Highlights of GAO-06-630, a report to congressional committees

June 2006

AIRLINE DEREGULATION

Reregulating the Airline Industry Would Likely Reverse Consumer Benefits and Not Save Airline Pensions

Why GAO Did This Study

The Airline Deregulation Act of 1978 phased out the government's control over fares and service and allowed market forces to determine the price and level of domestic airline service in the United States. The intent was to increase competition and thereby lead to lower fares and improved service. In 2005, GAO reported on the tenuous finances of some airlines that have led to bankruptcy and pension terminations, in particular among those airlines that predated deregulation (referred to as legacy airlines). The House Report accompanying the 2006 Department of Transportation (DOT) Appropriation Act expressed concern about airline pension defaults and charged GAO with analyzing the impact of reregulating the airline industry on reducing potential pension defaults by airlines. GAO subsequently agreed to address the pension issue within a broad assessment of the airline industry since deregulation. Specifically, GAO is reporting on, among other things, (1) broad airline industry changes since deregulation, (2) fare and service changes since deregulation, and (3) whether there is evidence that reregulation of entry and fares would benefit consumers or the airline industry, or save airline pensions.

DOT agreed with the conclusions in this report. GAO is making no recommendations in this report.

www.gao.gov/cgi-bin/getrpt?GAO-06-630.

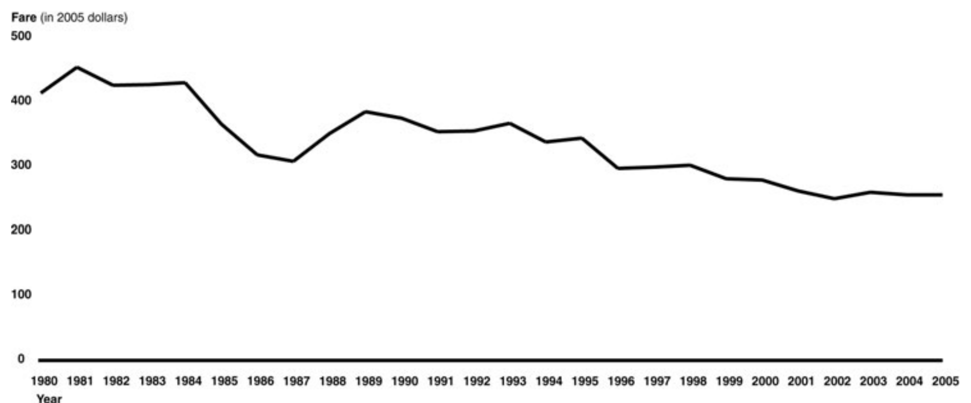
To view the full product, including the scope and methodology, click on the link above. For more information, contact JayEtta Z. Hecker at (202) 512-2834 or heckerj@gao.gov.

What GAO Found

The airline industry has undergone significant change since the late 1970s. Industry capacity and passenger traffic have tripled. At the same time, the industry's profitability has become more cyclical, and the financial health of large legacy airlines has become more precarious. Legacy airlines emerged from a regulated environment with relatively high structural costs, driven in part by labor costs, including defined benefit pension plan costs. Over the last few years, facing intense cost pressures from growing low-cost airlines like Southwest, both United and US Airways entered bankruptcy, voided labor contracts, and terminated their pension plans costing the Pension Benefit Guaranty Corporation, the federal government insurer of defined benefit plans, $10 billion and beneficiaries more than $5 billion. In 2005, two other legacy airlines entered bankruptcy leaving their pension plans in doubt. Only two airlines still have active defined benefit pension plans.

Airfares have fallen in real terms over time while service—as measured by industry connectivity and competitiveness—has improved slightly. Overall, the median fare has declined almost 40 percent since 1980 as measured in 2005 dollars (see fig. below). However, fares in shorter-distance and less-traveled markets have not fallen as much as fares in long-distance and heavily trafficked markets. Since 1980, markets have generally become more competitive; with the average number of competitors increasing from 2.2 per market in 1980 to 3.5 in 2005.

Median Fare, 1980-2005



Source: GAO analysis of DOT Origin and Destination Survey data.

The evidence suggests that reregulation of airline entry and fares would likely reverse much of the benefits that consumers have gained and would not save airline pensions. The change in fares and service since deregulation provides evidence that the vast majority of consumers have benefited, though not all to the same degree. Although a number of airlines have failed and some have terminated their pension plans, those changes resulted from the entry of more efficient competitors, poor business decisions, and inadequate pension funding rules. GAO has previously recommended that broad pension reform is needed.