*THE DEBATE ON AIRLINE SUBSIDIES – 2*

# Should Airlines be Subsidized in an Emergency? The Libertarian View

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The authors apply the theory of an unhampered market economy to the post-September 11 situation of the airlines in the United States, and argue that a government bailout ill-serves the market, misdirecting resources and retarding a consumer-driven adjustment of supply and demand to reflect the new realities of the marketplace.

**Key Words:** Airline bailout, economic role of government, market as allocator, entrepreneurial function, effects of government economic intervention, bailouts and employment, trade unions and the airline bailout, market self-regulation.

## I. Introduction

Demand for air travel is down in the U.S., and we must ask whether the U.S. government is not giving billions of dollars to an industry that consumers no longer wish to support at previous levels?

The arguments given in favor of the post-September 11 bailout focus on different issues, but the underlying theme in each of them is that there is a role for government to insure the viability of the American economy. Those, like the present authors, who oppose this viewpoint hold that the market itself plays precisely this role through the forces of competition and the allocation mechanisms of price and profit. They maintain that the most important element in the market is the entrepreneur who works to correct any lack of coordination through his self-interested profit-seeking. In taking money away from those who perform this function and giving it to the airlines, politicians disrupt the very economy they are supposedly trying to save. In this article we will consider and several of the most prevalent arguments made in favor of government's subsidizing the airline industry.

### *1. Unexpected attack*

The first argument in favor of subsidies in the present circumstances is that the terrorist attacks on September 11 were an unexpected occurrence. John S. Irons says, "...The events of the past week were an unexpected occurrence and had nothing to do with the fundamental viability of the industry (Irons, p. 1)."

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It goes without saying that the attacks on the World Trade Center and the Pentagon were unexpected. In fact, this was so much so that consumers were unaware of this particular risk associated with flying. However, to argue that surprise events are a reason to subsidize the industry is inherently contradictory. It is impossible to separate the events that happen in an industry from the industry itself. Buyers and sellers are constantly evaluating the costs and benefits of a transaction and thus making decisions that are mutually beneficial. When contracting parties are made aware of a new cost or risk, the parameters of the entire transaction are bound to change.

Ludwig Lachmann stated, "value is not a property inherent in goods, but constitutes a relationship between an appraising mind and the object appraised (Lachman, p. 95)."Using his view of the nature of value, we can see that air travel does not hold a specific value outside of the realm of the person who is (or is not) buying the ticket. Thus, the measurement of this value is subject to change when the perceptions or expectations of that person change (Littlechild, p. 13).That is precisely what happened when terrorists boarded four planes with the express purpose of using them as bombs. Consumers were made aware of the fact that terrorists could and would use commercial airplanes in this way. They could no longer ignore a new and substantial risk of flying in an airplane. The cost and value of air travel has changed. This is evident from the decrease in demand at the same time there has been a significant reduction of ticket prices.1

To bring ticket sales back to the level they were before September 11, ticket prices must fall by an amount comparable to that by which the implicit costs increased, ceteris paribus. Thus, although the events of September 11 were unexpected and had nothing to do with the industry before that date, they intimately affected the viability of the industry afterward. That unexpected events caused a change in the cost of air travel will not change that fact. It is neither just nor practical to make consumers pay for something that they obviously no longer want, certainly not to the same degree as before.

2. *Centrality of Air Travel*

The argument is made that the airline industry is a vital part of the economy and that we should not allow it to fail. Consider the claim

[1]The decrease in ticket prices is a direct result of a downward shift in the demand curve for air travel. As the implicit cost of air travel increases, namely the risk of being in a flying bomb, demand must decrease for all prices along the demand curve.





made by Continental Airlines CEO Gordon Bethune, who said, "You're not going to live without this vital part. We are not some machine, some computer. We're a pump just like the heart's a pump, and we need to facilitate and keep our economy going" (cnn.com, ailing airlines, p. 1).

This appeal claims that if the airline industry is allowed to flounder, then the economy will die just as the body dies when the heart stops. Again, we come to a basic error. It is assumed that the economy before September 11 is the same as after September 11.It is true that such swift changes in the nature of our economy are uncommon; but that does not mean that they do not happen. It also does not imply that we should try to restore the economy to its previous state (Hazlitt).The market is in a continuous state of change; when left alone it continuously finds better means of producing more and better goods.[2] If the value of air travel no longer justifies the cost, why do we assume that it is still a vital part of our economy? It is far more accurate to say that it was a vital part of our economy in the past and that we don't know what role it will play in the future. The market coordinates the allocation of resources to the most highly valued goods and services. It does this through prices and it is obvious from cheaper tickets, and fewer of them purchased, that air travel is not as highly valued as it once was, thus not as vital.

By giving the airlines billions of dollars, the government takes resources away from individuals who would spend the money in other ways and forces them to spend it on airlines. Without this forced investment, consumers would use their income on their highest alternative. Maybe it would be the railroads, or rental cars or dinner and a movie in their hometowns, but the resources would go to the industry that consumers value more than airlines. The billions of other people's dollars that the bureaucrats are so generously giving the airline industry is nothing more than a transfer of wealth from taxpayers, and the other industries that they would have voluntarily supported, to the air carriers and their stockholders. The airline industry will benefit only at the expense of other industries (Hazlitt, p. 101).

At one time in American economic history, the horse and buggy industry was riding high. It, too, was "vital" to the national prosperity. Apart from railroads, bicycles and skates, foot power was virtually the only way to move from one place to another. With the "logic" of the vi-

[2]The mainstream view treats the market as a mechanism by which given goods are produced with given techniques while Littlechild sees the market as an organism that unintentionally creates new goods and techniques by way of individuals seeking profit (Littlechild).

tal industry argument, horses and buggies, too, should have been subsidized.[3] But had the American government followed the subsidy policy that is now being widely advocated for airlines, the effect would have, instead of improving the economy, given it a severe case of arteriosclerosis. According to the doctrine of alternative or opportunity costs, industries can only be subsidized into (continued) existence at the cost of eliminating others. Would we really be better off with horses and buggies and typewriters at the expense of eliminating cars and computers? Hardly.

*3. Help the workers*

Proponents of the bailout demand subsidies if not for the airlines themselves then for their employees. But this claim, too, is suspect. First of all, it is doubtful that a government subsidy of the airlines will save jobs. As Steven E. Landsburg points out in his article, "Flying Pork Barrels," "Airplanes are flown when it is profitable to fly them, and they are not flown when it is not profitable to fly them. Giving cash to the airlines does not change the profitability of any given flight, so it does not affect any decision about which flights to offer" (Landsburg, p. 1).

In fact, what does influence decisions to fly planes is directly related to demand. With the downward shift in demand, prices are lower as well as the quantity consumed. Profitability of flights has been greatly reduced; thus, airlines are flying fewer routes. With fewer routes to fly, airlines need fewer employees, who will be laid off if demand remains poor. Giving money to the airlines will not change these facts. In fact, some proponents of the bailouts recognize the dilemma and consider it to be a solution for "explicit and enforceable job pledges to ...be built into an air-industry rescue (Donahue, p. 3).[4]"

The problem is that this proposition looks only at the short-run effects as they relate to one group and forgets about the long-run effects on the economy as a whole or even the short-run effects on other groups (Hazlitt, p. 18). Including a clause to ensure employment simply extends the subsidy to the airline employees without solving the problem. It is a direct transfer of wealth from the taxpayers to the airline employees. The transfer is at the expense of the workers in the other industries in

[3] And this goes, as well, for other now extinct or virtually extinct firms, such as typewriters, hula-hoops, candles, etc. Farming used to account for almost our entire employment; now, only a small fraction of the labor for works in this area.

[4] John D. Donahue argues for the bailout by comparing it to the Chrysler bailout. Further arguments from his analysis will be discussed later.





which people would have spent their money and is thus harmful to the economy. If labor is being employed for reasons other than productivity, then capital resources are being kept from industries where they would be most productive. This applies, also, to human resources. Can we really rationalize keeping thousands of people in jobs where they are not needed? It is a harsh fact that the terrorist attacks affected so many people, but keeping workers in jobs where they are not needed helps them only in the short-run at the expense of other people who will not be able to get jobs. In the long run it lowers the standard of living for everyone.[5]

Nor can we ignore the fact that "At big airlines, senior pilots make in excess of $200,000 annually" (Samuelson, 2001).Other salaries in this industry are similarly inflated above market levels. A large part of the bailout to the airlines, then, is really a subsidy to these radically-overpaid employees. That this is but further evidence of the problematic nature of this government plan is not at all an indication of greed, envy, egalitarianism or any other such sentiment. Rather, it stems from opposition to yet another government interference with markets: compulsory unionism. Were it not for such violations of the free society as the Wagner and the Taft-Hartley Acts, it is unlikely that workers' organizations would have been strong enough to compel such stratospheric wage rates (Block, 1991).That the airlines were forced to pay them is responsible for their parlous condition before 9/11/01, and continues to be an obstacle to any rational restructuring of the industry. A bailout would only validate these excessive wages. Without it, either unions would consent to a radical lowering of the salary structure, or, like parasites on a host, they would kill the airlines who consented to these contracts and their place would be taken by firms who could more strongly hold the line against them.

*4. Adjustment costs*

Another argument for saving the airline industry comes from John Donahue in his article, "Airline Package Harks Back to Chrysler Bailout. "Donahue supports the bailout on the grounds that "airline turmoil threatens consequences beyond the carrier's balance sheets" and that "a complete air-travel meltdown could have grim, far-reaching consequences (p. 2)."

[5] Hazlitt (p. x) states that by forcing people to subsidize employees of any industry, government is keeping them from spending the money in other industries, thus preventing additional employment in those industries.