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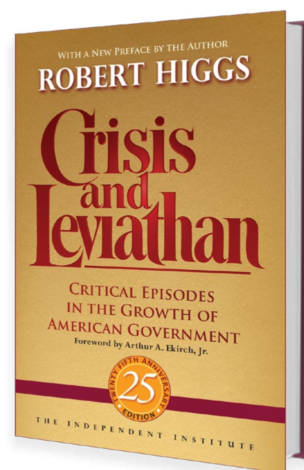

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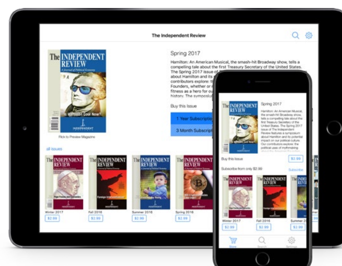

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What Caused Airline Deregulation: Economists or Economics?

Gary McDonnell

A robust economic theory of regulation should be able to explain deregulation (Peltzman 1989). Nevertheless, the idea that economic regulation has interest-group origins has been less controversial than the origins of deregulation. In *The Politics of Deregulation* (1985), Martha Derthick and Paul Quirk describe the historical process of deregulation as one where regulatory agencies were captured by industry, but politicians, through congressional oversight and public hearings, called regulators to task for blatant protectionism.[1] Various reformers, aided by the analysis of economists and the appointment of reform-minded individuals (such as Alfred Kahn) to head the Civil Aeronautics Board (CAB) and other regulatory commissions, created de facto deregulation. By demonstrating the efficacy of regulatory reform, reformers eventually drove the creation of legislation to deregulate entry and pricing. A significant share of the credit for this reform is given to economists. Quoting an

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1. Derthick and Quirk's analysis is fundamentally an attempt to answer a question regarding social phenomena that intellectuals have been debating for centuries (see Grossman 1943): Do ideas or "social forces" drive change, or do economic forces in the form of individual incentives drive changes? Even economists disagree as to cause and effect in the instance of airline deregulation. Elizabeth Bailey, a prominent regulatory economist, has stated that "[a]ir passenger deregulation was driven in no small measure by the purveyors of ideas" (2008, 1). Another prominent regulatory economist has noted that "one does not have to be a cynic . . . to question the thesis that it was persuasive testimony of regulatory economists that moved Congress to reverse course so suddenly in the 1970s" (Crandall 1986, 174).

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economist speaking to a gathering of his colleagues, Derthick and Quirk argue that "the fight for deregulation of transportation 'has been the story of a few brave but lonely economists stubbornly attacking the American economy's largest legal cartel'" (1985, 9). However, in Derthick and Quirk's view, economics—capture theory—cannot explain this political change. "We would not have bothered to attempt this analysis were we persuaded that deregulation is explicable mainly by reference to economic events" (1985, 19).[2]

George Stigler's seminal essay "The Theory of Economic Regulation" (1971) postulated that regulated firms succeed in capturing their relevant oversight agency. The agency then supplies regulation beneficial to the industry—limiting entry or regulating higher prices or both—which comes at the expense of relatively unorganized consumers and potential competitors to regulated firms. Narrow interests thus succeed in *capturing* the regulatory process. Sam Peltzman's (1976) formalization of Stigler's postulation showed that pure profit maximization for the regulated firms is not the typical regulatory outcome. Nevertheless, Derthick and Quirk prefer a "politics of ideas" explanation for *de*regulation because"[t]he most active and powerful organized interests [the regulated industry] were opposed to the policy change" (1985, 26). They aver that "[b]y the end of the 1970s, capture was nowhere in sight" (91). Their skepticism that capture theory can explain deregulation is warranted.[3] However, skepticism regarding the politics of ideas as a sole explanation for deregulation is also warranted.

Wayne Leighton and Edward Lopez's recent book *Madmen, Intellectuals, and Academic Scribblers* (2013) seeks to incorporate ideas into an economic framework to better understand political change. In their analysis, ideas are akin to higher-order capital goods that interact with incentives and institutions to affect political outcomes. "In short, political change happens when entrepreneurs notice and exploit those loose spots in the structure of ideas, institutions, and incentives" (134). Economic and "politics of ideas" explanations are not mutually exclusive. Given that all parties to political exchange face constraints, respond to incentives, and have their choice sets shaped by institutions, it can be shown that "political transactions costs and institutions influence the market for regulation," through which "the optimal regulation can shift with exogenous market shocks and endogenous responses to existing regulations" (Lopez 2010, 380).

This essay uses air-passenger deregulation as a case study to illustrate the nexus between ideas, institutions, and incentives in deregulation and to show that in this

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2. Quirk acknowledges that an economic theory of politics can be much more encompassing than the Stigler model: "an economic theory is one that assumes rational, goal directed behavior by all relevant agents and uses arguments from economic theory to predict behavior" (1988, 32).

3. Richard Posner has argued that there are some deficiencies in the political scientist's capture theory: this explanation "do[es] not tell us why some interests are effectively represented in the political process and others not, or under what conditions interest groups succeed or fail in obtaining favorable legislation" (1974, 341).

process both economics and ideas played a role. For example, regulatory agencies will not remain captured when exogenous and/or endogenous shocks upset political equilibrium and impose costs on elected officials (Weingast 1981; Weingast and Moran 1983). Furthermore, political actors face limited and scarce information. It can be shown that political institutions and ideas aid legislators in market-testing new legislation (Weingast 1981; Weingast and Moran 1983). Political institutions also shield them from the perception of opportunistic behavior and allow them to reduce transaction and information costs when dealing with interest groups (Tullock 1989; McChesney 1997). In short, I argue that the ideas of economists and interest-group politics together were responsible for deregulation of interstate air-passenger service. To answer my title question: *both* economists and economics mattered.

The Agency–Clientele Model

Barry Weingast has modeled the incentives faced by elected officials and bureaucrats: "legislators are simply assumed to rationally calculate the likely effects of various actions (e.g., voting decisions, introduction of legislation, or agenda control) upon their reelection chances." Furthermore, "[c]ongressmen seek reelection and career advancement. This implies that they bend with the wind of public opinion in general, and further the interests of attentive and politically active interest groups in particular. Often this entails that a particular congressmen becomes identified with a specific policy area" (1981, 155, 151; see also Weingast and Moran 1983).

An implication of the agency–clientele model is that elected officials do not merely respond to interest-group demands; they actively pursue their own interests. Weingast notes that administrative agencies (such as the CAB) operate without extensive intervention from Congress "as long as the relevant variables of public opinion, balance of power of interest groups, presidential initiative, and precential legal decisions are stable" (1981, 160). In this model, congressional oversight of regulatory agencies is loose and informal, where "[legislators] judge the success of agency decisions based on constituency reaction, and not through detailed, systematic study and oversight." For this reason "agencies may appear captured by their clientele" (1981, 153). The implication is that agencies will remain "captured" only if regulation is functioning well from the standpoint of constituency benefits and public opinion. When regulation fails to provide sufficient benefits to constituencies and/or imposes costs in the form of low public opinion of government officials, congressional hearings and investigations may be instituted to "police those areas functioning poorly" (Weingast and Moran 1983, 769). In this model, the "capture" of regulatory agencies by specified interests is contingent on a stable equilibrium—that is, one where the regulatory agency is serving elected officials' interests. During the period leading up to air-passenger industry deregulation, several factors, including the policies of regulators at the CAB, upset equilibrium.

Protectionist Policies Generate Disequilibrium

By the late 1960s and early 1970s, regulation of the interstate air-passenger industry failed to provide targeted returns to the industry. Nonprice competition (i.e., load factors, amenities, etc.), recession, rising fuel costs, and inflation were factors that reduced rates of return in the industry below the target rate of return (Bailey, Graham, and Kaplan 1985, 19). Interstate airlines were earning a rate of return below manufacturing during this period (Bailey, Graham, and Kaplan 1985, 25). In contrast, nonregulated *intrastate* carriers were earning higher profits while charging lower fares than their regulated counterparts (Bailey, Graham, and Kaplan 1985, 30). Rent dissipation not only posed problems for the airlines and regulators but were political problems as well. Profits on high-density routes were meant to subsidize losses on low-density routes. The failure of regulation to deliver profits on high-density routes meant that cross-subsidizing further eroded air carriers' profits, threatening their support for this practice, and potentially threatening the constituencies who benefited from this practice (Peltzman 1976).[4] Regulators interpreted their mandate to be one of maintaining this internal cross subsidy. In response to lower industry returns, regulators at the CAB instituted flagrant protectionist policies:

> [The CAB] refused to process applications by new companies to enter the interstate airline business. It denied standing in regulatory proceedings to consumer interests. It attempted to organize collusive agreements among airlines to reduce service in competitive markets so that airlines could earn higher profits. And it engaged in an almost comical process of trying to cure by regulation the recurrent outbreaks of competition in service amenities, even to the point of writing regulations that defined the size of a coach-class seat and the amount of meat that could be lawfully served on a sandwich. (Noll and Owen 1983, 156)

This behavior brought the rent-seeking aspects of regulation in plain view of the public and contributed to an already low public opinion of government (due to inflation and war, among other things). As one consumer advocate noted in testimony before Congress, "Economic regulation has become a disease, insidiously destroying the long-term potential of the air transportation industry, the affordability of air travel by a large majority of the population, and the faith of citizens in their government" (qtd. in A. Brown 1987, 37). Referring to the CAB's conduct and its effect on public opinion, Derthick and Quirk note that "[t]he themes that anticompetitive regulation had a pro-business bias and that regulatory agencies were at best

4. Weingast notes that prior to the 1970s protectionism "was not an issue." Whereas curtailing service to small communities "was highly visible and a significant issue . . . lost opportunities for fare reductions drew little attention. Since increasing competition risked greater chances of financial problems and service disruption with little promise of political reward, it was avoided" (1981, 166).

incompetent and at worst 'captured' and corrupt had been driven home quite widely by the mid-1970s, even if price and entry deregulation was not, strictly speaking, a mass issue. Anyone with an informed opinion on the subject could hardly have failed to have that opinion" (1985, 41).

Derthick and Quirk acknowledge that the impetus for reform was in no small degree brought about by the attempt to protect the regulated airline industry from competition: "It is often said in Washington, not altogether facetiously, that the CAB chairman who should be credited with deregulation . . . [is] Robert Timm, who was responsible for the unprecedentedly protectionist policies of 1973–74." In other words, "[t]he protectionism of the CAB . . . was so extreme as to constitute a very important stimulus for Reform" (1985, 58). Political disequilibrium was generated by the inability to control competition at all margins and by excessively protectionist policies that dramatically increased costs to consumers, which in turn imposed costs on elected officials, destabilizing what had previously been a relatively stable policy. Negatively impacted constituencies generated an *incentive* among the relevant congressional overseers to correct the undesirable consequences owing in part to administrative behavior. This factor as well as higher fuel costs and inflation combined to set the stage for influential political figures to use "hearings and investigations . . . to influence decisions and stymie unwanted policy initiatives" (Weingast 1981, 152).

Political Entrepreneurship

Politicians seeking to enhance their chances for reelection may respond to the opportunity to draw favor with a new constituency. In the airline case, it was Senator Edward Kennedy who (along with presidents Gerald Ford and Jimmy Carter) played the role of the "political entrepreneur . . . who seeks to change the issues within current public debate and in so doing becomes credited with this effort and subsequent policy initiatives" (Weingast 1981, 162). Senator Kennedy and his aides were able to capitalize on the disequilibrium generated by the CAB.

In late 1974, at the behest of Steven Breyer, then an aide to Senator Kennedy, the U.S. Senate Subcommittee on Administrative Practice and Procedure began investigative hearings (hereafter referred to as "the Kennedy hearings") on airline regulation and the CAB's practices. Though the committee lacked the authority to write new legislation, the Kennedy hearings granted standing to consumer interests as well as to the regulated airlines. The hearings also had the effect of changing how regulators at the CAB interpreted their mandate, directing them toward market-testing new policies before committing to new legislation.

By bringing regulatory failure further in the spotlight, Senator Kennedy was able to benefit politically. He was perceived as sympathetic to the plight of consumers and subsequently credited with instituting change. "'The way to get the press's attention,' a staff aide later said, 'was with the consumer stuff,' not just high prices, but also lost

luggage and suffering of household pets shipped as freight" (Derthick and Quirk 1985, 41).The extent to which the CAB had failed to protect consumer interests while attempting to protect the airlines from the pressures of market competition was consistently highlighted during the hearings. It was noted that regulators had spent 60 percent of their time monitoring charter airlines to be sure they did not undercut the regulated fares of the major airlines, while spending only 3 percent of their time on consumer complaints (Derthick and Quirk 1985, 51).[5]

During the Kennedy hearings, knowledgeable experts—including academic economists, members of the Council of Economic Advisers, and individuals from the Department of Justice—criticized airline regulation on the grounds of efficiency and equity (A. Brown 1987, 108). Intellectual justification gave weight to the criticism directed at regulators. The harmful effect that regulation of structurally competitive industries had on social welfare had been well established in the academic world before the 1970s (see, e.g., Caves 1962; Levine 1965), but, as Weingast notes, this negative effect was "yet to become [a] political issue" (1981, 166). Derthick and Quirk acknowledge the disconnect between the academic critique of regulation—that regulation failed the "public interest" test—and the effect on public policy when they note that "[e]conomists had begun making the bullets of pro-competitive reform fifteen years before politicians found them to be usable in particular battles they wished to fight" (1985, 56). Ideas are useful tools, but they become more effective when accompanied by the appropriate incentives. Derthick and Quirk acknowledge the *incentive* to use "advocates" in such a manner: "Typically, events must occur or background conditions of popular mood or opinion must develop in such a way that the politician sees in the advocates' prescription a way of responding to a problem of particular immediacy or of addressing the rising concerns of the public" (1985, 39).

Although it is difficult to know political actors' motives, the incentive to use the academic critique of regulation was absent until flagrant protectionism brought the rent-seeking aspects of regulation in open view of the public. Thereafter, in an entrepreneurial fashion, a few politicians saw an opportunity to gain politically by addressing this issue—*hence the long delay between the intellectual criticism of regulation and the public-policy response*. They now realized that intellectual justification could aid in shoring up public opinion and help to "stymie the unwanted policy initiatives"—that is, overtly protectionist policies. John Robson, chairman of the CAB during the Kennedy hearings, remarks that the hearings and intellectual criticism of regulation had such an effect: "The fact is I didn't have many views on [airline regulatory policy]. . . . The intellectual underpinnings were available. . . . Then Ted Kennedy had surfaced the

5. This public castigation over the protectionist policies took place in spite of evidence that Congress had in the past sanctioned and even promoted policies meant to maintain industry profit. Anthony Brown provides evidence for congressional sanctioning of rent-seeking behavior: "When the [Civil Aeronautics] Board announced its intention to deny recertification of a local carrier on the basis of high subsidy needs, Congress intervened. The option of denying certification to a local carrier judged to be too dependent on subsidies was removed when in 1955 Congress directed the CAB to grant permanent certificates" (1987, 73).

issue in hearings he held late in 1974 and 1975 so that deregulation became politically more visible" (qtd. in Derthick and Quirk 1985, 69).

The Political Market Test

Elected officials used the embarrassment induced by congressional hearings and the intellectual criticism of regulatory policy as a signal to change the manner in which the existing law was interpreted and administered. At this stage, the factors generating disequilibrium in constituency benefits and public opinion drove legislators and regulators to seek solutions, but they sought those solutions within the confines of the existing legislation.

The Subcommittee on Administrative Practice and Procedure could not initiate legislative changes (specific changes to the law were the responsibility of the Commerce Committee's Aviation Subcommittee). However, the Kennedy hearings were a means to address the poor public perception of government and signaled to regulators a preference for changing the manner in which the law was interpreted (though, as I suggest later, neither the means nor the will was evident at this stage to eliminate price and entry controls). The manner in which legislation is written—usually without specific details but requiring that the law be administered in a manner consistent with the "public interest"—facilitates this process.[6] Derthick and Quirk note, "Congress laid down only the general outline of a mandate or standard of private conduct to be enforced and left the commissions to fill in the detailed requirements" (1985, 62).

Senator Kennedy's hearings were successful in prompting regulators at the CAB to change how they interpreted their mandate. "The CAB reversed most of its policies criticized during the Kennedy investigation between December 1974 and the opening of the Cannon subcommittee hearings in April 1976" (A. Brown 1987, 112). CAB chair John Robson subsequently began promoting consumer-friendly "peanuts" fares,[7] price discounts to fill empty seats. In this manner, the CAB "performed an important 'market test' for Congress" (Weingast 1981, 169). Changes in the administration and enforcement of existing regulation are not inhibited by the cumbersome legislative process. Though referring to this test as a "demonstration effect" rather than a "market test," Derthick and Quirk acknowledge its political advantages: "Moreover, to the extent that the commissions did decide to moderate or cease anticompetitive regulation, the consequences for economic behavior could be

6. William Landes and Richard Posner (1975) argue that this indirect relationship hides and facilitates interest-group favors by establishing vague directives under which agencies are to administer legislation ostensibly in the public interest. Derthick and Quirk offer a different explanation, consistent with the public-interest theory of government: "Congress could have enacted detailed regulatory statutes, but preferred that experts with broad delegations of regulatory authority act on its behalf" (1985, 62).

7. President Ford appointed John Robson as CAB chairman in 1975. Robson "experimented with fare competition." Peanuts fares were "off-peak" fares offered by Texas International. American Airlines labeled its off-peak fares "Super Saver" fares (Vietor 1992, 35).

counted on to develop promptly, for they did not depend on any elaborate process of implementation by government" (1985, 63).

Weingast notes that lower fares were successful, generating benefits for consumers, but also proved profitable to the airlines and implicitly to members of Congress: "Indeed fares were down and profits were up, clearly demonstrating that decontrol was not the dangerous, disastrous alternative that pessimists and protectors of the status quo had predicted. . . . [B]y inventing a mechanism within existing laws, [the CAB] avoided the need for new legislation prior to policy change; and second, they implemented change in a nondisruptive manner, demonstrating viability" (1981, 169).

These policies benefited consumers and increased industry profits, but "[h]ad the attempt been unsuccessful, Congress would have denounced the [CAB] and curtailed the decontrol program" (Weingast 1981, 169). Legislators, in other words, had a viable exit strategy had the market test or demonstration effect proven unsuccessful from a constituency standpoint. Success of the market test opened the door to proceed with new legislation.

The Cost of Changing Legislation: Opportunistic Behavior

In private markets, the prospect for opportunistic behavior, lack of information, and transaction costs can limit exchange. These factors may also limit political exchange. Fred McChesney (1997) has applied Ronald Coase's (1937) theory of the firm—in terms of information costs, transaction costs, and opportunistic behavior—to political behavior. In his model, the politician's role is extended from one who not only facilitates exchange to one who actively seeks to enhance his own well-being. "Politicians are seen not as mere brokers redistributing wealth in response to competing private demands, but as independent actors making their own demands to which private actors respond" (McChesney 1997, 157). Politicians are akin to entrepreneurs who seek innovative ways to enhance their "political utility." In McChesney's analysis, attracting contributions from interest groups, either to create rents or to avoid the threat of expropriation, requires that politicians be able to make "credible threats" to private wealth and/or to establish *durable* legislative deals with interest groups. "If durability cannot be achieved in rent creation, whether because politicians act opportunistically or because only short term deals are made, both private producers and politicians will invest less in working toward creating rents" (1997, 89). Blatant repeal of legislation might prove costly to both politicians and interest groups.

Kennedy's aide Steven Breyer suggested that the subcommittee members holding the Kennedy hearings had to walk a tightrope between the potential gains from legislative reform and the maintenance of relations with important and influential constituencies: "[T]here may be an *advantage* in placing initial responsibility for

reforming a particular program in the hands of a committee that does not ordinarily supervise the agency concerned." And "[a]s an outsider the subcommittee was not *constrained* or *tainted* by direct political ties with the regulated agency" (qtd. in A. Brown 1987, 136, emphasis added).[8] As mentioned earlier, Senator Kennedy's committee did not have direct control over writing legislation. Its goals for regulatory reform were modest, within the confines of the current law, and less likely to be construed as hostile to the regulated industry (the focus of the Kennedy hearings was on regulatory conduct and so also included input and complaints from the regulated firms). The committee selection and the market test were therefore political institutions and practices that provided information and helped to overcome at least the appearance of opportunistic behavior.

The hearings held by the Aviation Subcommittee (the body responsible for legislative changes) had a different tone than the Kennedy hearings. When Senator Howard Cannon's Aviation Subcommittee began to examine regulatory reform, "his hearings were in the nature of legislative explorations rather than critical oversight of the commissions and began with an impartial tone" and thus did not seek to gather the attention of the press and the public (Derthick and Quirk 1985, 67).[9] The ultimate outcome of crafting new legislation was the elimination of the regulatory body, the CAB. Nevertheless, strong ideological commitments to the elimination of price and entry controls (as well as of the CAB) were evidently absent during the legislative process leading up to the Airline Deregulation Act of 1978. Derthick and Quirk give no indication that a commitment to complete decontrol of entry and pricing was the part of any reformer's agenda. (This topic is discussed further in the appendix on Alfred Kahn's view of deregulation and how it is consistent with the analysis here.)

A summary of the final bill from the Aviation Subcommittee noted that the subcommittee "has by no means concluded that total deregulation is desirable" and that the only reform required was "a moderate, controlled release of some regulatory fetters" (Congressional Record, September 14, 1978, 29528, qtd. in Derthick and Quirk 1985, 58). It was not until the bill moved through the conference committee that the term *deregulation* was inserted into the title of the bill. The more cautious term *regulatory reform* had been used up to that time. Given this moderate approach to reform, how did legislation that not only eliminated price and entry controls but

8. The appearance of opportunistic behavior may be a particularly acute problem for politicians who wish to seek policy change. Private parties may be less willing to pay for the services of politicians if politicians blatantly and capriciously repeal established legislation whenever there is a change in interest-group power: "there are no legal mechanisms analogous to a binding long-term contract by which an enacting Congress can prevent a subsequent [Congress] from amending legislation in ways unfavorable to a group, or from repealing it altogether! Such bad faith, by reducing the value of legislation to interest groups (and the benefits it bestows), also imposes costs on [current] members of Congress since the price legislators could demand for enacting such legislation would be lower" (Parker 1996, 20).

9. Senator Cannon apparently was a "staunch opponent of deregulation," and, as one observer noted, Kennedy's reform ideas were initially "treated with stony silence" (qtd. in Weingast 1981, 165).

created a "sunset" of the regulating agency itself end up in the Airline Deregulation Act of 1978?

Testing the Willingness to Pay

In both private and political markets, information tends to be scarce, and both politicians and interest groups seek to gather information as cheaply as possible. Legislators prefer to have knowledge regarding the value that interest groups place on political action. McChesney suggests that this information is provided by gauging the groups' willingness to organize effectively: "The total amount of net surplus available is itself a function of the extent of interest group organization" (1997, 145). Interest-group cohesiveness and organization are signals to elected officials regarding the potential value of legislation. Furthermore, the more an interest group is able to lobby and articulate its interests to the legislature with one clear, unified voice, the lower the transaction costs between private parties and politicians. All else equal, better-organized groups are more likely to affect legislation: "[I]t is cheaper to negotiate with an organization representing millions of persons rather than with those millions individually" (McChesney 1997, 83). To summarize, a well-organized group able to articulate its legislative goals will demonstrate that regulation is highly valued and in this way will enhance its rent-seeking ability. "Any private group will be more effective the better organized it is. Greater organization allows a group to make higher pecuniary offers to politicians. It also lowers politicians' cost of negotiations" (McChesney 1997, 144). Politicians, seeking lower costs for negotiating legislation, may go so far as to make it easier for interest groups to organize: "politicians [will] invest resources to encourage—subsidize—otherwise unorganized groups' attempts to organize, so as to lower politicians' cost of negotiating" (McChesney 1997, 157). Interest-group cohesiveness is so important to the political process that politicians are motivated to facilitate interest groups' ability to make deals.

In the 1970s, members of the interstate airline industry apparently understood the potential benefits of speaking with one voice. A memorandum by the Air Transport Association, the airline industry's primary trade group, during the period that members of Congress were considering new legislation, stated that "a positive, unified industry position will substantially increase chances of assuring the best possible legislative result, and help avoid the adoption of extreme or unacceptable proposals" (qtd. in Derthick and Quirk 1985, 158). Moreover, the Department of Transportation produced an analysis that was "designed to assist in tailoring reform advocacy to the particular airlines" (Derthick and Quirk 1985, 157). The industry had much to complain about, individually and collectively, with respect to the old regulatory structure. "[The CAB] refused to allow fare increases to support the burden of underutilized equipment and . . . and in a stock analyst's judgment, had

fare policies such that 'you could never catch up to costs, especially in an inflationary environment'" (Derthick and Quirk 1985, 153).

Nevertheless, in spite of attempts by the trade group and Transportation Department to organize and present a unified position on legislation, "no two carriers took positions that were completely alike," and "there was no clear industry position—no concrete counterproposal nor any clear refusal to contemplate a bill" (Derthick and Quirk 1985, 57). Legislators were willing to write a bill agreeable to the regulated carriers, but the industry was fragmented and unable to articulate clearly a bill that would be agreeable to all. Although still advocating "restricted entry" of new firms, United Airlines, the largest carrier at the time, "defected" and supported some deregulation because it believed it had been unfairly denied new routes by the CAB (Derthick and Quirk 1985, 157). Without enough political organization to have influence in crafting a bill and with both houses of Congress passing separate "reform" legislation, many airline executives reluctantly but eventually threw their support behind some deregulation (Vietor 1992, 34).

Organized labor had much to lose from deregulation. However, one union in particular, the Air Line Pilots Association, did not have an effective lobbying force at the time: "Because the industry had been regulated for so long, the Association hadn't had much need to have full-time lobbyists on staff," notes a retired association legislative counsel (qtd. in Francis 2004, 28). Perhaps the union leaders felt that regulation protected them from competition just as it did the regulated firms, and perhaps the unions felt that the industry would lobby on their behalf.[10] In fact, airline industry executives did use the potential harm to organized labor to argue against reform. Frank Lorenzo, president of Texas International Airlines (who after deregulation would ironically be accused of "union busting"), affirmed in testimony before Congress in 1977 that regulatory reform would be "an attack on the labor movement" (qtd. in Vietor 1992, 34). His statement, however, was one of a number of less than persuasive arguments against reform. Robert Crandall, president of American Airlines, argued that deregulation would lead to "degradation of service, safety, and the integrated air transport network" (qtd. in Vietor 1992, 34).

Even with regulatory reform moving along legislatively, at least one member of Congress was still attempting to promote cohesive lobbying. A sunset provision was introduced late in the legislative process that, if it had been allowed to remain part of the proposed legislation, would have eliminated the CAB. This provision was proposed not by a staunch promoter of deregulation, but by a legislator opposed to deregulation, Congressman Elliot Levitas. "[T]he unstated implication [of the sunset proposal] was that Congress could repeal the provision and there might never be much deregulation" (Derthick and Quirk 1985, 162). As Derthick and Quirk point

10. Derthick and Quirk note that the Teamsters Union was heavily invested in lobbying against deregulation of trucking (even to the point of offering Senator Howard Cannon a bribe) but say only that airline unions were "too small" to be of much influence in the case of airline deregulation (1985, 17).

out, the provision was meant to generate fear of an unfettered market, which might elicit strong lobbying responses against drastic reform. However, neither groups supporting reform nor the regulated industry lobbied for or against the provision. A strong response from the industry might have signaled substantial gain from regulation, but no such response developed (1985, 163).

Without direction and forceful opposition from the industry, deregulation proceeded to such an extent that even pro-reform forces were shocked at the "unexpectedly drastic" pace of reform. "What [Alfred] Kahn did not foresee, however, was that industry opposition would collapse—as the result of which the CAB received a charter to deregulate completely and rapidly" (Derthick and Quirk 1985, 155). Derthick and Quirk note that had the airlines been able to lobby effectively, the Airline Deregulation Act would not have "been so radical," and they attribute this radicalization to the industry's "political disorganization" (152). They note further that "[the airline industry's] resistance was ineffective and tended to deteriorate. Considered broadly, the sources of this weakness suggests reasons—although certainly not the only ones—why organized groups may at times be less able to obstruct policy change than the magnitude of their political resources would lead one to expect" (203).

This analysis of interest-group behavior suggests that *effective* lobbying is important for an interest group to have an influence on legislation. Legislators, with imperfect information regarding benefits to various interest groups, will test interest groups' willingness to pay either to maintain the old regulatory structure or to develop new rent-seeking legislation. This analysis also suggests that economic theory can explain deregulation in spite of the fact that the industry did not explicitly demand to be deregulated.

The legislative process revealed that there was too little "surplus" to be acquired from some form of continued economic regulation. "Since industry concessions were not made collectively or offered contingently—indeed, were not even explicit—the reformers had no need to respond with concessions of their own" (Derthick and Quirk 1985, 161).[11] Gordon Tullock (1989) points out that the willingness to lobby for rents reflects the expected return on investment from such efforts. By deciding to withdraw or reduce lobbying efforts, rent seekers are implicitly expressing the expected amounts of rents net of costs to be obtained from regulation. It was this signal that the regulated air carriers were sending to Congress. If there had been substantial rents, as evidenced by political organization and an ability to articulate clearly what was in the interest of the industry, deregulation would have been less likely to have occurred—at least not to the extent that it did.

11. Although a few airlines did lobby against reform, as Derthick and Quirk note, it may be an example of what Peltzman refers to as lobbying for a "cheap lunch" (1989, 20). Regulation may offer the possibility of some rents, but the rents may be too small to garner effective support. Lobbying efforts by the airlines were too unorganized and equivocal to be able to maintain cartel-like legislation. Thus, although they did not by and large lobby for deregulation—and in some cases lobbied against it—the lack of unity indicated too little gain from any continued entry restrictions and price controls.

Conclusion

Modest reform of airline industry regulation within the confines of existing legislation, the "political market test," was a response to a situation where costs were imposed on elected officials from a poorly functioning (from a constituency standpoint) regulatory structure—that is, overtly protectionist policies. The manner in which this process unfurled—initially through a committee without an ability to directly write legislation that would affect the regulated industry—is described well by the agency–clientele model. By changing how the existing legislation was interpreted, legislators were able to market-test new legislation. By separating the function of policing poorly performing regulatory bodies from that of enacting new legislation, legislators avoided the appearance of opportunistic behavior.

This process may have been necessary to bring about regulatory reform, but it was not sufficient to bring about complete deregulation—that is, freedom of entry and pricing as well as the eventual elimination of the CAB. The industry's inability to lobby with a unified effort, reflecting little perceived net benefit from regulation, was in effect the ultimate precursor to deregulation. The complete deregulation of entry and pricing was not the sole result of ideas generated by academic critiques (the politics of ideas) but rather was an unintended consequence of a process that revealed little expected value from continued economic regulation. This economic narrative is consistent with Derthick and Quirk's description of the political process in *The Politics of Deregulation*.

Economists working in the field of public choice focus on government failure and the inefficiencies generated by political outcomes. The analysis given here suggests a case (perhaps rare) where political action generated an increase in efficiency, a "political invisible hand," where individual actors pursuing their own interests unintentionally enhanced the public interest. If it is assumed that transportation deregulation was in the public interest—and many if not most economists believe that it was (see, e.g., Winston 1993; J. Brown 2014)—then what may have been in the public interest (deregulation) was found also to be in the relative interests of the parties responsible for effecting change. In this instance, ideas and the incentives facing political actors were compatible, generating an increase in economic efficiency.

In explaining economic development and progress, Douglass North has illustrated the importance of institutions in fostering growth and facilitating exchange: "[Institutions] define the choice set and therefore determine transaction and production costs and hence the profitability and feasibility of engaging in economic activity" (1991, 101). Similarly, institutions develop within the political process that facilitates implicit contracts, lowers "production" costs, and ferrets out those groups that can offer effective political support. These institutions are embedded in the legislative and regulatory process through the loose link between Congress and regulatory agencies and in the legislative process itself. In their work *The Politics of Deregulation,* Derthick and Quirk demonstrate some of these institutions.

Ideas matter and no doubt facilitated airline regulatory reform, but other factors were also necessary to bring about political change. This is not to suggest that social scientists have a firm grasp of how ideas effect social change. Robert Ekelund and Robert Tollison note one manner in which ideas may affect both political and market outcomes: "[I]deas, like technological advance, changes in transaction costs, and innovations, are 'shocks' to a given system composed of particular institutions. These 'shocks' must work through institutions that are established and evolve through markets guided by self-interested activity" (1997, 23).

Appendix: Alfred Kahn and the Economic Theory of Politics

Alfred Kahn is frequently invoked as a staunch ideological advocate of deregulation and even the "father of deregulation."[12] Prior to his appointment as chair of the CAB, he was one of the economists called to testify during the Kennedy hearings about regulatory inefficiencies, "[b]ut he did not advocate deregulation at the time" (Dudley 2010, 10). His appeal to politicians as CAB chairman may have been his pragmatism rather than his ideology. As chairman of the CAB, he demonstrated his ability to avoid taking actions that had the appearance of being opportunistic or alienating constituencies, showing that he was not beholden to any particular interest group but willing to serve the interests of those responsible for his appointment. His own words indicate that he was an individual conscious of who he was accountable to and desirous of seeking solutions in the confines of current law—someone not possessing an ideological commitment to freedom of entry and pricing.

Furthermore, Kahn's own comments and reflections indicate that he was committed to "gradualism," was cautious, and was not committed to outright decontrol of entry and pricing. Reflecting on his career many years later, he states in an article ironically titled "Reflections of an Unwitting 'Political Entrepreneur,'" "[A]ny implication that I came to the CAB, opportunistically and with a preconceived fixed commitment to flat-out economic deregulation, does an injustice to the complexities of the issue itself" (2008, 4). Kahn suggests that his approach to reforming regulation was practical and pragmatic: "Strategy? I didn't have one. I would encounter irrationality and I would work it for its worth. And I picked up on all these beautiful empty seats. A lot had been done by [previous CAB chairman] Robson, and I approved more 'peanuts' fares. I didn't set out to deregulate" (qtd. in Dudley 2010, 12).

Kahn's goal as chairman of the CAB was not an unfettered market. Early in his appointment to the CAB, he reassured industry opponents of deregulation that legislation would never go "all the way" to complete deregulation—that is, the door would presumably be left open to some limited control of entry (Derthick and Quirk 1985,

12. Weingast describes Kahn as a "strong critic of regulation" (1981, 168).

163). He notes that his eventual embrace of more complete deregulation was due not to a commitment to a free market in air-passenger service but to practicality. A year and a half into his appointment as chairman, he was struck by the "absurdities" of regulation and the difficulties of reforming partially and gradually (Kahn 2008, 14).

Kahn was in a sense conscious of his ability to "upset equilibrium" and was evidently aware of the interests of those who had put him in charge at the CAB. Derthick and Quirk characterize Alfred Kahn as an economist rife with experience and knowledge of regulatory policy but also as a man acutely aware of how his actions might affect the relevant interests and his congressional overseers: "I do not myself know to what extent I declare a commitment to gradualism insincerely, merely to reassure Congress and the industry I am not a madman, and that I am not solicitous of the financial fortunes of the industry, and anxious not to impair them" (qtd. in Derthick and Quirk 1985, 73).

In assessing regulators' incentives during this period, Derthick and Quirk admit that it is difficult to tell the extent to which regulators such as Kahn were driven by ideas or influenced by their elected overseers: "It is impossible to tell to what extent the [agencies] were influenced by the ideas themselves or by the sanctions and rewards disposed by influential institutions" (1985, 91).

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