

OPINION

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Why High Airfares are Here to Stay

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The summer travel season is fast approaching. As people begin to book their tickets, one consistent theme is high airfares — and the situation may not get better any time soon.

Does it need to be this way?

On the positive side, jet fuel prices are down from their spring 2022 peak. This gives airlines some leeway with airfare pricing, given that fuel represents around 20% of their overall costs. At the same time, inflation pressures have pushed the cost of most other materials higher.

There are several other factors that are placing sustainable upward pressure on airfares.

Labor costs at airlines have been surging. Pilot unions continue to be in negotiation with the airlines, seeking numerous concessions, including higher compensation. The same holds with flight attendant unions. Given that around 35% of airline costs are personnel, this places upward pressure on all sources of revenue, with airfares high on this list.

The supply of available seats has shrunk, while demand continues to be strong. This is an ideal environment for sustainable higher airfares.

Airlines voluntarily reduced the number of flights this summer into the busy Northeast corridor at the request of the Federal Aviation Administration (FAA) to accommodate air traffic controller shortages. By reducing flights, which can limit seats available, the FAA and airlines are effectively making seats more valuable, demanding higher airfares.

Airlines have learned that selling more seats at lower prices is not a formula for profitability. The key metric that determines profitability is revenue per available seat mile. These numbers are now at some of their highest levels in years. Adding flights and capacity that gets filled by leisure travelers paying deeply discounted airfares does not keep airlines profitable. This gives airlines the incentive to limit seat capacity, only increasing it to fill ample demand from travelers willing to pay high ticket prices for available seats.

In addition to higher ticket prices, airlines are generating substantial revenue on ancillary services like checked baggage, preferred seating and early boarding privileges. American, Delta and United each generated over \$5 billion in ancillary revenue in 2021. Such discretionary fees further increase the cost of air travel.

All these factors and the associated environment have made airline profits soar.

But what makes higher airfares sustainable?

Airlines have traditionally relied on business travelers to pay the highest airfares — purchasing pricier first-class tickets or booking last minute at a higher cost with their company footing the bill — while airlines filled excess capacity with leisure travelers who purchase discounted tickets. They structured their frequent flyer programs based on how much and how far a person flew. This means that high-volume, low-revenue leisure travelers were rewarded with the same perks in their frequent-flyer programs as high-revenue business travelers, even if leisure travelers generated little profit for the airlines. Such low-revenue travelers earned elite status, giving them complimentary upgrades, free checked baggage and access to premium seats and boarding, on their cheaper tickets.

This placed the carrot of elite status and benefits in the wrong place, which ultimately created headwinds for sustainable profitability.

So, what did the airlines do?

They transformed their frequent flyer programs into revenue-generation programs. Elite status is earned based on how much a traveler spends, not by how far a traveler flies or how many flight segments they took. This new model incentivizes people to pay more for their tickets if they wish to gain and retain elite status and all the benefits that come with such status. Airlines also linked their affiliate rewards credit cards to their revenue-generation program, allowing people to buy their way to elite status in addition to flying.

The net effect of this change is that leisure travelers who scrounge for the lowest possible fares will be hard-pressed to gain high-elite status, while business travelers who purchase last-minute tickets and pay top-dollar prices will be rewarded for their expenditures with the perks that come with high-elite status.

Such a transformation took years in the making, but for the airlines, it places upward pressures on airline ticket prices, particularly for those who seek high-elite status. With more people willing to pay higher ticket prices, the center of gravity for such prices naturally moves higher.

All such factors not only have made air travel more expensive, but they will also keep it there for the foreseeable future.

Much like how Americans were shocked by \$4 per gallon of gasoline in 2008, today we're not surprised by such prices and pay whatever it takes to fill our tanks. The same reaction will likely occur with higher airfares.

Given how the airlines control capacity and have restructured their loyalty programs, such airfares likely are here to stay.

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