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Low-Cost Carriers: A Force for Globalization and Growth

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Around the world, the roar of jet engines grows louder. In the last decade, the number of budget airlines has taken off, and low-cost carriers (LCCs) now number in the hundreds globally. While the spectacular growth of the sector has not meant good times for traditional airlines, the economic effects are profound and far-reaching. Over the next decade, the business model that has revolutionized travel in Europe and the Americas will continue to change how people live and work.

Its effects may only now be widespread, but low-cost air travel has a storied history. In 1949, Pacific Southwest Airlines—unrelated to the Texas-based carrier that shares part of its name—started undercutting the major airlines on its one route, from San Diego to Oakland. Its brand and image eventually foreshadowed the irreverent style that typifies LCC marketing today, with smiley-faces painted on the front of its planes and stewardesses in miniskirts. When PSA merged with US Airways almost four decades later, it left behind a model that would be perfected in Texas by Southwest Airlines, which today gets credit for creating the modern low-cost model. Launched in 1971, Southwest first turned a profit three years later and has remained profitable every year since.

Low-cost carriers have been most successful in Europe, where the sector grew from 8 million passengers in 1998 to more than 100 million in 2007. While budget airlines' lifespans can often be cut short by competition and the familiar challenges of the airline industry—in particular, the high cost base and the tough regulatory environment—LCCs are undoubtedly here to stay. This comes as good news for more people than just tourists seeking cheap vacations and the shareholders of companies like Ryanair, easyJet and JetBlue. Investors who snapped up Dublin-based Ryanair stock in 1997, for example, have enjoyed returns in excess of 1,400 percent. In contrast, the Amex Airline Index (XAL), which tracks the stocks of major U.S. and international airlines, dropped more than 60 percent over the same period.

Since the fall of the Berlin Wall in 1989, various private-sector initiatives have contributed to the reintegration of the European continent. However, most of these initiatives involve importing Western products and trends eastward, across the former iron curtain. Because cheap air travel involves the bilateral flow of financial and intellectual capital, it has helped to end the lingering cultural and political divisions of the cold war more than any other business.

Hotels in the picturesque Baltic capitals are often fully booked, hosting, among other things, many British bachelor parties. “When we opened this place 10 years ago, it was just for locals; now half of our clients are from the United Kingdom,” Mart Thomson, owner of the hip Pegasus hotel in Estonia’s Tallinn, told *Newsweek*. “Last year we sold out by the end of April; this year, it could be even sooner.” Airports in Prague and Warsaw are opening new terminals to cope with the increase in passenger traffic brought by fledgling Eastern European LCCs. In the words of the *Newsweek* reporter: “Back in the 19th century, a place on Europe’s rail network could make a city’s fortune. Now it’s a listing in the schedules of a new generation of low-cost airlines.”

Flights from Poland to Ireland are packed with a new generation of migrant laborers: in an era of LCCs, immigration no longer involves a state of semipermanent alienation from one’s homeland. College graduates and young people who travel in search of work once faced the prospect of settling down a continent away from where they grew up and seeing family once a year, if that. Now they fly home for the weekend and get back in time for work on Monday morning.

In the last decade, several trends linked to globalization have spread the formula perfected by Southwest and Ryanair across the world. Eager imitators have better access to capital, deal with lighter regulation and sell to a more affluent and savvy customer base. The effects have been most striking in the developing world.

In India, a country that shares a scale and level of regional diversity comparable to all of Europe, around a dozen LCCs now operate. To keep overhead and capital requirements down, Indian LCCs often lease 100 percent of their fleet. The dynamic industry has resulted in dizzying rounds of IPOs and mergers and a regularly changing roster of active airlines. Fares can cost less than 1,000 rupees, or about $25, easily affordable to India’s burgeoning middle class, a demographic that will number 350 million people by 2010, according to a McKinsey study.

Until recently, however, LCCs’ greatest impact has been in Europe, where many citizens have the economic means for frequent flying on LCCs and disused former military airstrips have provided a ready base for LCCs to expand into new regions. Those regions welcome LCCs with open arms, with good reason. According to the Airports Council International, every one million passengers that travel through a new European destination result in 1,000 jobs at the airport and another 2,700 in the local and regional area.

Such towns are often at the mercy of the airlines, which tend to have the upper hand in negotiations and can often dictate conditions, much like Wal-Mart does to its suppliers. Ryanair, widely perceived as a ruthless business partner, previously flew to Rimini, a coastal resort town in Italy on the Adriatic coast. When the Rimini town government refused to accept Ryanair's deal on landing fees and demanded better terms, the Irish airline literally wiped it off the map: the destination's name, and the thin blue line indicating the journey from London's Stansted to Rimini, were promptly and crudely removed with Wite-Out and masking tape from the route maps at Ryanair's check-in desks. Ryanair simply moved its destination to Forli, about 40 miles away, where another town government had a disused military airstrip and was thrilled to welcome Ryanair flights and passengers on any terms.

LCCs, then, wield an extraordinary amount of power. They do not simply change the expectations and habits of their customers; they reshape the landscape. When Ryanair announces a new destination, a local building boom follows shortly thereafter. LCC route planners can essentially create residential and commercial growth and infrastructural development simply by throwing darts at a map.

Several years later, in 1996, poor Rimini eventually convinced Ryanair to redraw that thin blue line—albeit from the UK's Nottingham airport, not from one of its London hubs. Observers suspected that the cause of the deal was airport negotiations rather than pent-up demand for Italian getaways from people in the British midlands. In such instances, Ryanair proudly claims that it has the ability to create demand wherever it likes. To paraphrase a mail-order marketing slogan of the 1970s: cheap flights became one of those things you never new existed and can't possibly live without.

Some LCCs implement such a rigorous cost-cutting policy that it seems like passengers have to pay extra if they want the staff to smile. Travelers who have suffered through a delayed or canceled flight with Ryanair will testify that "no-frills" often means no customer service. Passengers who actually arrive at their intended destination, though, feel lucky to move from point to point so cheaply.

As the LCC business model is imitated across the rest of the airline industry, more geographic areas and more industries will become dependent on the increasingly free movement of labor and potential customers made possible by low-cost travel. The sense of wonder that many people still feel at occasionally paying more for their lunch on board a plane than for their actual ticket will fade, but the economic benefits rippling outward from those roaring planes will only increase with time.