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Airlines Are Just Banks Now



They make more money from mileage programs than from flying planes—and it shows.

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Illustration by The Atlantic. Source: Getty.

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LAST WEEK, Delta Air Lines announced changes to its SkyMiles program that will make accruing status and taking advantage of perks much harder. Instead of relying on a combination of dollars spent and miles traveled in the air, Delta will grant status based on a single metric—dollars spent—and raise the amount of spending required to get it. In short, SkyMiles is no longer a frequent-flier program; it's a big-spender program. These changes are so drastic that one of the reporters at the preeminent travel-rewards website The Points Guy declared that he's going to "stop chasing airline status."

When even the points insiders are sick of playing the mileage game, something has clearly gone wrong. In fact, frequent-flier programs are a symptom of a much deeper rot in the American air-travel industry. And although getting mad at airlines is perfectly reasonable, the blame ultimately lies with Congress.

From the late 1930s through the '70s, the federal government regulated airlines as a public utility. The Civil Aeronautics Board decided which airlines could fly what

routes and how much they could charge. It aimed to set prices that were fair for travelers and that would provide airlines with a modest profit. Then, in 1978, Congress passed a sweeping law deregulating the airline industry and ultimately abolishing the CAB. Unleashed from regulation, airlines devised new tactics to capture the market. American Airlines was one of the most aggressive. In the lead-up to the deregulation bills, it created discount “super saver” fares to sell off the final few remaining seats on planes. That meant cheap prices for last-minute travelers and more revenue for American, because the planes were going to take off whether or not the seat was filled. But these fares upset business travelers, who tended to buy tickets further in advance for higher prices. So in 1981, American developed AAdvantage, its frequent-flier program, to give them additional benefits. Other airlines followed suit.

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In the early years, these programs were simple, like the punch card at a café where your 11th coffee is free. But three big changes transformed them into the systems we know today. First, in 1987, American partnered with Citibank to offer a branded credit card that offered points redeemable for flights on the airline. Second, in the '90s, the airlines proliferated the number of fare classes, charging differential prices for tickets. With more complicated fare structures came the third change: Virgin America realized that the amount people spend on a flight, based on the fare class, is more

important to its bottom line than the number of miles flown. So, in 2007, it introduced a loyalty program rewarding money spent rather than mileage accrued.

These three shifts fundamentally transformed the airline industry. They turned frequent-flier systems into the sprawling points systems they are today. And they turned airlines into something more like financial institutions that happen to fly planes on the side.

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Airlines create points out of nothing and sell them for real money to banks with co-branded credit cards. The banks award points to cardholders for spending, and both the banks and credit-card companies make money off the swipe fees from the use of the card.

Cardholders can redeem points for flights, as well as other goods and services sold through the airlines' proprietary e-commerce portals.

For the airlines, this is a great deal. They incur no costs from points until they are redeemed—or ever, if the points are forgotten. This setup has made loyalty programs highly lucrative. Consumers now charge nearly 1 percent of U.S. GDP to Delta's American Express credit cards alone. A 2020 analysis by the *Financial Times* found that Wall Street lenders valued the major airlines' mileage programs more highly than the airlines themselves. United's MileagePlus program, for example, was valued at \$22 billion, while the company's market cap at the time was only \$10.6 billion.

Is this a good deal for the American consumer? That's a trickier question. Paying for a flight or a hotel room with points may feel like a free bonus, but because credit-card-swipe fees increase prices across the economy—Visa or Mastercard takes a cut of every sale—redeeming points is more like getting a little kickback. Certainly the system is bad for Americans who don't have points-earning cards. They pay higher prices on ordinary goods and services but don't get the points, effectively subsidizing the perks of card users, who tend to be wealthier already.

Like the federal reserve, airlines issue currency—points—out of thin air. They also get to decide how much that currency is worth and what it can be spent on. This helps explain why the points system feels so opaque and, often, unfair. Online analysts try to offer estimates of points' cash value, but airlines can reduce these values after the fact and change how points can be redeemed. Airlines even sell points at above their exchange-rate valuation, meaning that people are paying for something worth less than the money they're buying it with, in part because it's so hard to know what the real value is.

In this context, it's easy to see why Delta is making changes. The shift to a focus on spending, rather than mileage, has long been coming, because of the rise of multiple fare classes and the decoupling of mileage and revenue. Limiting benefits and increasing the requirements for status, meanwhile, look like a way to spread out costs: 1 percent of GDP spending is a lot of outstanding points that could be redeemed.

Still, you might wonder how airlines can get away with angering their customers by devaluing loyalty programs. Aren't they worried that those customers will get a little less loyal? Well, not really. The U.S. has only four major carriers, which account for more than three-quarters of the market, and they tend to move in lockstep. Indeed, American Airlines recently made a similar change to its mileage program. Customers don't have many other places to go.

IN THIS and other respects, the strange evolution of airlines into quasi-banks reflects how badly deregulation has gone. Regulation carefully set the terms under which airlines could do business. It was designed to ensure that they remained a stable business and a reliable mode of transportation. Deregulation, in turn, allowed the airlines to pursue profits in whatever way they could—including getting into the financial sector.

The proponents of deregulation made a few big promises. The cost of flying would go down once airlines were free to compete on price. The industry would get less monopolistic as hundreds of new players entered the market, and it would be stable even without the government guaranteeing profitable rates. Small cities wouldn't lose service. In the deregulators' minds, airlines were like any other business. If they were allowed to compete freely, the magic of the market would make everything better. Whatever was good for the airlines' bottom line would be good for consumers.

They were wrong. As I explain in my forthcoming book, most of their predictions didn't come true, because air travel isn't a normal business. There are barriers to entry, such as the fixed supply of airport runways and gates. (And, for that matter, mileage programs, designed to keep customers from ditching an established airline for a rival.) There are network effects and economies of scale. There are high capital costs. (Airplanes aren't cheap.) The idea that anyone could successfully start an airline and outcompete the big incumbents never made much sense.

After a relatively short period of fierce competition, the deregulated era quickly turned to consolidation and cost-cutting, as dozens of airlines either went bankrupt or were acquired. Service keeps getting worse, because the airlines, facing little competition, have nothing to fear from antagonizing passengers with cramped legroom, cancellations, and ever-multiplying fees for baggage and snacks. Worse still, without mandated service, cities and regions across the country have lost commercial air

service, with serious consequences for their economies. And when a crisis like 9/11 or the coronavirus pandemic comes along, the airlines—which prefer to direct their profits to stock buybacks rather than rainy-day funds—need massive financial relief from the federal government.

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Deregulation even failed to deliver the one thing it is sometimes credited with: lowering prices. Airfare did get cheaper in the years after the 1978 deregulation law. But the cost of flying had already been falling before deregulation, and it kept falling after at about the same rate.

The old system of airline regulation wasn't perfect. Barred from competing directly on price, the airlines got into an amenities arms race that notoriously included in-flight piano bars. But the cure was worse than the disease. The industry went from being a regulated oligopoly, which had real problems, to an unregulated oligopoly, which we are now seeing is much worse.

Airlines serve a vital public need, just like railroads, the electric grid, and communication networks. They also exist within a system of special privileges from the government. The public has built and paid for a substantial federal infrastructure to coordinate flights safely. Historically, these are all standard reasons to regulate an