

Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Airline Productivity under Deregulation

TO THE EDITOR:

Since being "deregulated" the airlines have secured wage concessions, cut their work forces, reconfigured near-obsolete aircraft, started questionable promotional programs to increase their load factors, and cut air fares in competitive markets. At the same time they have trimmed low-density shorter routes from their systems while continuing to enjoy discriminatory, unreasonably high fares in noncompetitive markets. Most of these factors have contributed to the increase in productivity that Douglas W. Caves, Laurits R. Christensen, and Michael W. Tretheway predictably find ("Airline Productivity under Deregulation," *Regulation*, November/December 1982).

But the airlines are apparently not using these productivity savings to resolve their financial woes; they are awash in red ink. Dr. Julius Maldutis of Salomon Brothers wrote in *Airline Executive* (December 1982): "Overall, I fear the shape of the U.S. airline industry will be much different in years to come. Industry concentration is a vague term for the brutal fact we will have five or six large airlines left, with perhaps ten or so smaller specialized carriers." If he is right, what will be the economic consequences to the national airline system? To the nation?

Deregulation also places a costly burden on the air-traffic control system and the hub airports. As low-density shorter routes are dropped by larger carriers, they are

picked up by smaller carriers using smaller aircraft. It takes three trips by fifteen-passenger planes to replace one trip by a fifty-passenger plane, which adds to the existing congestion in hub airports. The gain in the "efficiency" of a few large carriers may very well be outweighed by the burden placed upon the public by delays, inconvenience, and the need to expand and improve airports and air-traffic control facilities. With 1982 airline industry losses estimated at between four and six hundred million dollars, the aerospace industry may also suffer—perhaps having to lay off more workers or lose out to foreign competitors.

Many small and medium-sized cities are now losing scheduled air service by air carriers using appropriately sized equipment to meet peak passenger demands and the air cargo and freight needs of a market. The change in the service capability of the air carrier serving a city may adversely affect the local economy. Obviously, any one city's loss does not seriously damage the national economy, but what happens when hundreds of cities lose reasonable access to the scheduled air transportation system?

In short, we must evaluate the full economic effects of airline deregulation—which reach far beyond the bottom line of an airline's profit and loss statement—before we can determine whether deregulation is a panacea as claimed.

*Kenton R. Hoeper,
Minnesota Department
of Transportation*

TO THE EDITOR:

Caves, Christensen, and Tretheway's otherwise excellent article makes the critical assumption that de facto airline deregulation began in 1976. The Civil Aeronautics Board first relaxed its policies on route awards and discount fares in mid-1977, and no new airlines entered the market until 1978. (The Airline Deregulation Act, of course, was not signed until October of that year.) It is inaccurate for the authors to

choose a year earlier than 1978 as the starting point for their study of deregulation.

By placing 1976, 1977, and 1978 in the deregulated period, the authors picked up total factor productivity gains of 6.8 percent, 3.1 percent, and 10.3 percent, respectively. This was enough to offset the much lower figures for 1979 and 1980 of 2.1 and -5.1 percent respectively (and, incidentally, a -2.7 percent figure for 1981, which they did not include). If the authors had selected 1978, the year the deregulation bill was enacted, as the base period, their results would have been markedly different. From 1978 through 1981 there was a -2.0 percent average yearly decline in airline total factor productivity.

Deregulation will ultimately improve airline efficiency, but recessions, sharp increases in the price of fuel, the controllers' strike, and other factors have so far prevented a clear analysis. As the airlines climb out of the current business cycle, their productivity gains will exceed those of the past because of the new flexibility they have in setting routes and fares. It is not possible, however, to claim that this improvement has already taken place, given the productivity figures for the actual period of airline deregulation since 1978.

*George W. James,
Air Transport Association
of America*

TO THE EDITOR:

The authors appear to have used the same methodology as in their earlier paper on the subject in the book *Productivity Measurement in Regulated Industries* (Academic Press, 1981). This methodology has several very desirable features. In particular, it allows one to measure changes in productivity directly without having to select a reference year for determining the relative prices of all factors and outputs. For this reason, MANDEX Inc. used the same methodology when we did a study on airline productivity trends in the 1970s for the Department of Transportation. Our estimates are in general agreement with the authors', and much of the difference between the two probably stems from a difference in how the aircraft input was measured.

However, we do not agree with the authors' view that their "results indicate that the growth in airline productivity improved by roughly 80 percent with the advent of deregulation." When we look at

productivity growth over a series of short periods, we see quite a different picture. Growth rates were quite high from 1968 to 1972—4.3 percent per year on average. But from 1972 to 1976, during which time there were two big jumps in the price of oil, an OPEC embargo and a major recession, productivity rose at an average of only 1.9 percent a year. It is true, as the authors say, that the CAB began to allow more competition in 1976, but we found no sign that these early steps toward deregulation boosted productivity by much: from 1976 to 1977 productivity increased only 0.9 percent.

Then came 1978, the year of most rapid deregulation culminating in the enactment of the Airline Deregulation Act. For that year, the rise in total factor productivity was dramatic—21.2 percent. This was the net result of a 15.7 percent rise in industry outputs and a 4.6 percent fall in inputs. The former is probably attributable to reductions in fares, the latter to the means by which the reductions were achieved, and both to the results of increased price competition.

It is too soon to be certain, but these results suggest to me that deregulation led to a one-time improvement in productivity, first, by eliminating operational inefficiencies imposed by regulation and, second, by causing a shift to lower priced (if also less luxurious) service. We should not be disappointed if it does not also improve the industry's sustained rate of productivity growth, especially since that rate was healthy before the jump in fuel prices.

David A. Coutts,
MANDEX, Inc.

DOUGLAS CAVES, LAURITS CHRISTENSEN, and MICHAEL TRETHERWAY respond:

Knowledgeable observers such as George James have expressed a variety of opinions as to when deregulation "really" started. For example, John R. Meyer and his associates believe that July 1975 "marked a turning point in CAB policies," after which the agency issued a steadily growing stream of pro-competitive decisions (see *Airline Deregulation: The Early Experience*, Auburn House, 1981, p. 45). Alfred E. Kahn expressed similar views in his 1982 Patterson lecture at Northwestern University.

Whether the early pro-competitive developments at the CAB were part of deregulation or only pre-

cursors thereof is a semantic issue that need not deflect us, since our finding that productivity improved under deregulation does not stand or fall with our choice of 1976 as the advent of deregulation. Productivity growth was good in 1976 and 1977, but not so good as in 1972. It was not until 1978 and 1979 that productivity growth reached the unprecedented rates of 11.8 and 8.1 percent (considerably higher than the 10.3 and 2.1 percent estimates that James suggests). This growth came about because the industry achieved tremendous increases in passenger-miles with very modest increases in capital, labor, and materials. We know of no one who has claimed that none of this was due to deregulation.

The bubble of traffic growth burst in 1980. Since then traffic has fallen below its 1978 level, but productivity has remained above the level of that year—despite the worst business conditions since the Great Depression. To our knowledge neither James nor anyone else has argued that recent productivity performance is worse than it would have been under the old regulated regime. The financial condition of some airlines might well have been better in the absence of deregulation, but that is a different issue. The airlines are facing the harsh fact that not all competitors thrive or even survive (or ought to) in a market system.

Kenton Hoyer does not dispute that productivity has improved under deregulation, but he suggests that deregulation may have some concomitant undesirable effects that more than offset the benefits of improved efficiency. We would heartily endorse the dispassionate investigation of all costs and benefits of deregulation. However, many of the alleged costs may well be more illusory than real. For example, David Graham and Daniel Kaplan of the CAB (*Regulation*, May/June 1982) provide evidence suggesting that Hoyer's allegations of harm to small and medium-sized cities are questionable at best.

Furthermore, Hoyer's comments display the common error of confusing costs and benefits. Yes, the aerospace industry must adjust to selling fewer airplanes to the airlines. But it is a benefit to our nation, not a cost, that the deregulated airlines can now better utilize their existing fleets and thereby save scarce resources to satisfy other human needs.

Contrary to the claim by David Coutts, his estimates of airline pro-

ductivity growth differ greatly from ours on a year-by-year basis. We know of no basis for his statements that, in 1978, airline inputs declined 4.6 percent and airline outputs grew 15.7 percent. Our figures, as well as those of the CAB, indicate that inputs *increased* and that outputs grew substantially less than 15.7 percent. Furthermore, we observed productivity growth of 4.5 percent in 1977, much higher than the 0.9 percent he indicates. Given the peculiarities of Coutts's productivity estimates, we must be dubious of any conclusions based on them.

Manville and Product Liability

Richard Epstein ("Manville: The Bankruptcy of Product Liability Law," *Regulation*, September/October 1982) is correct in observing that an adequate solution to the asbestos problem cannot be described in a five-paragraph editorial in the *New York Times*. Unfortunately, he goes on to propose his own solution in the last few paragraphs of his own article. The predictable result is that his policy recommendation, too, leaves much to be desired.

Epstein proposes to shift most asbestos liabilities from the tort system, where they are paid primarily by manufacturers, to the workers' compensation system, which is funded by employers. His case for this shift begins with the proposition that the workers' compensation system is the traditional way of recompensing employees for work-place injuries. But the coverage of occupational diseases under workers' compensation laws has expanded significantly over the years, and it is still an evolving and controversial phenomenon. Its development might even be considered to have seemed as radical and unexpected to employers as the development of product liability law has seemed to manufacturers.

Moreover, traditional workers' compensation law has always let employers obtain reimbursement from manufacturers for injury claims arising from product defects. Claimants know that whatever they collect from the workers' compensation system is likely to be deducted from their more lucrative product liability awards—which is one of the principal reasons, although Epstein does not mention it directly, why so few asbestos victims file workers' compensation claims. To suggest that these claims

should be their primary means of compensation, without allowing the employers any recourse against responsible third parties even where fault can be established, is to suggest a dramatic shift from the traditional approach.

Epstein's next proposition is that the employers were in a better position than the manufacturers to test for and discover the harmful side effects of asbestos exposure. This assumes that a product is best tested by the business closest to those who experience its harmful effects. But would we really want to rely on taxicab firms to test for defective automobiles, construction firms to test for defective ladders, or hospitals to test for defective drugs?

Epstein himself points out, by way of denying the manufacturers' duty to test their products, that a number of separate companies mined and supplied similar asbestos products. But the number of manufacturers is relatively small compared with the thousands of employers who have installed asbestos-bearing products over the years. Moreover, a typical manufacturer sells many fewer products than a typical employer purchases. This limits and focuses each manufacturer's product responsibilities, making them much more manageable than they would be for an employer required to test all the products it uses.

He adds that the manufacturers would have found it difficult to test the levels and effects of asbestos exposure in the work place. He ignores the fact that Manville had at least had its own factories and insulation workers on which to conduct tests, and that all the manufacturers would seem to have had at least as much access to insulation worker disease information as did Dr. I. J. Selikoff (who conducted the seminal studies of worker health) or any employer. The general pattern of short-term employment in the construction industry would have been an additional handicap for the employers, who would have had to trace the health histories of workers as they moved from product to product and employer to employer. Furthermore, most of the manufacturers were significantly larger and more sophisticated than the employers, and they knew such important variables as the type and amount of asbestos they used in their products.

Epstein argues that the manufacturers should have been legally secure in relying on independent

studies done by others. But if this is true for the manufacturers, it must be true in spades for the employers. Manufacturers are constantly assuring their customers that they stand behind the products they make. They provide product data and warranties, and their associations often collect and perform safety studies that they use to bolster these contentions. (For example, the Thermal Insulation Manufacturers Association has done extensive work on the safety of fiberglass products.) In short, each of Epstein's criticisms of Judge Wisdom's holding regarding manufacturers also appears to apply a fortiori to employers. Nothing is there to suggest that conventional thinking—that a manufacturer is responsible for testing the safety of the products he produces—should be reversed in this case.

Epstein's third theme is that employers are in a better position than manufacturers to guard against the harmful side effects of asbestos. This apparently assumes that the

controversial OSHA and EPA rules on the subject. And even good control of dust levels might not eliminate diseases like mesothelioma, which some medical experts believe can be caused by very low levels of asbestos exposure.

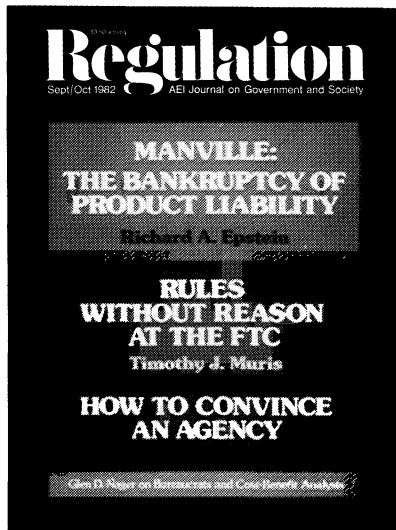
To the contrary, the preferable method of control would seem to be the one that has largely been adopted in fact: product substitution. In the mid-1970s, for example, the major insulation manufacturers developed largely asbestos-free product lines, apparently without significant cost increases or quality decreases. The few asbestos-bearing products that remained were generally encapsulated or bonded so as to prevent any release of asbestos fibers during use. Absent manufacturer liability through the tort system, it is questionable whether these changes would have taken place when they did.

Epstein's proposal also raises a host of questions which he fails to address. He supposes, for example, that the workers' compensation system is more efficient than the tort system. Administered legal systems with fewer issues to resolve, reduced attorney involvement, and simplified "last employer liable" rules may be cheaper than jury systems that allow for the introduction of a broad range of considerations, but that does not necessarily make them better. Obviously there is a trade-off between simplicity and equity.

Then there is the question of insurance coverage. Firms can insure themselves against both tort and workers' compensation liabilities, but the triggering mechanisms of the two types of insurance differ greatly, and shifting asbestos liabilities from the former to the latter system could well move them from an area where there is substantial insurance coverage to one where there is virtually no coverage. The result might be neither fair nor efficient.

Epstein's article discusses only the roles of asbestos manufacturers and employers, failing to consider the proper roles of other involved parties such as the government, tobacco companies, building owners and designers, unions, insurance companies, and safety officials. He also leaves out of the equation such issues as the precedent his proposal might set for other products.

Without jumping to any policy conclusions myself, let me note in closing that Epstein's proposal is not the only one on the table. Although he maintains that there are



most efficient way of limiting the harmful effects of asbestos is to control exposure levels in the work place. But is this really so? Employers who used asbestos products came in all sizes and levels of sophistication: auto repair shops, insulation contractors, schools, factories, wrecking companies, shipyards, landfills, and so on. Is it really likely that this assortment of economic entities is the group most suited to control the hazards of asbestos? Monitoring and controlling dust levels is a difficult matter, as witness the complex and

very few sensible ways to resolve the problem, numerous other solutions have been and are being proposed by thoughtful people who collectively have an enormous financial incentive to reach an efficient result.

Some of these proposals involve federal legislation and some do not. Among the most interesting proposals are those that would streamline litigation procedures and thereby reduce the legal costs of asbestos product liability proceedings—something that could probably be accomplished entirely without legislation. Another possibility is product liability reform. This would have the virtue of confronting the perceived problems of product liability directly and not shifting them onto another system. Also worthy of consideration are such court reforms as levying penalties for abuse of process, making the loser pay the winner's costs, and limiting contingent fee arrangements; other possibilities include arbitration, superfunds, and bankruptcy court. Leaving the system the way it is, of course, is another option, as is devising an administered no-fault product liability system similar in practice to the existing workers' compensation system.

Shifting asbestos liabilities onto the workers' compensation system would certainly serve the purposes of the manufacturers and insurers who must pay under the product liability system. It also strikes people at first blush as being eminently reasonable and "efficient." Such a proposal must make sense as a matter of economic policy and fundamental fairness, however, before it can be considered a real possibility. Epstein's efforts certainly have not made it so; and it appears doubtful that anyone could.

W. Kirk Liddell,
Lancaster, Pennsylvania

RICHARD EPSTEIN responds:

Liddell makes a spirited attack on one part of my article—the argument that workers' compensation provides the proper institutional framework for handling asbestos-related claims. There are difficulties in my approach, to be sure, as I freely acknowledged. The ultimate question, however, is where the balance of inconvenience lies, and it is here that Liddell fails to demonstrate that any product liability system can better handle the asbestos problem.

Nowhere does Liddell argue that my criticisms of *Borel* are unfound-

ed—and *Borel* is the *only* considered judicial authority for the product liability in question. And nowhere does he answer the charge that *Borel* is a form of retroactive judicial legislation. Workers' compensation coverage for asbestos cases is not my own invention; it represents the rule generally enforced in the United States. When Liddell argues that these losses should not be "shifted" to the compensation system, he ignores the central fact that they had been there long before *Borel*.

Liddell notes that employees have traditionally had the right to press third-party suits against manufacturers under the compensation system. So they have, but only where those suits were well conceived, which *Borel* is not. At a more fundamental level, we might ask whether it is wise to allow third-party actions at all, at least in the context of product liability cases. Under the present system a single injury can spawn at least three lawsuits: (1) the injured employee can sue the third-party manufacturer, (2) the employer can obtain reimbursement for the compensation payments made out of the tort damages the employee has recovered from the third party, and (3) in many states the third party can sue the employer in tort for indemnity or contribution. Liddell does not explain why three lawsuits are preferable to a single streamlined regime that either abolishes the third-party tort action in its entirety or at least restricts it to the excess of tort damages over compensation benefits.

Liddell also fortifies his case for product liability suits with a series of flawed analogies. One could, but need not, allow consumers product liability suits against manufacturers while adopting very different rules for work-place injuries. Employers are rarely the mere conduits that retailers and wholesalers so often are. Again, work-place injuries caused by defective ladders have always been covered by the compensation system. Indeed product liability suits are only credible, if at all, for latent defects (such as hidden cracks) that make the ladders dangerous in ordinary use. Finally, drugs present very different problems, particularly in monitoring adverse reactions, so that any system of hospital, physician, or manufacturer liability may well have to be supplemented by direct regulation through a (reconstituted) FDA. But no matter what the precise solution in these areas, industrial cumula-

tive trauma cases have their own distinctive pedigree and should be treated separately.

Liddell argues that employers could not be expected to test all the products they use. But the workers' compensation system has always imposed liability wholly without regard to an employer's ability to detect that sort of risk. Therefore, even if it is true that employers could rebut the charge of fault as well or better than manufacturers, it is irrelevant, for employers have experienced no change of rules in midstream. Fifteen years of fruitless litigation show that the appeal to vague considerations of equity in product liability cases is only an invitation to uncertainty and chaos.

Nor need we assume that the knowledge gap for employers is insuperable, even if relevant. Nothing says that employers cannot rely on the information supplied by others, such as studies by trade associations, insurers, government agencies, or independent medical experts. If the level of workers' compensation payments increases, the move toward product substitution that Liddell praises will continue apace, whether or not manufacturers are subject to product liability suits. The introduction of new insulation materials to which he refers began in the middle 1970s, and was the product of earlier research done at a time when product liability risk seemed minimal or nonexistent. It is doubtful, therefore, that it occurred in response to that risk.

Liddell points out the difficulty employers have in controlling the levels of dust in their work place, and I have no doubt that he is correct. But the point weighs more heavily against product liability actions, which are generally based on the defendant's failure, not to test, but to *warn*. What can a manufacturer do to control exposure levels? Can it possibly make any sense to treat as the dominant source of the problem the manufacturers' failure to provide information that was in the public domain or otherwise easily obtained by employers? Or to provide warnings on which employers and employees could not act in any case?

The gist of Liddell's proposal is a clumsy workers' compensation system, funded by manufacturers, without limitations on the level of damage awards. The compensation system we have today, although hardly ideal, is better fitted for that task. ■