A Thinking Person's Guide to Entry/Exit Deregulation in the Airline Industry

STEVEN C. DUPRÉ*

Federal economic regulation touches virtually every industry in the United States.[1] Advocates of free enterprise have challenged vigorously every governmental attempt to expand the scope of its control over economic activity causing a never ending controversy over the efficacy and, indeed, the propriety of regulation.[2] Among the most controversial

* Attorney, Levy and Erens, Chicago; J.D., Northwestern University, 1977.

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1. Every rule of law, whether promulgated by the legislative, judicial, or executive branch of government has an economic effect which arguably could bring it within the definition of "economic regulation." However, for the purposes of this article, "economic regulation" refers to the type of law which seeks to impose direct controls on a particular aspect of economic activity. *See* Shenefield, *Regulation and Deregulation—Where Do We Stand*, 45 ANTITRUST L.J. 244. 245 n.2 (1976) (for a consistent, albeit more limited definition). This regulation comes in myriad forms, ranging from general to specific applicability. Examples of the former include minimum wage laws and securities laws. Regulation of specific applicability includes that of rail, highway, and interstate gas transportation.

"An industry may be regulated for a variety of economic and noneconomic reasons, but, basically, regulation is applied when it is felt that private enterprise cannot be relied on to provide adequate service at a reasonable price." C. PHILLIPS, THE ECONOMICS OF REGULATION 44 (1965) [hereinafter cited as PHILLIPS]. This concern is reflected in the regulation of the airline industry. 49 U.S.C. § 1302(c) (1970). *See* test accompanying note 27 *infra*.

2. The efficacy of economic regulation is challenged whenever it is thought that regulation cannot achieve the desired results which initially prompted regulation. Such a challenge might have been levied at the minimum price regulation of milk which, although state and not

regulatory legislation was the Civil Aeronautics Act of 1938 (CAA).[3]

The enactment of the CAA came at a time when the commercial airline industry was still in its infancy.[4] The value of a comprehensive national air transport system was readily apparent.[5] Impatient to realize this value,[6] Congress responded to a perceived inability of the competitive market system to create such a transportation system.[7] The Civil Aeronautics Board (CAB) became the tool for implementing the regulatory scheme that Congress had created to replace the free market. The purpose of this scheme was to build a transport system better suited to the public interest than the existing system.

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federal regulation, resulted in one of the most significant pro-regulatory decisions of the United States Supreme Court. Nebbia v. New York, 291 U.S. 502 (1934). The purpose of that regulation was to protect producers and distributors of milk from destructive competition. It was feared that a "failure of producers to receive a reasonable return for their labor and investment over an extended period [would] threaten a relaxation of vigilance against contamination." *Id.* at 517. Such contamination was seen as contrary to maintenance of public health. The effect of setting milk prices higher than would have existed in the absence of regulation was to lower market demand for the large surplus of milk held by milk producers. By lowering demand, some producers were undoubtedly unable to recover even part of their costs of producing milk, and were thereby injured by regulation which was designed to protect them.

The propriety of regulation refers to the philosophical justification of economic regulation in a free society. At the very least, the efficacy of regulation must be demonstrated and not assumed in order to be justified. However, such a demonstration will only justify regulation to those who challenge its propriety if the alternatives to regulation are shown to infringe upon individual freedom. One of the most articulate attacks on such regulation can be found in F HAYEK, THE ROAD TO SERFDOM (1944) (the author argued that the steady imposition of government control through economic regulation is a course of action which, if not reversed, leads to a totalitarian state in which individual freedom is completely eliminated). *See also* M. FRIEDMAN, CAPITALISM AND FREEDOM (1962); 122 CONG. REC. H4389 (daily ed. May 13, 1976) (President Ford extolled the virtues of deregulation as preventing unnecessary infringement on individual choice). While the author does indeed challenge the propriety of most economic regulation, the details of that challenge are beyond the scope of this article.

3. Ch. 601, 52 Stat. 973 (1938).

4. In the seventeen years following the enactment of the CAA, industry revenues increased 4000 percent. Maclay & Burt, *Entry of New Carriers into Domestic Trunkline Air Transportation*, 22 J. AIR L. & COM. 131, 147 (1955) [hereinafter cited as Maclay & Burt].

5. 83 CONG. REC. 6635 (1938) (recognizing the value of air transportation and the need for regulation to help it develop).

6. As one commentator put it, the lack of growth "was attributed largely to the failure of the Federal Government up to that time to provide the machinery to encourage and regulate the use of aircraft in commerce." Hester, *The Civil Aeronautics Act of 1938*, 9 J. AIR L. 451 (1938).

7. It was felt that unimpeded competition among the air carriers "tend[ed] to jeopardize and render unsafe a transportation service appropriate to the needs of commerce and required in the public interest. . . ." S. REP. NO. 1661, 75th Cong., 3d Sess. 2 (1938). *See also* 83 CONG. REC. 6627 (1938) (Sen. Copeland characterized the aviation situation as chaotic and sought devices for protecting routes); *id.* at 6635 (Sen. McCarran felt that air transport could have a healthy development only if the competitive bidding process for awarding routes was replaced by a system which awarded routes to those who were best qualified to operate economically

The system that developed under the guidance of the CAB constitutes the most "comprehensive air transportation network in the world."[8] Thousands of communities have access to commercial flights which can transport people to distant points around the globe.[9] Nevertheless, the entire regulatory scheme enveloping the airline industry has been the subject of considerable criticism. Critics have challenged the underlying economic premises which precipitated the original legislation. Economists are surprisingly unanimous in the belief that the present regulatory scheme has resulted in a less efficient, more expensive mode of transportation than could exist without that scheme. While these economists may disagree with respect to the correct form that any changes should take,[10] regulatory change in the direction of greater reliance on competition seems inevitable.[11]

This article seeks to formulate an objective framework for analyzing the issue of deregulation. Although it focuses on aspects of the regulatory system that govern entry and exit, the analysis should be adaptable to other contexts as well.[12] The suggested framework is designed to be

and safely); Gorrell, *Rationalization of Air Transport*, 9 J. AIR L. 41, 42 (1938) (articulating a fear that unregulated competition would result in rate wars and safety deterioration).

8. *Oversight of Civil Aeronautics Board Practices and Procedures: Hearings Before the Subcomm. on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. 115 (1975) (prepared statement of Dr. George W. James) [hereinafter cited as *CAB Hearings*].

9. The Air Transport Association of America estimated that 58,000 domestic city-pairs received passenger service from the airlines. *CAB Hearings, id*. at 136 (exhibit 8). While direct non-stop service is not provided between every city receiving passenger service and every other city, one can get indirect service between such cities through connecting flights. For an example of this phenomenon, *see CAB Hearings, id*. at 122-23.

10. Some would seek to correct the mistakes perceived in the existing scheme by augmenting that scheme. *See, e.g.*, W. JORDAN, AIRLINE REGULATION IN AMERICA EFFECTS AND IMPERFECTIONS 229 (1970) [hereinafter cited as JORDAN; Jordan, *If We're Going to Regulate the Airlines, Let's Do It Right*, in PERSPECTIVES ON FEDERAL TRANSPORTATION POLICY 57, 64 (J. Miller III ed. 1975) [hereinafter cited as PERSPECTIVES]; D. LEISTER, THE HISTORICAL DEVELOPMENT AND SELECTED APPLICATION OF CRITERIA UNDER TITLE IV, SECTION 401, OF THE FEDERAL AVIATION ACT OF 1958 151 (1972) [hereinafter cited as LEISTER]. Others favor complete abandonment of regulation.

11. In the past two years, a number of legislative proposals which would change the present regulatory scheme governing the airline industry have been introduced into Congress. *See* text accompanying notes 162-176 *infra*. Significantly, the CAB itself authored one of these proposals. *See* note 163 *infra*. This suggests that even if no legislative proposal is enacted, the CAB will alter its policy to reflect present congressional concern. In doing so, it will lean more towards reliance on competitive market forces to accomplish the goals of airline regulation and less on its regulatory powers. Indeed, the CAB has already liberalized charter restrictions, and further liberalization which increases reliance on competition is likely. Altschul, *Friendlier Elements: For Airlines the Political and Financial Skies are Clearing*, Barrons, May 16, 1977, at 9, 24.

12. For instance, such an analysis might prove helpful in testing the continued viability of interstate trucking regulation.

"policy-neutral" so that any desired policy objectives of economic regulation may be tested under such an analysis. In particular, such an analysis should prove helpful in analyzing the viability of CAB fare deregulation.[13]

At the outset, the existing regulatory structure is outlined. The first step in the analysis identifies the public policy goals generally posited in justification of regulation of airlines, and the specific objectives sought by entry/exit regulation. The economic premises underlying these goals are then identified and examined for validity. The basic question asked is this: "Is regulation the most efficient method[14] to attain the objectives sought by that regulation?" If the answer is in the affirmative, then the specific type of regulation must be examined in the process of maximizing the desired goals. If, on the other hand, the answer is in the negative, then alternative methods for deregulating the entry/exit aspects of the industry must be examined.

THE REGULATORY SCHEME

The primary regulatory mechanisms that Congress gave the CAB to deal with the problems that precipitated regulation were control over fares[15] and control of the entry/exit aspects of the industry.[16] This article

13. Although this article does not analyze that issue, much of the research done in preparation of this paper suggests that the premises of fare regulation contain the same fallacies that exist in entry/exit regulation.

14. Efficient allocation and utilization of natural resources arguably constitutes a common "goal" in both a regulated and an unregulated economy. To the extent that particular "goals" exist in an unregulated economy, this common goal is helpful in searching for the optimum form of individual coexistence and the proper balance of governmental control with individual freedom. Presumably, if society accepts the goal and knows which of the opposing economic structures (pervasive administrative regulation versus basic reliance on market forces) is best suited for attaining that goal, then the determination of the proper regulatory structure will be a simple one. The fallacy in this argument is, of course, that society can accept a particular goal and, indeed, that such a common goal can be found. *See* text at note 56 *infra*.

15. The current statutory authority for airline fare control is found in the Federal Aviation Act. Air carriers are required to establish "just and reasonable individual and joint rates, fares, and charges . . . ." 49 U.S.C. § 1374(a)(1) (1970). CAB regulations are more detailed with respect to what a carrier may consider in establishing rates. *See* 14 C.F.R. §§ 221.1-250, 399.30-.44. Furthermore, the Board is authorized to prescribe rates whenever it is "of the opinion" that rates are or will be "unjust or unreasonable." 49 U.S.C. § 1482(d) (1970).

The author recognizes that regulation of fares is inextricably intertwined with control over entry. New entrants must be able to offer consumers the tangible benefits of equivalent service at lower prices, in order to induce consumers to switch affiliations from less efficient established carriers. "Without rate flexibility . . . freedom of entry [and exit] would simply increase the level of excess capacity without producing lower prices." SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE COMM. ON THE JUDICIARY, 94th CONG., 1st Sess., *Report on Civil Aeronautics Board Practices and Procedures* 97 (Comm. Print 1975) [hereinafter cited as *Comm. Print*]. Because of the interdependence of price and entry, it may be difficult to realize the full advantages of competition if only one of these controls is deregulated.

16. The present statutory authority for entry control can be found at 49 U.S.C. § 1371(a) (1970). Exit control can be found at *id*. § 1371(j).

deals only with the latter.[17] With respect to entry/exit, the substantive statutory requirements for operation of an airline seem quite simple. As stated at present in the statute: "No air carrier shall engage in any air transportation unless there is in force a certificate issued by the Board authorizing such carrier to engage in such transportation."[18] To qualify for such a certificate, an applicant must be "fit, willing, and able to perform such transportation properly,"[19] and the proposed transportation must be "required by the public convenience and necessity . . . ."[20] Once such a certificate is awarded, the certified carrier has a statutory duty to provide "reasonable through service . . . in connection with other air carriers,"[21] and no certified route may be abandoned "unless . . . the Board shall find such abandonment to be in the public interest."[22]

The apparent simplicity disappears upon examination of the procedural steps for obtaining a certificate. A written application containing information and proof required by Board regulation[23] must be submitted to the Board.[24] One need only examine the records in CAB route decisions to ascertain the complexity of the route application procedure.[25] The Board is required to set the application for public hearing and to "dispose of such application as speedily as possible."[26]

THE GOALS OF AIRLINE REGULATION

The Act's declaration of policy articulates Congress' express purposes for enacting the CAA and defines the "public convenience and necessity":

> In the exercise and performance of its powers and duties under this chapter, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:
>
> (a) The encouragement and development of an air-transportation sys-

17. *See* note 15 *supra*.

18. 49 U.S.C. § 1371(a) (1970).

19. *Id.* at § 1371(d)(1).

20. *Id.* Some of the apparent simplicity disappears upon an examination of the statutory definition of "public convenience and necessity." *See* text accompanying note 27 *infra*.

21. *Id.* at § 1374(a).

22. *Id.* at § 1371(j). The Board can make such a finding only upon application of the air carrier, after notice and a hearing.

23. The primary informational requirements may be found in 14 C.F.R. § 201.4 (1977).

24. 49 U.S.C. § 1371(b) (1970).

25. *See, e.g.*, New York-Florida Case, 24 C.A.B. 94-234 (1956); Denver Service Case, 22 C.A.B. 1178-315 (1955).

26. 49 U.S.C. § 1371(c) (1970). In view of the recent "route moratorium" in which the Board failed to set route applications for hearings, *see* text at note 38 *infra*, it is questionable whether the Board has complied with this mandate in all instances.

tem properly adapted to the present and future needs of the foreign and domestic commerce . . .
(b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, . . . and coordinate transportation by, air carriers;
(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without . . . unfair or destructive competitive practices;
(d) Competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce . . .
(e) The promotion of safety in air commerce; and
(f) The promotion, encouragement and development of civil aeronautics.[27]

The task of seeking the proper balance of these various considerations was left initially and primarily to the Civil Aeronautics Board. The only limitation on the CAB's power to interpret the statute is the limited judicial review available under the act.[28]

While Congress perhaps can be characterized as benevolent for articulating its general goals in regulating the airline industry, a close examination of those goals reveals the seeds of future controversy. Specifically, which of these potentially contradictory goals should be subordinated and which should be maximized, and in what circumstances should these priorities change?[29] Standards for setting priorities among these goals are not even hinted at in the statute. Thus, as could have been expected, implementation of this contradictory statutory language has brought about results that were feared explicitly by opponents of the original legislation. Certain members of Congress feared that, in exercising its authority, the regulators would effectively eliminate entrepreneurial ingenuity by preventing new firms from entering the industry.[30] The Act's "grandfather clause" automatically granted the requi-

27. 49 U.S.C. § 1302 (1970).

28. Any order of the Board is reviewable by the United States Circuit Courts of Appeals. 49 U.S.C. § 1486(a) (1970). However, findings of fact by the Board are conclusive if supported by substantial evidence. *Id.* at § 1486. In view of the vast discretion granted to administrative agencies by Congress, it is likely that the CAB's broad discretionary power was not a congressional oversight.

29. *See* R. CAVES, AIR TRANSPORT AND ITS REGULATORS: AN INDUSTRY STUDY 127 (1962) [hereinafter cited as CAVES]. "These are multiple objectives . . . with inconsistent optimization levels—i.e., optimization of the whole *cannot* be achieved through optimization of the separate parts. Therefore, the regulators must select a priority of goals which would take precedence over other goals." LEISTER, *supra* note 10, at 51-52.

30. Time and again in the debates over the Civil Aeronautics Act one can find reference to a fear that certificates of public convenience and necessity would be used to preclude pioneers in aviation from entering the industry. *See* 83 CONG. REC. 6729, 6851-52 (1938) (remarks of Sens. McCarran, King, Crowley, and Truman); *Comm. Print, supra* note 15, at 81-82.

site certificates to the existing air carriers, thereby conclusively presuming that the public convenience and necessity required the existing carriers to continue operations.[31] Critics of this legislation were mollified only by continued assurances of the legislation's proponents that complete preclusion of new entry would be an abuse of authority. "The legislative history of the 1938 Act reveals clearly that the intent of Congress was not to close entry . . . ."[32] It was felt that administrators of this legislation could be trusted not to contravene so blatantly the Congressional intent of keeping the industry open to new entrants.[33]

Unfortunately the fears of these critics have been realized. "Since its inception, the Board has authorized no 'long haul' or 'trunkline'[34] scheduled domestic passenger service by any new air-transport company (i.e., any company that did not originally qualify for certification under the grandfather clause) . . . ."[35] While new entry into established trunkline route segments has been permitted, the grandfather carriers constituted the sole beneficiaries of these route awards.[36] Although new carriers have obtained certificates to operate regionally, none of these has been permitted to expand its regional operations into the trunkline markets.[37] Whenever additional trunkline service was thought necessary, the routes were awarded to the grandfather trunkline carriers. In fact, the original group of grandfather carriers has dwindled to the ten trunkline carriers that are left today. Clearly, this has not been the result of a willful abuse of discretion on the part of the certificating authority. The CAB has never

31. Pub. L. ch. 601, § 401(e)(1), 52 Stat. 988 (1938).

32. *Comm. Print*, *supra* note 15, at 253 (appendix B); Maclay and Burt, *supra* note 4, at 137-38.

33. *See* note 30 *supra*.

34. In 1965, the "airlines were classified into four groups: 11 trunk, 13 local service, 3 all-cargo, and 13 supplemental carriers." JORDAN, *supra* note 10, at 14, *citing* CAB, *Air Carrier Analytical Charts and Summaries VII-4*, 19, 31, 32 (Dec. 31, 1965).

35. L. KEYES, FEDERAL CONTROL OF ENTRY INTO AIR TRANSPORTATION 170 (1951) (footnote added) [hereinafter cited as KEYES]. Eastern Airlines, Inc., Great Lakes to Florida Service, 6 C.A.B. 429 (1945) (application of State Airlines, Inc. denied); Colonial Airlines, Inc., Atlantic Seaboard Operation, 4 C.A.B. 552 (1944) (application of Seaboard Airways, Inc. denied); Trans Southern Airlines, Inc., Certificate of Public Convenience and Necessity, 2 C.A.B. 250 (1940) (application of Trans Southern Airlines denied). Douglas and Miller cite a more recent example as Motion of World Airways, Inc. for Expedited Hearing, CAB Docket No. 18468 (Oct. 9, 1967). G. DOUGLAS AND J. MILLER, ECONOMIC REGULATION OF DOMESTIC AIR TRANSPORT: THEORY AND POLICY 113 n.9 (1974) [hereinafter cited as DOUGLAS & MILLER]. *Accord* CAVES, *supra* note 29, at 169; JORDAN, *supra* note 10, at 15-16.

36. Maclay and Burt, *supra* note 4, at 132. Originally, 16 carriers were certificated. Those carriers that left the market all did so via merger with other carriers. JORDAN, *supra* note 10, at 15 n.6, 23.

37. *See, e.g.*, Chicago-Milwaukee-Twin Cities Case, 29 C.A.B. 901 (1959) (North Central's application to provide nonstop service in the pertinent markets was denied in favor of trunkline carriers).

adopted an explicit policy precluding all new entry.[38] Rather, it is the result of a plausible interpretation[39] of the elusive concept "public convenience and necessity."

Turning from these general congressional policy goals to the more specific economic objectives sought by entry/exit regulation, it is useful to ascertain why industry spokesmen and other commentators are concerned with deregulation. These concerns have been summarized recently by the Senate Subcommittee on Administrative Practice and Procedure.[40] One concern is that unregulated competition would foster monopolistic practices by enabling predatory pricing by the large existing carriers.[41] The fear here is that large airlines such as United would reduce prices below their costs, "thereby driving other carriers from these markets."[42] Another concern suggests that an unregulated market would result in wasteful or destructive competition.[43] The more plausible theory[44] of destructive competition finds its basis in the "cyclical nature"

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38. Arguably, such a policy was in fact adopted between 1969 and 1975 through what has come to be known as the "route moratorium." This was an informal policy articulated only through speeches made by several Chairmen of the CAB and enforced through tacit adherence to this "policy" by CAB staff. These speeches are unavailable. The propriety of adopting such a policy is discussed at length in *Comm. Print, supra* note 15, at 84-87.

39. The contradictory nature of the various objectives creates a broad range of interpretation within which the CAB can reasonably justify its decisions. For instance, while the CAB must promote competition "to the extent possible," it may very reasonably decide that competition will impair the achievement of other goals which it perceives as more important, such as the promotion of "adequate" service. Thus, virtually any decision that operates to the detriment of competition is legitimate if it promotes a different objective. *See generally* H. FRIENDLY, THE FEDERAL ADMINISTRATIVE AGENCIES: THE NEED FOR BETTER DEFINITION OF STANDARDS 74-105 (1962) [hereinafter cited as FRIENDLY].

40. *See Comm. Print, supra* note 15, at 58-76.

41. *Id.* at 58-59.

42. *Id.* at 58, *citing CAB Hearings, supra* note 8, at 585 (prepared statement of Harry Wexler, senior vice president, Continental Airline). For a more detailed analysis of predatory pricing behavior, *see* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 273-78 (1970); Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 HARV. L. REV. 869 (1976); Areeda & Turner, *Scherer on Predatory Pricing: A Reply*, 89 HARV. L. REV. 891 (1976); Scherer, *Some Last Words on Predatory Pricing*, 89 HARV. L. REV. 901 (1976) (the respective authors debate their theories on the proper antitrust approach to predatory pricing); Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975) (the article which triggered the debate between Scherer, and Areeda and Turner noted above).

43. *Comm. Print, supra* note 15, at 60. "Cutthroat competition may occur when investment in plant and equipment is large, fixed, and specialized and when competing firms have unused capacity." PHILLIPS, *supra* note 1, at 40.

44. The other suggests that competition will cause all airlines to reduce all prices to variable costs, thereby precluding any recovery of fixed costs. *Comm. Print, supra* note 15, at 60.

> Any one or a combination of a number of results may follow from such severe competition. One possibility is continuance of the low rates so long that bankruptcy may occur. However, long before this will occur, the service offered by the firms will

of the airline industry.[45] In periods of low demand, competition to fill excess capacity would result in "lowering prices to variable costs."[46] An inability to meet fixed costs "would lead [the airlines] to ground, lease or sell aircraft, suspend operations . . . and lay off employees."[47] The costs of increasing service once demand began to climb again are thus characterized as wasteful.[48]

Another concern voiced by industry representatives is a fear of reduced service to small communities. The argument generally divides into two theories: loss of the "cross subsidy" and "cream skimming."[49] The former theory comes from the notion that excess profits are earned by trunkline carriers on some routes and are used to cover costs on unprofitable routes.[50] Competition on the profitable routes would reduce profits and eliminate the ability to subsidize unprofitable routes. The cream skimming argument resembles the cross subsidy argument because it is feared that new competitors will operate only in the more profitable routes, and will drive down revenues earned in those markets.[51] This reduction will result in an inability to cover total overhead costs on marginally profitable routes, ultimately requiring a shrinking of the air transport system. Tied to this fear is the concern that competition will destroy the complex national airline network.[52] The final concern is that competition will cause lower profits, resulting in the deterioration of safety and the inability to finance new aircraft.[53]

From these concerns emerge a number of economic objectives which are sought by those who would continue entry/exit regulation. *First*, advocates of continued regulation seek to maintain a comprehensive network of airline service to small communities as an element of the national air transport system. *Second*, regulatory advocates seek to maximize safety of the airlines. *Third*, they seek to take advantage of certain market structure characteristics perceived to exist in the airline industry, such as economies of scale derived from full utilization of facilities and operations involving high fixed costs. Consumers would

suffer. Adequate outlays cannot be made for improvements. Maintenance will be neglected. Finally, it is likely, and this is substantiated by past experience, that the competitors will take steps to reduce the severity of rate competition.

PHILLIPS, *supra* note 1, at 41.

45. *Comm. Print*, *supra* note 15, at 60.
46. *Id*.
47. *Id*.
48. *Id*.
49. *Id*. at 63-70.
50. *Id*. at 63-68.
51. *Id*. at 69-70.
52. *Id*. at 71-73.
53. *Id*. at 73-74.

thereby receive the benefits normally thought to accrue from public utility regulation.[54] *Finally*, continuously improving airline technology is sought through regulation.[55]

Arguably, at least, all of these objectives are laudable. All reflect a policy to benefit the consumer by acting as solutions to problems that are thought to exist in the unregulated arena.[56] However, before those objectives are sought actively through regulatory mechanisms available to the CAB, the underlying assumptions must be scrutinized for validity. If those assumptions are invalid, the otherwise laudable objectives fail to justify continued regulation.

SCRUTINIZING THE BASIC ASSUMPTIONS

Service to Small Communities

Advocates of entry/exit regulation argue that less regulation would eliminate or substantially reduce service to small communities. This argument assumes that present service to such communities would be

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54. Public utilities generally are created to take advantage of scale economies, particularly in the case of "natural monopolies." As total costs increase, unit costs decrease. Regulation is justified to prevent such organizations from exploiting these scale economies by charging excess prices, or in order to prevent competition from stifling growth to the point where organizations take advantage of scale economies. *Cf.* CAB, *Materials Relative to Competition in the Regulated Civil Aviation Industry, 1956, Transmitted to the Select Senate Comm. on Small Businesses*, 7-8 (Comm. Print 1956) (CAB referred to air transport industry as public utility), *cited in* FRIENDLY, *supra* note 40, at 97.

55. "The airlines argue that the increased riskiness that competition would introduce into their business would make it difficult to place firm orders for aircraft; thus aircraft production would decline and the rate of technological advance would slow down." *Comm. Print, supra* note 15, at 74.

56. Assuming that such "problems" exist in that arena, it is not at all clear that they should be characterized as "problems." Such a characterization assumes that specific objectives exist in an unregulated, free market which are incapable of attainment by that market. It is generally assumed, in making such a characterization, that "the purpose of regulatory policy . . . is to stimulate and substitute the effects of competition and give the consumer the benefits which he would derive from a system of competition." PHILLIPS, *supra* note 1, at 19. However, it is contended by the author of this article that such objectives do not exist; rather, the free market is the starting point, a kind of natural order. Competition in such a market *results in* an efficient allocation and utilization of resources, but efficiency is not the *goal* of competition. While the *most* efficient allocation may be the goal sought by an attempt to implement the model of *perfect* competition, the unregulated market cannot be characterized as a model of perfect competition. Among other things, that model assumes the existence of perfect information, something which cannot exist given the reality of less-than-perfect human beings. *Id.* at 32. Another assumption of the perfect competition model that does not reflect reality is the idea that "there are no obstacles preventing complete mobility of resources, both into and out of an industry." *Id.* The very existence of the credit market demonstrates the reality of such obstacles. Thus while the model of perfect competition may have objectives which coincide with some of the objectives sought by regulation, such objectives do not exist in an unregulated market which neither actively seeks to emulate the model of perfect competition nor does anything to affirmatively prevent its attainment.

uneconomical in a more competitive atmosphere, and that these routes are in some way subsidized by regulation. Thus, it must be determined if this assumption is correct.[57]

In seeking a solution to this inquiry, the logical starting point is the industry itself. A representative of United Air Lines, Andrew de Voursney, recently stated that an "immediate effect [of entry/exit deregulation] would be the neglect or abandonment of economically marginal routes: smaller cities, low traffic density sectors, etc."[58] "Economically marginal routes" presumably refers to those routes which do not turn a sufficient dollar profit to justify continued service[59] in the event of entry/exit deregulation.[60] A simple study[61] was offered in support of this claim. In evaluat-

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Even where a coincidence of objectives does exist, though, complete identity of objectives sought by regulatory advocates and free market advocates is improbable. Air safety regulation exemplifies this idea. Regulatory advocates seek the "highest degree of safety" possible. 49 U.S.C. § 1302(b) (1970). While this unquestionably benefits all consumers as a group, not all consumers may be willing to pay the price of obtaining the "highest" degree of safety if a lower priced safety level were available. Free market advocates would say that the degree of safety which should be sought is that which consumers will pay for voluntarily.

57. This analysis operates within the parameters of the identified economic goals of the present regulatory scheme. However, a threshold inquiry into the *justification* of promoting service to small communities as a positive goal of regulation is appropriate. Regulation can be justified by this goal only if the goal is valid and if the goal could not be obtained without regulation. For the sake of argument, the latter will be assumed.

The argument used to justify this as a valid goal starts from the premise that these communities provide net benefits to society as a whole which in turn warrants a return of this value to the communities in the form of a subsidy. In economic terms, society as a whole (here personified as air travelers in other markets) receives a benefit from the small community for which it should pay. Similarly, the direct benefit that these communities receive in the form of air service is worth less than the direct cost of providing that service. Thus, the direct cost of that service is equal to some lower dollar figure plus the intangible value that the community bestows upon society.

The benefit that such communities bestow upon society generally consists of providing a convenient home for a particular economic enterprise which is seeking cost advantages not available elsewhere in order to survive economically. One such advantage is derived from airlines which are required to service such communities at a loss. Thus, in the case of the present regulatory scheme, other air travelers are subsidizing this economic enterprise. As Caves points out, it hardly seems equitable that a grandmother flying from New York to Los Angeles to visit her grandchildren, should subsidize "well-off businessmen travelling between small towns." CAVES, *supra* note 29, at 436. Thus, justification of the goal of service to small communities is questionable.

58. *CAB Hearings, supra* note 8, at 631 (prepared statement of Andrew de Voursney). It would appear that United has changed its view somewhat subsequent to the Hearings. United's president recently "declared that 'regulation worked well for nearly 40 years, but it's not working well today' and came out for a new regulatory law. The CAB's failure to award United significant new routes may have had some impact on that carrier's thinking." Altschul, *Friendlier Elements: For Airlines the Political and Financial Skies are Clearing*, Barrons, May 16, 1977 at 9.

59. In other words, these routes do not generate sufficient revenue to operate at a profit. It is generally thought that unprofitable operation mandates termination.

60. Accounting systems frequently do not include other factors which may outweigh the

ing United's 1974 scheduled passenger operations, Mr. de Voursney concluded that 163 of the airline's 327 non-stop city pairs were unprofitable routes with a net loss of $142 million.[62] Mr. de Voursney then concluded that the 20 million passengers using the profitable routes must have paid an average of $7.10 apiece as a direct cross subsidy of the unprofitable routes.[63] Ultimately, United concluded that 68 of 147 unprofitable routes would be considered for deletion in the event of entry/exit deregulation.[64] United admitted that such deletion would not necessarily result in total elimination of service to the communities in question. Yet, it implied that the remaining service, or any new service which tried to respond to United's abandonment would be much less than that provided by United prior to deregulation.[65]

It seems curious that United or any other airline would plead termination of service on routes that lose money, in attempting to prevent deregulation. Such a position contravenes on its face, at least, United's rational interest in maximizing profits. It is reasonable to assume that United has not adopted an altruistic attitude by donating service to small communlties. Indeed, if one accepts the premise that United seeks to maximize profits,[66] one might conclude that United's apparent altruism constitutes nothing more than a smokescreen disguising the true effect that regulation has on United's total profit picture. Perhaps the true effect is to cause minimal losses in these markets, while creating windfall profits because of the protectionist tendency of regulation in more lucrative markets.[67]

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lack of dollar profits in the decision of route abandonment. *See CAB Hearings*, *supra* note 8, at 636 (letter to Sen. Kennedy from Andrew de Voursney dated Feb. 28, 1975). For instance, many routes act as "feeders" for other more lucrative routes. In analyzing the net income of particular routes, an accountant might simply isolate the direct revenues and costs generated by that route. While such treatment is well within the bounds of accepted accounting principles, a more sophisticated treatment might attempt to allocate the costs and revenues of a group of routes to yield a more accurate reflection of the reasons that an airline might not abandon a seemingly unprofitable route. Since the feeder line is providing additional revenue for another route, part of the cost for operating the feeder would be allocated to the more profitable route in analyzing route net incomes. By so reducing the feeder's costs, its net income increases and the increase may well indicate a profit instead of a loss.

61. The characterization of "simple" is Mr. de Voursney's. *Id.*

62. *Id.* at 635.

63. This figure was computed by dividing the loss of $142 million in the unprofitable routes by the number of passengers who flew in the profitable routes. *Id.* at 636.

64. *Id.* at 637 (From a table entitled "Classification of Loss Markets" in a letter to Stephen M. Breyer from William R. Nesbit) (April 29, 1975).

65. *See id.*

66. "Economic theory assumes that producers endeavor to maximize profits . . . with profits serving as a proxy for the utilities of individual decision makers whose interests are, implicitly, thought to be identified with those of the owners of the firm." Jordan, *supra* note 10, at 59.

67. "[CAB] entry protection has been sufficient to enable the grandfather carriers to retain about nine-tenths of total domestic air service, despite a 250-fold increase in total traffic since

In addition to United's speculations, Eastern Airlines has considered the routes that it might abandon should entry/exit deregulation become a reality. Eastern claimed to have 200 routes that benefited from cross subsidy, 160 of which were domestic routes.[68] Before a nationwide television audience, the President of Eastern, Frank Borman, claimed that many of Eastern's routes would be abandoned under total deregulation.[69] Mr. Borman presumably felt that all 160 were candidates for abandonment.

Finally, the most exhaustive study of the effect of entry/exit deregulation on unprofitable domestic routes by industry representatives to date comes from the Air Transport Association of America (ATA).[70] In summarizing the ATA's analysis, Dr. George W. James, Senior Vice President of Economics and Finance for the ATA stated:

> [O]ur analysis shows that under deregulation scheduled air service might be eliminated or substantially reduced on 1,820 nonstop routes throughout the nation. . . . Currently, trunk carriers serve 994 non-stop routes. Of these 372 could be candidates for elimination under deregulation, while nearly all of the remaining 622 could experience sharp curtailment of service. . . .[71]

From the vantage point of the industry, which possesses the greatest financial interest in the deregulation decision, deregulation will result in substantially reduced service to communities which are incapable of supporting directly trunkline air service that is presently furnished to such communities.

Perhaps in recognition of the self-serving nature of these studies,[72] recipients of the studies have not left industry claims unscrutinized. Rather, each study has been subjected to independent analysis to test the accuracy of predictive mechanisms used by the particular study and the validity of the predictions themselves. At the very least, the conclusions of the independent analysts varied substantially from the conclusions of the industry analysts.

1938. . . . [I]t is difficult to imagine their retaining this level of industry share without direct regulatory intervention." DOUGLAS & MILLER, *supra* note 35 at 113 (footnote omitted). *See id.* at 112, 115-16; LEISTER, *supra* note 10, at 44; *Comm. Print, supra* note 15, at 98; *CAB Hearings, supra* note 8 at 93-94 (testimony of Alfred E. Kahn); 121 CONG. REC. S 22,656 (daily ed. Dec. 18, 1975) (remarks of Sen. Percy).

68. 122 CONG. REC. S12,983 (daily ed. Aug. 2, 1976).

69. *Id.*

70. "Consequences of Deregulation of the Scheduled Air Transport Industry," *CAB Hearings, supra* note 8, at 141-378. In a letter which accompanied this report when it was submitted to the Subcommittee, Dr. George James stated that "this information may represent the first aggregate analysis of its kind." *Id.* at 140 (Letter to Sen. Kennedy from George W. James) (April 25, 1975).

71. *Id.* at 140.

72. *See* text between notes 65 and 69 *supra*.

In scrutinizing the 58 city pairs[73] that United claimed were unprofitable and subject to abandonment, the Subcommittee on Administrative Practice and Procedure reduced the list to "29 route segments . . . that might be viewed as the beneficiaries of cross subsidy."[74] It eliminated four routes because they were flown to "position aircraft,"[75] 17 others because they were flown for their "traffic generating ability," and eight others because they consisted of routes that were less than 60 miles in length. The Subcommittee thought it "inconceivable that trunkline service is needed on [such] routes . . . ."[76] The 29 route segments that might be abandoned in the event of deregulation accounted for "about one-half of 1 percent of United's total domestic revenue passenger miles. United lost $5.5 million serving them.[77]

The Subcommittee also scrutinized the ATA's study. "[C]areful scrutiny of that study . . . confirm[ed] that it [was] fatally flawed."[78] The model used by the ATA in computing the effect of deregulation was based on the behavior of a monopolist in a fixed price market. "In fact, the real world without regulation would not be inhabited by an airline monopoly or a cartel. It would be a highly competitive world with flexible prices, . . ."[79] The economists who evaluated the study were unanimous in their conclusions concerning this flaw.[80] As James C. Miller III of the Council of Economic Advisers stated, "the model is incapable of simulating competition."[81] Rather, it is "capable of simulating [only] *price-regulated monopoly, but not free and open competition*."[82]

Eastern Airlines' allegations concerning deregulation's effect on its behavior were studied by an independent financial analyst.[83] He reach-

73. It should be noted that in the Committee Print reporting on the hearings, the Committee apparently misread the letter upon which it based its conclusion that United claimed to have 58 out of 327 unprofitable routes. *Comm. Print, supra* note 15, at 66. In fact, the United spokesman claimed that 68 of the 327 routes were unprofitable. *See* text accompanying note 64 *supra*.

74. *Comm. Print, supra* note 15, at 66.

75. Position aircraft "will be flown empty or full, with regulation or without. . . ." *Id.* at 67.

76. *Id.* at 66.

77. *Id.* Presumably, the Subcommittee's error in examining United's report would have little effect on the accuracy of this conclusion. *See* note 73 *supra*.

78. *Id.* at 67.

79. *Id.* at 67-68.

80. *See CAB Hearings, supra* note 8, at 382-436 (conclusions of the economists who examined the ATA study at the behest of Senator Kennedy). *See also* General Accounting Office, Report to Congress, Comments on the Study: "Consequences of Deregulation of the Scheduled Air Transportation Industry" 13-14, CED-77-38 (Feb. 25, 1977) [hereinafter cited as Report to Congress on ATA Study].

81. *CAB Hearings, supra* note 8, at 386.

82. *Id.*

83. That analyst was Thomas A. Trantum of H.C. Wainwright and Co., New York, N.Y. *See* 122 Cong. Rec. S12,983 (daily ed. Aug. 2, 1976).

ed conclusions similar to those reached by the independent observers of the United Airlines and ATA studies. His analysis was "restricted to a consideration of the possibility of abandonment. The simple criteria utilized [was] to examine the question as to whether the service provided in each segment is required by CAB regulation. If not, Eastern is free to abandon the segment irrespective of regulatory reform."[84] The analysis initially points out that Eastern "has already dropped 24 of the 160 unprofitable segments without any proceedings before the Board . . . ."[85] Of the remaining Eastern routes, "only 20 segments include[d] a point in danger of falling below minimum adequate service . . . . [O]f these 20, 12 segments received service in excess of the minimum. Eastern presumably provides service in excess of the minimum only if the segment is, in the relevant sense, profitable."[86] Of the eight remaining routes, the analyst concluded that one could be dropped at Eastern's discretion because it had only been added in 1974, three had sufficiently high load factors to "be profitable in normal times," and three others were served by competitors' voluntary service. Thus, the analyst concluded that "cross-subsidies *may* be required to continue certificated service over only three of those segments."[87]

The above analyses of the industry position on the effect of entry/exit deregulation indicate at the very least that deregulation will not have so devastating an effect on service to smaller communities as is claimed. Undoubtedly, the industry stance has been colored in part by a desire to protect the presently entrenched market position of the trunkline carriers. Given that many of the presently unprofitable route segments may be abandoned without Board acquiescence,[88] one can reasonably con-

84. *Id.* It should be noted that service cannot be abandoned completely without Board approval. Such approval may be obtained only upon a Board finding that the abandonment is within the public interest. 49 U.S.C. § 1371(j) (1970). Pursuant to that section, the CAB has promulgated regulations for the *temporary* suspension of service, 14 C.F.R. §§ 205.1-205.12 (1976), but even this requires Board approval. 14 C.F.R. § 205.6 (1976).

When the analyst refers to abandonment of service here, he speaks of Eastern's ability to reduce or expand its service of a particular city according to the conditions placed on its certificate by the Board, and pursuant to the authorization in 49 U.S.C. § 1371(e) (1970). Thus, Eastern's certificate gives it substantial discretion to adjust capacity, "subject only to the minimum level of service . . . . [M]inimum adequate service appears to imply at least one or two daily flights from and to a named point." 122 CONG. REC. S12,983-84 (daily ed. Aug. 2, 1976). Thus, so long as each city served by Eastern has two incoming and two outgoing flights per day, Eastern may terminate all additional flights according to the term of its certificate.

85. "All of these 24 segments were dropped without abandoning Eastern service to any point." 122 CONG. REC. S12, 984 (daily ed. Aug. 2, 1976).

86. *Id.*

87. *Id.* at S12,983.

88. While unprofitable route segments may be so terminated if the certificate gives management discretion over capacity decisions to specific cities, complete abandonment of service to a city requires Board approval. *See* text at and accompanying note 86 *supra*.

clude that regulation does not result in the degree of trunkline subsidization of small community service that the industry claims it does. And even where subsidization does occur, it is not at all clear that such subsidization would be lost upon terminating regulation. Although dollar losses exist in such routes when examined in isolation, such dollar losses may be offset by "feeder" revenues which those routes provide for other, more lucrative routes.[89]

It is for similar reasons that the "cream skimming" effect, which industry representatives fear would cause them to reduce small community service, does not hold up as a sufficient basis for regulation. It is feared that competition will reduce existing air carriers' abilities to cover overhead costs. However, the Subcommittee on Administrative Practice and Procedure cites examples of other highly competitive industries which in some instances reduce prices to variable costs and yet are still able to cover total overhead costs.[90] As long as overhead can be recovered from some set of sales, service will be provided.[91] While one might argue that a reduction in total revenues would render the existing carriers incapable of meeting *present* overhead costs, such costs would probably decrease if those airlines were required to operate more efficiently under the rigors of competition.[92] Furthermore, new entrants in

89. *See* text at and accompanying note 60 *supra*.

90. The examples include hardware stores, grocery stores, and department stores. *Comm. Print*, *supra* note 15, at 60.

91. *Id*. at 69.

92. Jordan offers the following table in support of his conclusion that increased competition would compel more effective utilization of resources and would motivate airlines to obtain "substantially greater output per employee . . . :" JORDAN, *supra* note 10, at 223.

Average Annual Operating Revenues per Employee
Total Trunk and Local Service Carriers, California Central Airlines,
Western Air Lines, Pacific Air Lines, and Pacific Southwest Airlines
Selected Years 1950-1965

	Trunk		Local Service		California Intrastate	
Year	Total	Western	Total	Pacific	CCA	PSA
1950	$ 9,100	$11,000	$ 7,000	$ 8,600	$ 6,100	n.a.
1951	9,800	10,700	7,600	7,800	n.a.	$ 7,800
1954	12,600	13,000	9,300	11,800	8,900	n.a.
1955	12,900	14,600	8,800	11,000	—	13,800
1957	13,100	14,800	9,600	12,600	—	18,200
1959	15,300	19,900	10,700	13,400	—	21,700
1962	18,800	25,700	14,000	16,400	—	31,600
1963	19,700	26,200	14,700	17,300	—	37,600
1964	21,000	26,700	15,700	17,600	—	41,500
1965	22,200	26,100	16,300	18,000	—	32,500

Id. at 219 (footnotes omitted).

the most lucrative routes would also have overhead costs which must be recovered to continue operations.[93] If such carriers reduce fares to variable costs, they will be required to maintain higher fares elsewhere. "There is no particular reason to believe that new entrants on particular routes will, in general, in the long run, be able to fly at lower costs than existing efficient carriers."[94] Hence, the "cream skimming" argument ignores the realities that new entrants in lucrative markets would be required to operate under, and in doing so, overestimates the reduction in overall service offered to small communities which *might* be caused by an inability to recover overhead costs.[95]

The inability of industry representatives to present persuasive reasons for disregarding the conclusions of the independent analysts,[96] coupled with the presumption that their arguments contain some self-serving bias,[97] suggests that the independent analysts' conclusions are correct.[98] At the very least, the evidence does not indicate that regulation promotes service to small communities by enabling otherwise infeasible

93. *Comm. Print, supra* note 15, at 69.

94. *Id.*

95.

> A group of competitive firms operating on the fringe of a market may skim the cream from flights of established firms: This is only possible, however, where there are some excess profits to be gained. But the availability of these profits indicates a monopoly restriction of flights and output. On balance, therefore, the fringe operators serve to increase flights and output to the competitive level.

DeVany, *Is Efficient Regulation of Air Transportation Possible?*, in PERSPECTIVES, *supra* note 10, at 85, 90.

96. Dr. James of the ATA attempted to meet the criticism of the ATA study. *CAB Hearings, supra* note 8, at 380 (Letter from George W. James to Sen. Edward M. Kennedy) (May 8, 1975). He made three points: (1) he suggested that criticism of the ATA study arose because of the Subcommittee's inability to articulate the precise nature of its request; (2) he claimed that the study was in fact based upon the present market structure, which he characterized as competitive, and not on the behavior of a monopolist; and (3) he claimed that the study may understate the effect of deregulation because of the possibility that "deregulation would encourage a heavier concentration on the more productive city-pair markets and less service in the managerial markets." *Id.*

The first point is largely irrelevant to the criticism because even though the Subcommittee's request was not articulated precisely, the criticism stated that the study was not what it purported to be. The second point is unpersuasive because while some competition does exist presently, that competition is restricted by Board entry policy and does not include the possibility of new air carriers offering more efficient service than the present carriers. Similarly, by basing the model on the present regulatory structure, the model necessarily cannot include the possibility of new carriers picking up routes that would be abandoned. This is true because under the present structure such carriers must first go through the Board. The final point is unpersuasive because of the evidence presented below that concentration of service in the industry would not occur. *See* text at and accompanying notes 122-124 *infra*. For a more detailed description of the ATA's response to criticism of its model, *see* REPORT TO CONGRESS ON ATA STUDY, *supra* note 80, at 19-32 (official statement of ATA responding to GAO criticism).

97. *See* text accompanying notes 65-68 *supra*.

98. Support for the idea that their conclusions should be accepted may be found in

subsidization from more profitable routes.[99] Hence, the premise that present service to small- and medium-sized communities is subsidized by entry/exit regulation cannot be relied upon to justify continued regulation.

Safety

The second[100] economic objective sought by regulation is maintenance of the highest level of safety possible. In order to justify entry/exit regulation, it must be shown that this objective is impeded where no such regulation exists. The premise, then, is that less regulation, results in a lower level of safety to the consumer.

The reasoning which leads to the conclusion that increased competition will decrease safety goes as follows. Profits in the regulated industry are higher than would exist in an unregulated industry.[101] Increasing competition in the regulated industry would result in a lowering of profits to a point closer to the unregulated equilibrium point.[102] This lowering of profits results in industry attempts to cut costs. These actions then cause the amount previously spent to insure a high level of safety to be reduced. This reduction in safety expenditure results in a more dangerous industry. Therefore, a reduction in regulation will result in a less safe industry.

The Subcommittee on Administrative Practice and Procedure took a neutral position with respect to the effect of entry/exist deregulation on safety. Because "safety is the concern of the Federal Aviation Administration, not the Civil Aeronautics Board,"[103] it was presumed that the FAA could maintain its safety standards regardless of any changes made with respect to the CAB's power to control entry and exit. In the context of the industry argument regarding deregulation's effect on safety, the FAA,

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Professor Jordan's study. He states that the ability of intrastate carriers to maintain profitable operations in minor markets "shows that CAB-type regulation is not a necessary condition for airline service to be provided in low-density markets, and it challenges the internal subsidy argument that the CAB needs to protect the trunk carriers from competition in profitable, high-density markets so that service will be provided in low-density markets." JORDAN, *supra* note 10, at 131-32.

99. Another commentator's economic analysis supports the conclusion that very little actual subsidization presently occurs which would be eliminated by deregulation. Keeler, *Airline Regulation and Market Performance*, 3 BELL. J. OF ECON. AND MANAGEMENT SCIENCE 399, 422 (1972) [hereinafter cited as KEELER]. This study has been updated and expanded by the United States Comptroller General. GENERAL ACCOUNTING OFFICE, LOWER AIRLINE COSTS PER PASSENGER ARE POSSIBLE IN THE UNITED STATES AND COULD RESULT IN LOWER FARES, CED 77-34 (Feb. 18, 1977, Report to Congress) [hereinafter cited as LOWER AIRLINE FARES].

100. The first objective was service to small communities. The order of discussion of these objectives is not meant to reflect a hierarchy of objectives.

101. Regulation enables maintenance of an artificially high price level.

102. Competition reduces the artificially high price level, and in turn reduces profits.

103. *Comm. Print, supra* note 15, at 73.

under the Subcommittee's reasoning, could prevent all cost cutting by the airlines in the area of safety.[104] This would be accomplished by requiring the same safety standards as are presently required. As long as the FAA enforced such requirements uniformly, safety costs would become a mere constant on both sides of the equation used in weighing the costs and benefits of deregulation.

Additional evidence, however, suggests that even this neutral position grants too much credence to the industry syllogism that more competition results in less safety. While it was initially felt that excessive competition among air carriers "tends to jeopardize and render unsafe a transportation service appropriate to the needs of commerce and required in the public interest,"[105] it would appear that this belief was unjustified. As two commentators note,

> [H]istorically, there has been no correlation between the economic soundness of an air carrier and its safety record. Despite a thin operation margin and high subsidy local service carriers and small trunks like Colonial have a better safety record than the Big Four. Other industries where safety is equally important have combined safety regulations with a policy of complete freedom of entry *e.g.*, manufacture of serums and vaccines, dispensing of prescriptions by drug stores, carrying and freezing of fruits and vegetables, meat processing and distribution.[106]

The maintenance of high levels of operational safety in the airline industry would seem to be a prerequisite to continued economic existence, particularly in a market characterized by freer entry. If one accepts the presumption that airlines operate for the purpose of making a profit, then it follows that almost all decisions, including those concerning safety, will be designed to maximize profits. In scrutinizing safety decisions with this goal in mind, airline management will try to predict the effect of cutting safety costs. The effect of decreased safety is increased risk of fatality. However, any fatality could prove to be the demise of the airline, particularly where a new entrant may offer an immediate substitute service to the consuming public. Not only do such fatalities result in expensive litigation, they also raise public wariness of the airline in question. Both expensive litigation and loss of customers to other airlines result in lower profits. Thus, decisions which lower the risk of fatalities, such as those which increase safety, are likely to be perceived by management[107] as fully consistent with profit maximization.[108] At the very least, it would seem that safety and free entry are not mutually exclusive.

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104. *See* Cortz, *A Case for Grounding the CAB*, 84 FORTUNE No. 1, at 66, 146 (1971).

105. S. REP. No. 1661, 75th Cong., 3d Sess. 2 (1938).

106. Maclay & Burt, *supra* note 4, at 133 n.6. As with the airlines, it is fully consistent with corporate self-interest to maintain high levels of safety in those industries. *See* KEELER, *supra* note 99, at 423. Failure to do so could result ultimately in corporate bankruptcy due to expensive litigation. *See* text accompanying note 107 *infra*; *but see* text at note 107 *infra*.

107.. An alternative analysis leads to a different conclusion. It is possible that fatalities

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An examination of Professor William Jordan's study comparing the regulated interstate airline industry with the relatively unregulated California intrastate airline industry supports this conclusion.[109] Jordan points out that between 1949 and 1965 the two markets operated under essentially identical safety regulations. While Jordan readily admits that it may be inappropriate to draw definite conclusions from his comparison,[110] he does conclude that

> the complete absence of fatal accidents by PSA [Pacific Southwest Airlines] during 16 years of unregulated operations, and by California Central/Coastal during their 8 1/2 years of existence, does indicate that economic regulation is not a necessary condition for airline safety, while the varying experiences of individual certificated carriers show that such regulation is not a sufficient condition for superior safety performance.[111]

In fact, because one California carrier was removed from the market by a single crash which raised the intrastate fatality rate above the interstate fatality rate,[112] one might reasonably conclude that the CAB's strict control over entry/exit *decreases* rather than increases safety in the industry.

Finally, Jordan points out that the inability of new carriers to offer substitute service to the consuming public after an air crash eliminates the opportunity for consumers to manifest objectively their concern

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would not significantly reduce an airline's profits. Such would be the case where the market is safety inelastic; a significant lowering in safety levels does not result in significantly lower revenues. Safety inelasticity would exist if consumers had no safer alternative to choose from, were incapable of evaluating safety levels of different airlines (through lack of information or through lack of effective comparative standards and abilities), or were unwilling to pay the price necessary to maintain high levels of safety. The lack of alternative service cannot be relied on here, since such a lack is caused at least in part by regulatory barriers to entry. Similarly, consumer unwillingness to "purchase" the "highest" safety levels should not be relied on since such collective unwillingness would be a clear indicator of the true nature of the "public interest." Thus, this analysis is persuasive only to the extent that consumers lack information or a comparative mechanism to make an informed choice regarding safety.

108. *See* JORDAN, *supra* note 10.

109. *Id.* at 51.

110. "[T]he small volume of traffic for the California intrastate carriers relative to that of the certificated carriers may well make it improper to compare their passenger fatality rates." *Id.* at 52.

111. *Id.* at 52-53.

112. 85 lives were lost in one crash of a Paradise Airlines airplane. "Paradise accounted for less than one-half of one percent of all RPM [revenue passenger mile] carried by the California intrastate carriers during these years but provided 93 percent of the total passenger fatalities." *Id.* at 51. The cause of this crash was unascertainable. The statistics compiled by Jordan from various sources indicate the precise effect that this crash had on the fatality rate per 100 million passenger miles flown:

Passenger Fatalities and Fatality Rates
Trunk, Local Service, and California Intrastate Carriers
Scheduled Domestic Service, 1949-1965

Carrier Group	Number of Passenger Fatalities[a]	Total Revenue[b] Passenger Miles (000)	Passenger Fatality Rate per 100 Million RPM
Trunk	1,809[c]	402,736,593	0.45
Local Service	151	16,392,377	0.92
California Intrastate			
All Carriers	87	3,254,630[d]	2.67
Excluding Paradise	6	3,240,710[d]	0.19

[a] Includes both revenue and nonrevenue passengers.
[b] Nonrevenue passenger-miles are not available for the California intrastate carriers.
[c] 108 passenger deaths occurring in dynamite/sabotage accidents are excluded.
[d] Partially estimated.

Id. at 50. The load factors for the intrastate carriers during this period were substantially higher than for the interstate carriers. Since this gives rise to the possibility of a greater number of fatalities per crash, it suggests that more reliance can be placed on Jordan's speculations than Jordan was willing to concede. *See* text accompanying note 110 *supra*. Jordan presents a table of those load factors in the following form:

Average Annual Passenger Load Factors for the Certificated and California Intrastate Carriers Scheduled Service, 1946-1965

	Passenger Load Factor (Percent)			
	Certificated Trunk		Total Cert.	Total
Year	First Class	Coach	Local Service[a]	Intrastate[b]
. . .				
1949	58.7	70.2	28.2	66.9
1950	61.2	74.2	31.5	73.9
1951	68.9	74.5	37.4	69.0
1952	65.3	75.6	37.5	65.9
1953	62.2	72.8	38.6	67.1
1954	61.2	68.2	42.2	69.2
1955	62.3	67.6	45.2	72.2
1956	62.4	67.3	45.8	75.7
1957	59.4	65.1	45.2	80.6
1958	58.9	61.7	45.7	72.4
1959	59.5	64.1	44.4	71.1
1960	56.1	63.3	41.9	71.1
1961	51.6	60.2	41.6	72.1
1962	46.6	57.6	42.3	75.3
1963	51.7	54.9	43.8	72.8
1964	49.9	57.8	46.4	74.9
1965	49.0	57.7	47.3	63.3

. . . .

[a] Some local service carriers operated small amounts of coach service in 1952-53 and from 1956 to early 1965.

. . .

[b] Partially estimated, includes all services.

Id. at 202.

about safety.[113] Presumably, if consumers were as safety conscious as Congress or the CAB believes them to be, new entrants would rapidly obtain part of a negligent airline's market under a system of freer entry.[114] Bankruptcy provides a natural culling mechanism for removing undesirable firms from a competitive market.[115] No certified trunkline carrier has ever gone bankrupt.[116] Continued regulation on the basis of safety, then, substitutes Congress' imperfect judgment on the public's safety desires for the more precise indicator of public concern over safety: the exercise of the economic franchise to choose an airline on the basis of its safety record.[117]

Arguably, the California experience indicates that entry/exit competition results in the maintenance of higher rather than lower safety standards. At best, safety should not weigh one way or the other in evaluating the justification for and necessity of entry/exit regulation. Thus, the concern of regulation advocates about safety cannot be used to justify continued entry/exit regulation.

Economies of Scale

Economies of scale, which are based on large fixed investment requirements, have caused a perceived market structure which forms the basis for the objective of maximizing the airlines' natural monopoly

113. *See* note 145 *infra*.

114. *But see* text at note 107 *supra*.

115. This is true to the extent that consumers can make an informed choice to use certain airlines based on safety factors. *See* text at and accompanying note 107 *supra*.

116. One might argue that the bankruptcy of a major trunkline carrier should not be allowed to occur because it would substantially interfere with the adequacy of trunkline air service. However, it is less than clear that such interference would result from bankruptcy. The California intrastate market has witnessed a number of bankruptcies with no significant interference in service. New carriers inevitably filled any gap left by the bankrupt carrier. *Comm. Print*, *supra* note 15, at 99. The only factor that might mitigate the comparison value of the interstate and intrastate markets here is the existence of high entry barriers in the markets serviced by a bankrupt trunkline. *See* text at and accompanying notes 125-138 *infra*.

117. The truly democratic nature of the unregulated marketplace becomes apparent upon further analysis. At the very least, a majority of individuals whose price/safety preferences coincide, will be able to obtain the degree of safety that they want. Individuals who find themselves in the minority also may be able to satisfy their preferences. For example, suppose 60 percent of the consumers in any given market prefer lower prices to the highest level of safety while the other 40 percent prefer the opposite. What prevents the coexistence of two services, with one satisfying the desires of each group? The only conceivable factor that would prevent this would be the inability of the market to support more than one service. However, in such an instance, one would fail because of the other's ability to attract more passengers who generate revenue. The exercise of this choice by consumers more accurately reflects the public interest than a situation where the CAB's requirements reverse the decision of the consuming public. On the other hand, if both can coexist, are not the interests of more members of the public satisfied than would be the case with a prescribed safety level?

capabilities.[118] It is felt that by granting the airlines partial monopolies through limitation of entry into various markets, they will be able to "serve a market at a lower average cost than several competing firms [could]."[119] Any given airline will be able to offer such service at the lower cost only to the extent that those economies of scale and high barriers to entry exist. If they do not, this natural monopoly objective cannot be used to justify regulation of the entry/exit aspects of the airline industry.

Industry representatives have voiced the belief that airlines of sufficient size could operate at lower average costs than smaller carriers, and that high initial investment requirements effectively bar entry. They have been unable to produce empirical economic evidence to support such a proposition.[120] These allegations sound very similar to the numerous allegations voiced in Congress prior to the enactment of the CAA[121] over the existence of cutthroat or destructive competition. Although the inability to present empirical economic data in support of this proposition might have been acceptable in 1938 when the science of economics was less well developed, unfounded allegations cannot be readily accepted any longer. In fact, if economic evidence to the contrary can be presented, it should lay to rest any lingering doubt that the air transport industry should be regulated on the basis of vague notions of public utility theory.

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118. Phillips discusses natural monopolies as follows:

> The regulated industries are frequently referred to as 'natural' monopolies. . . . [I]n some of the regulated industries, however, competition is limited by legislative policy rather than by technological conditions. In such cases, there is nothing natural or inherent about the resulting market structure. . . . [I]t is clear that monopolization is not a universal characteristic of the regulated industries. On the contrary, these industries commonly operate under conditions of imperfect competition. Finally, economic conditions are constantly changing. New technology may dictate either larger or smaller optimum-size plants; substitute products or services may be developed. What is natural at one period of time, therefore, may become quite unnatural at another. 'Perhaps, as others have observed, the notion of a natural monopoly was invented to justify exclusive markets for utility companies after their ineffectual and sometimes wasteful rivalry proved unsatisfactory to both the investor and the consumer interests.

PHILLIPS, *supra* note 1, at 21 *quoting* E. TROXLER, ECONOMIES OF PUBLIC UTILITIES 27 (1947). *See* A. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS VOLUME 1, at 10 (1970); A. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS VOLUME 2, at 113-71 (1970).

119. PHILLIPS, *supra* note 1, at 21.

120. *Comm. Print, supra* note 15, at 62.

121. *See id.* at 61-62. The original Civil Aeronautics Act of 1938 apparently was justified on three grounds by its proponents:

> (i) past "destructive competition which the testimony [then before Congress] show[ed] to be now underway," (ii) a fear of future "[dis]-orderly development" caused by future "destructive competition," and (iii) "the recognized and accepted principles of regulation of public utilities, particularly as applied to other forms of transportation," which apparently refers to regulation of the railroads and the ICC.

Comm. Print, supra note 15, at 209 (Appendix B). After a careful analysis of the legislative

Such contrary economic evidence appears to exist. Professor Jordan's analysis is perhaps the most incisive. With respect to economies of scale, Jordan states:

> If only very large airlines had been able to survive while providing low-fare service, this would provide evidence that economies of scale exist in the airline industry. The fact is, however, that the smallest of airlines introduced low-fare service and that at least one of these managed to survive while achieving operating ratios and returns on stockholder equity comparable or superior to those of the much larger certificated carriers operating under substantially higher fares per mile. This indicates that there are no significant economies of scale in domestic air transportation that cannot be achieved by a carrier operating four or five aircraft of a suitable type over a small route structure. It follows from this that without regulation the U.S. airline industry would probably consist of many small carriers rather than a few large ones.[122]

In fact, Jordan concludes that in the absence of entry/exit regulation, there would be approximately 100 to 200 trunkline and local service carriers serving a market which is presently served by approximately 20 carriers.[123]

Professor Richard Caves draws similar conclusions concerning the lack of significant scale economies in the airline industry. In comparing medium, small, and local carriers' costs to those of the top four airlines in 1958, Caves concludes that "diseconomies of . . . scale afflict, if at all, only the smallest of the domestic trunklines."[124] Thus, it would seem that advocates of regulation mistakenly rely on the argument that the airline industry is characterized by high economies of scale.

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history surrounding the act, the Subcommittee on Administrative Practice and Procedure reached the following conclusion:

> In light of these considerations the subcommittee can only conclude that to the extent that Congress in 1938 intended to restrain free competition in the airline industry, its judgment was based primarily upon evidence of past or potential "destructive competition" which evidence appears in retrospect to have been without any substantial foundation.

Id. at 212 (emphasis omitted). Hence, it would appear that the allegations before Congress which were accepted as true and then relied upon to justify that legislation were in fact, empty. *See also* 83 CONG. REC. 6635 (1938) (where no evidence was referred to in charging the industry with "vicious" competition; remarks of Sen. McCarran); S. REP. No. 1661, 75th Cong., 2d Sess. 2 (1938) (similar unsupported allegations with respect to safety).

122. JORDAN, *supra* note 10, at 195. *Accord* De Vany, *Is Efficient Regulation of Air Transportation Possible?, in* PERSPECTIVES, *supra* note 10, at 85, 89; PHILLIPS, *supra* note 1, at 26; *see Leister, supra* note 10, at 50.

123. *CAB Hearings, supra* note 8, at 453; *contra id.* at 100, 117 (George W. James gives reasons why he believes concentration would result).

124. CAVES *supra* note 29, at 57. In comparing costs of other carrier groups relative to costs of the Big Four (American, United, Eastern, and TWA) in 1958, Caves found that the Big Four had costs of 100.0, the medium-sized carriers (Braniff, Capital, Delta, National, and Northwest) had costs of 97.4, the small lines (Continental and Northeast) had costs of 101.6, and the local service carriers had costs of 187.9. CAVES, *supra* note 29, at 58. With respect to the small lines, it

In his barriers-to-entry analysis of the airline industry, Caves uses the structure presented in Bain's *Barriers to New Competition* and narrows the focus to three criteria: economies of scale, product differentiation, and absolute cost barriers.[125] Economies of scale have been dealt with above,[126] and Caves concludes that with the exception of safety, product differentiation[127] has very "little significance as a general feature of market structure in the airlines."[128] Hence, the existence of barriers to entry depends upon Caves' absolute cost barriers. Caves defines that term as "elements which place the costs of the new carrier above those of existing carriers at any given scale of operation . . . ."[129]

Caves found only one important absolute cost barrier: "capital requirements that are large in comparison to the capital-rationing practices enforced by lending institutions."[130] He argues that this characteristic makes it easier for established firms to obtain needed capital than it is for new firms. In reaching this conclusion, he assumes the existence of a minimum efficient size—a minimum optimal scale of operations.[131] Furthermore, he assumes that "capital-rationing practices of lending institutions" would operate to deny a new firm such large quantities of

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is possible that they have achieved more efficiency, since, when placed together with the medium-sized carriers in 1963 for comparison with the Big Four, their costs were down to 92.0. T. LEVIN, AN ECONOMIC STUDY IN AIR TRANSPORTATION: LOCAL SERVICE AIRLINES 89-90 (1965) (table V) [hereinafter cited as LEVIN].

125. CAVES, *supra* note 29, at 84.

126. *See* text accompanying note 122 *supra*; *but see* CAVES, *supra* note 29, at 88 (here, Caves concludes that there is a minimum optimal scale of operations for trunkline carriers, thereby implying the existence of some scale economies).

127. By "product differentiation," Caves refers to the consumer's ability to evaluate a product of a given industry (here, the service of the airlines) and to choose on the basis of tangible factors between competing products. CAVES, *supra* note 29, at 88. Apparently, the greater the ability to choose between competing products, the lesser the significance that product differentiation has with respect to barriers to entry. Caves excepts safety from the insignificance of this category because of a perceived traveller inability to evaluate statistically the relative safety of various airlines.

> [W]hen considered as a possible source of barriers to new competition . . . [safety] becomes . . . significant. The new airline, particularly if it seeks business on the basis of low price and relatively spartan service, might well face a disadvantage due to consumer suspicion of its safety, whether objective information warranted it or not. . . .. [T]he question before us is whether an existing certified carrier would have a product differentiation over a new one or alternatively, with no certification, whether a carrier with a well-known history of regular operation would have such an advantage. In this setting the product-differentiation advantage of an existing carrier would probably be small or transient or both.

Id. at 88-89.

128. *Id.* at 88.

129. *Id.* at 89.

130. *Id.*

131. Implicit in this assumption is the existence of significant scale economies in the airline industry. Yet Professor Jordan's study and Caves himself conclude that such economies of scale cannot be attributable to the airline industry. *See* text accompanying notes 122-124 *supra*. If Jordan is correct, then this assumption may be invalid.

capital.[132] The evidence offered in support of these assumptions, however, is weak. Caves implies that the difficulty encountered by existing airlines in obtaining capital would be magnified with respect to a new entrant.[133] He offers no empirical evidence to support this speculation.[134]

Indeed, a persuasive counter-argument can be speculated. Although an inexperienced new entrant would undoubtedly encounter obstacles in seeking capital sufficient to enable it to immediately operate on the same scale as United Airlines, this seems beside the point. With respect to barriers to entry, so long as profitable operations can be attained on a small scale, no logical obstacle prevents a new entrant from gradually building itself into a major competitor. At the outset of such a climb, that entrant's capital requirements would be substantially lower than those of the Big Four. Furthermore, the difficulty encountered by the large airlines in obtaining capital could work to the advantage rather than the disadvantage of new, small entrants. This difficulty is thought, in part, to be based on the risk involved in obtaining profitable routes. The nature of the size of large airlines indicates that they would be more risky because of less flexibility in adapting to changing market demands, whereas the smaller firms could adapt quickly, particularly under conditions of freer entry. This adaptability should make it easier for the smaller competitors to maximize profits, a factor that would be viewed with favor by any money lender.

Additionally, "the fact that the federal government felt it necessary to assist the financing of the local-service carriers by means of a guaranteed-loan program,"[135] is also used by Caves to justify his conclusion that barriers to entry are high. This fact's logical relevance to absolute cost barriers is tenuous at best. The subsidization of local service carriers is irrelevant in an analysis of trunkline carriers' capital requirements because of the inherent differences in the markets served.

Finally, it would appear that the rate of return on capital in the airline industry is very close to the average rate of return earned by all active corporations.[136] Although one might argue that deregulation could lower

132. CAVES, *supra* note 29, at 89.

133. *See* LEVIN, *supra* note 124, at 89 (who supports Caves conclusion but also offers no evidence).

134. CAVES, *supra* note 29, at 91.

135. *Id.*

136. Dr. Thomas Keeler concluded that the pretax rate of return on airline capital was 12 percent, while the General Accounting Office concluded it was only 10.5 percent. LOWER AIRLINE FARES, *supra* note 99, at 23-25. Keeler's explanation for this difference was that "the set of approximate adjustments he made to consolidate aggregate corporate financial and income statements for all active corporations" differed somewhat from the GAO's disaggregation adjustments. *Id.* at 25. At any rate, both conclusions put the airline rate close enough to the average rate to make the differences de minimus for the purpose of analyzing capital cost barriers to entry.

that return, a recent study by the General Accounting Office which examined deregulation's probable impact on fares suggests a contrary conclusion.[137] Thus, airlines should have no more or less difficulty in obtaining capital than similarly situated non-regulated industry firms. Cave's ultimate conclusion, then, that the airline industry has moved into Bain's category of an industry with "substantial barriers" is at best unsupported.[138] Since evidence to the contrary exists, the better conclusion is that significant barriers to entry do not exist.[139]

The inability to characterize the airline industry market structure as containing significant economies of scale and barriers to entry removes the justification for applying natural monopoly and public utility concepts to that industry.[140] The absence of these characteristics renders it impossible for the larger airlines to operate at lower average costs than the smaller airlines. Thus, the objective of establishing airlines' natural monopoly capabilities cannot be accomplished through entry/exit regulation.

Technological Advancement

The final economic objective sought by advocates of continued regulation is the promotion of technological advancement in the airline industry. In one sense this goal is related to the promotion of safety, for as the technology improves, so does the ability to maintain safe operations. The premise that underlies the proposition that regulation will better enable attainment of this goal is that a reduction in profits, which arguably would accompany increased competition, also reduces the resources that can be devoted to airline technology.[141]

Improved airline technology is financed by airline manufacturers through profits earned on the sale of airline equipment. Clearly such technology is directly affected by the profitability of air carriers. Only if such carriers can afford to purchase new equipment will those manufacturers have sufficient profits to finance research and development.

Once again, Professor Jordan's study suggests that this process is not advanced by entry/exit regulation. Jordan points out that while the

137. *Id.* at 23-26.

138. CAVES, *supra* note 29, at 91.

139. *See* text accompanying notes 118-124, *supra*.

140. Levin states:

> The [Civil Aeronautics] Act combines regulation of a public utility nature with a mandate to promote civil aviation. It is this combination of promotion and regulation of an industry which does not possess the "natural monopoly" characteristics of most public utilities which complicates the administration of the Civil Aeronautics Act.

LEVIN, *supra* note 124, at 51.

141. *See* note 55 *supra*.

present CAB regulatory scheme has created a cartel,[142] that cartel is imperfect because it does not allocate industry profits according to a prearranged plan.[143] Related to this imperfection is the CAB's failure to control service quality competition.[144] This failure, in fact, has resulted in intense competition by the airlines with respect to services according to Jordan.[145] This competition in effect has consumed any "excess" profits that might have been earned through the establishment and maintenance of a price above the price that the competitive market would have sustained. Hence, the artificially high profits which theoretically could have been used in purchasing new equipment, thereby promoting improved technology, were merely transformed into artificially high service levels.[146] What this implies is that the regulated airlines have not in fact earned profits which are higher than would be earned in a competitive market. Rather, their gross revenues have been higher than the gross revenues in a competitive market. The excess expense which reduced these profits to a normal level went to improved service quality, and not improved technology.

Since the excess profits which would theoretically be used to advance airline technology are virtually nonexistent in the regulated market, it is difficult to argue that regulation is needed to continue rapid advancement of airline technology. Excess revenues which might be available from the regulated industry are completely consumed by service competition between regulated firms. Hence, the final economic objective used to justify entry/exit regulation is not necessary for attainment of any of the goals sought by regulation. The answer to the question, "is regulation necessary to attain the objectives sought by regulation?" is "no."[147] Therefore, alternative methods for deregulating entry/exit aspects of the industry must be examined to discover a way to maximize the desired objectives.

DEREGULATION: THE ALTERNATIVES

Much of the empirical economic evidence examined in the previous

142. JORDAN, *supra* note 10, at 226-28.

143. *Id*. at 229.

144. *Id*.

145. *See id*. at 34-56:

> The relevant question is whether the extra quality [which is purchased with the higher interstate price] is worth the extra cost. . . . [I]t appears that the unregulated California markets come much closer to matching service quality and price with passenger preferences. . . . Thus, it would appear that the major cost of regulation is a non-optimal price-quality mix.

DOUGLAS & MILLER, *supra* note 35, at 145-46.

146. The excess profits have not gone to the purchase of new equipment and hence aircraft manufacturers have not been the beneficiaries of the excess revenues available in the regulated economy. They are the chief innovators with respect to airline technology.

147. DOUGLAS & MILLER, *supra* note 35, at 178.

sections of this article has been available for some time. For example, Professor Jordan published his incisive study in 1970, almost coinciding with the commencement of the CAB's "route moratorium."[148] This raises the question of how the CAB could justify the policy of not setting route applications for hearings in light of the overwhelming evidence that consumers would be the direct beneficiaries of new entry.[149] Ironically, Professor Jordan suggests that the congressional intent was to protect existing carriers from the rigors of competition,[150] which, if true, could provide justification for such a route moratorium. This is in fact what the CAB has done in implementing its statutory mandate over its 39 year history; the CAB has protected the market positions of grandfather

148. *See* text at note 38, *supra*.

149. The answer to this question is elusive due to the "secrecy and . . . highly improper procedures" surrounding the formulation of the "route moratorium." *Comm. Print, supra* note 15, at 86. Apparently, the various CAB Commissioners who recognized this policy were responding to industry suggestions that airlines needed an opportunity to digest new routes which had recently been awarded. They were also responding to perceived financial difficulties of the airlines. *CAB Hearings, supra* note 8, at 652, 653 (testimony of G. Joseph Minetti, member, CAB). No explicit justification was ever found necessary because the route moratorium was "a policy decision by the Chairman, taken without hearings or formal consultation with other members . . . ." *Comm. Print, supra* note 15, at 87.

One might think that judicial review of such a policy would have obviated the problem. However, reasons for the lack of such review are obvious.

> The combination of (a) the Board's practice of determining the merits of a route case on the procedural motion for an expedited hearing, (b) its refusal to hold a hearing on the matter of a general change in route policies, and (c) the Board's claim that its failure to grant hearings are simply a matter of controlling its own docket, . . . make judicial review difficult—or impossible—to obtain. Moreover, any carrier successful in proving that the Board wrongly changed its route policy without a hearing, or challenging the Board's decision successfully in some other way, would obtain as judicial relief only an order for a new hearing before a now-hostile Board. Since the standards used by the Board in granting route awards are so vague, it is unlikely that the carrier could force the Board to award it a route. Thus there was little incentive to mount a court challenge.

Id. at 88.

150. Jordan's analysis goes as follows:

> There is abundant evidence that air transportation is not a natural monopoly—that is, that there are few, if any economies of scale available in nonregulated airline operations. This and other data provide good reason to believe that the nonregulated, open-entry airline market structure would approach a competitive market structure, thereby maximizing overall consumer benefits while yielding efficiency in production and exchange. It follows that if Congress believed that the public interest should be equated with consumer benefit, Congress would have adopted a policy of nonregulated open entry for the airlines. But instead Congress enacted the Civil Aeronautics Act of 1938, and then, after observing twenty years of CAB performance during which entry was largely closed, it left the CAB's economic regulatory powers essentially unchanged when enacting the Federal Aviation Act of 1958. This demonstrated that Congress believed the CAB's performance to have been appropriate and believed that the public interest included more than consumer benefits.

PERSPECTIVES *supra* note 10, at 60-61.

Two flaws in Jordan's analysis render his conclusion with respect to Congressional intent incorrect. First, the data which demonstrates that the airline industry approaches a competitive

carriers to the virtual exclusion of all others.[151] Given the statutory mandate of promoting the public interest, is the CAB's policy fulfilling this mandate?

An examination of the statutory definition of "public convenience and necessity"[152] leads to the conclusion that a route moratorium would be justifiable under the statute had the Board followed proper procedures in formulating such a policy.[153] That definition is broad enough so that the concept can be interpreted reasonably to mean almost anything. No standards are given to the CAB to formulate a *proper* adaptation of the air transportation system to present and future needs of commerce.[154] Advantages which are *inherent* in an air transport system by definition should exist without the aid of governmental planning. *Sound* economic condition is not defined in the CAA.[155] Protecting existing carrier's market positions is not necessarily inconsistent with adequate, economical, and efficient service.[156] Although competition is mentioned as a goal, it is required only to the extent necessary for the *sound* development of an air transport system *properly* adapted to the needs of

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market structure was not convincingly available until Jordan published his study in 1970, 12 years *after* the enactment of the Federal Aviation Act of 1958. Second, while that Act left the economic regulatory powers of the CAB virtually intact, such a reenactment of provisions was to "be considered as an absolute neutral factor in any question of interpretation which may arise in the future." *Air Transportation Development and Airspace Problems*, H.R. REP. NO. 2360, 85th Cong., 1st Sess., *reprinted in*, [1958] U.S. CODE CONG. & ADMIN. NEWS 3750, 3755. This probably should be taken as an indicator that Congress simply did not reexamine economic regulation in the 1958 legislation. Its concern was focused elsewhere. Thus Jordan's reliance on statutory reenactment as evidence of Congressional acquiescense in a protectionist policy is misplaced.

151. *See* note 67 and accompanying text *supra*.

152. *See* text accompanying note 27 *supra*.

153. Looking to that definition, the CAB could have determined that new routes were presently inadvisable in order to maintain "sound economic conditions" in air transportation. The possibility that carriers were suffering financial difficulties at that time lends credence to such an argument. *See* note 149 *supra*.

154. It seems an awesome burden to place on anyone the task of predicting something as unpredictable as the "future needs of commerce!"

One might argue that the CAB could have exercised its discretion more appropriately, and its failure to do so thus constitutes an improper exercise of discretion. Such an argument, however, is circular because a determination of what is "proper" necessarily depends on the decision maker's personal opinion. Clearly two people can reasonably arrive at quite different conclusions given the same information. To a large extent, such opinions will depend on the philosophical and political orientation of the decision maker.

155. If we define "sound economic conditions" in a given line of business to mean the permanent profitability of every firm in that line, then there is little doubt that one way of promoting these conditions (though not of assuring them) is the use of governmental power to quash any serious competition, both from new firms and among the fortunate incumbents.

Keyes, *A Reconsideration of Federal Control of Entry into Air Transportation*, 22 J. AIR L. & COM. 192, 197 (1955).

156. Often, the effect of a CAB decision is to protect existing carriers while the CAB justifies the decision on other legitimate grounds. "[T]he Board . . . in almost all [cases] in which it has

commerce and is prohibited to the extent that it is perceived as destructive or unfair.[157] And finally, promotion of a cartel is not inconsistent with development of civil aeronautics.

The basic problem stems from the vagueness of the congressional intent to promote the public interest through the use of a public convenience and necessity standard.[158] By itself, this standard is objectively undefinable:[159] what may be in the interest of one segment of the public may undercut completely the interests of another segment of the public.[160] Congress apparently recognized this because it attempted to define the term in an objective manner. Unfortunately, as the foregoing discussion indicates, its "objective" definition embodies inherently inconsistent and subjective terms. The inability for the CAB to simultaneously maximize all elements of the definition leaves open the possibility that widely disparate interpretations could occur from period to period, while still remaining consistent with the statutory language. Yet the foregoing analysis indicates that the results of such inconsistent interpretations bear little relation to the economic objectives sought by regulation, and vary substantially from the concerns of Congress when it enacted the CAA.

The initial portion of this article identified and analyzed the economic objectives which generally are considered as reasons for regulating. However valid a congressional pursuit these objectives may be,[161] it also has been seen that the objectives are not necessarily achieved by entry/exit regulation, and that the vagueness of the statutory language permits continued pursuit of these objectives through regulation despite an inability to achieve them. New legislation is required to prevent further pursuit of economic objectives through statutory language which can be interpreted legitimately to effectively undermine those very objectives.

Congress presently is aware of this need, as evidenced by a variety of recent legislative proposals that would alter existing airline regulation. These proposals are divisible into two categories: one type would con-

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dealt with the relative merits of authorizing service by a 'newcomer' as compared to an established company, base[s] its decision[s] on specific and positive advantages other than the protection of existing carriers . . . ." KEYES, *supra* note 35, at 172.

157. *See* H. FRIENDLY, *supra* note 40, at 74-105.

158. "Once the decision is taken to restrict route awards beyond the 'fit, willing and able' criterion, proceedings lengthen considerably and it becomes difficult to find a coherent set of standards that will not have the effect of restricting entry entirely." *Comm. Print*, *supra* note 15, at 95.

159. *See* PERSPECTIVES, *supra* note 10, at 58.

160. "It is often said that the proper role of regulation is to serve the 'public interest,' but this raises the twin problems of defining just what comprises the 'public' and identifying just what is in their best 'interest.'" *Id*.

161. *See* note 2 *supra*.

tinue the need for a certificate of public convenience and necessity but would redefine "public convenience and necessity" to make explicit a congressional intent to promote competition through freer entry policies; the other type would eliminate the concept of public convenience and necessity and only require that carriers obtain a certificate of fitness. In seeking an effective deregulatory proposal[162] an examination of these two types proves useful.

The proposals which retain the requirement of a certificate of public convenience and necessity typically include a redefinition of that term. Those proposals contain many similar elements in the redefinitions. However, the following elements of various redefinitions exemplify the variances of the pending bills:

> The phased and progressive transition to an air transportation system which will rely on competitive market forces to determine the variety, quality, and price of air services, through the facilitation and promotion of entry and potential entry of new carriers into all phases of air transportation, meaningful price competition, and optimal carrier efficiency . . . .[163]
>
> Reliance on entry of new carriers to provide a variety of efficient and innovative low-cost transportation services . . . .[164]
>
> The reliance on entry or potential entry of new carriers into all phases of air transportation to provide the stimulus for the provision of efficient and innovative air transportation with a meaningful price competition and optimal carrier efficiency. (4) The continued access of rural or isolated areas to the Nation's air transportation network with direct Federal assistance where appropriate. . . .[165]
>
> The encouragement of new carriers; (5) The provision of a variety of adequate economic, and low-cost services by air carriers . . . .[166]

In addition to offering substantive changes in the definition of public convenience and necessity, some of these proposals would change the weight that the CAB must place on that term in deciding whether or not a certificate will be issued. A bill introduced by Senator Cannon in 1976 would have required that a certificate be issued to a new applicant "unless . . . such transportation [was] not required by the public con-

162. Deregulation here does not necessarily refer to complete abandonment of regulation of the airline industry. While such a situation might be justifiable and even advisable in the long run, it is clear that such a proposal would presently be politically infeasible. Thus, it is probable that deregulation will come through implementation of gradual steps.

163. 122 CONG. REC. S8656 (daily ed. June 8, 1976) (S. 3536 introduced for the CAB by Sens. Cannon and Pearson).

164. 122 CONG. REC. S16164, S16166 (daily ed. Sept. 20, 1976) (S. 3830 introduced by Sen. Cannon).

165. 123 CONG. REC. S877 (daily ed. Jan. 18, 1977) (S. 292 introduced by Sens. Pearson and Baker).

166. 123 CONG. REC. S2489 (§ 5) (daily ed. Feb. 10, 1977) S. 689 introduced by Sens. Cannon and Kennedy).

venience and necessity."[167] Arguably, this language would create a rebuttable presumption in favor of a route applicant that a route was required by the public convenience and necessity. This presumption would be rebutted by a showing *on the part of an opponent* to the route application that the public convenience and necessity did not require the granting of this route. An alternative interpretation, however, would read this language as not shifting any burden of proof away from the applicant. The use of the double negative, "unless . . . not," is sufficiently ambiguous as to allow both interpretations.

The 1977 Cannon-Kennedy proposal would also require issuance of a certificate without demanding a showing that the public convenience and necessity *required* such issuance. Rather, the Board would be required to issue the certificate "unless the Board finds that such transportation is not consistent with the public convenience and necessity."[168] Again, it would appear that this proposal would create a presumption of consistency with the public interest, although it is conceivable that the use of the double negative could result in a contrary presumption.

Changing the weight attached to the public convenience and necessity from an affirmative "requirement" to a mere showing of "consistency" offers the CAB an opportunity to loosen its entry policy. Unfortunately, "consistency," "requirement," and perhaps even "unless inconsistent" are all sufficiently ambiguous terms, when used in conjunction with public convenience and necessity, to lessen considerably the impact that these legislative changes would have on CAB policies in the long run. The language is vague enough to permit the CAB not to take this opportunity to loosen its entry policy and still remain within the parameters of the present or even proposed statutory language. The CAB could effectively interpret these terms to preclude new entry without abusing its authority.

These proposals become no more helpful when read in conjunction with the redefinitions of public convenience and necessity discussed above. Even the most explicit of definitions includes the safety valve of "among other things,"[169] thereby offering the CAB an opportunity to use its own criteria for defining the term. Neither the statute nor any of the proposals state the amount of "consideration" that the CAB must afford to the statutory criteria. Thus, the proposed changes retain much of the

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167. 122 Cong. Rec. S16164, S16166 (daily ed. Sept. 20, 1976) (S. 3830). *See* text accompanying note 164 *supra*.

168. 123 Cong. Rec. S2487, S2489 (§ 9) (daily ed. Feb. 10, 1977). *See* note 110 *supra*.

169. All of the proposals included language such as this: "the Board shall consider the following *among other things*, as being in the public interest." 123 Cong. Rec. S2487, S2489 (§ 5) (daily ed. Feb. 10, 1977) (emphasis added).

inherent vagueness of the present statutory language,[170] and thereby leave open the possibility for coexistence of widely disparate policies which bear little relationship to the concerns of Congress.

The only legislative proposal to date that would have eliminated the requirement of considering the elusive public convenience and necessity in a route application proceeding was S. 3364, introduced in 1976 by Senator Kennedy at the close of the Subcommittee hearings concerning the CAB.[171] That bill provided for a four-year transition period[172] to a system which would have mandated that the CAB issue a "certificate of fitness" to any carrier capable of demonstrating that it was "fit, willing, and able to perform the air transportation applied for."[173] Since this requirement presently exists, air carriers and potential air carriers can look to past Board decisions interpreting this relatively objective language for guidance in meeting this requirement. More importantly, however, this virtually eliminates CAB discretion to restrict entry and exit[174] for economic reasons in the airline industry.[175] In effect, then, this certificate of fitness can be equated with an operating license of a business which must be granted if the applicant can show that it is objectively capable of performing the proposed service.

This legislative proposal provides an example of what should be sought in eliminating entry/exit regulation from the airline industry. First, its elimination of the presently required showing of public convenience and necessity cuts to the heart of present regulatory problems. It removes the CAB's ability to roam at will on a broad range of interpretation in which it can justify virtually any entry/exit policy which it deems to be within the public interest at that moment—from completely closed to completely free entry. Second, the resulting system under such a proposal would be much better adapted to maximization of the economic goals sought through present regulation. This is evidenced by entry/exit regulation's inability to induce significant service to small communities, its inability to provide for a safer or more technologically advanced

170. *See* notes 152-160 *supra*.

171. 122 CONG. REC. S6295 (daily ed. May 3, 1976).

172. *Id.* at S6297 (Subtitle IV-C).

173. *Id.* (Subtitle IV-B §§ 451(a), 451(d)). Section 451(d) provides: "The Board shall issue a certificate of fitness upon a finding that the applicant is fit, willing, and able to perform the air transportation applied for." *Id.*

174. Section 460 provides that "each air carrier may reduce, increase or otherwise alter the level of air service, or cease all air service to a point it is authorized to serve." *Id.* at S6300.

175. In addition to this substantive limitation of discretion, this act would have provided for an expedited application process where a certificate would be granted automatically if the CAB failed to act on an application within 180 days. *Id.* at S6297 (§ 451(c)). This procedure would substantially lessen the CAB's ability to operate under an informal route moratorium. *See* note 39 *supra*.

industry, and its inability to capitalize on non-existent market structure characteristics. These failings would not exist under competitive conditions. Finally, the four-year transition period would enable an orderly change from a highly-regulated to a significantly less-regulated market structure. It would mitigate the fear of chaos caused by sudden change while at the same time acting as a controlled experiment to test the theory that greater competition will benefit consumers more than regulation does.[176] Thus, such a proposal offers an opportunity to maximize the goals sought by economic regulation of the airline industry, and also provides a forum in which the effect of greater competition on consumers can be ascertained more accurately than under the present scheme.

CONCLUSION

This article has sought to develop an objective framework within which the issue of entry/exit deregulation of the airline industry may be dealt with effectively. It was seen that the underlying economic premise thought to justify economic regulation of entry/exit aspects in the airline industry proved to be invalid. Furthermore the available economic evidence leads most economists to conclude that the airline industry approximates a competitive market structure. That being the case, the logical conclusion is that Congress should lean heavily toward revamping its regulation of the airline industry so that the beneficial elements of the competitive market may operate freely.

A number of pending or past legislative proposals have been examined briefly. Only one of those proposals offers an efficacious solution to the problems caused by present regulation, because it was the only proposal that eliminated the concept of the public convenience and necessity from certification requirements. Additionally, its transition period offers economists an opportunity to evaluate the precise effects of deregulation, and, if necessary, seek legislative solutions to unforeseen problems. Most importantly, the proposal's increased reliance on competitive market forces will better enable the consumer to reap the full benefits that necessarily will accrue from competition for the transportation dollar.

176. A word of caution in evaluating the effects of freer entry/exit during this period is necessary. Any system attempting to mix regulation and competition undoubtedly will contain some imperfections. In evaluating the results obtained under such a system, the analyst should be exceedingly careful to avoid attributing problems to the existence of either the regulatory or the competitive elements. The fact may be that the problems arise specifically from the mix rather than from the separate elements. If problems are mistakenly attributed to the wrong cause, any solution geared to eliminating that cause will create greater problems than existed previously.