Pathfinder

CENTER FOR EDUCATION AND RESEARCH IN FREE ENTERPRISE
TEXAS A&M UNIVERSITY COLLEGE STATION, TEXAS 77843

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THERE'S MONOPOLY, THEN THERE'S (REGULATED) MONOPOLY

In 1979, the airline industry in the United States was deregulated. Since then, we have seen a tremendous amount of discussion concerning the pros and cons of deregulation. Those who favor deregulation argue that consumers benefit from lower fares, even though planes are more crowded and delays more frequent. No one can repeal the law of demand—more is demanded at lower prices. Those who oppose deregulation say that without regulation, many airlines have gone out of business and several others have merged, which has caused the industry to become much more concentrated and, hence, more monopolistic.

A recent article in *The Dallas Morning News** cited a study by Solomon Brothers, Inc. that showed increasing concentration at the nation's 50 busiest airports. In that study, 40 airports were classified as having an "excessive concentration" of air service by one or two carriers. The study also pointed out that concentration at the major airports has increased considerably since deregulation.

The *Morning News* gave particular attention to the two Dallas airports. At the Dallas-Fort Worth (D/FW) airport, American Airlines had 63 percent of all boardings. And D/FW was the most concentrated of the 10 largest airports. Dallas Love Field had the highest level of concentration of the 50 airports. Southwest had 100 percent of all boardings.

Is this necessarily bad for those of us who fly frequently into and out of Dallas? Is it bad for anyone who travels through a heavily concentrated airport? The answer is, "It depends on why concentration came about." To see this, let's compare the two Dallas airports.

The article emphasized that concentration came about for two entirely different reasons. American Airlines attained its 63 percent share of boardings at D/FW through "aggressive competition." It has been our observation that American, since deregulation, has consistently offered low fares, a good time schedule, and relatively good service. The American Advantage program has been one of the most successful of such incentive programs, possibly the most successful.

The Solomon study noted that American and other airlines that enjoy a considerable share at major hub airports do, in fact, face "abundant competition." Passengers connecting at hub airports compose more than half of all U.S. boardings. The study noted, "airline fares are held in check where airlines compete for connecting traffic." It stated that a passenger flying from Boston to Phoenix could not travel nonstop. Rather, the passenger had the choice of nine hubs through which connections could be made. Travelers don't have to fly American through D/FW airport. If American does become careless and raises prices or reduces flight frequency, there are, in the absence of regulation, other airlines—such as Delta with a 24 percent share— that clearly will be able to grab a great deal of business from American.

Dallas Love Field is quite a different story, according to the Solomon report, which attributed Southwest's monopoly to federal laws that restrict flights at Love. "Dallas' close-in Love Field is an anomaly. The airport is unique because it is a government-created monopoly."

Thus, concentration at one airport came from aggressive competition and at the other from government regulation. The consequences of monopoly power from aggressive but effective business practices and monopoly power from government can differ considerably. This is not to say that American is a well-managed firm and Southwest is not. Certainly Southwest faces considerable competition at other airports it serves and has had a considerable amount of success in these markets. The point is that monopoly power attained and held in the absence of regulations brings about a different incentive structure and a different type of management than monoply power under and because of government regulation.

Consider an industry first under regulation, then in the absence of regulation. Under regulation, suc-

Continued on next page

*Dennis Fulton, "Airline Dominance Studied," *Dallas Morning News*, September 4, 1987, pp. 1D and 4D.

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cess or failure depends to a large extent on the decisions of a government agency. Successful managers are those who are better lobbyists, who can best get regulations interpreted or changed for their benefit. A considerable proportion of the firm's resources must be devoted to dealing with government. Managerial qualities necessary for success in a regulated environment differ from those needed to prosper without regulation.

With little or no regulation, a firm achieves a strong market position, even a monoply, by competing successfully against its competitors. An unregulated firm is not protected from competition, nor is it aided in any way by government. Firms with managers who find better ways to serve customers and attract the best resources are the most successful. These managerial qualities are quite different from those required for success in a heavily regulated industry.

What about a strong market position attained through merger? Does merger mean a firm is more successful in attracting customers than its rivals? Many have pointed to merger as a principal reason for concentration in the airline industry.

In the absence of regulation, concentration through merger can have the same effect as concentration through aggressive competition. Firms most successful in attracting customers and serving them well gain market position. Mergers often occur when a successful company, seeing a profit opportunity, takes over a less well-managed firm and installs a new management team. Consumers of the product get the benefit of being served by a better company. Thus, mergers do not always mean a deterioration of service.

Many argue that after a firm or a few firms achieve a strong market position or even a monopoly, the price will rise and service will deteriorate. Customers will be worse off as the monoply tries to increase its profit. Again the consequences differ between monopoly attained and held by government regulation and that attained through the market. If market position is held because of government, it is extremely likely that the firm will survive and even prosper when it behaves like a monopoly. In a nonregulated environment, a firm will be able to hold on to a monopoly position only if it does not behave like a monopolist. As long as a firm faces potential competition from new or even existing firms, it must keep its price low and serve its customers well. If it does not another company will, or the firm will find itself the target of a takeover.

Concentration attained and held by competition is quite different from concentration because of government regulation. Profit and prices typically will be lower in the absence of regulation because of competitive pressures. Well-managed firms will drive out or absorb the less successful. Finally, a large market share does not mean that a firm can exercise its monopoly power.

—Charles Maurice
Steve Pejovich

NEWS FROM THE SOVIET UNION

A trade official interviewed on Soviet television on June 13 appeared cross with the female population of the U.S.S.R. Many women who never before wore tights were now buying them, making it very difficult to plan production years ahead. The official said: "After all, we have an institute to assess demand!"

Soviet Analyst, 6/17/87

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In a protest about the shortage of sugar, voters in two villages in the Ukraine threatened to boycott the elections to the U.S.S.R. Supreme Soviet last June. The local authorities moved fast to placate the disgruntled villagers. Sugar shortages are, however, making themselves felt throughout the U.S.S.R., and discontent is widespread. The reason for the shortage is that sugar is being bought up for the production of home-distilled alcohol.

Radio Liberty, 8/27/87

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A Polish woman who calls herself Julia argues that Polish women have much more to fear from the state than from men. "A real, genuine Polish woman is prematurely aged and grey" from working hard at her job, running the home, and struggling to find food for her family. Women, Julia says, have usurped man's ancient role as hunter, "for everyone knows that it is the women who stand and fight in lines for a piece of rationed meat and who hunt for any other 'unrationed' scraps."

Soviet-East European Report, 10/1/87

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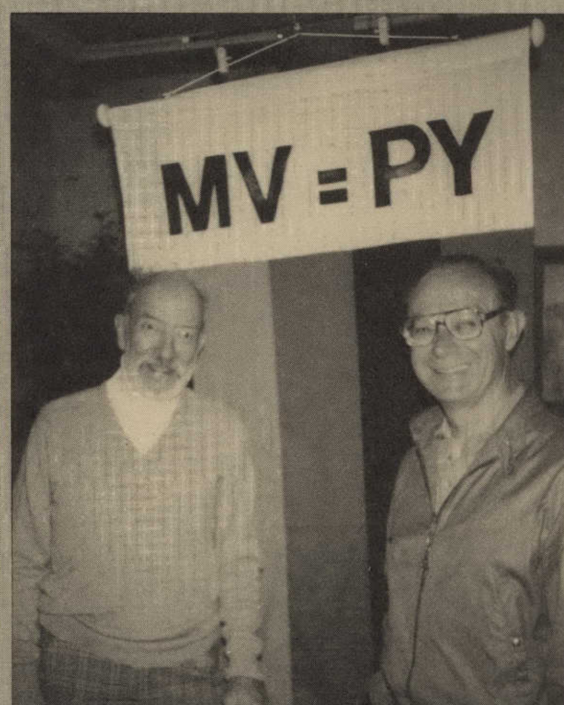


Professors Brunner and Meltzer, cofounders of the Shadow Open Market Committee.

BUDGET PROCESS HORROR STORIES

Horror Story #1:
Congress Consistently Outspends the President. Congressional leaders such as Speaker of the House Jim Wright of Texas are fond of labeling the budget red ink of the 1980s "Reagan deficits." Since 1981, Congress has spent over $140 billion more than the White House has requested. Congress has outspent the President every year since 1976.

Horror Story #2:
Why Congress's Budget "Cuts" Never Reduce the Deficit. Congress has enacted "cuts," yet federal spending has risen by over $300 billion since Ronald Reagan entered office. The reason: Almost all Americans define a budget cut as a reduction from what was spent last year, *but not Congress.* In congressional parlance, a budget cut is any reduction from what lawmakers call "current services." The catch is that spending hikes, caused by inflation or even an increase in the number of eligible program recipients, are built into the current services calculation automatically.

Horror Story #3:
Lower Deficits through Economic Fantasy. When the President released his FY 1988 budget in January, Congress spent the next three months denouncing the budget as a fraud. But when Congress had to construct its own budget, it unblinkingly embraced the White House forecasts—even after the Administration itself had disavowed them.

Horror Story #4:
Congress Runs through Its Own Red Lights. Appropriations bills exceeding the Budget Resolution spending allocations are prohibited from floor consideration. Yet these budget decrees are waived routinely—almost 500 times in 10 years in the House alone.

Horror Story #5:
Loan Guarantees—$160 Billion of "Free" Federal Subsidies. Last year, Congress congratulated itself for crafting a budget containing $15 billion in deficit reduction. Although the deficit did seem to shrink by $15 billion, Congress quietly issued an all-time record $160 billion in subsidized loan guarantees. Under current federal credit accounting practices, loan guarantees do not require immediate outlays; thus, they are treated as if they were free to the taxpayer. In fact, however, the guarantees place billions of dollars of future liabilities on the taxpayers' shoulders.

Horror Story #6:
Using Subsidized Federal Mortgage Insurance to Reduce the Deficit. Congress in 1986 "cut" the deficit by issuing billions of dollars of taxpayer-subsidized Federal Housing Administration (FHA) mortgage insurance. In exchange for guaranteeing these home mortgages, the FHA collected fees from the new homeowners. The $700 million in alleged deficit reduction was the amount of cash pocketed by the federal government in up-front mortgage insurance fees. The problem is that these mortgage guarantees likely will drain the federal coffers of considerably more funds than were collected in fees. The reason: many of the homeowners who obtained cut-rate FHA insurance eventually will default.

Horror Story #7:
Congress Disguises a $2 Billion Subsidy to Rural Voters. The single largest deficit reduction item in this summer's FY 1988 budget package is a multibillion dollar giveaway to rural voters: the prepayment of some $7 billion of below-market federal loans made to rural electric and telephone cooperatives. All told, prepayment would cost the federal government about $2 billion.

Horror Story #8:
Congress Ignores Budget Deadlines. A primary objective of the 1974 Budget Act was to enable Congress to finish its budget well before the start of the fiscal year. Only once in the past 12 years, however, has it met its self-imposed timetable. Starting the budget late creates end-of-the-year legislative logjams that the Budget Act was supposed to eliminate.

Horror Story #9:
The Case of the Missing $2.4 Billion Appropriation. Last year's $576 billion continuing resolution was so voluminous that not a single congressman was aware that missing from the legislation it delivered to the President's desk were two if its 690 pages. This was no minor oversight: the omitted pages contained a $2.4 billion appropriation for renting and operating federal buildings across the country.

Horror Story #10:
Robbing the Defense Budget to Pay for Domestic Programs. Between 1982 and 1986, $32 billion of funds that the Budget Resolution had earmarked for national defense were shifted to domestic programs by the appropriations committees. These shifts in budget priorities directly thwart the will of the whole Congress and render the Budget Resolution meaningless.

Horror Story #11:
Congress Cuts the Defense Budget With the Old "Check Is in the Mail" Routine. Last year, Congress claimed $3 billion in deficit reduction through old-fashioned "creative accounting." It ordered the Pentagon to send out the last military paychecks of FY 1987 on the first day of FY 1988, rather than the last day of fiscal 1987 as scheduled. This gimmick, of course, will not save the taxpayer a penny.

Horror Story #12:
Congress Strips the President of His Budget Powers. By impounding funds, a President can refuse to spend money appropriated by Congress. Presidents Kennedy, Johnson and Nixon cut annual federal spending between 5 and 8 percent annually by exercising their impoundment authority. The 1974 Congressional Budget and Impoundment Control Act, however, stripped the President of his impoundment power. In its place, the President was given rescission authority. A rescission is a presidential request to cancel unnecessary spending that has already been appropriated by Congress. According to Office of Management and Budget figures, over the last three years, Congress has ignored more than 400 Reagan rescissions, blocking potential budget savings of over $18 billion.

(Excerpts from S. Moore's article in the Backgrounder, *a Heritage Foundation publication. David Park, an economics student at Texas A&M, contributed to this article.)*

U.S. Attorney General Edwin Meese and Dr. Pejovich at a Heritage Foundation function.

INTERVIEW WITH A NEW DIRECTOR

Frank M. Muller, Jr., of Tulsa, Okla., is a new member of the center's board of directors. Excerpts from an interview with him follow. An interview with Jack Brown appeared in the September issue.

Pathfinder: Mr. Muller, how did you become interested in the center?

Muller: I first became interested after attending a seminar for businessmen that the center sponsored. Then I met Les Appelt and was greatly impressed by his enthusiasm for the center and its activities. It just rubbed off.

Pathfinder: What do you think the goals of the center should be?

Muller: I enjoy being in the corporate world, in international business. I've spent a considerable amount of time in Third World countries around the world. I quickly realized how wonderful what God gave us here in the United States is—certainly vast natural resources and agricultural land. Few if any countries have what we do—a democratic society and free enterprise. I've seen people come to this country and develop a work ethic. Why? Opportunity for creation; a very precious thing. The average American doesn't appreciate the opportunity to do so much with so few constraints. Our right of ownership is a beautiful freedom.

The center should strive to perpetuate and ensure this individuality. Education is the primary key. Youth in particular and all Americans in general must learn how lucky we are as a society.

Pathfinder: Are you optimistic or pessimistic about the future of free enterprise in the U.S.?

Muller: Rather pessimistic. People who believe in free enterprise tend to stay in the business arena. People who make the rules tend to become impatient with the slow process of free enterprise. If we're not careful, we'll find ourselves limiting potential through extensive regulation.

Pathfinder: What about the role of Texas A&M?

Muller: Texas A&M is strategically located. We need to bridge the gap between academia and business. There is so much that can be done together for the good of both, both locally and statewide. We're not using the wealth of talent in academia. The potential is huge.

Pathfinder: Thank you, Mr. Muller. We look forward to having you on the board.

Muller: I'm looking forward to it also.

GORBACHEV'S *PERESTROIKA* SATIRIZED IN SOVIET PRESS

A short article by the well-known satirical writer Arkadii Arkanov appeared in *Literaturnaya gazeta* on August 5. It tells the story of an imaginary factory-planet somewhere within the Earth's orbit. A top-secret product, code-named *pablosurzhik,* is being developed there. Nobody has any idea what *pablosurzhik* is, but everyone knows—because that's what they read every day in the newspapers—that it is something roseate and beautiful and very important; that to make it, "everyone must roll up his sleeves, mobilize the collective, outstrip the leading workers, gather up the stragglers, pull together, arm-in-arm, nose-to-nose."

The reader gets the impression that what *pablosurzhik* really means is communism. "Every evening, reading the papers, people went home from work with the feeling that the roseate *pablosurzhik* was a day closer, a day more real." Yet development of the new product is plagued by bad management. A succession of managers are sent from Earth, but each proves a failure. Finally, a special robot is constructed. Named "Solomon" after the biblical hero, the robot is "all-wise, with deadly logic, able to undertake the deepest analysis and global synthesis." The robot sets out to make a fresh start.

The reader is left in little doubt that "Solomon" represents Mikhail Gorbachev. "The main thing," the robot decides, "is to stimulate initiative and self-awareness. I must stop people from agreeing with everything I say." The robot calls a meeting and tells his subordinates that he is an idiot. The statement is met with thunderous applause. Horrified, the robot decides to take a risk. He will issue such stupid orders that people will be forced to learn to think for themselves.

He summons another meeting. "The most important element in the construction of *pablosurzhik,*" he announces, "is to ensure *brynzovelost*!" (*Brynzovelost*, another nonsensical word, bears a passing resemblance to the name of a popular kind of cheese; it seems to mean either *perestroika* or *glasnost*.) Far from ridiculing the robot's words, however, his subordinates express wholehearted approval. "Until now," they cry, "we shut our eyes to *brynzovelost*. But it is an objective factor, and must be taken into account!" Neon signs appear all over the planet: "*BRYNZOVELOST* IS BRINGING US CLOSER TO *PABLOSURZHIK*!"

The robot is appalled. He calls yet another meeting. "*Brynzovelost,*" he declares, "is rubbish!" Immediately, new slogans appear. "WHAT HAVE YOU DONE TO ELIMINATE *BRYNZOVELOST*?" they demand.

Things go from bad to worse. At last, the robot gives up. He sends a message back to Earth to say that everything that occurs on the planet is nonsense, that successes are failures, and that the construction of *pablosurzhik* is only in the very earliest stages. He calls for the sacking of all his subordinates. With that, his electronic mind blows a fuse, and the robot disintegrates.

It is unusual to find a satire on *perestroika* in the official Soviet media. To find one with so pessimistic an ending, in which a figure clearly intended to represent Mikhail Gorbachev suffers total defeat at the hands of the bureaucracy, is even more unusual.

—Elizabeth Teague
Radio Liberty Research Bulletin,
September 2, 1987

INSIDE THE CENTER

PEJOVICH AND LIGGIO IN FRANCE

Dr. Pejovich and Leonard Liggio, a member of the National Advisory Board, gave seminars at the University of Aix-en-Provence conference on the economics of property rights. At the reception for the conference participants in the city hall, Dr. Pejovich received a special medal for his contribution to the cause of freedom.

Steve Pejovich and Leonard Liggio in Aix-en-Provence.

AN AGGIE IN D.C.

David Park, a senior economics major and a staffer in the Center for Free Enterprise, spent the summer in Washington, D.C., as an intern at The Heritage Foundation. Heritage is a major U.S. public policy research and education institute whose research and policy recommendations are designed to apply the ideals of individual freedom, limited government, the free market system and a strong national defense to current policy questions.

Park worked as a research assistant to policy analyst Steven Moore in the Domestic Policy Studies Department. Park's research centered on the privatization of government assets and budget process reform. His research was conducted with resources at Heritage and the Library of Congress as well as by attending numerous House and Senate committee hearings.

One of the highlights of his internship was to receive recognition for his outstanding research and contribution to a Heritage *Backgrounder,* "Budget Process Horror Stories." As a result of Park's work as an intern, he was recommended to Heritage president, Dr. Edwin Feulner, for future employment.

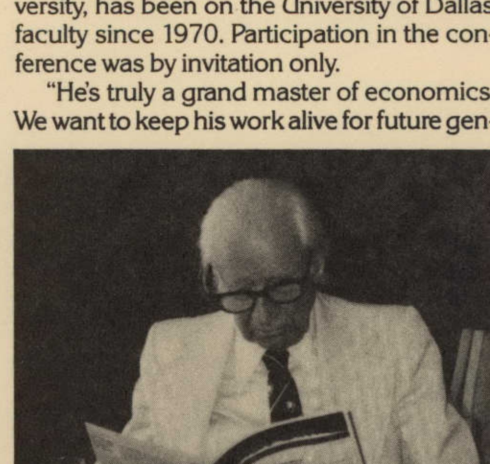
Park participated in the Heritage Lecture Series, which included seminars by Senator Phil Gramm, Russell Kirk, Robert Owen and Michael Ledeen.

During the summer, Park also attended a special one-week seminar for outstanding graduate and undergraduate college students. The Institute for Humane Studies hosted the seminar, held at George Mason University, on the origins of classical liberal thought. Participants came from North America, Poland, the United Kingdon, Denmark, Sweden, Norway, Argentina and France among others.

LIBERTY FUND CONFERENCE

On September 18-19, the center organized a Liberty Fund conference in honor of 88-year-old economist, W.H. Hutt. Hutt, a former visiting professor at Texas A&M University, has been on the University of Dallas faculty since 1970. Participation in the conference was by invitation only.

"He's truly a grand master of economics. We want to keep his work alive for future generations," Dr. Steve Pejovich said. Hutt focused his research on the economics of labor and Keynesian economics.



Bill Hutt reads Pathfinder.

Eighteen economists gathered to evaluate Hutt's work, including last year's Nobel laureate, James M. Buchanan of George Mason University; Armen Alchian of UCLA; Brian Kantor of the University of Cape Town; Karl Brunner of the University of Rochester; Leland B. Yeager of Auburn University; and Morgan O. Reynolds of Texas A&M.

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Contributors of $5 or more receive *Pathfinder* for one year; teachers in elementary and secondary schools may receive *Pathfinder* without a donation.

UNITED WE STAND, DIVIDED WE FALL

The United States of America is a monolinguistic country, although it has the most heterogeneous mixture of people in the history of the world. Proponents of bilingual education would like to change this. The push for bilingual education centers around the Spanish language. Bilingualism not only will impede the success of today's youth, but also create a rift between cultures that could become irreparable.

Legislators and a few activists appear to be the force behind bilingualism. Lawrence Uzzell, in a September 28, 1987, *Wall Street Journal* editorial, claims that if parents are given a choice, bilingual education will become obsolete. The basis for this claim is a comparison between bilingual programs in public and parochial schools with large Hispanic populations. Uzzell finds that only 4 percent of parochial schools offer bilingual education. He contends that parochial schools are sensitive to the desires of their clientele; thus, the market for bilingual education is minimal.

The question then is: why is government supporting a program in bilingual education that parents do not appear to want? The answer may lie in an analysis of interest groups. The proponents of bilingual education are often institutions and groups that stand to gain from the program. These organizations have the financial resources to lobby for the program that reflects their own, but not the students', self-interest. Thus, only a system that would allow each parent to make the final choice would eventually eliminate programs like bilingual education. The voucher system—which allows one to select from a number of schools and educational programs—would provide parents with direct control over the curriculum their child will study, thereby effectively eliminating the influence of special interest groups on public choice.

Parents know that their children must speak English to compete in the marketplace. Children should not be taught a second language *at the expense of English.* Uzzell points out that in the case of bilingual education, "the immigrants do know what is better." The limited number of parochial schools with bilingual education indicates that when parents are free to choose, they choose programs that will enhance their child's English capabilities. Bilingual education appears to create a disability for children in later years. Students who are enrolled in bilingual education tend to have lower verbal scores on the SAT and are more likely to drop out of college.

The negative aspects of bilingualism extend beyond the student to society as a whole. Language can unite or divide a country. There is much unrest between different linguistic groups in multilinguistic countries. In Canada, Quebec has been trying to secede from Canada for years. Different languages may not be the only source of unrest, but they are an important cause. The inability of people within a country to communicate can cause many problems. Consequently, through bilingual programs, legislators would be impeding the future success of Hispanics. Without competency in English, Hispanics would be forced to take low-level jobs with little vertical mobility. Their inability to rise above the poverty level could lead to political unrest within the country.

—Sheila Amin

[Sheila Amin is a senior in the Department of Economics at Texas A&M. She will be working in the Center for Free Enterprise until her graduation in May.]

Mrs. Pejovich with James Buchanan and Lord Bauer.

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