

Economics of Airline Alliances

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Alliances combine networks

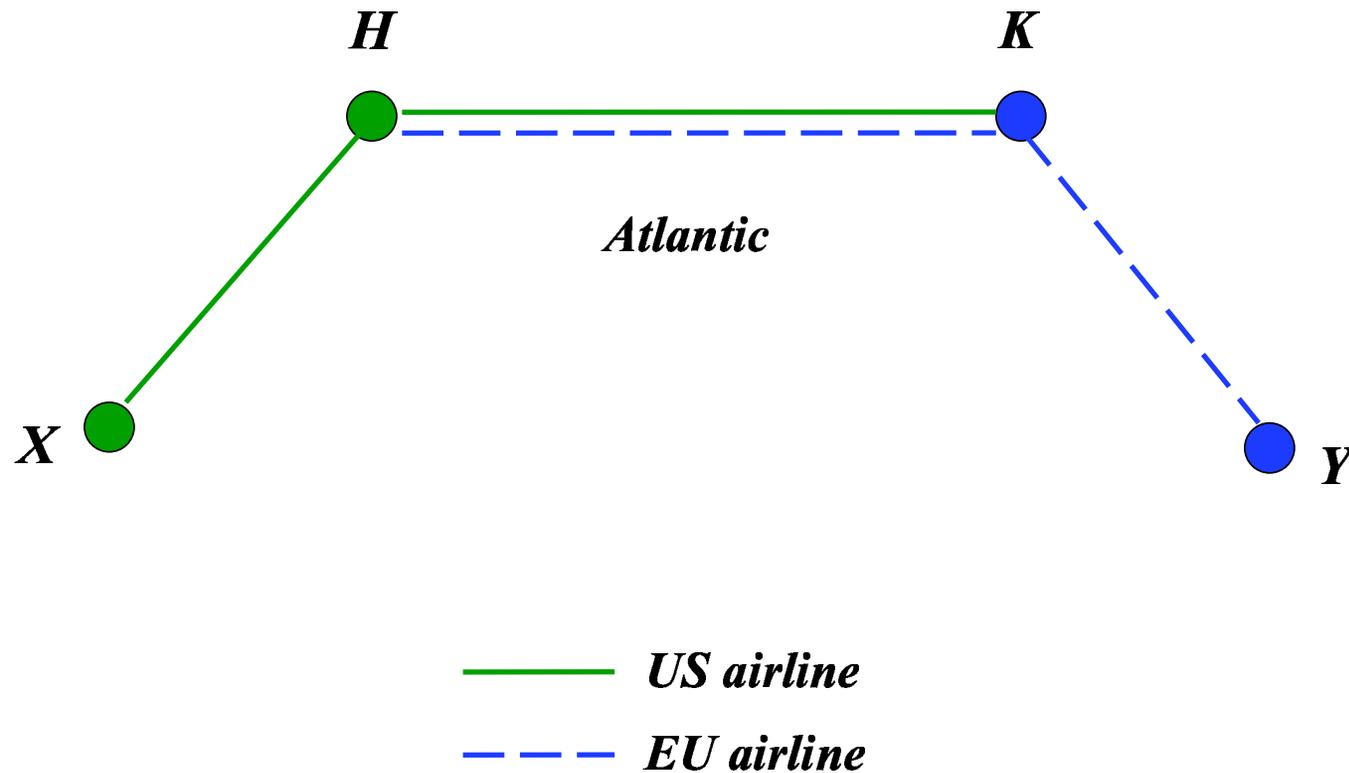
An alliance leads to an **end-to-end linkage** of two airline networks.

This linkage is the **source of their benefits**.

But alliances also involve some **route overlaps**.

Potential source of **negative effects**.

Network map



End-to-end linkage allows cooperative service in XY market.

But overlap in interhub HK market may be anticompetitive.

In **absence of antitrust immunity (ATI)**, fare-setting in XY market involves **“double markups,”** or **“double marginalization.”**

Acting noncooperatively, each **airline sets subfare for its portion of the interline trip,** marked up over cost.

Sum of subfares **gives overall XY fare.**

Each airline **doesn't consider negative impact of a higher subfare on other carrier (lower traffic, profit).**

In immunized alliance (especially JV type), carriers **take into account this negative spillover** on their partner.

Subfares are set lower, **overall XY fare falls**.

So XY cooperation is **pro-competitive**.

Additional **benefits include schedule coordination**, connecting gate proximity, single check-in, etc.

Potentially anticompetitive overlap

Story is potentially different on the HK route.

Here, passengers don't need to combine two airlines to make their trip— it's an either-or choice.

Given the right to cooperate under ATI, alliance partners might try to reduce the number of HK seats sold so as to raise the fare.

Could happen even though total HK capacity rises in order to serve more XY passengers.

Carve-out can be used to address issue.

Empirical evidence

Evidence shows that **XY fare discount** relative to non-ATI case was once **as large as 25%**, but it has fallen over time.

Studies showed annual aggregate fare benefits to interline passengers **as large as \$100 million** for a single alliance.

Evidence on the **anticompetitive overlap effect is mixed.**

But it remains a **major concern of regulators**, especially when HK route has high O & D traffic.

Concern was a **roadblock to ATI for AA-BA** until Open Skies reduced barriers to entry on US-UK routes.