider competitive impacts, so that it was impossible to challenge individual applications as part of an orchestrated program to consolidate the industry. The idea that United and Lufthansa would want to respond to an ATI approval giving the Air France-led group nearly twice LH/UA’s existing market share, with an application allowing it to reclaim market leadership was treated as a totally unforeseeable surprise.

Each subsequent ATI application (United/Continental and British Airways/American Airlines) raised far greater competitive issues but DOT ignored these in order to foster “inter-alliance competition” with the Air France-led grouping. DOT approvals also ignored the question of how allegedly independent US airlines (Delta/Northwest, United/Continental) could actively share data and collusively set prices and schedules in their most lucrative market while remaining aggressive competitors in domestic US markets.

The third direct result of the Air France-KLM merger was consolidation of six US legacy hub carriers into just three. Again, in each case, a higher cost airline took control of a more efficient competitor and did so at very low cost, because the DOT’s ATI decisions had destroyed the corporate value of the three Legacy airlines that did not control one of the three collusive alliance franchise that DOT had allowed.

A direct result of the Air France-KLM merger was consolidation of six US legacy hub carriers into just three

Originally, the alliance carriers expected the full consolidation of both the North Atlantic and domestic US hub carriers, to be completed before the end of the Bush Administration in 2008 but this was delayed two years because of the extended negotiations over the new EU-US treaty, and the 2008 economic crash.

The North-Atlantic Cartel

The EU actively defended the power of the North Atlantic cartel. After rubber-stamping Air France-KLM, it refused to allow a merger between Ryanair and Aer Lingus, much smaller airlines but ones that threatened the cartel with aggressive price competition. Any airline wishing to feed long-haul passengers to or from North America or Europe had to deal with the cartel on its terms, and smaller European flag carriers could not survive unless they became (very) junior alliance members.

The distortions to domestic US competition went beyond the initial 50 percent reduction in competition between legacy hub carriers. Southwest correctly realized that after rubber-stamping these mergers, the government would do nothing to stop its acquisition of Airtran, the only other large scale LCC in America. As with Air France-KLM, antitrust officials ignored that the huge acquisition premium Southwest paid could only be explained by the elimination of its major price competitor and that future entry that might discipline market power abuses was totally impossible.

Other major domestic US distortions are explained by the how the orchestrated consolidation effort had been structured. For both the antitrust immunity and merger decisions, Delta went first, United went second, and American went third. This gave Delta an artificial head start on exploiting their larger and more powerful position before others could catch up. United applied for expanded antitrust immunity less than 60 days after DOT had approved the DL-NW-AF-KL deal, but could not begin merger implementation before the 2008 economic crash. The American-US Airways integration could not begin until seven years after Delta-Northwest.

Delta's huge competitive advantage was totally due to the artificial nature of the orchestrated Alliance/DOT process for reducing competition.

The PR Program

US airline deregulation was only implemented in the 1970s after an extensive, transparent public debate. When these pro-competition policies were reversed after 2004, there were no independent analyses of issues or options, and no public debates before the DOT or Congress. Coverage of the industry in the business press was completely limited to a one-sided barrage of PR claims presented by the Alliance carriers, with United CEO Glen Tilton taking the lead role in the US, where the critical ATI decisions would be made.

Since Tilton and the Alliance carriers had no economic evidence that would support their claim that consumers would be much better off if the number of airlines was dramatically reduced, they needed to mount an overwhelming PR effort designed to create the sense that the "debate" was already over and that consolidation was inevitable.

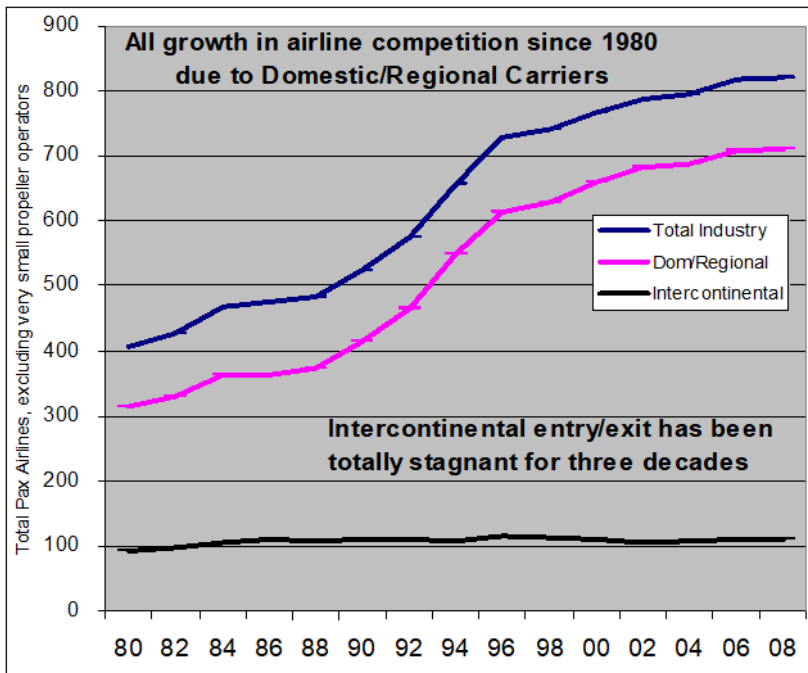
Alliance PR aggressively exploited confusion and ignorance of actual industry economics, and never bothered to explain what exact changes "consolidation" would involve.

US politicians and reporters tended to improperly assume that all markets everywhere were just as competitive as domestic US markets had been in the 1990s, had little understanding of hub network economics, and were unaware that international markets were the critical drivers of Legacy carrier profitability. The prospect of new consolidation would not have troubled reporters and politicians who

did not understand United, Lufthansa, SAS, Austrian and TAP had already been merged into a single integrated competitor.

As the data in Exhibit 5 documents, its claim that there were far more airlines than the public needed misrepresented an exclusively short-haul issue as an excuse to reduce competition in the already stagnant intercontinental market. The claim that a shakeout was an inevitable result of “market forces” misrepresented industry dynamics (demand was still growing robustly), industry economics (United Airlines was not too small to compete efficiently), and the actual consolidation process (driven entirely by governmental decisions, not by the judgement of capital markets about relative efficiency levels).

Exhibit 5



Alliance PR always called the alliances “Star” “Skyteam” and “Oneworld” in order to confuse the ATI petitions to expand collusive alliances with the branded marketing alliances focused on more benign things like frequent flyer reciprocity and shared lounges.

Occasionally, the PR would cross over from misrepresentation to outright fabrications, such as the claim that liberalizing “cross-border investment” (so that the EU carriers could own and fully control their US partners) would create more new jobs than the combined employment of Delta and Continental and would create more new revenue than the combined revenue of Northwest and Southwest.

The Alliances’ “consolidation is necessary and inevitable” message got across because no other voices could be heard. Nobody at the DOT or the EU’s Competition Directorate was publishing analysis of airline competition issues. The political leadership of these agencies was focused on supporting the largest corporate interests, not consumers.

There were no competing views in the industry since all of the large legacy airlines would benefit from consolidation, and neither the LCCs nor the aviation industry press thought it was sensible to challenge the well-organized Alliance advocacy program. The only jobs available for policymakers, lawyers and consultants were ones supporting radical industry consolidation.

The biggest barrier to intercontinental consolidation was the US laws that established strict evidentiary requirements before antitrust immunity could be approved. If those laws had been obeyed, none of the post-2006 ATI applications would have been granted, none of the subsequent US mergers would have occurred, the North Atlantic would not have been reduced to a permanent 3-played oligopoly/cartel.

[The industry would](#) not have undermined the resiliency needed to deal with the coronavirus crisis. But those laws were not obeyed, and Part 4 will describe the false and deliberately misleading claims that Alliance carriers and the DOT used to evade and nullify the laws designed to protect competition and consumers.

How Airline Alliances Convinced Regulators That Collusion Reduces Prices

By [Hubert Horan](#)
May 11, 2020



United Airlines Boeing 777-200ER (N78008) landing at Milan Malpensa Airport (Wikipedia)

The Department of Transportation granted antitrust immunity to Atlantic alliances that reduced competition on the basis of a single paper written by a United Airlines consultant that argued market concentration only has a positive impact on consumers. Part four of four.

In the space of just a few years, the North Atlantic, the world's biggest aviation market, was converted from robust competition to a permanent oligopoly/cartel of [three collusive alliances](#). By design, the consolidation of the North Atlantic, in turn, forced a wave of mergers that consolidated the domestic US market (the world's second-largest) and forced most Transpacific and Latin American long-haul airlines to align with one of the three collusive groups.

This radical consolidation undermined the resiliency the industry would have needed to cope with the major downturns it regularly faces and desperately needs as it faces the unprecedented coronavirus crisis.

In order to drive this radical consolidation, the alliances had to reverse 30 years of aviation competition policies, discussed in [Part 2](#) of this [series](#), that saw level-playing field competition as a critical driver of the innovation needed to drive ongoing improvements in industry efficiency and consumer welfare.

They needed to re-establish the regulatory capture that existed prior to the deregulation/liberalization of the 1980s, where the most powerful airlines could negotiate policies about industry structure and competition through private, backroom discussions with government officials without any public discussion or debate or legislative authorization.

[Part 3](#) of this series described the alliance's orchestrated 2004-08 applications to the US Department of Transportation (DOT) that would expand the share of the market served by the collusive alliances with antitrust immunity (ATI) from just under half of the North Atlantic to virtually 100 percent, and the major PR program to convince politicians and the media that radical consolidation had nothing to do with these government decisions to reduce competition but was the inevitable result of "market forces."

"In order to drive a radical consolidation, the alliances had to reverse 30 years of aviation competition policies "

Case-Specific Evidence?

Getting DOT officials to privately agree to reverse policies that were popular and had been highly successful was the easy part. US laws established clear requirements before antitrust immunity (which has the same competitive impact as a merger) could be granted.

None of the radical post-2004 industry consolidations could have occurred if the US government obeyed these laws. The consolidation movement's biggest challenge was developing a basis that the DOT could use to circumvent and nullify these laws.

These laws required a Clayton Act test of whether the reduced competition would increase market power, including evidence [demonstrating the absence](#) of risk that it could harm competition by increasing the ability or incentive to raise prices or reduce output in any relevant market and evidence

that markets are fully contestable, so [that](#) “...entry into the market would be timely, likely, and sufficient either to deter or to counteract a proposed alliance’s potential for harm.”

The law also [clearly stated](#) that the apparent absence of serious competitive issues was not sufficient; airline antitrust immunity requests could not be granted unless “required by the public interest” and “necessary to achieve important public benefits.”

The Joint Venture Guidelines and the [Horizontal Merger Guidelines](#) defined the evidentiary standards that claims of public benefits must meet:

“[the applicants] must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so) how each would enhance the merged firm’s ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means.”

The DOT’s dilemma was that it was determined to reduce intercontinental competition to permanent oligopoly/cartel levels, but had absolutely no objective, verifiable evidence that consolidation would not create pricing power or other forms of artificial market power, could not honestly state that intercontinental markets were contestable (there had been no successful new North Atlantic entry since 1983) and had no evidence demonstrating that high levels of concentration would produce things like lower prices and increased service that could legitimately constitute “public benefits.”

Do Consumers Always Win When Industries Consolidate?

DOT’s decisions in all three ATI cases were based entirely on false carrier claims that the reduction of competition would create significant public benefits. The DOT knew that these claims were vague and speculative, could not be independently verified, and were not backed by case-specific evidence but willfully misrepresented them as objective research that had been independently vetted and was now widely accepted by objective outsiders.

The DOT knew that these claims could not withstand independent scrutiny so it created an ironclad rule establishing that since these claims were immutable truths that would apply to every possible ATI case, these applicants did not have to obey the requirement for case-specific evidence, and DOT could reject all challenges to these claims, and objective evidence others might present contradicting the Alliance carriers’ claims.

The Alliance carriers’ false antitrust claim was that reducing the number of competitors would automatically produce 15-25 percent consumer price reductions regardless of market conditions. Yes, you read that correctly—a claim that consumers always win big when industries consolidate.

“The Alliances claimed that every possible merger in the industry would reduce prices by 15-25 percent, regardless the impact on concentration.”

This isn’t a claim that a specific merger under unique conditions might increase consumer welfare, backed by case-specific evidence that those unique conditions exist. This is a claim that every possible

merger in this industry would reduce prices the same 15-25 percent, regardless of the impact on concentration, specific merger synergies, or whether it occurred during boom times or a recession.

This is a claim that is so absolutely certain that every grant of ATI that reduces competition will reduce prices 15-25 percent that the legal requirements for objective, verifiable, case-specific evidence can be ignored.

Taken at face value, the carriers were arguing that even a merger of the three remaining alliances into a monopoly alliance would meet the legal “public benefit” standard, because every possible antitrust immunity grant would reduce prices by the same 15-25 percent.

The American/British Airways ATI application even included a specific estimate of the increased welfare it would create, claiming that prices would immediately fall by \$257 per ticket in all connecting markets currently served on an interline basis by the applicants, creating an annual consumer benefit of \$92 million.

The entire claim (known as “double marginalization”) is based on a single 1990 journal article by Jan Brueckner, Distinguished Professor of Economics at the University of California, Irvine, who at the time and throughout this period worked as a consultant for United Airlines, although this fact was never disclosed in any of the case submissions or decisions.

Brueckner’s “double marginalization” theory asserts that airlines are physically incapable of setting rational, revenue-maximizing fares on connecting interline itineraries.

If United and Lufthansa had wanted to offer an interline fare between Athens and Seattle (without antitrust immunity), this theory claims that they would completely ignore what other carriers’ fares were in that market, and set a fare that was the sum of independent calculations of Athens-Frankfurt-Chicago and Chicago-Seattle costs, with each carrier separately adding a profit markup on their leg (thus “double marginalization”).

“Double marginalization,” according to this theory, was a “structural negative externality” that forced interline prices 15-25 percent higher than efficient levels universally across the industry. The only ways to eliminate this “structural negative externality” are merger or full immunity to collude on prices. Thus granting ATI automatically and immediately reduces these fares 15-25 percent every time competition is reduced. Not under certain market conditions, but automatically from each and every ATI grant organized along Northwest/KLM lines, just as night automatically follows day.

This “double marginalization” inefficiency was a complete fabrication. Since the first publication of this claim in 2000, no carriers have ever tried to fix the “problem” of interline prices 15-25 percent above efficient levels. Brueckner’s papers on airline pricing present no objective, verifiable evidence that this critical “structural negative externality” ever actually existed.

The airlines applying for antitrust immunity are the world’s experts on how international airline pricing works, but produced no evidence aside from citations of Brueckner’s paper. These applicants knew full and well that no airlines set short-term prices as a function of route costs while disregarding market conditions and competitive prices, and never used “markups” in setting interline prices.

Brueckner's statistical analysis is also hugely flawed. Brueckner ran regressions of industry pricing data from time periods highly unrepresentative of market conditions when these ATI applications were filed.

As discussed in [Part 2](#) of this series, it is entirely unsurprising that an analysis of the 1990s transatlantic market identified consumer benefits; fares fell 8 percent in the 1990s while capacity grew 54 percent.

None of the variables in Brueckner's regressions represent his alleged "structural negative externality" and there is nothing in his statistical analysis supporting his assertion that the elimination of this alleged problem was the single, sole cause of these mid-90s pricing gains.

Many factors contributed, including the initial gains from market liberalization, larger and more efficient hubs, increasingly efficient long-haul aircraft, robust demand growth, much better connection scheduling, and improved supply/demand conditions.

As discussed in Part 2, the actual pricing gains from the original collusive alliances had been exhausted by the end of the decade (when interline travel became nearly extinct) and [no one has found evidence](#) of ATI-driven pricing gains after 1999.

Nothing in Brueckner's analysis supports his critical claim that the impact observed when ATI was first introduced would always occur under different market conditions.

The DOT never demanded these airlines produce case-specific evidence of their alleged "structural negative externality" because they knew that it did not exist. It nonetheless proceeded to convert this academic malfeasance into an ironclad, absolute regulatory rule.

The absolute rule was needed to block anyone from challenging the large numbers that the DOT was accepting as evidence of "public benefits" and to block anyone from using facts or logic to challenge the claim that every ATI application would automatically produce them.

The DOT justified its ironclad rule using the false claim that the ability of immunized alliances to eliminate the "double marginalization" inefficiency has been documented in the "economic literature." [This "literature"](#) is nothing more than follow-up pieces by Brueckner making the exact same points as the original article.

No other published original research has ever documented the existence of "double marginalization." In the last 20 years, the DOT has never published any research demonstrating whether consumers actually realized any of the benefits promised by these antitrust immunity applicants.

The "Double Marginalization" Claim

As with other industries, governmental oversight of airlines had long depended on having a large set of competitors with diverse, often adversarial interests. As discussed in Part 2, key aspects of Civil Aeronautics Board decision making in the 1960s may have been "captured" by the largest Trunk airlines but every other airline, airport, union, and government entity could file objections within formal rulemaking procedures.

As competition shrank, regulatory capture became simpler and more powerful because the remaining companies could present their shared interests as accepted conventional wisdom. DOT officials responsible for oversight who wanted to implement “pro-business” policies had no incentive to seek out contrary views and stopped exposing its policies to the public scrutiny of rulemaking processes.

For several years, no one raised any questions about the now shared DOT/alliance beliefs about the virtues of radical consolidation, but when challenges emerged in 2009 DOT simply blew them off. In the AA/BA case, DOT explicitly rejected a detailed challenge to “double marginalization,” even though it acknowledged DOJ comments that the link between “double marginalization” benefits and ATI had never been proven, did not dispute any of the observed flaws in the theory and was unwilling to openly defend any of the logic or analysis that the theory is based on, and had no evidence of any actual consumer gains from the previous ATI awards. It nonetheless accepted the AA/BA \$92 million annual consumer benefit claim solely on the basis of the Brueckner paper.

At the beginning of the Obama administration, Christine Varney, the new head of the DOJ’s Antitrust Division, filed an attack on the DOT’s preliminary approval of the expanded United/Continental/Lufthansa ATI application, pointing out DOT’s complete failure to meet any of the legal requirements for case evidence.

DOJ comments included: “the Applicants have made no showing that such entry (that could curb any anti-competitive abuse) would be timely, likely, or sufficient”; “The Applicants present no evidence however, that customers will receive quantitatively or qualitatively different service if Continental receives antitrust immunity, compared to what would be provided if Continental merely interacted with the level of cooperation expected of any member of the broader, non-immunized Star Alliance”; “In [DOJ’s view](#), it is not sufficient, however, merely to point towards claimed benefits; rather the Applicants need to demonstrate that immunity is necessary to achieve them. In this regard, the Applicants fall short”; “The Applicants also suggest, without evidentiary support, that consumers benefit from competition between alliances, particularly immunized alliances”; “DOT does not cite the other information it relies upon to analyze the alliance plans, nor does it explain how Continental, or more significantly consumers, would be harmed by the lack of global immunity.”

The DOT’s approval of the United/Continental/Lufthansa application had consisted of nothing more than a verbatim repetition of the applicants’ claims.

But the DOT refused to acknowledge, much less explain, the evidentiary approaches DOJ has criticized, and defended its right to decide cases on the basis of whatever policies it preferred.

The heated inter-agency battle was resolved when Obama’s chief economic advisor, [Lawrence H. Summers, came down](#) firmly on the DOT’s side.

Varney resigned from DOJ roughly a year later. If the DOJ’s position had not been beaten back by the DOT and the Obama White House, the expanded Lufthansa group immunity would not have been approved, the even more problematic British Airways-American immunity would not have been approved, the subsequent domestic US consolidation would probably not have happened, and the alliances would not have been able to solidify into a permanent intercontinental oligopoly/cartel.

The DOT simply began asserting that laws now had totally different meanings than they had prior to the turn of the century.

The Airline Deregulation Act's focus on maximizing long-term consumer welfare was reinterpreted as the basis for DOT policies favoring the largest, most politically influential companies.

"Open Skies" treaties were no longer designed to increase and protect international airline competition, they were now designed to drastically reduce it.

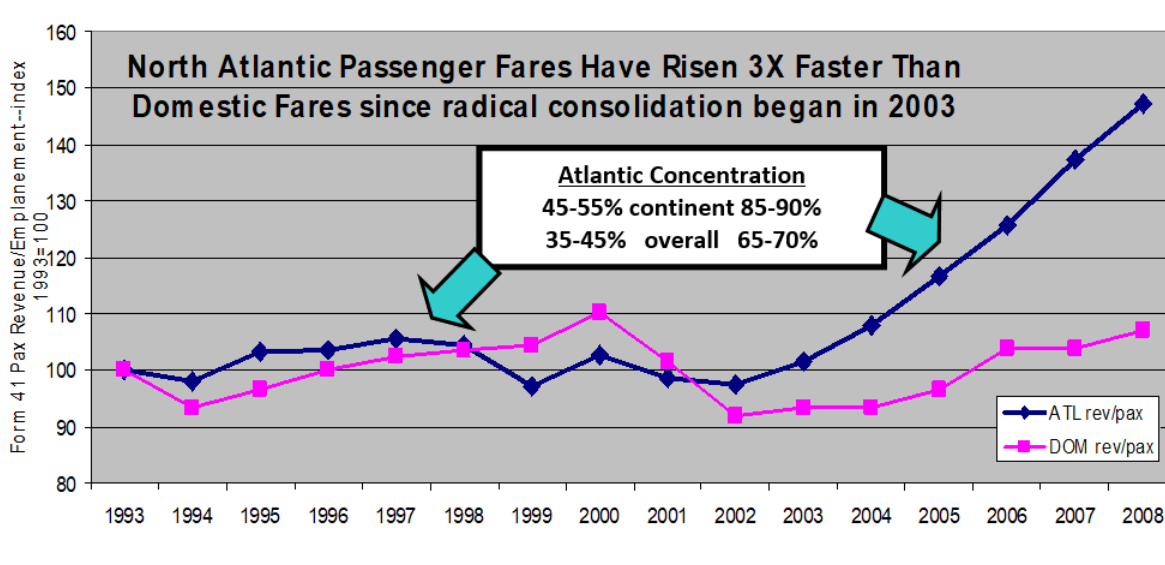
"The Airline Deregulation Act's focus on maximizing long-term consumer welfare was reinterpreted as the basis for DOT policies favoring the largest, most politically influential companies."

DOT's Antitrust Immunity Decisions

Had the DOT conducted the legally required Clayton Act review, they would have found ample evidence that the radical post-2004 consolidation had already increased artificial market power even before the final cases were decided.

From deregulation until 2003, North Atlantic price trends closely tracked domestic price trends. As shown in Exhibit 7, from 2003 onward, [a totally new pattern emerged](#), with North Atlantic fares rising three times faster than domestic fares.

This fundamental shift in pricing behavior exactly tracks the move towards extreme North Atlantic concentration, which started when Air France announced its intention to acquire KLM, previously the largest single driver of price competition in European long-haul network markets.



The near-term pricing power created by consolidation was much worse than this simple Atlantic/Domestic fare comparison suggests. Under normal competitive conditions, airline fares are highly responsive to changes in capacity.

Domestic fares increased 15 percent since 2003 because the industry did not add capacity. When Atlantic capacity spiked in the late 90s, average fares fell, even though this was the peak of the dot-com business boom. But the market power created on the Atlantic in recent years meant normal supply/demand relationships had been subverted.

Atlantic fares increased 46 percent since 2003, even though capacity also increased by 45 percent. If 2008 capacity levels had been operated under pre-2003 competition levels, 2008 Atlantic fares might well have been 30-40 percent lower than observed, suggesting an annual consumer welfare loss due to increased market power of \$9-12 billion. Even if one arbitrarily assumes that only half or less of the observed pricing shift is due to market power, consumer welfare losses have been staggeringly larger than the false claim that the AA/BA ATI grant would reduce fares by \$92 million a year.

“Atlantic fares increased 46 percent since 2003, even though capacity also increased 45 percent. If 2008 capacity levels had been operated under pre-2003 competition levels, 2008 Atlantic fares might well have been 30-40 percent lower than observed.”

As was always intended (and discussed in Part 2), the North Atlantic ATI decisions immediately drove further rounds of consolidation, including mergers between all of the US airlines who had jointly filed for immunity, the absorption of the few remaining independent European legacy carriers into the three collusive alliances, and a major reduction in competition across the Pacific.

Additional domestic mergers (Southwest-Airtran and Alaska-Virgin) followed once it was clear that Washington had no problem with combinations where the economics would reduce price competition.

Following classic cartel behavior, the three collusive alliances aggressively attacked any carrier unwilling to submit to their dominance. Once North Atlantic consolidation was finalized, the cartel moved aggressively to lock long-haul carriers from Japan, Korea, Australia, and other major Pacific markets into the three collusive alliances.

They mounted a massive political attack on the three independent Middle Eastern hub carriers (Emirates, Etihad, Qatar) even though their network overlap was extremely small, and many other alliance partners were doing the exact same things that constituted unacceptable market behavior when done by independent non-cartel carriers.

Delta invested in developing new international hubs at Seattle and Boston designed to cripple the smaller independent carriers (Alaska, JetBlue) already operating hubs there.

The radical consolidation of the North Atlantic was designed to create a pool of supra-competitive profits that could be used to strengthen market power and distort competition elsewhere. In addition to funding the war on the Middle Eastern carriers and Delta's attacks on Alaska and JetBlue, it prevented the smaller domestic LCCs such as Spirit and Frontier (and Airtran, before Southwest acquired it) from competing on price in markets where they had much lower costs than the three alliance carriers.

Until ten years ago, the lower-cost non-hub carriers could readily capture large volume point-to-point markets, because the Legacy hub carriers could not sustain the losses. But (prior to coronavirus) those supra-normal international profits funded those domestic losses, preventing resources from shifting from less efficient to more efficient uses within the industry.

The consolidation of the North Atlantic was designed to create a pool of supra-competitive profits that could be used to strengthen market power and distort competition elsewhere

The Counterrevolution

Well after the development of jet technology and modern airline networks, international competition was still controlled by private backroom deals between government officials and the largest incumbent carriers. For roughly thirty years that regulatory regime was superseded by a much more liberal regime that emphasized longer-term improvements in consumer welfare and industry efficiency instead of the short-term financial results of individual airlines.

Laws were established to protect robust competition under level-playing field conditions, so that consumers and investors would determine marketplace winners and losers.

In less than ten years, that more liberal regime has been effectively destroyed, and the ancien régime has been restored. The regulatory capture problem that helped justify deregulation has returned in an even stronger form. Backroom deals between government officials and the largest incumbent carriers have not just distorted market results, but have destroyed the corporate value of smaller competitors.

Government policies are no longer established by legislation based on extensive public debates and detailed analysis of objective evidence about industry economics.

International aviation presents a useful case example of the utter failure of competition policy and antitrust administration. Clearly written laws were ignored by senior officials of both Republican and Democratic administrations who employed falsehoods and serious misrepresentations without consequence.

Procedural structures were reduced to Potemkin Village facades, isolated objections were easily beaten back, and absolutely no one in the legal or economics professions or the business media seemed the least bit troubled.

Decisions were totally devoid of objective data about prices or cost efficiencies or market contestability and were written by people who appeared willfully indifferent to industry economics and competitive dynamics.

“The international consolidation movement successfully recaptured industry oversight and successfully gutted existing deregulation laws, bankruptcy rules and antitrust requirements designed to protect broader consumer and industry interests .”

The Coronavirus Crisis

The DOT/Alliance claim that consumers and industry efficiency never required more than three competitors in a market was never backed by a shred of evidence. It was always ludicrous to assume that competition limited to United, Delta, and American—three companies that had just emerged from bankruptcy—would remain stable and evenly balanced forever.

Consolidation into a tiny number of Too-Big-To-Fail companies undermined the resiliency the industry needs to cope with the huge coronavirus revenue collapse.

The large number of competitors that were critical to all prior industry restructurings are gone. In the US, \$43 billion in desperately needed cash was stripped via extractive stock buybacks and by inflated executive compensation for the managers who believed that that the industry would never face another serious downturn.

“Consolidation into a tiny number of Too-Big-To-Fail companies undermined the resiliency the industry needs to cope with the huge coronavirus revenue collapse.”

Barring the miraculously rapid development of an effective vaccine, no international airline companies are viable going concerns. Bankruptcy-type processes can work when a small percentage of capacity faces liquidity problems but cannot possibly deal with a situation where worldwide demand has totally evaporated.

Airline capacity and employment worldwide will need to shrink far more than anyone had thought possible. This will mean effective nationalization of the industry (including many suppliers), and the establishment of reorganization processes that convince the taxpayers (who will fund it) that the huge costs and sacrifices will be shared equitably.

Those processes will also need to restore the industrial competitiveness of the late 20th century, in order to drive badly needed innovations and efficiencies and to ensure that scarce capital is allocated to where it can produce the most service, employment, and overall economic benefits.

Unfortunately, the international consolidation movement successfully recaptured industry oversight and successfully gutted existing deregulation laws, bankruptcy rules, and antitrust requirements designed to protect broader consumer and industry interests.

The people who now control the industry are the ones who spent the last 15 years undermining competition, maximizing artificial oligopoly market power in order to generate readily extractable cashflow, misallocating capital to less efficient airlines, and ensuring the hegemony of investors pursuing short-term capital appreciation over customers, workers, suppliers, local communities, and every other longer-term stakeholder.

The industry consolidation movement was initiated so that the owners of the largest airlines (in collusion with officials in Washington and Brussels) did not have to admit responsibility for any of the bad decisions that led to the last major (1998-2000) industry crisis.

There is huge danger that the people who now control the industry will use the “no one could have foreseen coronavirus so you can’t blame us for anything” claim to ensure that industry restructuring does not threaten their control, that the industry’s many structural pre-coronavirus problems are ignored, and that the pain and sacrifice of restructuring is disproportionately borne by labor and outsiders.

There is huge danger that the people who now control the industry will double down on reducing competition and maximizing artificial market power, since that has been their single-minded focus for years. But that approach cannot possibly restore a viable, efficient private sector industry.