Pathfinder

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ETHNIC ISSUES IN YUGOSLAVIA

Recent reports by the American press on a number of ethnic problems in Yugoslavia have been both correct and misleading. Most reports describe the *current* situation in Yugoslavia correctly. By failing to evaluate those current ethnic issues in their historical context, however, the American press wrongly attributes them to either a rise of Serbian nationalism, to the Serbian leader Slobodan Miloshevich or both.

Two major ethnic issues in Yugoslavia are the relationship between the Serbs and the Croats and the relationship between the Serbs and the Albanians. To a large extent, these two issues control the future of Yugoslavia.

The Serb-Croat Relationship

With only a few brief interruptions, the relationship between the Serbs and the Croats has been deteriorating steadily since 1918. Some important contributing factors are:

1. The history of the Serbs on the one hand and the Croats on the other has proceeded along completely different cultural, social and economic paths. The Serbs, dominated by the Turks for about 500 years, found themselves in many ways second to the Croats, whose development had flourished under the Austrian rule. For example, in 1918, about 75 percent of existing manufacturing enterterprises were located in the former Austrian provinces of Yugoslavia. As a result, the Croats considered themselves more civilized than the Serbs, while the Serbs believed that the political leadership of Yugoslavia should be entrusted to them because of their tradition of statehood (from the 12th to the 14th century, the kingdom of Serbia was a true political and cultural center in central and southern Europe), democracy (the kingdom of Serbia was a classic liberal democracy on the eve of World War I), the number of Serbs in Yugoslavia (about 8.5 million compared to about 4.5 million Croats), and the fact that they liberated the Croats from the Austrian rule. In time, those differences grew into open hostility between the two national groups.

2. Turkish rule in Serbia led to a steady migration of the Serbs into Croatia. The Austrian government encouraged this northward migration of the Serbs because they were known and respected as fighters. Consequently, the Serbs account for close to 15 percent of the total population in Croatia. During World War II, the neo-Nazi government of Croatia indiscriminately arrested and killed many Serbs. With their memories of the past still much alive, and fears of their future in Croatia understandable, if not necessarily justifiable, this Serbian minority plays an important role in shaping the relationship between the Serbs and the Croats today.

3. The republic of Bosnia and Hercogovina traditionally has been an issue between the Serbs and the Croats. Given the population mix of this repub-

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lic (1.6 million Moslems, 1.3 million Serbs, and .7 million Croats) both the Serbs and the Croats tend to think of this area, which is rich in resources, as their potential domain.

The Serb-Albanian Relationship

In Kosovo, a region in southern Serbia, the Serbs and the Albanians have been engaged in a bitter struggle for more than 300 years. Thus, the demographic situation alone (the Albanians represent over 80 percent of the total population in Kosovo) could not explain the issue. The Kosovo problem can be understood only in its historical context.

In the early Middle Ages, the region of Kosovo was settled by a homogenous Serbian population. In the late 12th century, Kosovo became a part of the Serbian state. The most important Serbian monasteries were built in Kosovo and created the basis on which the Serbs developed their national and cultural identity.

The battle of Kosovo, one of the greatest armed confrontations in medieval Europe, was fought between the Serbs and the Turks in June 1389. Defeat of the Serbs in this battle became the most important event in Serbian history. Kosovo became a "holy land" of the Serbian people and the source of their nationhood.

According to Turkish records, the Serbs accounted for about 97 percent of the total population in Kosovo in the 16th century. Significant demographic changes occurred only in the 18th and 19th centuries. Three great migrations of the Serbs into Austria (1690, 1737 and following the Congress of Berlin in 1878) were accompanied by a strong penetration of the Albanians into Kosovo. Reports by European diplomats in Skopje, Bitolj and Prizren speak of the harshness with which the Serbs were treated.

A major purpose of the Balkan War of 1912, which was fought by the Serbs and the Montenegrins, was the liberation of Kosovo from the Turks. In the Memorandum to the European powers of January 1913, the Serbian government said that "no Montenegrin or Serbian government would hand over this "Holy Land" of the Serbian people to the Albanians or anyone else." In the following years the Serbs began to return to Kosovo.

After the collapse of Yugoslavia in 1941, Albania annexed Kosovo. This led to a northward migration of about 100,000 Serbs. After World War II, Marshal Josip Tito gave Kosovo autonomy, which accelerated pressure on the Serbs to leave the area. The last 10 years brought about yet another migration of the Serbs northward.

To say that the status of Kosovo should only depend on the current demographic situation ignores the fact that for the Serbs this region is much more than a piece of real estate. It is their motherland, the source of their history and nationhood. Moreover, a shift in the population mix that began in the late 17th century was not a consequence of natural (voluntary) movements of two peoples. The population change was brought about by force.

—Steve Pejovich
Charles Maurice

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CENTER TO DIRECT TWO SUMMER CONFERENCES

The Center for Free Enterprise will direct and administer two major conferences in Europe this summer.

The Fourth Hayek Symposium on Knowledge, Evolution and Competition will be held June 9-12 in Bleibach, Germany.

The 17th Karl Brunner Symposium on Analysis and Ideology will be held June 4-8 in Interlaken, Switzerland.

Prominent scholars from the United States and Europe, including the center director, are participating in both conferences. Texas A&M President William H. Mobley will give the opening remarks at both conferences.

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15TH ANNUAL AEI BEGINS

The Center's 15th annual American Enterprise Institute (AEI) will be held June 4 through 22. Approximately 50 high school and elementary school teachers are registered. The AEI offers intensive training in economics to teachers of economics. The course will be taught by Dr. Richard K. Anderson, associate professor of economics at Texas A&M.

FLYING THE DEREGULATED SKIES

The following article is from the inaugural issue of Ceteris Paribus, *a new journal founded, edited and published by the Texas A&M Economics Society. The Economics Society, made up of undergraduate economics majors, is sponsored by Dr. Art James, assistant lecturer in economics. The first issue of* Ceteris Paribus *was financed by the Center for Free Enterprise. This article, by a Texas A&M undergraduate economics major, has been shortened slightly.*

Airline deregulation is under attack. Pointing to a recent wave of mergers between airlines, some observers claim that deregulation has failed. These critics say that the rise of dominant airlines at "hub" airports has decreased competition dramatically, signaling the emergence of higher fares, reduced choice and an airline oligopoly. Many legislators, fed up with complaints of fare increases, assert that deregulation hasn't worked in cities of 100,000 or less. The battle cry rising out of Congress is for government intervention to prevent airport dominance, limit fares and thus spur competition.

The facts, however, describe an industry far more healthy and efficient than it was during the days of regulation. Reregulation is not the answer to consumer woes simply because deregulation is not the problem. The most troublesome facets of today's airline industry are local airport authorities' control over capacity allocation and construction, and the marketing practices of dominant airlines.

The most significant changes brought about by deregulation were the rise of "hub and spoke" networks, price competition and entry by new low-cost carriers.

When airlines were regulated, their routing systems were similar to those of railroads, with aircraft making stops at various cities during a flight. Realizing the inefficiencies of this system, airlines restructured to create a more efficient "hub and spoke" network. Under the hub and spoke system, passengers are flown to a central hub airport from which they travel to their final destination.

Through the hub system, airlines exploited economies of scale in the frequency of flights to less-traveled destinations, and nearly eliminated the need for passengers to change airlines in mid-trip.

Competition on the basis of price was perhaps the most visible result of deregulation. Most airlines, accustomed to 40 years of government-imposed price floors, opposed complete price discretion fearing competition would cause chaos. At that time, cocktails and miniskirts were considered competitive tools. Price competition meant passengers would choose to fly on the airline that offered the lowest fare. As a result, discount fares flooded the market and ridership skyrocketed, bringing domestic enplanements from 225 million to 425 million in the 10 years since deregulation. Under price competition, which effectively began in early 1976, average yields per mile dropped 28.5 percent in real terms between 1976 and 1986. The decrease in fares alone resulted in savings of $11 billion to airline passengers in 1986.

The end of entry regulation brought a flock of upstart low-cost airlines into the market, increasing competition across routes and offering consumers more choice than ever before. Spartan carriers such as Peoples Express, Muse Air and World Airlines forced the majors to trim the fat and lower fares as much as possible. From 43 certified U.S. airlines in 1978, the number rose to a peak of 87 in 1984. Mergers and failures have cut the total to 61 currently. Though the majors have increased their market share in the past few years, the influence of low-cost carriers is still significant. By itself, the presence of low-cost carriers at an airport is estimated to produce a 0.4 percent average fare reduction per percentage share of enplanements by the low-cost carrier.

While deregulation has not delivered a perfectly competitive airline industry, its effects on airlines and consumers have been overwhelmingly positive. Deregulation researchers Morrison and Winston estimate an annual welfare gain of $6 billion to travelers and $2.5 billion in industry profits, all without significant losses to any specific group in society. Though many feared deregulation would cause the loss of service to small communities, previously guaranteed under regulation, losses of service to small communities have been minimal and mostly the result of increased fuel prices and the relatively higher costs of flying small aircraft into low-volume airports. Consumers also have benefited from greater frequency of flights and choice among carriers on a given route. In addition, deregulation brought more efficient use of capital, increases in revenue per passenger mile and a higher return on investment to the nation's 10 largest airlines.

In spite of these positive results, many legislators and consumers are unnerved by certain aspects of today's airline industry, namely safety, rising fares and airport dominance. First and foremost, air travel safety has improved. There were fewer accidents and fatalities in the last decade than there were in the decade before—even with thousands more flights each day. The alarming safety statistic is not the number of fatalities, but the number of "near misses." Although "near misses" per passenger mile decreased during the first five years of deregulation, that rate has increased significantly since 1982, a symptom of the growing capacity problem.

Fares, while rising some this year, actually declined in real terms in seven of the last 10 years, and have risen only half as fast as the Consumer Price Index since 1978. Higher-than-average fares are present in concentrated markets where one carrier serves a large number of passengers at one of the endpoints on the route. This is not, however, simply the result of deregulation, but of improper capacity control and marketing practices of the dominant airlines.

Lastly, while it is assumed that "fortress" hubs have led to less competition and higher fares, the number of carriers serving a given route has increased, signaling an unmistakable increase in competition since the airlines were deregulated. In 1977, for instance, almost half of all passengers traveled on airlines that carried 70 percent of the traffic on that route. In 1987, only 19.5 percent did so. Still, the ability to control the majority of an airport's facilities allows majority firms to insulate themselves from full price competition, through participation in local airport operating authorities and the use of marketing devices that increase barriers to entry.

The Capacity Problems

The most troublesome aspect of today's airline industry is not a failure of deregulation, it is a legacy of its success. Crowded airports and tardy planes are the natural consequences of a boom in ridership within a system of stagnating capacity. FAA projections show that the unbridled success of deregulation will nearly triple enplanements over 1978 levels by the turn of the century. During the same era, no major capacity expansion has been completed, and only one new airport is scheduled to be built within the next 10 years. According to the FAA, 16 major airports were seriously congested in 1985, and that number will grow to 58 in the 1990s, affecting 76 percent of all passengers unless actions are taken immediately to increase capacity. In 1994, the majority of delays are expected to occur at the top 20 airports, which in turn will cause a ripple throughout the rest of the system.

Insufficient growth in capacity, coupled with poor allocation of existing capacity, has created a more costly and potentially less competitive market. Two factors have contributed to capacity-related barriers to entry: mismanagement of the Aviation Trust Fund and deficient government by local airport operation authorities.

The Aviation Trust Fund is financed by user taxes at local airports and designed to fund capacity and technological enhancement projects where needed. Under pressure to lower the federal budget deficit, Congress has allowed the fund's surplus to grow even as the capacity crunch worsens. While the surplus of uncommitted user tax funds is nearly $6 billion, airlines continue to pay a whopping $3.5 billion a year into the trust fund, $1 billion of which is added directly to the surplus. To reduce congestion and preserve competition, the Aviation Trust Fund should begin funding major capacity and technological improvement projects in accordance with its need-based purpose. The $6 billion uncommitted trust fund surplus could build three new airports.

The control single carriers now wield over many of the nation's largest airports inhibits entry by new carriers into congested markets. Entry into a given city-pair market requires two items: slots and gates. A slot is the right to have a plane take off or land during a certain time period. Gates are the physical assets, the building and jetways.

When a single airline controls most of the gates at an airport, it not only can refuse to sell or lease facilities to entrants, but also influence the decision of the airport operator, usually a local government, regarding expansion of the airport to accommodate new entrants. Similarly, at an airport where a market for take off and landing slots exists, control of a dominant share of the slots can allow an airline to inhibit profitable entry by controlling the price of the slots.

Such temporary leasehold monopolies arose because ground service capacity historically has been financed at major airports by proceeds from revenue bonds issued by airport operating authorities. Because of this involvement in the financing of airport facilities, many airlines were able to have "majority in interest." Airlines holding such leases

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may be reluctant to sublease underused facilities to carriers intending to begin competitive service.

At the airports where landing slots are controlled, the FAA should consider allocating at least some slots through direct auctions, at which both new and existing airlines would have equal access. At all other airports, especially those soon-to-be-congested airports, landing fees should be set according to demand so that the full economic costs of the landing right are represented.

Airports also should review the way in which gates and terminal capacity are leased. The long-term leases now generally used can hinder entry by new competitors. When current leases expire, local airport authorities should consider replacing them with leases that can foster better competition.

Marketing Ploys

Barriers to entry in today's airline market are not limited to the availability of physical facilities. Schemes used by dominant airlines to sell tickets also make competition much less profitable. Frequent flyer programs (FFPs), for example, offer special benefits ranging from service upgrades to free flights to passengers who travel extensively on a given airline. Because these programs offer increasing marginal bonuses with higher purchase volume, they encourage the buyers to make all of their purchases with one or just a few sellers.

FFPs do in fact benefit passengers, but they result in what economists call the "principal-agent problem." This means a business traveler may choose to fly an unduly expensive airline simply to obtain a frequent flyer benefit, while his employer pays the tab. To nullify the lure of FFP bonuses, employers should be encouraged to monitor the bonuses and adjust salaries accordingly. The federal government also should consider equalizing the tax treatment of frequent flyer benefits and other employee fringe benefits.

A similar increasing marginal payoff schedule exists in many of the commission arrangements established between an airline and the travel agent who sells its product. Travel agent commission override programs are contracts between an airline and a travel agent in which the airline agrees to increase the agent's proportional remuneration, usually in the form of higher commission rates, if the agent reaches certain sales goals. For example, the commission rate can be raised from 10 percent to 12 percent if the agent sells more than $100,000 of travel on the airline in a month. Again, this marketing device may be used most effectively by the dominant carrier at an airport to bias brand choice in travel purchases.

Computer reservation systems (CRSs) also may be used to bias the airline choice of travel agents and travelers. Though in 1983 the Civil Aeronautics Board banned the most blatant display bias—the practice of an airline that owns a CRS listing its flights before those of other airlines—there is evidence that more subtle biases may remain, though interpretation of these data is open to dispute. An airline is still thought by some to have an advantage in gaining bookings from travel agents that

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Svetozar Pejovich, Director
S. Charles Maurice and Svetozar Pejovich, Editors

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use its CRS. One considered reform would be a locally owned CRS funded by all carriers within a given region or market.

The Last Word

Despite mergers, the U.S. airline industry today is more competitive than when it was regulated. Measured by route, competition has increased substantially. With the development of the hub and spoke routing system, the share of flights handled by particular airlines at certain large airports has increased. But even at hub airports, route-by-route competition is still far better than before deregulation.

Nevertheless, U.S. policymakers should take steps to increase competition even more, and protect it from erosion caused by a growing capacity problem and anticompetitive marketing advantages of dominant firms. They should reduce barriers to entry where possible, explore means of better allocating existing airport landing slots and gate capacity and expand capacity where needed.

More than a decade after its enactment, the Airline Deregulation Act of 1978 continues to be a boon to travelers, providing lower prices and much wider access to the air travel system that otherwise would have been impossible. In keeping with this revolutionary change in the U.S. airline system, careful consideration of the overwhelmingly positive benefits of the deregulated market should be considered before intervention is duly conceded.

—Peter Rodriquez
Senior Economics Major
Texas A&M University

NAME YOUR PRICE

In "Name Your Price: Should Minimum Prices Be Set by Manufacturers?," Stephanie Britt, Texas A&M economics major, analyzes the economics of resale price maintenance agreements. Her article, in the initial issue of *Ceteris Paribus,* stated that resale price maintenance occurs when a manufacturer sets the minimum price retailers may charge for his product. The U.S. Supreme Court ruled such agreements illegal in 1911.

Britt argues, "at first glance, this mechanism appears to be anticompetitive because it prevents some retailers from using their superior efficiency to sell the product at a lower price. Further examination of the rationale behind resale price maintenance, however, indicates its use permits the manufacturer to determine fully the nature of his product and does not inhibit the function of the market."

She points out that stores selling products under such agreements would not be subject to low price competition from stores selling the same product, but the product itself faces price competition from all other similar products. Consumers ultimately determine what products will sell and at what price. Consumers are not hurt at all; they can choose to pay or not to pay the full price of the product—the value of the product plus any additional status or service attached to it.

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