

OVERBOOKING

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Abstract

We consider optimal pricing policies for airlines when passengers are uncertain at the time of ticketing of their eventual willingness to pay for air travel. Auctions at the time of departure efficiently allocate space and a profit maximizing airline can capitalize on these gains by overbooking flights and repurchasing excess tickets from those passengers whose realized value is low. Nevertheless profit maximization entails distortions away from the efficient allocation. Under regularity conditions, we show that the optimal mechanism can be implemented by a modified double auction. In order to encourage early booking, passengers who purchase late are disadvantaged. In order to capture the information rents of passengers with high expected values, ticket repurchases at the time of departure are at a subsidized price, sometimes leading to unused capacity. (JEL: D42, D44, D82)

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