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20TH ANNIVERSARY OF AIRLINE DEREGULATION: CAUSE FOR CELEBRATION, NOT RE-REGULATION

ADAM D. THIERER

Despite years of falling prices, increased travel options, and vigorous industry competition, some federal policymakers appear to be ready to abandon America's incredibly successful 20-year experiment in airline competition. On April 6, 1998, the U.S. Department of Transportation (DOT) released its "Proposed Statement of Enforcement Policy on Unfair Exclusionary Conduct by Airlines" to remedy alleged anti-competitive practices within the industry. Specifically, the DOT's proposed enforcement policy targets efforts by major carriers to offer consumers significant discounts to compete with smaller carriers or new entrants in the market. If such fare wars hurt the smaller companies or drive them from the market, DOT will take action against the larger carriers.

The DOT claims that these steps will "ensure that free market principles and competition continue to thrive in commercial aviation," and says that its proposed enforcement policy "does not attempt to regulate the market in any way." The reality, however, is far different. "No matter how they cut it, this policy puts government bureaucrats in the business of setting fares and determining the level of service in the market," argues Carol Hallett, president of the Air Transport Association of America. In the words of James L. Gattuso, vice president for public policy and management at the Competitive Enterprise Institute, "The message is, don't compete too hard; don't lower your prices too much." In short, the DOT's proposed enforcement policy is tantamount to reintroducing federal bureaucracy and regulation into the airline marketplace; it will have a chilling effect on industry competition by discouraging fare wars that offer consumers significant savings.

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Surprisingly, these threats of airline re-regulation have been met with casual acceptance or, worse, general approval on Capitol Hill. In an attempt to counter calls for re-regulation, some legislators even suggest that increased subsidization of small carriers or new industry entrants is the best way to bring more competition to the industry and ensure price competition and lower fares. These new calls for the

re-regulation or increased subsidization of the aviation industry are not justified. Despite the ebbs and flows of the volatile airline market, consumers clearly have benefited significantly since the market was deregulated in the late 1970s.

Deregulation by the Numbers: A Quick Summary of Airline Deregulation Benefits

Fact: Airline ticket prices are almost 40 percent lower today than they were in 1978.

Fact: The average fare per passenger mile was about 9 percent lower in 1994 than in 1979 at small community airports, 11 percent lower at medium-sized airports, and 8 percent lower at large community airports.

Fact: From 1939 to 1978, there were an average 6 fatal accidents per year. After deregulation (from 1978 to 1997), the average was only 3.5 fatal accidents per year. Fatal accidents per million aircraft miles flown have averaged 0.0009 since deregulation. In the 40 years before deregulation, they averaged 0.0135.

Fact: The U.S. General Accounting Office (GAO) found no statistically significant difference in air safety trends for airports serving small, medium-sized, and large communities. For each airport group, the accident rate was lower in 1994 than in 1987.

Fact: The overall number of airline departures has risen from just over 5 million in 1978, when airlines were deregulated, to 8.2 million in 1997—a 63 percent increase over the past two decades.

Fact: According to the GAO, in May 1995, small community airports as a group had 50 percent more scheduled commercial departures than in May 1978; medium-sized community airports had 57 percent more departures; and large community airports had 68 percent more departures.

Fact: Air carriers flew roughly 2.5 billion miles in 1978, but they logged more than twice that amount last year, flying approximately 5.7 billion miles in 1997.

Fact: Airlines served approximately 250 million passengers in 1978 and roughly 600 million (almost two-and-a-half times as much) in 1997.

New regulations or subsidies will not alleviate the problems that DOT or some Members of Congress fear will arise. Indeed, reintroducing bureaucratic regulation into the airline market will only ensure a return to the stagnant, cartel-like markets that existed before liberalization. There are better solutions to many of the problems the DOT addresses in its enforcement policy that do not require the re-regulation of airline routes and rates.

The following five recommendations, if adopted, would do far more to improve airline competition than could ever be done under the DOT's regulatory approach:

1. **Privatize** airports to expand airport capacity and improve infrastructure;
2. **Allow** market-based pricing at airports for takeoff times, slots, and gates;
3. **Privatize** the air traffic control system to reduce congestion and improve safety;
4. **Cut** airline fees and taxes; and
5. **Encourage** increased foreign competition for the domestic marketplace.

—Adam D. Thierer is Alex C. Walker Fellow in Economic Policy at The Heritage Foundation.

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The DOT claims that these steps will "ensure that free market principles and competition continue to thrive in commercial aviation," and says that its proposed enforcement policy "does not attempt to regulate the market in any way."[1] The reality, however, is far different. "No matter how they cut it, this policy puts government bureaucrats in the business of setting fares and determining the level of service in the market," argues Carol Hallett, president of the Air Transport Association of America.[2] As James L. Gattuso, vice president for public policy and management at the Competitive Enterprise Institute (CEI), observes, "The message is, don't compete too hard; don't lower your prices too much."[3] In short, the DOT's proposed enforce-

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1. U.S. Department of Transportation, "DOT Releases Airline Competition Policy Statement," Office of the Assistant Secretary for Public Affairs, April 6, 1998, p. 1.
2. See Bruce Ingersoll, "DOT Proposes Policy to Deter Airlines from Engaging in Unfair Competition," *The Wall Street Journal*, April 7, 1998, p. A2.
3. *Ibid.*

ment policy is tantamount to reintroducing federal bureaucracy and regulation into the airline market, which would have a chilling effect on competition by discouraging fare wars that result in significant savings for consumers.

Surprisingly, threats of renewed DOT regulation of the airline industry have been met with casual acceptance or, worse, general approval on Capitol Hill. In an attempt to counter such calls for re-regulation, some legislators have even suggested that increased subsidization of small carriers or new industry entrants is the best way to bring more competition to the industry, thereby ensuring price competition and lower fares. Such calls for the re-regulation or increased subsidization of the aviation industry are unjustified. Despite the ebbs and flows of the volatile airline marketplace, consumers clearly have benefited significantly since the airline market was deregulated in the late 1970s.

New regulations or subsidies will not alleviate any of the perceived problems that the DOT or some Members of Congress fear may arise. Reintroducing bureaucratic regulation into the airline marketplace will only ensure a return to the stagnant, cartel-like markets that existed before liberalization. There are better solutions to many of the problems the DOT addresses in its enforcement policy: solutions that do not require the re-regulation of airline routes and rates.

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4. **Cut** airline fees and taxes; and
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HOW THE AIRLINES WERE DEREGULATED

Although federal regulation of the airline industry can be traced to the Air Mail Act of 1925 and the Air Commerce Act of 1926, serious economic regulation of commercial aviation began with passage of the Civil Aeronautics Act of 1938. This Act created the Civil Aeronautics Authority, which later became the Civil Aeronautics Board (CAB), and gave the CAB the power to regulate airline routes, control entry to and exit from the market, and mandate service rates. Airline safety regulation would come much later with passage of the Federal Aviation Act of 1958, which created the Federal Aviation Administration (FAA).

The Growth of Regulation

By the 1940s, federal economic regulation of the airlines was in full swing. Typical regulatory thinking from the 1940s onward is evident in a Civil Aeronautics Board report: "In the absence of particular circumstances presenting an affirmative reason for a new carrier, there appears to be no inherent desirability of increasing the present number of carriers merely for the purpose of numerically enlarging the industry."[4] In effect, the CAB intentionally limited competition and consumer choice through a variety of regulatory tools and powers. During the era of airline regulation from 1938 to 1978, the CAB's anti-competitive powers included:

- **Entry restrictions:** the authority to determine which airlines were certified to enter the market or a segment of the market;
- **Exit restrictions:** the authority to control how and when a carrier could exit the market or a segment of the market;
- **Price controls:** the authority to require carriers to file rate tariffs and to approve and disapprove those rates;

4. Civil Aeronautics Board, *Investigation of Nonscheduled Air Services*, 6 CAB 1049 (1946).

- **Business structure restrictions:** the authority to control mergers, acquisition, and joint ventures;
- **Route controls:** the authority to determine and micromanage the routes that carriers could fly and the cities they could serve on those routes;
- **Service quality mandates:** the authority to establish service standards for the industry;
- **Financial controls:** the responsibility to monitor the financial performance and health of air carriers, including the establishment of the allowed rate of return for individual companies;
- **Cargo regulations:** the authority to determine what type of cargo could be carried on a plane; and
- **Employment policy oversight:** the authority to monitor day-to-day employment policies and practices within the industry.

Neil Goldschmidt, former U.S. Secretary of Transportation and current co-chairman of the Airline Competition Committee, a private Washington, D.C.-based group formed to commemorate the 20th anniversary of airline deregulation, has noted that this system had many perverse incentives and effects.[5] For example, when Continental Airlines wanted to initiate service between San Diego and Denver, the CAB took eight years to approve the new route. Likewise, on one route from Baltimore to Kansas City to Denver, United Airlines was allowed to take passengers from Baltimore to either of these two destinations, but was not allowed to pick up any travelers in Kansas City who wanted to fly to Denver along the way.

In a 1991 study for the Center for the Study of American Business, economist Richard B. McKenzie found that the folly of pricing rules and route restrictions was evident during the days of regulation within the states of Texas and California. Within their large, unregulated intrastate markets, Texas and California air fares were much cheaper than fares for regulated interstate routes of similar length from Texas and California to other states. In fact, McKenzie noted that air fares for an intrastate California carrier between Los Angeles and San Francisco were 30 percent to 50 percent lower than the fares United Airlines charged for comparable flights. United was unable to lower its fares at the time because it was restricted by the CAB from doing so.[6]

As noted by former CAB Chairman Alfred E. Kahn, there were "thousands and thousands of restrictions on where you must land and where you may not land and how many stops you can make before you land and what percentage of your trips can be off-route and who has the right to do what and with which and to whom."[7] Goldschmidt notes that the government's power to control industry competition had the net effect of "exclud[ing] nearly every would-be entrant for four decades."[8] And McKenzie notes that the CAB approved less than 10 percent of airline applications to open new service routes between 1965 and 1978.[9]

Goldschmidt concludes that, overall, government regulation of the airlines "fostered inefficiency and stifled innovation. The traveling public was the big loser."[10] Somehow, concluded Darryl

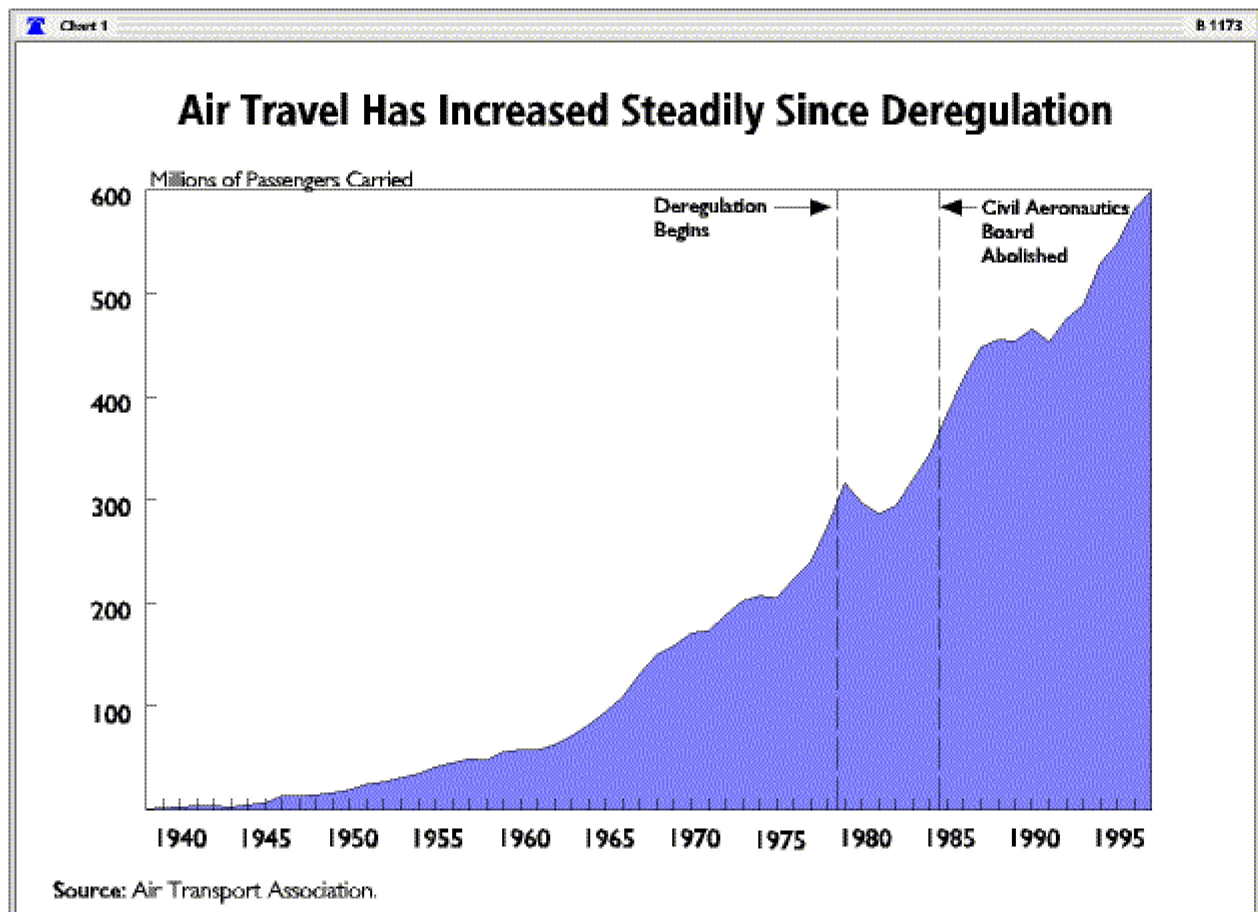
5. See *Remarks by Neil Goldschmidt, GWU Congressional Staff Briefing*, The Airline Competition Committee, Washington, D.C., February 3, 1998, p. 1.
6. Richard B. McKenzie, "Airline Deregulation and Air Safety: The American Experience," Center for the Study of American Business *Formal Publication* No. 107, July 1991, p. 7.
7. See *Remarks by Neil Goldschmidt*, p. 1.
8. *Ibid.*
9. McKenzie, "Airline Deregulation and Air Safety," p. 7.
10. *Remarks by Neil Goldschmidt, op. cit.*

Jenkins, director of the Aviation Institute at George Washington University, "We seem to have forgotten how bad things really were when government set fares, picked routes and limited new entrants."[11]

The Need for Deregulation

The airline industry's darkest days did not come until turbojet-driven planes entered commercial use in the late 1950s and early 1960s. As jets were integrated into the market, the industry experienced dramatic growth. In the mid-1950s, airlines carried roughly 40 million passengers. By the mid-1960s, they were carrying roughly 100 million passengers; and by the mid-1970s, over 200 million Americans had traveled by air.

This steady increase in air travel began placing serious strains on the ability of federal regulators to cope with the increasingly complex nature of air travel. Simultaneously, "beginning in 1969, changes in basic economic conditions and in aircraft technology triggered a sudden decline in the industry's performance,"[12] notes Richard H. K. Vietor, professor of Environmental Management at the Harvard School of Business Administration and author of *Contrived Competition: Regulation and Deregulation in America*. The onset of high inflation, low economic growth, falling productivity,



11. Darryl Jenkins, "Keep DOT at Bay," *The Journal of Commerce*, March 30, 1998, p. A7.

12. Richard H. K. Vietor, *Contrived Competition: Regulation and Deregulation in America* (Cambridge, Mass.: The Belknap Press of Harvard University, 1994), p. 41.

rising labor costs, and higher fuel costs devastated the airlines, and "regulators, in their initial efforts to cope with these problems, only made matters worse."[13]

The CAB encouraged the formation of cartels, disallowed new route requests, and restricted airline capacity. Decades of inefficient regulation began to take its toll on air carriers. The increasing inflexibility of federal regulation made it virtually impossible for carriers to respond to these problems. Flights were less full, industry profits were dropping, and consumer prices were higher.

By the mid-1970s, the CAB began to recognize its inherent inability to deal with the increasingly complex airline industry and the macroeconomic problems that were plaguing it. Remarkably, the CAB defied traditional regulatory practice and asked Congress to take away much of its rulemaking authority so that the airlines could operate freely in the marketplace, industry competition could be increased, and consumer prices thereby could be lowered.

Two CAB chairmen, John Robson (from 1975 to 1977) and Alfred E. Kahn (the late 1970s), embarked on a bold plan with two goals: radical reform of airline regulation and eventual abolition of almost all rules and the CAB itself. The CAB received support from congressional Democrats, led by Senator Edward Kennedy (D–MA), who sponsored legislation to liberalize the airline market in order to improve efficiency, encourage growth, and (most important) reduce prices. The Airline Deregulation Act of 1978 was passed by Congress and signed into law by President Jimmy Carter on October 24, 1978. In effect, this Act and the subsequent Civil Aeronautics Board Sunset Act of 1984 provided for the complete deregulation of the nation's airline market through the decontrol of prices, freedom of entry into and exit from the marketplace, complete freedom for mergers and alliances, elimination of service standards and requirements, and an end to route authorization.

Since 1978, the federal government's only important regulatory role in the airline market has been to establish and enforce safety standards through the Federal Aviation Administration. However, it is worth noting that the Airline Deregulation Act did not address two important facets of the airline industry in which government remains an important force: the air traffic control system and the ownership and maintenance of airports. A variety of government entities and officials remain in control of these important components of aviation infrastructure, and problems have arisen regarding both the technological obsolescence of the air traffic control system and the mismanagement of the nation's airports. This has created additional safety concerns regarding traffic congestion and has led to such serious problems as runway congestion, "slot" or gate allocation and availability, and occasional delays for travelers.

HOW AIRLINE DEREGULATION HAS HELPED CONSUMERS

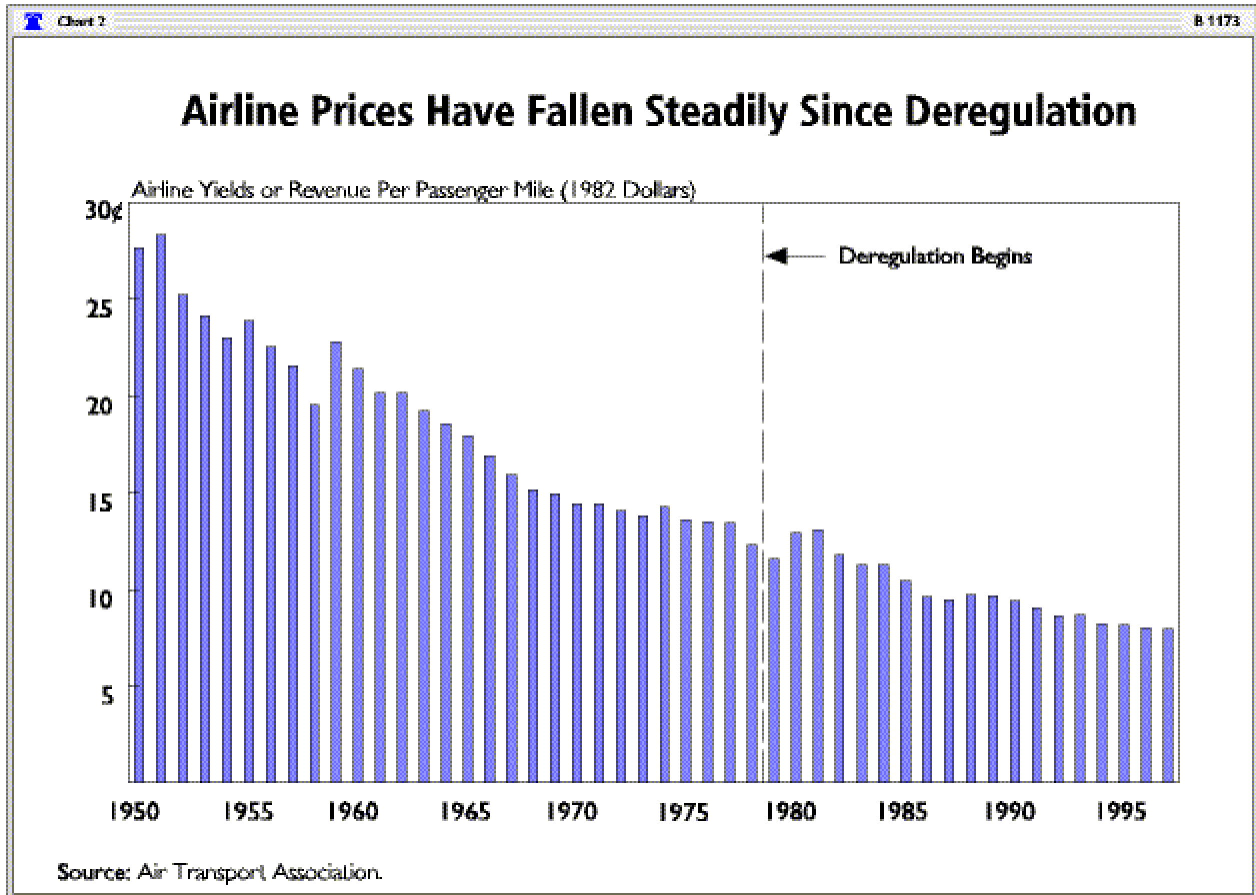
Despite its shortcomings, airline deregulation has been overwhelmingly beneficial for consumers. Typically, economists examining deregulation to see how successful it has been within the airline industry base their analysis on three variables: price, safety, and service quality. On each count, airline deregulation has been a stunning success.

Prices Have Fallen

Consumers probably are most interested in the potential benefits deregulation can provide in terms of real price reductions. Airline deregulation has not disappointed them.

- **Prices have declined steadily since deregulation.** The best measure of trends in airline prices is the "yield" (revenue generated per

13. *Ibid.*



passenger mile) that airlines receive. The inflation-adjusted 1982 constant dollar yield for airlines has fallen from 12.27 cents in 1978 to 7.92 cents in 1997. This means that airline ticket prices are almost 40 percent lower today than they were in 1978 when the airlines were deregulated. Chart 2 illustrates the price decrease.

These reported declines are bolstered by the recent work of economists Jerry Ellig, senior research fellow at the Center for Market Processes at George Mason University, and Robert

Table 1 — B 1173

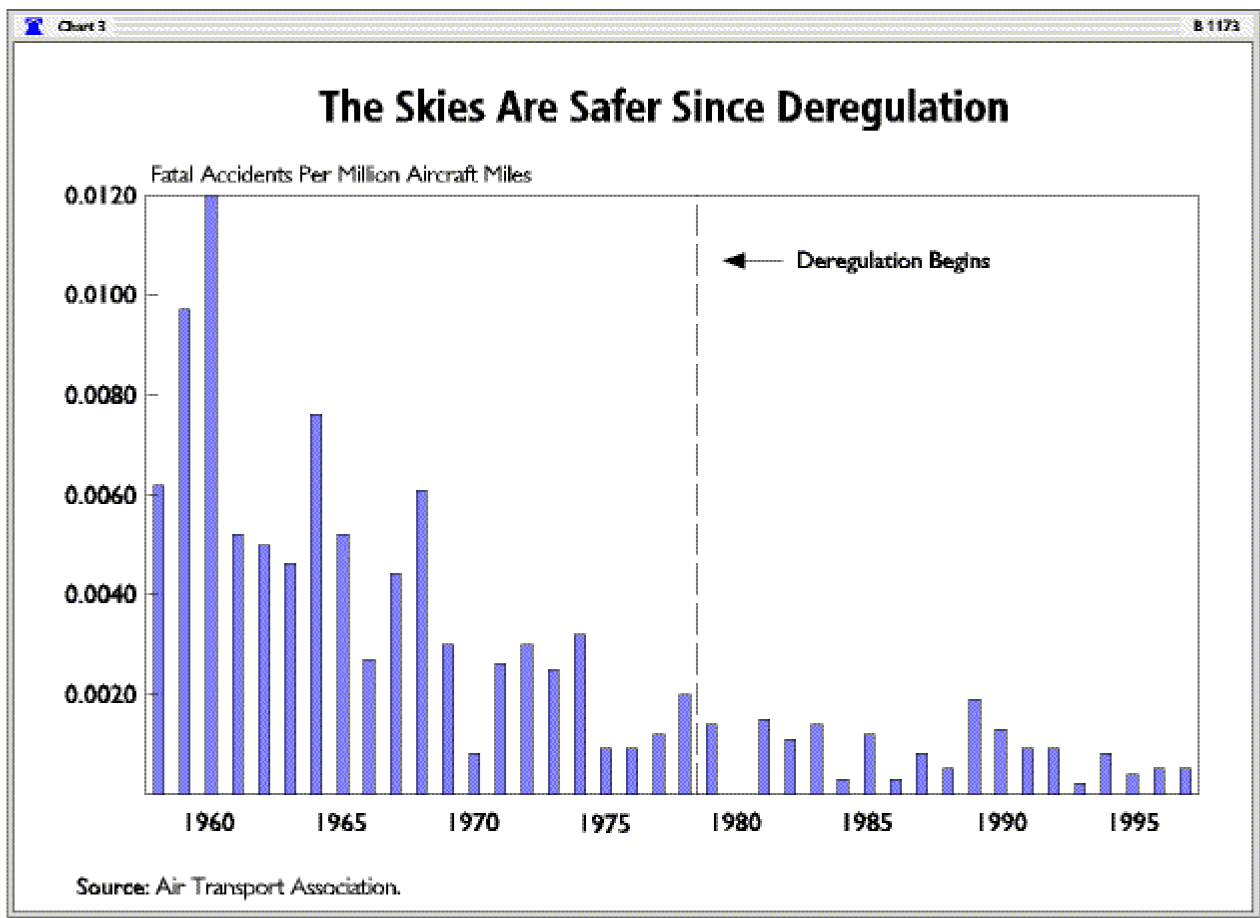
Prices Have Fallen Steadily Since Deregulation, Saving Consumers Billions of Dollars

	Real Price Reductions for Airline Service
After 2 years (1977–1979)	13%
After 5 years (1977–1982)	12%
After 10 years (1977–1987)	29%
Annual Value of Consumer Benefits	$19.4 billion

Source: Crandall and Ellig, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry*, Center for Market Processes, George Mason University, 1997.

Crandall, senior fellow in the Economic Studies Program at the Brookings Institution. In their 1997 study *Economic Deregulation and Customer Choice: Lessons for the Electric Industry,*[14] Ellig and Crandall found that real price reductions of roughly 13 percent occurred as early as two years after deregulation, that reductions of almost 30 percent were evident ten years after deregulation, and that the annual value of consumer benefits generated by deregulation equals $19.4 billion in 1993 dollars.

- **Prices have fallen at all airports.** Airline deregulation might be considered a failure if fares at small and medium-sized airports had not declined as they did at large airports, but small and medium-sized airports have not been denied the benefits of lower prices and better service. An April 1996 General Accounting Office study found that "The average fare per passenger mile, adjusted for inflation, has fallen since deregulation about as much at airports serving small and medium-sized communities as it has at airports serving large communities."[15] Furthermore, "The average fare per passenger mile was about 9 percent lower in 1994 than in 1979 at small-community airports, 11 percent lower at medium-sized airports, and 8 percent lower at large-community airports."[16]



14. Robert Crandall and Jerry Ellig, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry* (Fairfax, Va.: Center for Market Processes, 1997), p. 2.

15. U.S. General Accounting Office, *Airline Deregulation: Changes in Airfares, Service, and Safety at Small, Medium-sized, and Large Communities*, GAO/RCED-96-79, April 1996, p. 3.

16. *Ibid.*, p. 4.

Air Travel Is Safer

Consumers obviously would not be happy if prices fell this much and safety also was reduced in the process. But the opposite has been true: Safety has improved as prices have fallen.

- **Airline safety has improved since deregulation.** Between 1939 and 1978, fatal airplane accidents averaged six per year. After deregulation, from 1978 to 1997, the average was only 3.5 fatal accidents per year. The safety record of America's airways is determined more accurately, however, by examining how many airline fatalities occur annually relative to the overall number of miles flown by the nation's air carriers. As Chart 3 illustrates, the overall safety record of America's airlines has continued to improve since deregulation: During the 20 years since deregulation, fatal accidents have averaged 0.0009 per million aircraft miles flown. During the 40 years before deregulation, on the other hand, fatal accidents averaged 0.0135 per million aircraft miles flown.
- **Airline safety has improved for airports of all sizes.** The GAO also found that "for each airport group [small, medium-sized, and large], the accident rate was lower in 1994 than in 1987. The GAO study did not find any statistically significant differences between the trends in air safety for airports serving small, medium-sized, and large communities."[17]

Service Quality Has Improved

The quality of airline service can be measured in many different ways, including the number of aircraft departures, the total number of miles flown, the timeliness of service, other programs and services, and various frills or amenities. On the vast majority of these counts, the overall quality of airline service has improved since deregulation.

- **There are more aircraft departures than ever before.** One method that can be used to measure service quality is the number of flights available to consumers before and after deregulation. This provides a good indication of how many options are available to consumers. According to the Air Transport Association of America, which represents the airline industry, the overall number of airline departures has risen from just over 5 million in 1978 when airlines were deregulated, to 8.2 million in 1997, a 63 percent increase over two decades. Chart 4 illustrates the rise in departures after deregulation.
- **There are more departures for small, medium-sized, and large airports alike.** "The quantity of air service, as measured by the number of both departures and available seats, has increased since deregulation for all three airport groups," according to the 1996 GAO study.[18] "Specifically, in May 1995 small-community airports as a group had 50 percent more scheduled commercial departures than they did in May 1978; medium-sized community airports had 57 percent more departures, and large-community airports had 68 percent more departures."[19]
- **Airlines fly more miles.** Airlines also are logging more miles than before deregulation. Whereas carriers flew roughly 2.5 billion miles in 1978, they logged more than double that number last year alone, flying approximately 5.7 billion miles in 1997. Furthermore, as Chart 5 illustrates, this trend increased much more rapidly after deregulation than it did before market liberalization.
- **More Americans are flying than ever before.** Airlines are logging more miles because more Americans are flying than ever before. Although approximately 250 million passengers were carried in 1978, roughly 600 million people (almost two-and-a-half times as many) traveled by air in 1997. As Chart 1 showed,

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17. *Ibid.*, p. 3.

18. *Ibid.*

19. *Ibid.*, p. 33.

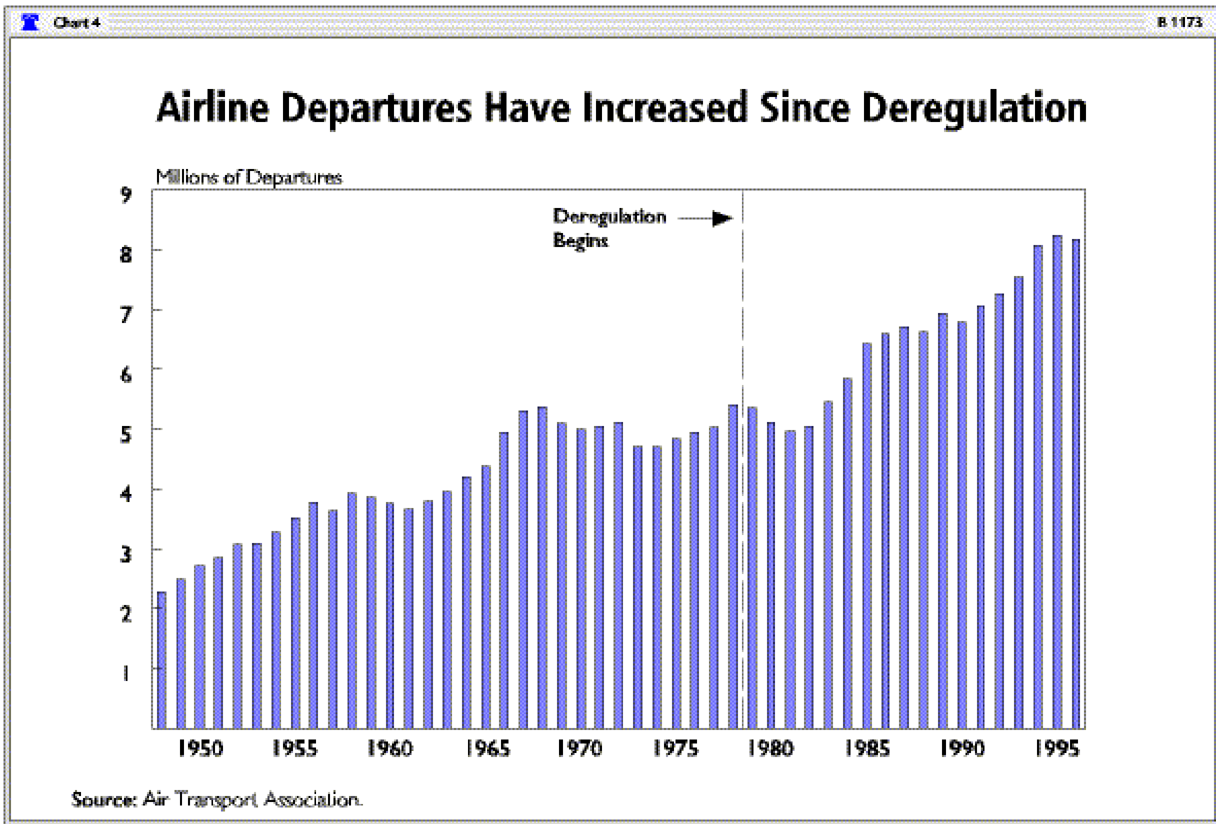
Chart 4
B 1173
Airline Departures Have Increased Since Deregulation
Millions of Departures
9
8
7
6
5
4
3
2
1
Deregulation Begins
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
Source: Air Transport Association.

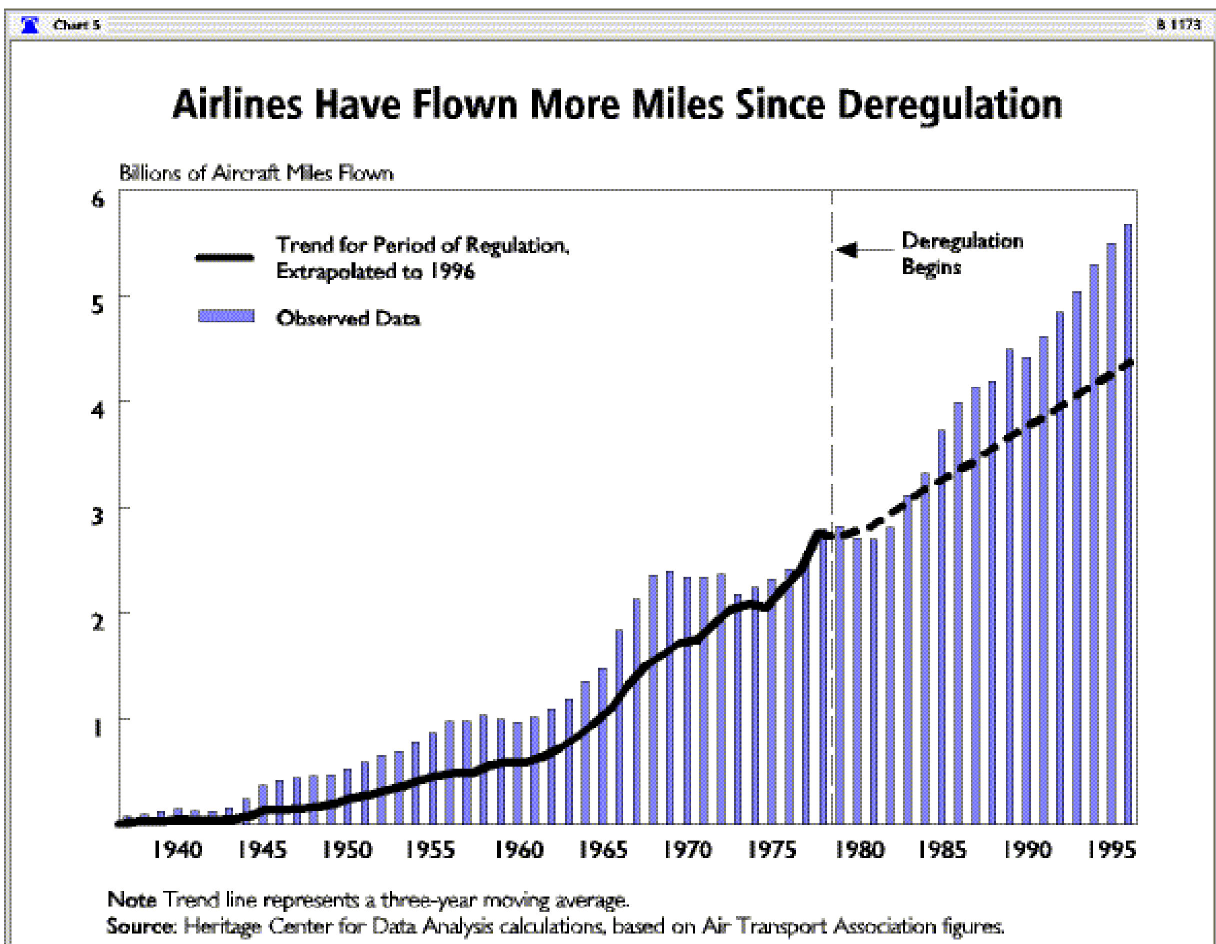
Chart 5
B 1173
Airlines Have Flown More Miles Since Deregulation
Billions of Aircraft Miles Flown
6
5
4
3
2
1
Trend for Period of Regulation, Extrapolated to 1996
Observed Data
Deregulation Begins
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
Note: Trend line represents a three-year moving average.
Source: Heritage Center for Data Analysis calculations, based on Air Transport Association figures.

this trend increased more rapidly after deregulation went into effect.

- **Airlines are more timely than ever before.** Although little historical data are available to gauge these results, anecdotal evidence indicates that flights are on time more frequently now than before deregulation. Development of the airlines' "hub and spoke" system has made many different routes available to consumers, allowing travelers to reach their destinations via tightly coordinated routes. Delays continue within the system, but they are due primarily to the sort of airport mismanagement that accompanies government ownership of this important infrastructure component.

- **New types of services have become available.** Many unforeseen consumer services and benefits sprang up following deregulation. For example, the travel agent industry expanded to assist consumers in booking air passage. This was facilitated by the development of sophisticated new computerized booking systems, which recently became directly accessible to consumers through the Internet. Not only has this development made it easier for millions of Americans to book air passage tailored to their specific needs, but it also has created new types of travel and vacation packages for consumers.

- **Airlines have developed new marketing options to serve the newly empowered consumer more effectively.** Frequent flyer miles, for example, are a widely utilized consumer option that provides substantial discounts once the minimum number of miles has been logged. Many air travelers are able to strike time-saving or money-saving bargains with travel agents or airline reservation attendants, who can bump travelers to earlier flights or issue them discounted or free tickets to later flights if they are willing to surrender their tickets on an overbooked flight. Such bartering options were rare before deregulation. Consumers also have benefited from the rise of innovative low-cost carriers and commuter airlines that offer extremely competitive rates or that serve short-haul or "puddle jumper" routes. Such carriers crop up periodically to satisfy demands for cheaper, more frequent flights between certain destinations.

- **Frills and amenities may have declined slightly.** Perhaps the only service quality variable that could be considered a deregulatory disappointment concerns the lack of airline frills and amenities. As the cliché goes, there is perhaps nothing worse than airline food. And outside of magazines for travelers to read or an occasional in-flight movie, airlines offer little for the consumer to do on the average flight. But this begs the question of whether such frills or amenities are a priority for most travelers. Clearly, most airline customers do not purchase tickets to receive a five-star dinner and the finest champagnes or wines. They are looking primarily for the quickest, cheapest path from one destination to another. Today's deregulated marketplace provides them with such options. Consumers looking for more expensive frills and amenities can get them on some airlines by flying first class.

WHY AIRLINE RE-REGULATION WILL BE BAD FOR CONSUMERS

The Department of Transportation's "Proposed Statement of Enforcement Policy on Unfair Exclusionary Conduct by Airlines" reflects a newly found willingness to turn back the regulatory clock on the airline industry. Surprisingly, the DOT's proposed enforcement guidelines begin with a statement recognizing the undeniable benefits that deregulation has wrought:

> With a minimum of government economic oversight, the domestic airline industry has generally evolved in ways that have increased competition, improved the convenience and usefulness of air service to most people and lowered

> inflation-adjusted fares for the nation as a whole.[20]

This acknowledgment, however, not only represents little more than lip service to the benefits of deregulation, but also is followed by a bold new re-regulatory agenda for the airline industry. One concern expressed in the enforcement policy is whether major carriers exercise exclusionary market power over certain routes and airport hubs as a result of how slots and gates are allocated and utilized at major airports. But the concern that dominates the DOT's new guidelines is the alleged anti-competitive predatory pricing techniques of major carriers.

The predatory pricing accusation states in essence that a large carrier might be acting in an exclusionary or anti-competitive fashion by pricing "below-cost" for a period to drive new entrants out of the market. The major carrier is willing to accept losses in the short term, the theory states, to eliminate the new entrants that operate on thin profit margins and limited capital resources. Once new entrants have been driven from the market, the major carrier can hike its prices to recoup its losses.

"It's a nice-sounding theory, but in practice such predatory behavior rarely if ever works," notes the CEI's James Gattuso.[21]

> To make the gambit worthwhile, the predator must not only make monopoly profits at the end, but make enough to compensate for its lost revenue—plus interest. That's hard to do, especially since another airline could always enter the market at a later date. In the history of antitrust law, there have been few, if any cases of successful predatory pricing.[22]

"For this reason," as the U.S. Supreme Court noted in its 1986 decision in *Matsushita Electric Industrial Company* v. *Zenith Radio*, "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."[23] Indeed, Judge Robert H. Bork, noted legal scholar and author of *The Antitrust Paradox: A Policy at War with Itself*, has argued that "predatory price cutting is most unlikely to exist and…attempts to outlaw it are unlikely to harm consumers more than would abandoning the effort."[24] Bork believes that consumers will be harmed because "The result [of predatory pricing cases] can only be to dampen the vigor of price competition."[25]

Yet, ignoring the overwhelming academic evidence against this thoroughly discredited theory, the DOT's enforcement policy establishes a detailed plan to review accusations of predatory pricing on a case-by-case basis and then, if need be, set up trials before administrative law judges.

This bears out Gattuso's contention that "rules against below-cost pricing are likely to cause more harm than good. They are every weak competitor's dream. If your rival is underpricing you, drag him into court. The prospects of years of litigation would certainly make anyone think twice about lowering prices to beat, or even meet, the competition."[26] In other words, companies will spend more time battling in the courtroom than in the marketplace. "If courts start to uphold the accusations of predation, they will have misused the antitrust laws to protect competitors instead of protecting competition," argue economists Jerry

20. U.S. Department of Transportation, "Proposed Statement of Enforcement Policy on Unfair Exclusionary Conduct by Airlines," Office of the Assistant Secretary for Public Affairs, April 6, 1998.

21. James L. Gattuso, "Don't Outlaw Cheap Airfares," *The Wall Street Journal*, April 8, 1998, p. A22.

22. *Ibid.*

23. *Matsushita Electric Industrial Company* v. *Zenith Radio*, 475 U.S. 574 (1986).

24. Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York: The Free Press, 1978, 1993), p. 155.

25. *Ibid.*

26. Gattuso, "Don't Outlaw Cheap Airfares."

Ellig and Wayne H. Winegarden in a 1993 study for the Washington, D.C.-based Citizens for a Sound Economy.[27]

With apparent disregard for the likelihood that it will lead to a flood of litigation, the DOT's proposed enforcement policy outlines broad criteria that will allow regulators and administrative law judges to decide when a carrier has engaged in "unfair exclusionary practices." Such a violation will be present under this policy when one or more of the following occurs:

1. The major carrier adds capacity and sells such a large number of seats at very low fares that the ensuing self-diversion of revenue results in lower local revenue than would be generated by a reasonable alternative response;
2. The number of local passengers carried by the major carrier at the new entrant's low fares (or at similar fares that are substantially below the major carrier's previous fares) exceeds the new entrant's total seat capacity, resulting through self-diversion in lower local revenue than would be generated by a reasonable alternative response; or
3. The number of local passengers carried by the major carrier at the new entrant's low fares (or at similar fares that are substantially below the major carrier's previous fares) exceeds the number of low-fare passengers carried by the new entrant, resulting through self-diversion in lower local revenue than would be generated by a reasonable alternative response.

Problems with DOT's Enforcement Policy

The proposed enforcement policy poses many troubling questions that the DOT has failed to address. For example:

- **Who** should be regarded as a "major carrier" and subject to these new rules? Is it fair that only larger carriers should be singled out and targeted for punishment under the new rules if they lower their fares "too much"?
- **When and how** would a fare be judged "substantially below" the major carrier's previous fares? In other words, how will the DOT know when a carrier is pricing "below cost"? To make such a determination, DOT assumes that its regulators, not the marketplace, are the best judges of the proper price of air service.
- **Does** the DOT have the statutory authority to re-regulate the airlines unilaterally? Most antitrust determinations and decisions such as these are handled by the Antitrust Division of the U.S. Department of Justice, not by another executive branch agency or an administrative law judge.
- **If** it becomes illegal for any large carrier to lower prices to compete with smaller carriers or new entrants, would this discourage fare wars that benefit consumers shopping for cut-rate bargains? Prohibiting or discouraging such rate wars undoubtedly would have negative financial effects on the targeted carriers, affecting their profitability and their shareholders.
- **Why** should it be a crime for a company to cut consumer prices? "Telling firms that they cannot lower prices is no way to help consumers," conclude Ellig and Winegarden.[28]

The Department of Transportation has not asked or addressed many of these questions in its new enforcement policy, because there are no good answers to them. "As a practical matter," argues Darryl Jenkins, "DOT's proposed guidelines are unenforceable because (1) they are based on vague, subjective terms and (2) DOT has neither

27. Jerry Ellig and Wayne Winegarden, "A Consumer Perspective on Airline Policy," Citizens for a Sound Economy *Economic Perspective*, August 26, 1993, pp. 8–9.

28. *Ibid.*, p. 9.

the resources nor the expertise to apply them uniformly and fairly."[29]

Consequently, if the DOT moves forward with its plan, America's airline consumers will be the real losers, since the proposal will discourage price wars and do little to encourage greater travel choice or better service. For these reasons, congressional policymakers must realize that the DOT is acting in an irresponsible and unauthorized manner that runs counter to both the Airline Deregulation Act of 1978 and the Civil Aeronautics Board Sunset Act of 1984. Thus, it seems clear that Congress should not allow the DOT to pursue unilaterally any further action under its new enforcement policy.

FIVE PRO-COMPETITIVE ALTERNATIVES TO THE DOT PLAN

There are solutions to many of the problems addressed by the DOT that do not involve the re-regulation of airline routes and rates. The following five recommendations, if adopted, would do far more to improve airline competition than could ever be done under the DOT's new regulatory proposal:

1. **Privatize airports to expand capacity and improve infrastructure.** Deregulation did nothing to end government ownership and management of most airport infrastructure. Because of this, impediments to increased industry competition and efficiency remain. As noted by Robert W. Poole, Jr., president of the Los Angeles-based Reason Foundation:

   > Federal policies, bureaucratic tradition, and nonmarket thinking have combined to make airport operations a kind of bureaucratic-socialist enterprise—which the airlines have long since learned how to manipulate to their advantage. As a result, incumbent airlines can insulate themselves from new competition.[30]

   Privatization of airport infrastructure would encourage increased capacity and improved efficiency by allocating gates and landing slots to parties that value them most highly.[31]

2. **Allow market-based pricing at airports for takeoff times, slots, and gates.** If full-scale privatization of airport infrastructure proves politically difficult, then at a minimum, market-based pricing techniques should be utilized. Slot and gate allocations and fees currently are allocated or set by bureaucratic rules or random weight charges. This causes significant delays and lessens competitive entry at many airports. Steven A. Morrison, professor of economics at Northeastern University, and Clifford Winston, senior fellow in economic studies at the Washington-based Brookings Institution, argue that

   > [T]he inefficiencies due to the slot system could be eliminated if the system—whose very purpose…is to reduce congestion—were replaced by congestion pricing—charging aircraft for their takeoffs and landings according to the cost of the delay that each aircraft imposes on other aircraft. Congestion charges would reduce delays from congestion by encouraging planes, especially general aviation and commuter planes, to use congested airports during off-peak periods or to switch to less congested airports.[32]

29. Jenkins, "Keep DOT at Bay."
30. Robert W. Poole, Jr., "Onward and Upward," *Reason*, February 1989, p. 34.
31. See also William G. Laffer III, "How to Improve Air Travel in America," Heritage Foundation *Backgrounder* No. 806, January 25, 1991, pp. 6–8; James L. Gattuso, "Privatization of Britain's Airports: A Model for the U.S.," Heritage Foundation *International Briefing* No. 17, January 23, 1989.
32. Steven A. Morrison and Clifford Winston, "The Fare Skies: Air Transportation and Middle America," *The Brookings Review*, Vol. 15, No. 4 (Fall 1997).

Not only would such market-based pricing help alleviate congestion, but it also would encourage greater competition. Morrison and Winston note that several major American airports continue to operate under a number of unique regulatory requirements, including slot restrictions (at New York's LaGuardia and Kennedy airports, Washington's Ronald Reagan National airport, and Chicago's O'Hare airport) and perimeter rules (at LaGuardia and Reagan National), which limit the distance airlines can travel to or from an airport, and destination restrictions (at Dallas's Love Field), which limit the number of cities to which an airline can travel from the airport. Not only do these continuing regulatory burdens cause delays, diminish competition, and raise consumer fares, but Morrison and Winston estimate that if they were lifted, consumers could realize benefits of roughly $1 billion annually.[33]

3. **Privatize the air traffic control system to reduce congestion and improve safety.** America's air traffic control system is technologically obsolete and inefficient. As a federal entity, the air traffic control system is subject to cumbersome procurement rules and costly labor rules and restrictions. Moreover, as is true with most federally controlled entities, there is little accountability to customers (in this case, both travelers and airlines), and little effort is made to price airport access or air travel times efficiently.

   The solution to these problems is privatization. The federal air traffic control system should be converted into a private corporation funded by user fees. In a privatized market, the corporation would implement policies to encourage fewer delays, less congestion, simpler and less expensive procurement practices, and safer air travel through superior technological innovation. Experiments in other countries with air traffic control privatization have proven successful, notes Daniel M. Kasper, co-chairman of the transportation industry program at Coopers & Lybrand in Boston: "Following the corporatizing of their air-traffic control systems, the cost of handling flights in Australia and New Zealand has dropped almost 25%; flight delays have been reduced; and the time required to buy and put in place modern technologies is shorter than it used to be."[34]

4. **Reduce airline fees and taxes.** Air carriers face a stifling variety of taxes and fees, including excise taxes, fuel taxes, passenger ticket taxes, cargo taxes, and arbitrary landing fees. As the adjoining table documents, these taxes and fees cost the industry roughly $7.6 billion

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The Crushing Burden of Airline Taxes

	Estimated Annual Tax Expense
Domestic passenger ticket tax and flight segment tax	$5 billion
$12 international departure tax and a $12 international arrival tax ($1.1 billion over 5 years)	$22 million
4.3 cents per gallon tax on domestic air fuel	$550 million
$6.50 customs fee for travelers entering the U.S.	$300 million
$6.00 immigration fee for international arrivals	$300 million
$1.45 agriculture fee for arriving international passengers and $53 aircraft fee	$65 million
6.25% air freight or cargo tax	$361 million
$3 passenger facility charge per airport used, up to $12 per round trip	$1 billion
Estimated Annual Tax Burden for Airlines	**$7.6 billion**

Source: Air Transport Association, 1997.

33. Steven A. Morrison and Clifford Winston, "Foul Regulatory Weather Grounds Airline Competition," *The Wall Street Journal*, December 3, 1997, p. A22.

34. Daniel M. Kasper, "Blue Skies and a Cloud for Air-Traffic Control," *The Wall Street Journal*, May 4, 1994, p. A14.

annually, although the total burden is likely to be much higher due to the recently imposed 7.5 percent tax on airline frequent flier miles.

These taxes have imposed a crushing burden on the airlines during the 1990s, both by lowering corporate profitability and by restricting industry expansion. According to Scott C. Gibson of the Washington, D.C.-based Economic Strategy Institute:

> Since 1991, the cumulative effect of the increase in taxes has exceeded $12 billion, an increase of 48% on the $25 billion that would have been collected had taxes remained at the 1989 level. The bulk of this increase is directly passed on to consumers in the form of higher prices, but given the inability of the airlines to raise prices on the majority of airfares without negatively impacting demand, the tax increase essentially decreases airline revenues…. Had the tax burden not been increased in 1990, the airline industry would have lost approximately $2 billion rather that the $13 billion in losses that occurred from 1990 to 1994.[35]

This result has led John H. Dasburg, president of Northwest Airlines Corporation, to conclude that "The story of the airline industry in the 90's is a textbook example of the damage that ill-conceived tax policies can do to an industry."[36] Lowering this multibillion-dollar tax burden would do much to increase industry competition, encourage new entry, and improve service rivalry.

5. **Encourage increased foreign competition in the U.S. market.** Just as Americans benefit from free trade in other foreign goods and services, foreign competition in air service could bring them new service options and lower prices. But government regulations continue to restrict foreign competition for domestic airline routes. This policy limits industry competition and consumer choices. Americans have the uninhibited right to choose freely from among foreign makers of automobiles, electronic products, clothes, and countless other goods and services; airline travel should be accorded the same treatment.

Finally, it is important that policymakers on Capitol Hill reject inefficient and expensive attempts to encourage more industry competition through new or increased federal subsidies to rural areas or to new carriers. The federal government already operates the Essential Air Service (EAS), which distributes subsidies to roughly 100 rural communities, a quarter of which are based in Alaska. As Heritage Foundation Fellow Ronald D. Utt has noted with respect to the EAS:

> Taxpayers should not have to subsidize those few travelers who chose air travel over unsubsidized alternatives. Individuals who wish to fly to and from remote locations should pay the full cost themselves. If they are to be subsidized, the subsidy should be paid by the local communities that allegedly benefit from the less costly service. In either case, if those who benefit from having regularly scheduled air service to these locations are not willing to bear the full costs themselves, the service should be discontinued.[37]

For many of the same reasons, it would be a mistake for Congress to begin subsidizing new entrants into the airline industry as a way to increase competition. Creating new forms of corporate welfare to encourage industry

35. Scott C. Gibson, *Scorecard on U.S. Airline Deregulation*, Economic Strategy Institute, March 31, 1998, pp. 35–36.
36. John H. Dasburg, "A Taxing Drag on the Airlines," *The Wall Street Journal*, March 21, 1995, p. A20.
37. Ronald D. Utt, "The Essential Air Service Program," in Scott A. Hodge, ed., *Balancing America's Budget: Ending the Era of Big Government* (Washington, D.C.: The Heritage Foundation, 1997), p. 218.

expansion not only will result in an expensive new federal spending program, but also will be tantamount to creating a massive new industrial policy for the aviation marketplace. Federal intervention of this magnitude will demand a sizable expansion both of the federal bureaucracy and of the overall tax burden borne by millions of Americans.

CONCLUSION

The deregulation of America's airline industry has been a great success by every statistical measure available. Americans today can fly from coast to coast more cheaply and frequently than ever before. Deregulation has converted airline travel from an upper-class luxury into a transportation option within the reach of millions of Americans.

It is therefore somewhat surprising, and quite regrettable, that the 20th anniversary of airline deregulation has occasioned calls for the re-regulation of prices and operations in the industry. Such a move is wholly unwarranted, given the record of deregulatory achievement over the past two decades. "In the end," summarizes Darryl Jenkins, "DOT's new policy would accomplish exactly what the Congress and the country left behind 20 years ago—a regulatory quagmire that eliminates consumers' choice and chills competition."[38]

Consumers, not regulators, are in the best position to make pro-competitive choices in this industry. Allowing Washington bureaucrats to reassume their positions as dictators of rates, routes, and quality would be worse than shortsighted: It would send the industry back to the regulatory Stone Age. As United Airlines Chairman Gerald Greenwald aptly concluded in a speech at the Economic Strategy Institute last November, "there is a huge and frightening cost in tinkering with the most efficient, innovative and competitive airline system in the world. We have everything to lose—and absolutely nothing to gain."[39]

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38. Jenkins, "Keep DOT at Bay."

39. Gerald Greenwald, "Perception, Reality, and Re-Regulation," *Remarks at the Economic Strategy Institute*, November 18, 1997, p. 6.

Table 3 B 1173

Airline Data, 1950–1997

	Passengers Carried	Thousands of Aircraft Miles Flown	Thousands of Departures	Fatal Accidents	Fatal Accidents Per Million Aircraft Miles Flown	"Yield" or Revenue per Passenger Mile in 1982 Cents
1950	19,102,905	477,463	2,482	6	0.0126	27.62¢
1951	24,694,012	526,591	2,713	9	0.0171	28.29
1952	27,376,266	589,429	2,847	8	0.0136	25.17
1953	31,425,421	657,092	3,070	6	0.0091	24.11
1954	35,222,667	689,777	3,094	4	0.0058	22.98
1955	41,443,772	779,926	3,276	9	0.0115	23.86
1956	45,689,240	869,314	3,503	4	0.0046	22.50
1957	49,120,271	976,169	3,769	5	0.0051	21.51
1958	48,853,324	972,987	3,633	6	0.0062	19.52
1959	56,002,094	1,030,242	3,912	10	0.0097	22.78
1960	57,886,566	997,976	3,856	12	0.0120	21.40
1961	58,411,977	969,556	3,750	5	0.0052	20.13
1962	62,548,399	1,009,784	3,660	5	0.0050	20.15
1963	71,437,828	1,095,058	3,788	5	0.0046	19.20
1964	81,752,273	1,189,135	3,954	9	0.0076	18.53
1965	94,662,314	1,353,503	4,197	7	0.0052	17.95
1966	109,390,556	1,482,486	4,373	4	0.0027	16.86
1967	132,088,038	1,833,563	4,946	8	0.0044	15.89
1968	150,162,701	2,123,993	5,300	13	0.0061	15.15
1969	159,213,414	2,359,745	5,377	7	0.0030	14.95
1970	171,697,097	2,394,313	5,100	2	0.0008	14.39
1971	173,664,737	2,343,578	4,999	6	0.0026	14.44
1972	188,938,932	2,336,992	5,044	7	0.0030	14.04
1973	202,207,000	2,368,550	5,102	6	0.0025	13.78
1974	207,449,006	2,177,253	4,694	7	0.0032	14.27
1975	205,059,571	2,240,506	4,704	2	0.0009	13.61
1976	223,313,131	2,319,997	4,833	2	0.0009	13.51
1977	240,326,516	2,418,645	4,937	3	0.0012	13.42
1978	274,717,832	2,520,165	5,015	5	0.0020	12.27
1979	316,683,000	2,791,120	5,399	4	0.0014	11.58
1980	296,903,000	2,816,303	5,353	0	0	12.89
1981	285,976,000	2,703,219	5,112	4	0.0015	13.08
1982	294,102,000	2,698,928	4,964	4	0.0011	11.78
1983	318,638,000	2,808,566	5,034	4	0.0014	11.25
1984	344,683,000	3,113,604	5,448	1	0.0003	11.27
1985	382,022,000	3,319,955	5,835	4	0.0012	10.46
1986	418,946,000	3,728,429	6,427	2	0.0003	9.62
1987	447,678,000	3,988,105	6,581	4	0.0008	9.44
1988	454,614,000	4,140,911	6,700	3	0.0005	9.69
1989	453,692,000	4,192,820	6,622	8	0.0019	9.68
1990	465,560,000	4,490,793	6,924	6	0.0013	9.42
1991	452,301,000	4,414,087	6,783	4	0.0009	9.03
1992	475,108,000	4,619,117	7,051	4	0.0009	8.60
1993	488,520,000	4,846,458	7,245	1	0.0002	8.72
1994	528,848,000	5,033,398	7,531	4	0.0008	8.20
1995	547,773,000	5,293,401	8,062	2	0.0004	8.15
1996	581,234,000	5,500,980	8,230	3	0.0005	8.01
1997	598,895,000	5,678,956	8,157	3	0.0005	7.92

Source: Air Transport Association website, *http://www.air-transport.org/data/.*