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Regulation, the Market, and Interest Group Cohesion: Why Airlines Were Not Reregulated

Michael E. Levine*

When policy analysts contemplate regulatory change, they commonly focus on how it will affect their desired state of the world. Few ask whether one can even "get there from here" or can stay if one does make it. If they do consider this question at all, they tend to assign it to "politics" and treat it nonsystematically. To address this question seriously, however, one needs a framework, a theory, that can be used to predict whether a regulatory change could occur and, if it occurred, could persist. Most policy analysts have such a theory in mind, whether or not they know it. Some believe that a government acts to make outcomes more efficient or "fairer." Others think that "it's all politics" and concentrate on the impact of politics on the institutions they are analyzing. They often confuse the normative question, "What would be the best outcome?" with the positive question, "What outcome can I predict we will get?"[1]

An appropriate framework for the inquiries and case studies in this volume is one that addresses the positive question. No proposed rearrangement of markets and regulatory institutions would be worth pursuing if one knew in advance that it was impossible to implement or would be quickly undone, as in the case of the 1986 U.S. tax reforms or various attempts to reform agricultural subsidies and quotas. The success or failure of any attempt at regulatory change clearly depends on recognizing and addressing, through institutional design, the present and future political forces that will aid, obstruct, or shape its implementation and operation. That exercise, in turn, can benefit from the lessons of history, arrived at through the examination of particular cases and application to other cases.

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The Economic Theory Challenged

In the past thirty-five years or so, the only hypothesis [exposed to rigorous specification and serious testing is the "economic theory of regulation."[2] Although it has received wide, if grudging, acceptance among economists, this theory, in its pure form, fails to account for both the adoption and the persistence of airline deregulation. This difficulty, first highlighted in an earlier Brookings volume addressing the deregulations of the 1970s and 1980s, has been confirmed by subsequent events. Clearly, the theory now needs to be modified, to take into account the information that has emerged after thirty years of experience with airline deregulation.[3]

According to the economic theory of regulation, the main purpose of regulation is to create rents or to transfer them from politically weak interest groups to politically stronger groups. Which group is "politically stronger" usually depends on an increasingly concentrated impact and low organization costs. Furthermore, regulation is generally instituted or exercised to entrench existing firms and to promote special interests at the expense of the consuming public. In this view, the aspect of political strength that determines the regulatory regime is the ability to help regulators gain utility—that is, continued or enhanced power or a valuable post-government position. That ability is manifested in activities such as organizing votes or contributing resources to help win elections or otherwise influence whoever is in a position to appoint or elect regulators and retain them, or in making a well-known practice of employing former regulators on attractive terms. Given that large sums of money can be at stake, it is often supposed and occasionally demonstrated that the "support" reaches beyond what is legal. Typically, the theory predicts that the probability a public policy that creates or transfers rents will be adopted is directly proportional to the degree of organizational efficiency (the ratio of outcome benefits to the costs of organizing to achieve them) of the policy's potential beneficiaries in comparison with those potentially harmed by it.

But airline deregulation principally benefited poorly organized consumers and was adopted over the opposition of a relatively small and well-organized group of regulated airlines. And it has persisted despite spectacularly negative impacts on organized labor, management, investors, the largest firms in the industry, and assorted other interests. This is not to say that deregulation has been inefficient—by stripping the industry of government protection it allowed creative destruction and provided enormous benefits to the public, unorganized

labor, some municipalities, and a few new entrant entrepreneurs.[4] Yet a conventional ex ante calculus would have suggested that the beneficiaries were too expensive to organize and the individual impacts too little (especially since monopoly rents were greatly reduced and hence not available for distribution) to dominate regulatory politics under the economic theory of regulation. Under the circumstances, several commentators have wondered whether it is time to revive a public interest theory of regulation abandoned since 1960 or so.

The Economic Theory Enriched

Despite the number of substantial losers as well as winners, some might describe the outcome of airline deregulation as a normative victory for an idea-driven, consumer-oriented "public interest." Any number of labor union members, investors, lenders, airline management, and municipalities that lost cross-subsidized service of large aircraft or that invested in airline facilities that had to be abandoned later would be willing to quarrel with that assessment. The central reason is that it is almost impossible to specify a priori precisely what is normatively justifiable, despite some heroic efforts in that direction. Be that as it may, the economic theory of regulation purports to be a positive, not normative, theory, and it is my task here to try to explain the airline deregulation outcome (an initial destruction of concentrated benefits that persists and resists reversal) in positive terms using a version of the economic theory.

I believe that both the deregulation and lack of reregulation of the airline industry can be explained by modifying the economic theory of regulation:

—First, one must define more precisely what is meant by special interests and their opposites. To do this, I abandon "public interest" as a positive rather than normative concept and instead posit a "general interest" that can be defined a priori in positive terms, as distinct from a "public interest" that for the most part denotes the preferences of the commentator rather than the polity.

—Second, I add to the theory's standard transaction and organization costs the information and monitoring costs that are pervasive in any real-world economic or political environment and that have been the linchpin of the new organizational economics. This modification, explained in detail elsewhere, explicitly takes into account (a) the "slack" that shields regulators from scrutiny or influence by the general electorate and (b) the

constraints introduced by the reduction or disappearance of slack through the mechanism of a short public agenda of widely publicized issues.[5]

Slack occurs when information and monitoring costs shield the actions of a regulator from being observed by a rational electorate.[6] The economic theory of regulation must implicitly rely on the existence of slack in order to be operative. After all, if all actions by regulators could be perfectly observed and understood and voted on, no regulator in a democratic system would be allowed to introduce a policy that left a general polity (an electorate acting through its ordinarily accepted aggregation rules) worse off than before. Thus it is necessary to impose relatively high monitoring and organizing costs on the public or on institutional barriers that insulate regulators from influence by the general electorate in order to benefit special interests at the expense of the general polity or to enforce unpopular ideological views.

Slack arises because members of a polity ordinarily find the information necessary to monitor public officials too expensive to be worth acquiring or organizing to act upon. In the presence of slack, self-regarding regulators can "sell" policies to special interests in return for career support (help in achieving reelection, reappointment, or post-regulatory employment).[7] Alternatively, other-regarding regulators can pursue policies that they believe to be efficient or morally desirable but that they know would not be supported by the electorate. In the absence of slack, only policies that would be approved by the electorate can prevail, and these will not always, be efficient and will often be morally dubious (dairy price supports) or worse (segregation).[8]

Slack disappears when the issues addressed by and actions of the regulator become the subject of such intense public scrutiny that the costs to a citizen of becoming informed on a matter drop to nearly zero, and are therefore noticed by a rational electorate. Issues that are so publicized become part of the "public agenda," the set of issues that are so widely discussed in the media and elsewhere that no member of the polity can easily remain unaware of them. The presence or absence of an issue on the public agenda profoundly affects whether policies can be adopted that put at a disadvantage or displease whatever coalition of the polity is necessary to win an election. The public agenda for any polity is very limited at any given time, usually consisting of no more than a handful of pervasively discussed and highly salient issues. Even the fact of being directly represented on a ballot does not ordinarily make either a candidate or an issue part of the public agenda.[9]

Note, too, that putting an issue on the public agenda does not automatically lead to less or even better regulation. The existence or absence of slack does not automatically map into "good" or "bad" rent seeking in general. When a problem hits the headlines, "doing something about it" may be the general interest (*not* "public interest") result, but the "something," or even the doing of it at all, will not necessarily lead to more efficient or fairer outcomes. It will simply tend to lead to an outcome of which an informed polity approves. As in the case of rent control, public agenda issues may even involve rent creation and transfer, although in that case the theory says that the transfer will be to the general public but with a deadweight loss. Putting an issue on the public agenda simply makes it much harder (in principle, impossible) to generate private rents at the expense of a dominant voting coalition. Much regulation of "hot" issues (public agenda issues) imposes private costs on nondominant groups that exceed the benefits conferred on the public groups supporting it. This regulation might not be adopted if there was slack and the private groups could invest unseen in defending themselves.

So one has to distinguish the outcome of the airline case from possible outcomes in general. Airline regulation and, as of now, any possible reregulation, requires a transfer of benefits under cover of slack from a dominant voting majority to an organized minority. "Freeing" of the industry made the firms' interests so diverse that it has so far been impossible to organize a potentially effective industry coalition (still a non-dominant subset of the polity and therefore a "special interest" faction, in this hypothesis) by the rest of the subset, even if all this is going on behind the slack curtain.

If one believes that airline regulation was created to decrease competition and thereby create and distribute monopoly rents, then the likelihood of deregulation would be inversely proportional to the degree of competition and consumer benefit that deregulation would introduce, given the original distribution of slack and political salience.[10] Airlines were well organized as they sought regulation to greatly reduce competition among themselves, and that the general public (most of which did not fly) was little affected and even less interested. As time went on and airlines responded to regulatory incentives, airlines became even more alike and airline interests became even better organized, and they and their co-participants (lenders, labor unions, small communities and, to a somewhat lesser extent, aircraft manufacturers) made relationship-specific investments that they needed to protect. It was thought that the potential benefits of deregulation would be quite large but would be widely

dispersed among air travelers and conferred on firms not in existence or workers not yet hired.[11] As a result, the public, policy entrepreneurs, and journalists all ignored academic calls for deregulation.

Consequently, when new proposals for airline deregulation emerged in the 1960s virtually no observers applying the economic theory predicted deregulation as the outcome, and the matter was ignored politically for almost a decade.[12] Very few have used the theory even in hindsight to explain what happened.[13] The government adopted a policy that destroyed the value of Civil Aeronautics Board (CAB) certificates (including their value as implicit loan collateral), destroyed the ability to suppress or greatly delay fare competition by concerted action through the CAB, ended a forty-year de facto moratorium on entry by new firms offering scheduled service in dense or long-haul markets, dramatically revised the route network (making some facilities and fleets obsolete), reduced or eliminated the incentive to maintain cross-subsidized service to smaller communities, and exposed to competitive pressure labor contracts that were well above the market in wages and work rules.[14] Why, then, was the industry deregulated?

The Enriched Theory Applied to Deregulation

Since the story of airline deregulation has been recounted at length elsewhere, only the critical details need to be reviewed here.[15] This industry was deregulated owing to the coincidence of several factors: (1) The country was experiencing high inflation, which focused public attention on anything that promised lower prices; (2) Several academic analyses supported deregulation as a policy that would lower prices to benefit the consuming public and so could be translated into something newsworthy for the media and striking for policy entrepreneurs; (3) The political ideology (of the Ford administration) engaged Republicans and jockeying between Jimmy Carter and Edward Kennedy in anticipation of the 1980 presidential election garnered the support of centrist Democrats. (4) Sleazy relationships given unfavorable publicity and an atmosphere of suspicion related to Watergate made many uneasy about widespread direct contact between the regulators and the industry and sensitive to even a whiff of scandal.. Several congressional hearings ensued, along with an explosion of media coverage, and placed the issue on the public agenda, thus dramatically lowering information and organization costs to the consuming public. Hence the issue became politically salient and generally popular, thus eliminating the veil of slack that had protected the industry and its regulators from public scrutiny.

As mentioned, the political competition between Senator Edward Kennedy and Governor Jimmy Carter at this time helped eliminate slack, as did the widely-reported activity and statements of Alfred E. Kahn, chairman of the CAB in the Carter administration. An intellectually powerful, attractive, and mediagenic advocate of deregulation, Kahn had advocated airline deregulation in an academic treatise on the economics of regulation, testified before Congress, lobbied the White House, engaged the industry in debate, and was very accessible to the media. Kahn's charisma was supported by the work of the staff he assembled, which included, in addition to myself (I was in charge of the regulatory staffs, with jurisdiction over rates, routes, and interfirm agreements, domestic and international), Darius Gaskins (an innovative and energetic chief economist, later chairman of the Interstate Commerce Commission), and Philip J. Bakes (congressional staff member turned CAB general counsel), along with the voting and intellectual support of Member Elizabeth E. Bailey, as well as the important other-branch engagement of then-professor and now-justice Stephen Breyer as a Senate staff member and Mary Schuman (now Mary Boies) of the White House domestic policy staff. The often disputatious and always articulate interaction of Kahn, Bailey, Bakes, Gaskins, and Levine was displayed in public on a weekly basis owing to the adoption of "sunshine" rules exposing agency internal decisionmaking processes. What was sometimes called the "greatest regulatory show in Washington" (admittedly not a high bar to surmount) attracted media and industry attention and further contributed to the collapse of slack.

The issue and its proponents became prominent subjects of the print and broadcast media, and the lower fares and new airlines promised by deregulation seemed attractive to the very large segment of the population by then familiar with and attracted to air travel as a result of the widely-publicized introduction of jets. They wished to fly or fly more often but were deterred by the cost of tickets. Airline deregulation generated so much publicity that members of the public almost had to exert effort not to be aware of it or informed about the arguments over it. With the disappearance of slack, the industry came under overwhelming public pressure, to which first President Carter and ultimately Congress responded with the Airline Deregulation Act of 1978 and the International Air Transportation Competition Act of 1980, which deregulated the airlines.

These statutes had a huge financial and structural impact on the industry: Of eleven trunklines (legacy airlines) that existed at the time of airline deregulation, at least three (Braniff, Eastern, and Pan American) were liquidated through asset sales and then bankruptcy. Two or three disappeared less directly: National was absorbed

by and then liquidated with Pan Am, Western was absorbed by Delta, and TWA merged with American and was then almost immediately liquidated. Only five of the eleven—American, Continental, Delta, Northwest, and United—are still flying. Delta and Northwest are now in bankruptcy reorganization. and United has recently emerged from one. Continental has been through bankruptcy reorganization twice, American seems likely ultimately to follow suit, and it is easy to imagine circumstances that will force those that have emerged to go through the process again. Of the ten regional airlines existing at the time of deregulation, two were liquidated, three were formed into a mainline operation (US Airways) that has emerged from bankruptcy reorganization for the second time, three more were first merged then absorbed by Northwest, and another was merged into a trunkline that was then liquidated (Ozark into TWA). Of the Alaskan and Hawaiian airlines, only Alaska has survived without bankruptcy reorganization.

Deregulation generated numerous "poster children"—former intrastate[16] carriers and new startups that grew to a significant size. A few have become major airlines, such as Southwest, JetBlue, Frontier, and AirTran, but most have disappeared without a trace, some after very short lives, including among many Midway, People Express (nominally merged with Continental in bankruptcy), Air Florida, Altair, Pride Air, Air One, and Columbia Air.[17] A few were merged into legacy airlines and absorbed (PSA, New York Air, Air California, Reno Air). America West has been reorganized in bankruptcy twice and continues to struggle, now merged with twice-bankrupt US Airways. Time will tell about a few of the more recent start-up attempts (JetBlue, Frontier, Airtran). Only Southwest has thrived (it is now the fourth largest domestic airline) and endured for any substantial period of time without falling back on the bankruptcy laws or a major financial "workout."

All this bankruptcy reorganization and liquidation, merger activity, and transformation has wreaked havoc on various segments of the industry: creditors have seen their security impaired and unsecured bonds repudiated, shareholders have been wiped out, and, most dramatically, unionized employees have lost all the security, above-market wages and special benefits that they enjoyed under contracts of the regulated era. Tens of thousands of such employees have lost their jobs. Those still on the job remain there at considerable personal cost, especially where their high-paying and work-rule-protected jobs have been replaced by lower-paying and more demanding ones. Some civic interests lost their airline service. Others built facilities to accommodate airlines that ultimately disappeared or reorganized their route network to reduce service to the city, leaving the facilities abandoned and

their operators holding a bag of debt when the airlines repudiated their obligations in bankruptcy. From time to time, "scandals" have erupted over stranded passengers, flight delays, denied boardings, passengers snowbound on aircraft within sight of the terminal, lost baggage, fewer amenities, and all-round poor customer service. Such lapses receive extensive media coverage, which puts pressure on politicians to "do something." High fares in some hub markets and on some business-oriented routes also draw media attention, not to mention creating intense passenger resentment. This in turn generates widely reported political posturing on the part of elected officials and airline executives.

The Enriched Theory Applied to Reregulation

Given this history, why has airline deregulation persisted? Public policies are created at the intersection of interests, institutions, ideology, and information. Even in the formal world of social choice theory, an equilibrium condition chosen from among several core possibilities may be difficult to restore once it has been changed.[18] Policy, too, is difficult to change. It cannot be made instantaneously, without political friction, or without much time and effort. In the case of real-world regulation, the forces at play are not only interests and organization costs but also political institutions that mischaracterize or conceal information and that limit alternatives at any given moment.[19]

However, interests are in a constant state of flux, as people and organizations adapt over time and invest in responses to current policies. Furthermore, ideologies change as theoreticians, politicians, and events interact over time. All policies are created, applied, and changed through political institutions that facilitate some expressions of interest and ideology and suppress or impede others. These may change over time as well, along with the polity's level of information as issues move on and off the public agenda. Finally, to the extent that policy-affecting individuals are independent actors rather than merely role-playing products of the forces around them, changes in the cast of characters can also profoundly affect the outcome of the policy drama.

Why hasn't a coalition of the aggrieved not organized some form of reregulation to protect or restore their rents or quasi rents? The economic theory of regulation would seem at first blush to suggest that airline deregulation should have been stifled by some combination of creditors, civic interests, unions, and other groups inducing legislators or agencies to reregulate the industry, either returning it to the status quo ante or imposing on

it various uneconomic requirements designed to generate or protect economic rents or quasi rents created by regime-specific investments.[20] Yet Congress and the executive branch have by and large resisted and refrained from doing so. The industry has continued to operate with freedom over pricing, routes, and services; over success and failure; and over the use of labor, pension, and bankruptcy laws to rearrange its contractual commitments to employees, aircraft suppliers, and infrastructure providers.

Careful econometric analysis says that airline deregulation has been successful for the most part in that social benefits have vastly exceeded costs.[21] This is clearly an important aspect of the airline story but seems insufficient as a political explanation and certainly is not in itself an explanation under the economic theory of regulation, which predicts the victory of inefficient rent-creating policies over efficient policies that benefit the less organized or less informed.[22] The economic theory explains regulation as a device used to impose inefficiencies that create and transfer monopoly rents. If, after the airline industry became regulated in 1938, it developed solid constituencies that opposed change and then were increasingly discomfited when change occurred, why have they not been able to reorganize to achieve reregulation and minimize or eliminate the costs that deregulation imposed on them? What explains the persistence of deregulation as a public success for many and a concentrated private disaster for a potentially influential few?

First, and perhaps most important, what had been an almost unanimous coalition of perceived industry interests changed over time as new firms entered and old firms adapted in different ways to the pressures of new competition. In 1938, when the Civil Aeronautics Act was passed and again in the 1975–77 period, when deregulation was proposed, the large airlines were unanimous in their preferred policy—regulation by the CAB. This unity ended when United Airlines broke ranks in 1977, although there continued to be widespread, nearly unanimous industry opposition to deregulation until the passage of the Airline Deregulation Act became a certainty in the late summer of 1978.[23] Admittedly, this opposition began to weaken as the CAB took actions that made the board less valuable to certificated incumbents in that they promoted competition and ended protection in regard to both entry and pricing. As one industry official told me after we issued the instituting order in the *Oakland Service Case* proposing to allow service to Oakland by any airline that wanted to offer it: “If this is the sort of thing you intend to do, who needs you?” (To which I answered, “Precisely.”)

Today, there is no longer an "industry position" on most matters of regulation and perhaps no "industry" at all in its historical sense. The airline industry is now a much more heterogeneous collection of firms than it was in 1978. Successful and struggling new entrants have emerged, and what in the way of government policy will protect or destroy quasi rents varies from firm to firm, whether a new entrant or a "legacy" carrier.

Under the deregulated regime, the legacy carriers themselves face widely differing financial and strategic situations and therefore differ greatly in their policy preferences. As noted earlier, almost all have been or are going through bankruptcy reorganization. As a result, they are pursuing diverse new strategies, shedding, modifying, or intensifying various commitments and investments in different ways. In addition to other changes, one or two (Continental and US Airways) have used bankruptcy laws, to drive down labor costs to levels close to those of mature low-cost carriers (or LCCs[24]) like Southwest. Others are still trying to do so. United has tried and failed. Meanwhile, American Airlines is still operating with labor contracts specific to, left over from, or heavily influenced by the regulated era that continue to make its unit costs uncompetitive. Continental and American have legacy fleet and infrastructure commitments that will probably require bankruptcy to reform. Most significant, American, Delta, and Northwest (and Continental, though it first eliminated then reestablished an extensively modified its plan through its two previous bankruptcies) bear the regulatory-era burden of defined-benefit pension plans[25], which LCCs do not have, and these will have to be addressed through bankruptcy or legislation. United and US Airways have already terminated theirs in bankruptcy (repudiated them and turned them over to the PGIC[26]). Others are attempting to "freeze" them (honor old defined benefit obligations but refuse to take on new ones). All are searching for new strategies that will enable them to succeed in competition with LCCs. None has the assurance of continuity that came with a CAB certificate before 1978.

Under these circumstances, government policies that would best promote profit vary widely among airlines. Southwest, which is well financed and has low unit costs, would be perfectly happy to see some of the legacy carriers liquidate and certainly has no interest in preserving the present survival-biased Chapter 11 procedures.[27] JetBlue is in a similar situation. Two others concerned that Chapter 11 is keeping competitors alive, AirTran and Frontier, have complained that legacy airlines such as America West are pricing "below cost" to compete with them. They have demanded government action to limit legacy airline competitive responses to LCC initiatives, which would make it more difficult for the legacy airlines to defend themselves against displacement

by LCCs. Delta and Northwest have not yet shed their defined-benefit pension plans in bankruptcy, as did U.S. Airways and United, but instead achieved legislation that redefines and effectively refinances their funding obligations over a long period of time. The LCCs, United, and US Airways are indifferent or hostile to such remedies, since they no longer need it. American and Continental were at first indifferent, but became conditionally hostile (unless they were included) once the bill passed when it became clear that Delta and Northwest would have more favorable pension obligations than they would They are now struggling to reopen legislation that has already been enacted , without the support of the others.[28] In short, Airlines have championed their own relief needs while opposing those of others.

LCCs have also been unwilling to pay the market price for the "slots" (rights to land or take off) necessary to serve slot-controlled La Guardia and Reagan National airports, alleging that legacy airlines have conspired to keep them from purchasing these slots at "reasonable" prices. LCCs have therefore lobbied for government intervention to make slots available to them. Not surprisingly, legacy airlines have vigorously opposed such action. For them, portfolios of these slots represent important financial and competitive assets, often pledged as loan collateral (some to agencies of the U.S. government!). Southwest, which does not serve these airports, appears not to care. Air Tran and Frontier, which operate hub-and-spoke systems serving New York and Washington, care very much.

These diverging interests and attitudes have a direct impact on the politics of reregulation. The Air Transport Association (ATA), the industry's most powerful trade association, requires unanimity among its members before it can take a position on legislation or regulation. Some of the LCCs (ATA Southwest, and JetBlue) and all the surviving legacy airlines, whatever their condition, are members. Not surprisingly, the Association has seldom reached a consensus on a regulatory issue since deregulation and it is difficult to imagine a regime that would affect pricing, entry, service standards or capacity that it could support. What it has been able to promote are transfers from public treasury funds to the industry such as the $5 billion in compensation for the Federal Aviation Administration's "ground-stop" following the terrorist attacks of September 11, 2001. The Air Transport Association is no longer the effective instrument to promote policy change that it was when it was formed during the Great Depression. This increases organization costs for any proponent of reregulatory policy change.

Municipalities also have evolved from a world in which they simply joined together to lobby the Civil Aeronautics Board for more service. Some municipalities, for example, made relationship- and regime-specific infrastructure investments on the basis of the intentions and success of particular airlines that are now readjusting fleets and route systems and turning to the bankruptcy laws to repudiate contractual obligations for assets they regard as unnecessary. These bankruptcies can leave the municipalities with indebtedness but no corresponding revenues. In extreme cases, airlines are liquidated with real consequences to the city at which they were based or maintained hubs. For example, TWA's *de facto* liquidation cost St. Louis service and jobs.

On the other hand, municipalities are also served by growing and successful new entrants do not want to see those airlines inhibited. Some municipalities are conflicted. The proposed end of legislative limitations on the scope of service from close-in Love Airport has left the Dallas city government torn between its desire to promote low-fare service by Southwest from Love and its dependence on American Airlines' huge hub system at Dallas-Fort Worth International Airport.[29] The net result of all this means that there is seldom anymore one "municipal' or "airport" voice on policies that differentially affect particular airlines.

Customers are not of one mind, either. Some are sorry to see the frequent and convenient legacy-line service disappear, such as that provided by the US Airways hub at Pittsburgh or at Philadelphia, now threatened by new competition from Southwest. On the other hand, some customers at Philadelphia have become fans of Southwest and worry less about the effects of its expansion on US Airways. Similarly, travelers from the Northeast or Midwest to Florida welcome the deregulated free-for-all, while those at Minot, North Dakota, worry about whether and how they will get service if Northwest goes into bankruptcy.

Unions opposed deregulation and served as a focus of efforts to prevent it. They have continued to seek protection from competitive labor markets. In the Airline Deregulation Act of 1978, they were promised public assistance if the number of workers employed in the industry shrank. That assistance never materialized because in fact airline industry employment has grown enormously since 1978. Unfortunately for the unions, the new employees have been largely nonunion workers. Even those who are union members, as at Southwest, are working under contracts and conditions vastly more productive than those at legacy airlines. As a result, the interests of new employees differ greatly from those of the traditional airline unions: with a strong desire to

preserve growth opportunities for their firms, they do not wish either to halt the "deregulation movie" or rewind it to an earlier time.

This has been a problem since the early 1980s for those concerned about competitive freedom, but it has become particularly important in the recent years, with the vast expansion in the LCCs' market share. Most of the first-generation new entrants (such as People Express and New York Air) died or were absorbed in the 1984–87 period. Likewise, most of the second-generation new entrants (Reno Air, Vanguard, and others) died or were absorbed in the 1990–93 period. Although there was a political constituency for low airfares, especially in the leisure segment of the market, there was much less pressure on business-type fares. As a result, by 1994 (after the 1990–93 shakeout), the "industry" market share of LCCs was still only a little more than 7.7 percent of passenger revenue and 13.7 percent of passengers. By 1998 the figures were not much higher: 10.9 percent and 17 percent, respectively. The most important nonlegacy Air Transport Association member initially was rapidly growing Southwest Airlines, which often broke with legacy airlines on policy matters, but by 2002 the association included Airtran, Jetblue, Frontier, and other LCCs. As of this writing, the LCCs have a growing market share of about 30 percent of passenger revenue and 37 percent of passengers, while the legacy airlines have been conspicuously unable to find a fare structure and level that they all find are willing to accept.[30]

All this discord in the absence of "mediagenic" regulatory issues builds slack. The issue of regulation and competition rarely makes the news, let alone the public agenda, with the exception of local interest at hub cities that pay relatively high prices for the abundance of nonstop service they get. Service failures such as lost baggage and late departures and arrivals are covered by the media and occasionally merit government hearings, but those issues have failed to achieve a policy consensus comparable to the academic unanimity on deregulation that prevailed in the mid- to late 1970s.

Perhaps more interesting than any differences on particular issues is the fact that management at the legacy airlines have adapted or been selected to operate without many regulatory constraints and would find it costly to readapt to a regulatory regime (in other words, the management and people inside the major airlines have become a regime-specific interest group separate from shareholders, Even the weak cannot imagine a regulatory regime that could help them much in an era of legacy hub-and-spoke route structures (with mostly common costs in every city-pair market), concomitant price discrimination, and intense pressure from low-cost competitors. No

one thinks it is politically imaginable that the LCCs will be prevented from offering low fares in any foreseeable regulatory regime.

Managements have also made many investments in assets required under deregulation, from facilities to software to fleets. Deregulation has created pressure to exchange large aircraft for smaller ones to serve more fragmented markets, to adapt terminals to serve as hubs for connections, to offer more choices of U.S. gateways for international service. So airlines have built or financially guaranteed terminals and maintenance hangers specifically adapted to these route structures, schedules, and fleet patterns. They also bought fleets of aircraft to fly these routes and use these facilities. And nonairline entities (such as those that locate corporate headquarters and factories) and suppliers (that design and build aircraft and equipment) have invested heavily as well.

Moreover, the proliferation of fares and the freedom to price-discriminate even under competition have stimulated huge investments in revenue-management software and the human capital to operate it.[31] This has forced even new entrants and other LCCs that formerly eschewed them to adopt the strategy and make the investments, although their systems are often simpler and cheaper than those used by legacy airlines. The enormous growth and expansion in scope of the route system under deregulation has created many opportunities for complementary investments in hard assets and human capital, including the location of plants and offices by actors with no other connection to the industry. The development of hub-and-spoke systems to efficiently maximize system scope and of point-to-point airlines to minimize costs on the densest routes has created intense but divergent local constituencies. They have become a very important force for policy conservatism, almost like a spontaneous and uncoordinated version of those in many congressional districts that have won contracts for key defense systems. The current rash of bankruptcies and liquidations is putting some of those investments in jeopardy (an enormous maintenance hanger in Indianapolis built with public funding for United is going for a very good price), but making others even more precious.

Paradoxically, the only voices for reregulation have been some struggling new entrants and a couple of academics. One law professor is in favor of “enlightened” reregulation that would not have the defects of the old regime (what such a structure might look like is not made clear).[32] An emeritus New Dealer thinks that all unregulated competition, especially in infrastructure industries, is “wasteful.”[33]

Some have also charged that deregulation has changed government institutions and bureaucratic

incentives and capability in a way that makes political meddling more difficult. But this is largely illusory. The change in institutions has been subtle compared with the substantive change in regulation. If anything, airline regulators should have become more politically responsive to interest groups, not less. The Civil Aeronautics Board was nominally an "independent agency," constitutionally a "creature of Congress" staffed by civil servants and a few political appointees directed by a small cadre of Congressionally confirmed bipartisan Members serving fixed terms and ultimately operating under "sunshine" rules. The airlines now are regulated (to the extent regulation remains) by several hundred specialist staff members in the Office of the Secretary of Transportation, reporting to a politically-appointed assistant secretary and through the political organization of the department to the secretary and ultimately the president under rules mandating much less process transparency than was imposed on the CAB as an independent agency.

As to the civil servants themselves, about half of the CAB's employees, including virtually all of those working on policy matters, went over to the Department of Transportation (DOT) and became the core of the its airline group. Only now has its composition begun to change significantly, as staff members retire. Even so, many of DOT's senior airline staff still have CAB backgrounds. The policy preferences of that group have not changed much over time. Without constraints from above, they remain enthusiastic about deregulation as long as there is a continuous and obvious flow of visible benefits—an oversupply of aircraft, a proliferation of entrants and declining prices. They become worried about it when the opposite is the case: when the carrier population is in decline, the market is cyclically undersupplied pending new investment, and cyclical demand has turned around (allowing price increases on the reduced supply). While they have lacked the statutory power to reimpose the ancien regime, they retain considerable residual power over conditions of competition and agreements, especially in the international arena, and the important power to distribute valuable operating rights in limited-entry international markets. And from time to time they have expressed considerable interest in making proposals designed to "preserve" the advantages of deregulation by imposing new regulations that will encourage new entrants, keep a lid on pricing, or make the competitive process less "unfairly predatory." Some of these, such as the Computer Reservation System rules, served their intended purpose but persisted despite being rendered obsolete by the Internet. Others, such as the competition conduct rules proposed at the end of the Clinton administration, would have created a regulatory swamp from which deregulation would not have returned alive.

What is different from 1975–84 and earlier is that the department is officially and overtly part of the administration and thus explicitly subject to political and broad policy considerations. Before, the administration and even members of Congress were merely, if they chose to be, a "party" in CAB proceedings, in which their advice was made public. Now the only insulation from the executive branch lies in route awards and other adjudication functions (as defined by the Administrative Procedures Act). This creates slack that could support a coalition for reregulation, but that could also be "consumed" as ideological advertising for the Republican Party, behavior that can be used to appeal to a broad constituency or a Burkean minority. As an example, when the DOT staff started a policy proceeding in 1998 designed to limit incumbent competitive responses to new entry (a matter that might not have gone far in the Levine-Gaskins-Bailey days at the CAB but that was, surprisingly, explicitly supported by its most influential deregulation-era chairman, Alfred E. Kahn, and might have done well at an independent CAB somewhat insulated from administration politics), opposition came from many quarters to which the Republicans are responsive, and the matter was unceremoniously dropped when the Republicans took the presidency in 2001.[34]

In the same way, the CAB, then DOT, and, very publicly, Kahn became concerned about the Reagan administration's unwillingness to use the antitrust law aggressively with respect to mergers and industry structure, although the administration's policies for the deregulated airline industry were entirely consistent with those it pursued in other unregulated sectors. With a lingering attachment to traditional regulatory concerns, the staff appeared naive about the way both competitive airline markets and the new regulatory politics actually work.

First, it did not recognize the economics of scope and density that make it difficult to support more than one airline's hub at a city. Second and perhaps more important, to them competitive markets meant a kind of gentlemanly competition in which losers did not complain because winners did not play rough. This style has never existed in the business world without government enforcement, is widely regarded as protectionist and inefficient, and has disappeared even from modern sports, amateur and professional. In real-world business competition, competitors try to gain as strong a market position as possible and fight competitors wherever and however it seems worthwhile. If competitors disappear, so much the better. They do not observe Marquess of Queensberry rules but limit themselves only to the degree necessary to avoid antitrust prosecution. Antitrust prosecution is limited by law to preventing mergers that would create a monopoly or to thwarting deliberate

attempts by single firms to achieve and maintain a monopoly. Fierce, unkind, and "ungentlemanly" efforts to take business away from competitors are explicitly permitted, even when fatalities occur.[35]

Further, the staff regards price discrimination as evidence of monopoly. But price discrimination is essential to the recovery of common costs in competitive markets[36]. Airline networks, like all networks, incur many costs in common to serve a diversity of customers. It is necessary to aggregate passenger trips in order to put together a group of passengers large enough to fill even the smallest aircraft that can provide service at competitive costs. Individual flights in hub-and-spoke systems carry passengers on many different itineraries, and even in systems that emphasize point-to-point service, flights carry passengers who attach widely varying value to a particular schedule or route.

Once airline pricing was freed from its regulatory straitjacket, price discrimination became pervasive in the system. It was and is necessary for survival in a competitive airline industry. But price discrimination is also a tool that can be used to establish, enforce, and maximize the value of a monopoly. Smaller competitors have complained bitterly as larger, higher-cost airlines have adjusted their mix of fares to keep passengers from defecting to new entrants that introduce lower fares reflecting their lower costs, especially when capacity is increased to accommodate passenger volumes stimulated by the new lower fares. Their cries of "foul" resonate especially strongly in the political arena when the new fares imposed on incumbents are promoted vigorously by them and then abandoned as soon as the new entrant exits the market. They have demanded, and some have proposed, regulatory intervention to prohibit or inhibit this behavior. But efforts to enforce "fair" competition deprive customers of low fares in the here and now; produce many unintended negative consequences when applied to firms whose costs, demands, and competitive alternatives are not and cannot be transparent to regulators without full reregulation; have "chilling" effects on markets; and promote political distortions.

In this world, the choice is never between imperfect markets and perfect regulation, or between imperfect regulation and perfect markets. The choice is between imperfect markets and imperfect regulation. The antitrust laws now reflect this, but the losers are never enthusiastic about the outcomes or the methods used to reach them and can always cite some deficiency in the competitive or regulatory process that has brought them to the sad pass they find themselves in. Accepting that neither markets nor regulation are perfect, the interesting question presented by airline deregulation is why imperfect but freer markets were allowed to continue in the face of

pressure from those significantly disadvantaged by them, and why there was not even more pressure to reimpose regulation, however imperfect.

One factor accounting for the persistence of airline deregulation might be the changes both in received ideology and party alignment since 1980. Coupled with the institutional change, this means that actions undertaken both in the presence and absence of slack are different from those that obtained in the heyday of regulation. Of course, the liberal wing of the Democratic Party can always be counted on to press for regulation insofar as it retains, against all evidence, a sometimes hidden and sometimes overt belief that regulation almost always produces superior results to those achieved in imperfect markets. Also at any given moment, one will find industry, labor, and other political interests lobbying for this or that form of protectionist modification to deregulated competition to cure some impact they are suffering under the existing regime. At the same time, public and political faith in the efficacy of regulation as a way to lower prices or improve service has declined considerably over the past thirty years. The party currently in power is committed to that posture, although it does not always act on its word.[37]

The liberal wing of the Democratic Party has not controlled both the presidency and the Congress since 1968. Since the airline deregulation of the late 1970s, the only Democratic president was a centrist . The Party lost control of the Congress in 1994 and has not regained it since. Airline deregulation was initiated by the Ford administration but achieved by a centrist Democratic president and a Democratic Congress supported by scholars, think tanks, and policy entrepreneurs, many of whom were Democrats themselves. Any urge on the part of Democrats to backslide was kept in check by the need to gain the support of now-dominant Republicans, without much help from scholars, who generally continued to support the policy.

Although the Republican Party has been rhetorically committed to free markets for the period since deregulation, it has certainly demonstrated an ability to create and transfer rents when politics required it.[38] Hence the change in party alignment is not itself a full explanation of deregulation's persistence. Senator John McCain, who identifies himself as a conservative, market-oriented Republican, has nonetheless managed to manipulate policy to favor his Arizona constituents, often at the expense of the general public. As chairman of the Senate Commerce Committee, for example, he carved out an exception to the National Airport perimeter rule so as to allow America West to serve it nonstop from its Phoenix hub, while Delta's Salt Lake City hub and United's

Denver hub continued to be excluded. He also helped to make slots at National available to America West without allowing existing airlines to use them to expand service. As the ultimate transfer, McCain helped persuade the Air Transport Stabilization Board to guarantee $380 million of $450 million in loans to keep America West afloat and then to permit it to use those proceeds to merge with US Airways. The market-oriented solution to each of these issues would have been to eliminate the perimeter rule, continue to permit slot purchases and sales or go to an auction or variable landing-fee system, and to leave America West to the tender mercies of private capital markets.

Ironically, Senator McCain achieved much of this while also appearing responsive to political pressures in the wake of various momentary public-agenda "scandals" related to delays, baggage mishandling, pricing, service failures, and such headline-grabbing incidents as Northwest's inability to get passengers off an aircraft trapped on the ground for six hours in a snowstorm at Detroit. He has done so by holding distracting hearings from time to time and threatening to reregulate the industry in various ways! The industry would respond with promises to do better (which usually brought some political benefit to Senator McCain), and the issues would recede into obscurity again.

I do not mean to single Senator McCain out for obloquy. Most, perhaps all, legislators have from time to time abandoned ideological commitments to do favors for constituents at the expense of the general interest. For example, consider the support by dairy-state Democrats of regulations that raise the price of milk to the urban poor who are nominally an important object of their concern. And the creation of mediagenic but ineffective events to gain publicity is part of every politician's repertoire. Rather, Senator McCain's performance on these issues despite his general track record as an independent legislator highlights the almost universal manipulation of slack by public officials for political ends.

General policy is certainly affected when the party in power changes, but this has not been the sole, or perhaps even most important, factor governing decisions regarding comprehensive reregulation of airlines. After all, there appears to be little or no constituency in the Democratic Party for price and entry regulation, even in the face of the huge decline in rents captured by labor unions. The persistence of deregulation despite its negative impacts on well-organized constituencies is best explained by changes in the amount of slack, perceptions of the

electorate that influence what they will support in the absence of slack, and the nature of the reward structure for regulatory actors.

The Interests Affected

Deregulation succeeded against industry opposition because it was supported by a coalition of assorted interests: consumer groups, academics who were able to provide concrete examples of lower fares with less regulation, , a public disgusted with scandals, charismatic individual spokespersons, and politicians looking for an anti-inflation or pro-free market issue. All these interests excited a media blizzard that lasted for several years. At the moment that deregulation occurred, there is no doubt that much of the electorate was aware of the issue and that most in that group supported the policy. The Levine-Forrence model[39], would explain airline deregulation as a "general interest" policy (a policy that benefited a majority of the polity), was "on the public agenda" (very prominently discussed in the media, so that the public was very well informed about its benefits and followed its fate at very low cost), had easily identified supporters and opponents ("slack" had been greatly diminished), and thus could be opposed only at a public official's peril. Those were the days!

As the old blues song goes, "Everybody wants to go to heaven, but nobody wants to die." Everybody wants competition, but nobody likes competitive markets. Consumer groups wanted deregulation because they wanted more competition and lower prices, but they also wanted the government to prevent price discrimination, to lower prices at hubs, and to police competitive practices. Small communities wanted to benefit from more flights and lower fares but objected to the fact that the expense of serving thin markets would be reflected in deregulated fares, and that more flights meant smaller propeller aircraft would be substituted for larger jets. Recognizing that it could not oppose deregulation successfully, organized labor was mollified for a time by the fact that the airlines at which it had contracts were expanding rapidly, thereby increasing its dues-paying members. Later, labor was not so happy when the expanded union membership found it could not compete with the many new employees working at low-cost, nonunion airlines or under contracts that undercut theirs and thus forced their firms to reduce staff or even go bankrupt.

Aircraft manufacturers and lessors were thrilled by the expansion of the industry, then appalled as their airline customers became tougher purchasers and much worse credits. Big cities were happy with lower fares and

more service but grew uneasy as airlines came and went, often leaving unpaid infrastructure commitments behind them. Cities without hubs found themselves one stop from everywhere but able to fly nonstop only to hubs, which made them unhappy. Those lucky enough to have hubs discovered that they paid higher fares for the abundance of nonstop service than did those who got worse service. Service lapses had occurred before deregulation, but the explosive growth in markets, coupled with the need to control costs to meet fare competition, meant that lapses happened more often and airlines often could not be as generous in dealing with them as in the good old days of regulation.

In short, deregulation generated markets that looked like other real-world, mostly competitive markets, warts and all. Groups that were by general inclination in favor of government intervention on behalf of consumers were as vocal about the lack of regulation as they were in other markets. They blamed the lack of competition, but they really meant that the market had not turned out to provide what they thought it should, or to be as civil and other-directed as they had hoped. Competitors bit, scratched, lied (a little), cheated (occasionally), and sometimes even stole. But that is the way it is out there in the competitive world. The aggregate results were attractive to consumers, but many instances were not. And as consumers consistently showed that they cared more about price than quality, the market gave them what they wanted, whereupon they became nostalgic for the service quality of the good old days (but wanted it at the new prices, of course).

New airlines found the real world frustrating as well. They thought they would be competing against dinosaurs en route to extinction, then discovered the dinosaurs were not down and out but fighting for their lives. Now it looked as though the deregulation that had given them the freedom to compete needed the active supervision of the Department of Transportation.

All this discontent was reported in the press, but there was nowhere near the unanimity of informed opinion that had supported deregulation in the first place as to whether these difficulties reflected serious problems with deregulation or justified a return to the old regime or major intervention. The public remained interested in airlines, perhaps because so many people had flown by then, but many other issues crowded it off the public agenda. When it did surface from time to time—because another bankruptcy had occurred, a hub had been abandoned by a major airline, or people were complaining about a service atrocity or fares—arguments and counterarguments flew back and forth and then the matter receded. Complaining to the DOT was not particularly

helpful, since it had limited power to help. And the problem with complaining to Congress was that when hearings were held, Congress received conflicting advice from apparently respectable and equally politically salient sources.

In fact, the greatest pressure for the government to "do something" and the most frequent instances of oversight tended to arise over the kinds of issues that regulation can be least effective in addressing, such as quality of service and response to service emergencies. More addressable issues such as mergers and monopoly were handled first by the Department of Justice, then transferred to the Department of Transportation, then finally sent back to the Department of Justice, almost never making it onto the public agenda.[40] Even congressional hearings on these subjects were covered largely by the trade press and in the business pages.

To the extent that individuals are thought to make a difference by serving as catalysts for putting issues on the public agenda and reducing slack, the only individual in a position to affect airline regulation during this period who had the media power of an Edward Kennedy, a Gerald Ford or Jimmy Carter, or a Fred Kahn was Senator McCain. Although McCain intermittently looked into securing favorable government treatment for his Arizona constituent America West and into certain consumer issues (some of which, notably nonstop service from National Airport to Phoenix, affected him personally), he had no continuous interest in structural overhaul of the industry and no source of consistent advice as to what that overhaul should consist of.

Thus on the critical dimension of information, the post-deregulation period was quite different from the circumstances of 1975–79. With industry regulation rarely on the public agenda, slack became the normal condition. Views about how to use this slack differed widely among various interests, instead of being divided in a bipolar fashion between a nearly unanimous industry (and its unions) and almost everyone else, as in 1975–79. The industry itself was divided. Consumers were very happy with prices and generally willing to put up in sullen but not mutinous fashion with the service that went with those prices. Competition increased dramatically, if erratically, in the deregulated era. Ideology was more favorable to markets and less favorable to regulation.

Canada: The Other Side of the Coin

Heavily influenced by the widely publicized successes of airline deregulation south of its border, Canada decided to deregulate its airline market in the National Transportation Act of 1987, which entered into law in 1988.[41]

Subsequently, it privatized its national airline, Air Canada, which, with government encouragement, acquired failing Canadian Airlines in December 1999. Unlike the any one airline in the United States, Air Canada emerged as a clearly dominant firm, with a domestic market share measured by seat kilometer[42] (of about 73 percent in 2002, and a domestic market seat share[43] of 64 percent in 2002.[44] Though it experienced strong competition in certain markets from LCCs, especially Westjet, many travelers were dependent on its service, and it vigorously combated efforts to gain footholds in its market. However, its methods generated allegations of predatory pricing.

Whereas such complaints failed to win intervention in the United States, either in court under the antitrust laws or at the DOT, they met with some success in Canada.[45] Rather than press their case in the courts or in the Competition Tribunal under standard predatory pricing provisions, however, those concerned about Air Canada's dominant position and practices petitioned for legislation to restrict airline pricing. Bill C-26, passed in 1996, reimposed a form of regulation on the airline industry, and particularly on Air Canada. Under its terms, the Canadian Transportation Agency is empowered to review prices on monopoly routes and to disallow and roll back any "unreasonable" fares.[46] But the government also took steps to ensure that Air Canada did not set prices too low by creating special provisions in the Competition Act[47] addressing predatory pricing in the airline industry.

What accounts for the different responses in Canada and the United States? First, the industry structure was different. The broad proliferation of business models and firms that emerged and survived in the United States, with multiple examples of each, had no counterpart in Canada. Although several LCC's sprang up and continue to be established, no other airline shared Air Canada's interests, and it chose to lower its costs through a bankruptcy that devolved the airline into a constellation of firms, all owned by Air Canada and each specializing in meeting a particular competitive threat. These firms might have had an interest in different and competing government policies but were of course coordinated in their political program. As a result, most attempts to start new airlines in Canada failed, and Air Canada's singular dominance created relatively low organizing costs for those seeking protection from it. Interests were easily aligned in Canada—fare ceilings protected consumers while fare floors protected competitors (at the expense of consumers), preventing monopoly but restricting competition..

Second, this was an easily understood and appealing news story. Periodic failures plus the constant drumbeat of warning from the only apparently viable low-fare competitor, Westjet, created a David-versus-Goliath scenario for the press, which portrayed Westjet as seeking help in defending the consumer from monopoly dominance. The result was reregulation.[48] Once the reregulation was established statutorily, slack reemerged, allowing Air Canada, with its ongoing contact with the Canadian Transport Agency and large stake in the outcome, to begin special interest lobbying when the political economy returned to "normal." In response, the agency recently proposed to relax its restrictions on Air Canada's pricing.[49]

This effort was helped by policy entrepreneurship. Pointing to evidence that, notwithstanding its problems, airline deregulation has brought benefits and has generated academic support for policy change, Air Canada has been able to persuade the government that its pricing policies should be left to the market. Furthermore, it has urged the government to focus attention on remaining monopolies in airports and other infrastructure that inhibit entry and raise costs (the lion's share of which are, of course, Air Canada's!). In the sense of policy entrepreneurship, then, the Canadian case is not inconsistent with the U.S. case and even appears to support it.

Is This a Testable Story?

One might object that there are a large number of "moving parts" in this explanation and wonder whether it could be empirically tested. It is beyond the scope of this essay to do so, but some appropriate tests can be suggested:

—One could study the news media for the period 1975–78 to measure the frequency, extent, and prominence (reflected by column inches, location on a front page or business page, TV news time, "teaser" status, and so on) of stories that mention the possibility of new regulation or deregulation and compare that period with any four-year period since. One could also consider the number of hearings devoted to deregulation or reregulation, perhaps weighted by congressional importance: Did the reviewing committee have regulatory jurisdiction? Was the hearing chaired by a mediagenic member? The purpose of such exercises would be to determine whether the issue had reached comparable "public agenda" status after deregulation. This would function as a measure of slack.

—If little slack was present, one could study past public opinion polls or conduct surveys to see whether service quality dominated price and schedule as determinants of consumer choice in an effort to measure political salience. This would help to establish whether there was general support for regulation that might improve service quality but reduce competition and raise prices.

—To determine whether political entrepreneurs thought that price and entry regulation would attract general support, one could investigate which government hearings were concerned with reducing slack on issues related to price and entry regulation. To the extent that they were attempts to expose service failures and that the remedies discussed were essentially quality regulations with no restrictions on prices or entry, the hypothesis would tend to be confirmed. If, on the other hand, the hearings focused on ridding the industry of bad actors and installing minimum prices to eliminate cutthroat competition forcing quality cuts, the hypothesis would be disproved.

—Where slack could be found, one could study organized industry-wide attempts to resist deregulation or promote reregulation by the U.S. Air Transport Association. Did the ATA take a position on any regulatory issues after United broke ranks in 1977, for example? If so, were any of the issues on which it took a position related to competition? Evidence of industry unanimity or of ATA testimony in favor of restricting competition would tend to prove the hypothesis false.

—In the presence of slack, one could apply conventional measures of political support such as PAC contributions and congressional representation to see whether any credible coalitions in favor of competition regulation had emerged. If deregulation remained in the face of both slack and a powerful coalition to reregulate, that would prove the hypothesis false.

—By way of a case study, one could examine the most comprehensive attempt to reregulate competition—the DOT's so-called guidelines for competitive behavior proposed in 1998–99 (which failed to be adopted)—to test any conclusions drawn from the foregoing investigations.

Conclusion

Deregulation survived in the airline industry despite drastic changes of fortune that it induced among its participants for reasons related to interests, institutions, ideology, and information. Market forces changed the shape of the industry in ways that were hard to anticipate politically, institutionally, contractually, and financially.

Some new entrants became important to the system and provided more nonstop service to a number of medium-sized cities that had regarded as themselves as neglected. They could do this because they did not focus nonstop service mainly on the relatively few cities that had been the developed as hubs by legacy airlines. All the LCCs tended to operate simpler fleets than those that legacy airlines had been forced to employ to serve diverse routes and to use smaller aircraft than were required by legacy airlines to amortize cockpit labor costs over many seats. LCCs were able to avoid many of the unproductive labor practices and fixed pension obligations that had grown up in the regulated oligopoly.

As firms diverged in character and firms and communities made specific asset commitments on the basis of the deregulated regime, interests too became more diverse. Under the tight oligopoly created by the Civil Aeronautics Board, airline interests had been fairly uniform, with the result that airlines were able to lobby the CAB and Congress for positions that were agreed on in trade associations or were a natural outgrowth of their circumstances. When market forces reshaped the industry, airlines could no longer sustain the contractual commitments to ground facilities, aircraft, labor unions, and other investments and relationships that had grown up under regulation. The resulting financial and political damage forced many to modify or nullify those commitments, often with the aid of the bankruptcy laws.

At the same time, airlines that could adapt to the new circumstances found opportunities for new and expanding business. Since they benefited from deregulation, they were opposed to regulatory responses designed to protect the older relationships and investments. Those that had benefited from firms, practices, and facilities adapted to the regulated era were unable to align their interests with those of the group benefiting from the new market freedom. Even among the latter group, the differences were marked enough to make it difficult to formulate and sustain a specific LCC position on airline issues.

With institutions changed as well, regulatory authorities became more responsive to the administration that happened to be in power. The ideology of the administrations themselves changed during the relevant period, in general becoming more hostile to regulation (if not necessarily to cash wealth transfers). And finally, what had for a time been an issue of pervasive public interest with overwhelming support on one side, became part of the usual political cacophony of recommendation and counter-recommendation, with little eye-grabbing drama to support its presence on the public agenda for any extended period of time. Even airline bankruptcy

reorganizations failed to disrupt service enough to capture the public's attention. All in all, the diversity of interests and the institutional inertia of the status quo have enabled airline deregulation to survive.

Many of the lessons observed here can be generalized. Perhaps the most interesting and important observation is that the existence and nature of regulation reinforces the stability of the regulatory regime in a kind of positive feedback loop. Regulatory regimes tend to emerge from circumstances that put most or all firms in the same boat and reduce their diversity of economic and political interests: persistent industry-wide economic pressures like the Great Depression or shocks to the system like disruptions, catastrophes or scandals. Some of these circumstances reduce slack and some create it, but the resulting alignment of interests makes firms easier to organize and hence more effective in either lobbying the general public or exploiting slack to obtain protective regulation. Once a regulatory regime is put in place, firms adapt to it in order to maximize the benefits to be received from the regulators. In fact, the regulators themselves encourage this process so as to enhance the political stability of the regulated regime. For example, the CAB spent much of its 40 years of regulatory history trying to make the trunklines more like each other by increasing the size of the smaller airlines and favoring them in the award of new routes. But once a change in circumstances creates deregulation, the firms diverge in character and interests as they pursue different strategies and seek different niches in the deregulated market. These different firms are harder to organize and align and the industry loses political coherence and influence. In such circumstances, as in the case of U.S. airlines, the deregulated regime can withstand fragmented or disputed challenges by even very distressed interests.

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1. Joskow and Noll have called this the "normative as positive theory" ("NPT") approach. See P. L. Joskow and R. G. Noll, "Regulation in Theory and Practice: An Overview," in *Studies in Public Regulation*, edited by G. Fromm (Cambridge, Mass.: MIT Press, 1981).

2. Also known as the "public choice" theory of regulation or the "government services" theory of regulation. It is usually distinguished from the "public interest" theory of regulation, which posits that regulation is brought about by public-spirited government actors (legislators or administrators) to serve as a public corrective for inefficiencies or injustices generated by market imperfections or the failure of market outcomes to conform to social norms. The theory is usually attributed to George Stigler. See his "The Theory of Economic Regulation," *Bell Journal of Economics* 2 (Spring 1971): 3–21. For alternate theories of regulation, see R.A. Posner, "Theories of Regulation," *Bell Journal of Economics and Management Science* 5 (Autumn 1974): 338–58.

3. See Sam Peltzman, "The Economic Theory after a Decade of Deregulation" and comments by M. E. Levine and R. G. Noll, M.N. Bailey and Clifford Winston, ed *Brookings Papers on Economic Activity, Microeconomics* (1989).

4. Steven A. Morrison and Clifford Winston, "The Remaining Role for Government Policy in the Deregulated Airline Industry," in *Deregulation of Network Industries*, edited by Sam Peltzman and Clifford Winston (AEI-Brookings Joint Center for Regulatory Studies 2000).

5. Michael E. Levine and Jennifer L. Forrence, "Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis," *Journal of Law, Economics and Organization* (Fall 1990). Vol. 6, Special Issue 1990, pp. 167-198

6. The term "slack" was first introduced into the political economy literature by J.H. Kalt and M. A. Zupan, "Capture and Ideology in the Economic Theory of Politics," *American Economic Review* 74 (June 1984): 279–300.

7. In fact, a general version of the economic theory of regulation makes slack in the political process the normal case and assumes that officials can optimize the amount of slack that they experience. *See* S.P. Magee, W. A. Brock and L. Young, *Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium* (New York: Cambridge University Press, 1989). chap. 18, "Optimal Obfuscation."

8. ***Ibid***.; J. H. Kalt and M. A. Zupan, "Capture and Ideology in the Economic Theory of Politics." An inefficient result might be achieved in the absence of slack when economically efficient rents or quasi rents (that is, locational, scarcity, inframarginal, asset-specific rents) accrue to a relatively small and politically weak subclass or to individual firms outside the electorate determining the careers of the relevant regulators and are destroyed or transferred by inefficient policies to a general electorate. Residential rent control usually operates in this way, especially in jurisdictions like New York City, which have a high percentage of tenant occupiers. And policies designed to disadvantage minorities, women, or "deviant" groups often are supported by the general polity.

9. See for example , C. Haberman, "Beware: Voters Could Sway This Election ," *New York Times*, September 2, 2005.

10. For a reasonable hypothesis, see Lucile Sheppard Keyes, *Federal Control of Entry into Air Transportation* (Harvard University Press, 1951).

11. Michael E. Levine, "Financial Implications of Regulatory Change in the Airline Industry," *Southern California Law Review* 49 (May, 1976): 645–64.

12. Michael E. Levine, "Is Regulation Necessary? California Air Transportation and National Regulatory Policy," *Yale Law Journal* 74 (July, 1965): 1416–47. William A. Jordan, *Airline Regulation in America: Effects and Imperfections* (Baltimore: Johns Hopkins Press, 1970).

13. The most conspicuous exception is Sam Peltzman, "The Economic Theory after a Decade of Deregulation," *Brookings Papers on Economic Activity, Microeconomics* (1989), pp. 1–58.

14. The CAB created no new "trunklines" (combination carriers of passengers and cargo with no categorical restrictions written into their certificates) between May, 1938 (when sixteen airlines were "grandfathered" by the Civil Aeronautics Act of 1938) and 1978, although it did allow limited entry by firms with more specialized roles, such as operating regional, (Hawaii and Alaska) non-scheduled or charter service or had the primary objective of serving smaller markets (although they may have been permitted limited scheduled service in dense markets to cross-subsidize their obligated service in thin ones).

15. See notes 3 and 6. Also, Martha Derthick and Paul J. Quirk, *The Politics of Deregulation* (Brookings, 1985); Stephen Breyer, *Regulation and Its Reform* (Harvard University Press, 1982), pp. 197–221; and Barbara Sturken Peterson and James Glab, *Rapid Descent: Deregulation and the Shakeout in the Airlines* (New York: Simon & Schuster, 1994).

[16] Federal economic regulatory jurisdiction extended only to airlines operating across state lines. Safety jurisdiction was plenary.

17. I have neglected to mention any number of smaller start-ups or the many financial reorganizations and changes in morphology of others. See, for example, T. A. Heppenheimer, *Turbulent Skies: The History of Commercial Aviation* (New York: John Wiley & Sons, 1995).

18. See A. Schwartz: "Statutory Interpretation, Capture and Tort Law: The Regulatory Compliance Defense," A*merican Law and Economics Review* 2 (Spring 2000): 26.

19. McGee and others, *Black Hole Tariffs*, chap. 18; K.A.Shepsle and B.R. Weingast "Structure-Induced Equilibrium and Legislative Choice" *Public Choice* 37 (June 1981): 503.

20. O E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985; **David** Besanko, David Dranove, and Mark Shanley, *The Economics of Strategy*, 3rd ed. (New York, John Wiley & Sons 2003), pp. 128–32.

21. Steven A. Morrison and Clifford Winston, *The Evolution of the Airline Industry* (Brookings, 1995), pp. 6–7; see also note 3.

22. An odd version of the economic theory was proposed by Gary Becker, "Comment," *Journal of Law and Economics* 19 (August, 1976): 245–48. According to Becker, the deadweight loss from inefficient regulation creates pressure for structures that dissipate less value, so that more benefits can be distributed to organized constituencies. Thus inefficient regulation is replaced by more efficient measures in a continuing process, of which airline deregulation is an example. Of course, this Panglossian version of regulatory theory does not explain how inefficient regulation arises in the first place or why all inefficient regulation does not ultimately wither away, to be replaced by an efficient regime, a manifestly false prediction.

23. Although it had initially joined in the regulated airline industry's opposition to deregulation, United, then the largest U.S. domestic airline, concluded in 1977 that network size mattered competitively, that its size meant that it was unlikely to get many new route awards in competitive proceedings (the CAB had a tendency to promote industry competitive "balance" through its route awards), and therefore that it could accept competition if deregulation would also confer route entry freedom.

24. Airlines that have entered or risen to prominence since deregulation have come to be called LCCs.

[25] Pension plans that guarantee a fixed monthly payment on retirement that is a function of length of service and previous compensation.

[26] Pension Guarantee Insurance Corporation, a government entity

27. See especially the provisions that give a six-month exclusivity to existing management to put together a financial reorganization plan, usually extended many times to achieve a period as long as several years. At this writing, United management's exclusivity has been extended for more than three years. This produces rents for labor and particularly management that keep operating under some vestige of the nonviable arrangements while being protected from creditors, who are very much losers in the circumstances. Effective October 17, 2005, the law was changed to limit the exclusivity period to eighteen months. 11 U.S.C. 1121(d)(1), (2) (2005).

[28] H.R. 4 Pension Protection Act of 2006., See *Aviation Daily***,** October 11, 2006, item 6

[29] This dispute has been "settled" between American, Southwest and Dallas by agreeing to grant Southwest a *de facto* monopoly on expanded service from Love Field, tempered only by two gates (out of 20)assigned to American and two to Continental) U.S. House Committee on Transportation and Infrastructure Press Release 2006/103 Wright Amendment Reform Act HR 5830, 2006. American and Southwest, of course, have a concentrated common interest in keeping competitors out of the "neighborhood" at the expense of Dallas Metroplex consumers and were able to engage a Senator (Hutchison of Texas) to represent their local interests in a Congress with bigger fish to fry, a classic example of a local regulation that followed the economic theory in its enriched or original versions.

30. See, for example, Keith L. Alexander, "American Fare Cuts Presage Price War; Discounts Up to 85% on Florida Flights," *Washington Post*, November 19, 2004, p. E01.

31. Michael E. Levine, "Price Discrimination without Market Power," *Yale Journal on Regulation* 19 (Winter,2002): 1.

32. P. S. Dempsey and A. R. Goetz, "Regulatory Failure as Catalysts for Political Change: The Choice between Imperfect Regulation and Imperfect Competition," *Washington and Lee Law Review* 46 (Winter 1989): 1–40.

33. F. C. Thayer, *Rebuilding America, The Case for Economic Regulation* Praeger Publishers, 1984; F.C Thayer "Airline Regulation: The Case for a 'Public Utility' Approach," *Logistics and Transportation Review* (Vancouver) 18 (September, 1982): 211–35.

34. 63 Fed. Reg. 17, 919-22 (April 10, 1998).

35. *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Matsushita Elec. Industrial Co.* v. *Zenith Radio*, 475 U.S. 574 (1986).

[36] M.E. Levine, *supra* n. 28

37. Jonathan Weisman and Jim VandeHei, "Road Bill Reflects the Power of Pork, White House Drops Effort to Rein in Hill," *Washington Post*, August 11, 2005. p.A1

38. See, for example, John J. Fialka, "White House Expresses Concern over Cost of Senate Energy Bill," *Wall Street Journal*, June 15, 2005, p. A4; "The Ethanol Party," Editorial, *Wall Street Journal*, May 26, 2005, p. A12; James A. Barnes, "Beating the Bushes for Earmarks," *National Journal*, February 10, 2001, p. 415.

[39] M.E. Levine and J.L. Forrence, Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis" Jennifer *Journal of Law, Economics and Organization*, Fall, 1990. pp..

40. Except for a few specific issues, such as the grant of antitrust immunity for agreements between airlines in international service.

41. R.S. 1985, c. 28 (3rd Supp.) For many of the facts and most of the references in this section, I am indebted to Edward Iacobucci, Michael Trebilcock, and Ralph A. Winter "The Political Economy of Deregulation in Canada," in this volume. The analysis and interpretive conclusions are my own, and those authors are in no way responsible for them.

[42] One passenger carried one kilometer, the standard metric measure of business volume.

[43] The number of seats installed in its fleet, a measure of capacity.

44. Debra Ward, independent transition observer on airline restructuring, *Airline Restructuring in Canada: Final Report* (September 2002), p. 76.

45. *U.S.* v. *AMR Corp*, 335 F.3d 1109 (10th Cir. 2003), *aff'g* 140 F. Supp. 2d 1141 (D. Kan. 2001).

46. An Act Respecting the Oceans of Canada 1996, C. 31 (Bill C-26) (assented to December 18, 1996, ACT).

[47] *Competition Act*. R.S., 1985, c. C-34, s. 1; R.S., 1985, c. 19 (2nd Supp.), s. 19. secs. 78,79

48. See Edward Iacobucci, "Public Choice Theory and Recent Developments in Canadian Competition Policy," in *Selected Topics in Corporate Litigation* (Kingston, Ont.: Queen's Annual Business Law Symposium, 2000/ 2001).

49. The Canada Transportation Act Review Panel, *Vision and Balance* (Ottawa, June 2001), recommended the elimination of this provision. In addition, the government has proposed changing course by eliminating all airline-specific provisions in the Competition Act. *See* Minister of Industry, "Minister of Industry Tables Amendments to Strengthen Competition Act," press release, November 2, 2004.