Airline Industry: Price Elasticity of Supply and Demand

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The airline industry is largely dependent on the supply of the oil industry (Pilcher, 2006). There is too much dependency on oil, and at present, the industry is inelastic. The increase or decrease of the price of airfare is directly related to the increase or decrease of the oil's price to fuel the aircrafts (Pilcher, 2006).

There is little room for the airline industry to adjust the rates as the oil industry dictates the price and the airline industry is left with no choice but to yield to the demands of the latter industry. The only way for airfare prices to mark down is when there is an abundant supply of oil wherein oil price would greatly reduce.(Pilcher, 2006).

Airline Strike Impacts Supply

There are a number of airlines to service the passengers. There is a demand for the service but the supply is hardly satisfied (Pilcher, 2006). In case of a strike like what happened with the Cincinnati/Northern Kentucky International Airport, supply would be harder to provide (Pilcher, 2006). There are actually two viable airlines in this case, and the prices of the tickets do not vary much. There is a limited option for flying offered to the passengers.

There had been labor disruptions in 2006 for both Delta Airline and Comair. These potential problems were said to occur during Easter Holidays around spring break. Delta Airline had been trying to get the pilots' union to take the $300 million cuts in a year while Comair had been fighting bankruptcy in court for $8.9 million worth of concessions (Picher, 2006).

The airlines have experienced cancelations of booking which translates to a decreasing demand due to the threat of union strikes (Pilcher, 2006). Both airlines released statements as a resolution to the problem. They advised customers to stay put because they cannot afford a shutdown or a strike.

Airlines' Revival from September-11 Attacks

Another factor that can affect any industry is a tragedy that affected the whole world. It is a hindrance for the airline industry to be directly targeted by a tragedy brought about by terrorism. Over four years, from 2001 to 2005, there had been at least $40 billion worth of losses in the airline industry because of the September-11 attacks in 2001 (Martin, 2005). There had been an expected and significant decrease in the demand for the airline industry services because of the attacks that involved airplane hijacking and crashing into key locations like the World Trade Center and the Pentagon. In the 2005 survey, passenger traffic is back to the levels after the said tragedy. There had been a six percent increase in the passenger traffic, to go along with the global economic growth (Martin, 2005). The improved statistic has shown that more passengers are taking more flights.

Budget airlines' account had a 20-percent increase in flights showing 10 percent of the total number of passengers (Martin, 2005). The rising popularity of budget airlines had been an incentive for travelers throughout the world to travel more. Nevertheless, the contribution of budget airlines are not enough to fight off the detriment of high cost of fuels that serves as a major factor its budget.

Despite the fact that there is also fuel price increase, many airlines are said to impose fuel surcharges on their passengers (Martin, 2005). Fuel costs can even account for a quarter of Cathay Pacific's operating expenses in 2004. The fierce pressure of high fuel prices had locked up the elasticity of price rates of the airline industry (Martin, 2005).

According to the International Air Transport Association (IATA), the accelerating price hike of oil could actually reach a level that would require the airline industry an additional budget of more than $5 billion (Martin, 2005). Merely recovering from the

September-11 crisis, the airline industry was left battered, fragmented, and constrained (Martin 2005).

Positive or Negative Externalities the Industry Produces

ETS and the Greenhouse Effect

European Union (EU)'s Emissions Trading Scheme (ETS) is the world's largest multi-country, multi-sector emissions trading system that covers about 12,000 installations in the energy, metals, minerals and paper industries (Renouf, 2007).

There is an existing proposal from the European Commission to integrate aviation activities (Renouf, 2007). This would affect commercial flights between the airports within the EU starting 2011.

The concern here is the greenhouse emissions and how it affects global warming. The air quality would be better once this new regulations are adopted. However, it would affect large airlines. It could increase the price of tickets because of economic fees that airline companies have to cover (Renouf 2007). It gives a negative impact on the European-based and owned airline companies (Renouf, 2007). On the positive side, the environment would be healthier as the earth's temperature would rise, and greenhouse effect would be dramatically reduced. This positive effect can come at a cost that is greater than most people perceive. There is a potentially high cost that could serve as the incentive for the airline and airport operators to actually consider the influence of the European Commission's proposal (Renouf, 2007).

The Issue on Airline Deregulation

Americans are now flying more while spending less whichcontributes to lessening the role of airline industries in the growth of the GDP (The Economist, 2007). Airfare has become cheaper, it reached half of its price since the deregulation of America's domestic airlines in 1978 (The Economist, 2007). The popularity of low-cost and no-frills airlines has brought down the fares for other established carriers. Companies have also lessened sending their employees on business trips and restricted flying them on first class or business class (The Economist, 2007). An increased usage of private and executive planes also played a factor in the lessening revenue of the usual airlines. Before the deregulation actually took place, there were fewer options for the public to choose from, and the fares where set by the federal government (The Economist, 2007).

The industry is losing money, and airline companies are either declaring bankruptcies or talking about merging possibilities (The Economist, 2007). The deregulation gave more companies a chance to be part of the airline industry that opened up more traveling options for the passengers.

The industry is torn between increasing revenue and maintaining a clientele in order for it to survive. The third party that includes passengers, future travelers, the government, and the environment are not affected by the deregulation. The industry has become more public as a result of the deregulation. However, it is still heavily subsidized by the government; there is little recognition from the government for the fact that a country needs a prosperous airline industry (The Economist, 2007). This has benefited the foreign carriers and troubled the local ones.

The situation is on the verge of having a better position for American airlines as they are recovering their losses and generating income to pay debt, and acquire more modern equipment which is highly needed to survive in the industry like having air traffic control system as well as other aviation services (The Economist, 2007). America needs this to be able to compete with newer industries from developing countries that leap straight to purchasing the latest aviary technology while the country is still with the older infrastructure (The Economist, 2007).

IT Units Prices Go Down

In the recent years, the information technology had been able to provide units that the airline industry needs (Baker, 2007). There is still a strong demand for the IT industry. The airline industry have been increasing budget to spend for IT units that are available in low prices as it was seen as an investment in new technology (Baker, 2007). The advantage lies with the airlines; even though they need to cut back on their budgets, the costs are apparently going down wherein they can get more with less (Baker, 2007).

Airline Industry and Wage Troubles

In the case of the Cincinnati/Northern Kentucky International Airport, the strike was a gauge of the dissatisfaction of the pilots' union and flight attendants' union with their wage compensation. The combination of monetary concessions from Delta and Comair added up to $308.9 million per year; part of the concession area distribution includes wages (Pilcher, 2006). Delta has been negotiating with the unions to get its pilots to agree to the $300 million in cuts a year. A crew strike threats the said airport, knowing it would not only cripple but also kill airline operations. This is the major sign of wage troubles. This depends on how far the unions and the companies are in terms of compromising and reconciling towards solving issues while taking advantage of the recovery the industry is experiencing. This stretches larger problems for the industry to prepare for as it is not doing well in terms of revenue and contributing to the country's GDP despite the increase of passenger traffic and flights (The Economist, 2007).

Due to the fact that the airline industry is losing money, the United Airlines felt the need to cut the wages of their ground workers by three to five percent over the length of their contract. The International Association of Machinist and Aerospace Workers will experience the changes through their holiday pay and vacation pay and the ground workers are to feel the changes in their pension plans (Airline Industry Information 2007).

Workers are expected to ratify their new contracts with their airline. This cut would result to saving $175 million for United Airlines annually throughout a period of five years. The airline also sees the need to increase rates by three percent due to fuel charges for international and domestic flights (Airline Industry Information, 2007).

The stringent labor laws affect the airline industry largely as they give trade unions the power to demand wages and conditions that can be unrealistic due to the current state of the industry in terms of gaining revenue (The Economist, 2007). The wage troubles are just perceived as added beatings to the crushed industry.

On the other hand, some other carriers are forced to trim down their workforce and dismiss their employees while others desperately try to negotiate for new contracts (The Economist, 2007). Now that the airline industry is slowly recovering from the September-11 tragedy and the steep oil price hikes, the profits are returning to the carrier companies only for a short period of time. Unions are taking advantage of this recovery as the rifts are opening up again with the airline unions (The Economist, 2007).

It is seen that the wage inequality comes from the unrealistic demands of the airline unions, and their failure to compromise with the carrier companies despite the fact that they know the industry is not in the verge to lose more money (The Economist, 2007). The companies may perceive that with the increasing rise of prices, increase in the employee wages has the potential to lead to company bankruptcy. Additionally, the threats to go on strikes give a perception of unsatisfied employees and reflect their views of wage inequality. Whoever is at fault or whoever needs to compromise does not take the fact of how this is hurting the industry. It does not send a positive signal to the potential passengers who are worried about strikes that would delay their travel plans without sufficient returns on their ticket fares.

Monetary and Fiscal Policies

Deregulation

In the mid1970s, there were reports of complaints about the burdening regulation and the costs imposed on consumers which lead to a deregulation for a number of industries (Pompe & Rinehart, 1999). This was when the Airline Deregulation Act of 1978 was formed. Since then, the airline industry had been more concentrated since this deregulation. From 87 percent of the traffic in 1978, it grew to 93 percent in 1995 (Pompe and Rinehart, 1999).

Expansionary Fiscal Policy

After the September-11 attacks, the government had provided a total of $40 billion to aid the airline industry after the shock of the tragedy from the effect of the expansionary fiscal policy (Chan, 2007).

Shortly after the attack, the congress already passed a measure to give a start of $15 billion as a financial aid package to help the industry that was crippled by the attacks. This was also to set up government compensation to fund the victims to prevent lawsuits (Barrett, Bash, & Snow, 2001). This was because the government saw the importance of how an effective and safe air travel system is important to the economy, and this fund would help in making sure that is secured (Barrett et al., 2001).

Impact of Policies on Competition

The airline industry has been known to be a combination of competitive and regulated industry with policies that affect the level of competition. One of the central policy choices is the mechanism that allocates airport boarding gates and facilities. Majority of airports actually relies on several non-market mechanisms to allocate the scarce resources (Gowrisankaran, 2002). The anti-trust policy also affects the level of competition. Airfares increase as the market concentration increases, the market then benefit more consumers by having bigger networks; frequent and convenient flights are available to them (Gowrisankaran, 2002). Mergers are possible because it leads to concentrated markets and anti-trust policy gauges the need for a merger (Gowrisankaran, 2002).

The airline industry is controlled by firms that set prices and the domestic routes based on the market conditions. Profits fluctuate a great deal in the U.S. airline industry which point to a steady growth manifested by lower airfare prices, moderate concentration, and suggesting a positive impact of deregulation. The effort to allocate key inputs on a market basis also provides for a more efficient result (Gowrisankaran, 2002).

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