

Deregulating the Airlines

Elizabeth E. Bailey, David R. Graham, and Daniel P. Kaplan
 Cambridge, Mass.: MIT Press, 1985, 225 pp.

Presidents may come and go, but the bureaucracy goes on forever, right? Well, not always. In 1984, which was supposed to be the year of Big Brother, we actually witnessed the demise of a major federal agency, the Civil Aeronautics Board (CAB).

Since its founding in 1938, the CAB told the airlines what fares they could charge and what routes they could serve. Although designed to protect the public, the regulated carriers were the winners under this system. Indeed, they were the principal lobbyists for establishing the CAB, and a former chairman of the agency once observed (without intended irony) that "If the CAB did not exist, the airlines would have had to invent it. And in point of fact, they did."

It is easy to see why the regulated airlines liked regulation. Entry into the industry was virtually blocked, and the CAB was stingy in giving an existing airline a license to enter another carrier's route. The CAB handed out generous rate increases every time the airlines bought too many new airplanes or found traffic falling off during a recession, and price competition was an alien concept. Interestingly enough, the intended beneficiaries of this system—small communities—did not fare all that well under regulation. Between 1960 and 1977, the CAB allowed regulated airlines to drop all service at 179 communities across America, hardly a model of sound, public-utility-style regulation.

It was this system that Congress set out to reform in 1978, and the prescription was remarkably simple. Get the CAB out of the business of regulating airline routes and rates; subsidize the smallest communities for 10 years, but do it more efficiently than in the past; and close the agency down by the end of 1984. And despite periodic cries for "reregulation" or "fnetuning" the Airline Deregulation Act, that is exactly what happened. The CAB closed its doors at the end of 1984, and certain residual functions which were not deregulated (for example, small community subsidy, international aviation, consumer protection, and anti-trust enforcement) were transferred to the Department of Transportation. Air safety, which is regulated by the Federal Aviation Administration, a separate agency, continues to be regulated in the same manner as it was prior to economic deregulation.

Airline deregulation has always been a controversial topic. When it was being debated in Congress, support came from an unlikely coalition which brought together such strange bedfellows as Ralph Nader's Aviation Consumer Action Project and the American Conservative Union, Common Cause and the National Taxpayers' Union, as well as such groups as the National Association of Manufacturers, the American Association of Retired Persons, and Sears Roebuck. Since the law was passed in 1978, the topic has remained controversial, partly because everyone

who flies has an opinion on how well it has worked, and partly because the industry has undergone some radical changes since then.

The airline deregulation experiment is important, not only because it was the first time Congress lifted economic controls on a regulated industry, but also because the Airline Deregulation Act served as a model for later legislation which reformed economic regulation in other modes of the transportation industry. Thus, the experience under airline deregulation is interesting in its own right, as well as providing possible insights into other deregulatory initiatives.

This book makes an important contribution to public understanding of what airline deregulation is all about, and the authors are uniquely qualified to offer this perspective. Elizabeth E. Bailey is a professional economist (now dean of the graduate school of industrial administration at Carnegie-Mellon) who was a member of the CAB from 1977 to 1983. David R. Graham and Daniel P. Kaplan were senior staff members at the CAB during this period, and in December 1982 they published a comprehensive economic analysis of how the act has worked, which provides the analytical foundation for this book.

The authors trace the origins of airline regulation, how it worked for 40 years, and why Congress changed the law in 1978. Then they get to the heart of their book, which is what happened during the first few years under deregulation. Perhaps not surprisingly, the authors regard the deregulation experiment as a success in terms of achieving its goals of increasing airline competition and productivity, offering consumers more choices when they need to fly. Specifically, they conclude that "productivity and service convenience are improving and that over the long run consumers can expect to pay lower fares than they would have in a regulated regime."

The book is not a puff piece, however. It acknowledges that there have been winners and losers, and the authors are careful to outline the pros and cons of deregulation and to offer economic analysis to explain why things have happened the way they did.

For instance, take the familiar example that transcontinental travelers have benefited from \$99 fare wars, while travelers on smaller carriers flying a fraction of the distance pay twice as much if not more. The authors point out the economics of why this phenomenon has occurred. Prior to deregulation, the CAB required airlines to set their coach fares according to a formula that was based strictly on how far an individual was flying. There were several key problems with this formula, however. First, it pegged fares too high on long-distance flights, so these fares logically fell once they were decontrolled. Second, the CAB formula assumed that distance was the key factor in setting fares, ignoring the fact that dense markets (such as New York-Los Angeles) were less expensive to serve, mile per mile, than short, thin routes. Add to that the fact that when deregulation occurred, the airlines had an excess of wide-body jets on their hands, which they found cheaper to fill through mar-

ginal pricing, and you have some idea why fare wars have broken out on these longer routes.

By contrast, short-haul flights (especially on small commuter airlines) are more expensive to operate, mile per mile, partly because there is less traffic and partly because short-haul flights are inherently more costly than long-distance flights. Also, short commuter flights tend to be used primarily by time-sensitive travelers who strongly value the convenience of a 45 minute flight over a three hour drive and may be willing to pay a premium for this service. Some critics charge that this disparity is not "fair," but the result does reflect a key conclusion of the authors, namely, that the competitive pressures spawned by deregulation seem to be pushing airline fares more closely in line with the actual cost of providing service.

This example illustrates what is perhaps the principal value of this book, both for students of regulation in general, as well as people who want to understand the airline deregulation phenomenon in particular. It offers an economically rigorous explanation not only of fare wars, but of other key developments, such as why "hub and spoke" route networks evolved; why some small communities gained and why others lost service; why airline employees have accepted wage freezes and cutbacks; and how new airlines such as People Express have changed the industry.

Although the authors had a bird's eye view of how deregulation unfolded, this book is not written as an "inside" account of what the CAB was doing during this critical transition period. Instead, the authors explain what the CAB did during this period and how the airlines reacted to their new freedom, and they are content to let the economic data speak for itself. Although the authors bring an economic perspective to this work, it is written in a straightforward style that should be accessible to nonspecialists.

Much of the economic data that is examined here is from the 1978-81 time frame, thus reflecting the early experience under deregulation. The authors chose this cutoff primarily to avoid distortions caused by the air traffic controllers strike in 1981. The authors argue (I believe correctly) that the experience during the economic recovery bolsters the qualitative conclusions about deregulation, and they occasionally refer to more recent data. I would have preferred to see more of that data in the text, but this is a quibble.

Perhaps wisely, given the economic uncertainty of recent years, the authors refrain from trying to gaze into the crystal ball and to predict what changes lie ahead. They do briefly mention some of the emerging competitive issues in the industry, such as limitations on airport capacity, and the ability of United and American to bias their computer reservation systems against the interests of smaller carriers, although the analysis of these points is not particularly detailed.

CATO JOURNAL

In any event, this book succeeds in answering the question, "Are air travelers better off today than they were seven years ago?" The authors provide some solid reasons why the answer is "yes."

Con Hitchcock
Aviation Consumer Action Project