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THE TRAVEL AGENT, THE IATA CARTEL, AND CONSUMER WELFARE

KENNETH G. ELZINGA*

I. INTRODUCTION

RECENTLY the Civil Aeronautics Board examined the arrangements by which travel agents are compensated by air carriers for booking international air travel.¹ The primary question at issue was whether all agents should be paid a uniform commission rate, approved by the CAB, to which every member of the International Air Transport Association (IATA) would then be bound, or whether the rate should be "open", with each IATA member then able independently to file any commission level whatsoever. From 1940 until April, 1975 IATA established a uniform commission level for payments to its agents. Since 1956 the rate paid by IATA members has been seven percent of the ticket price on point-to-point scheduled travel and ten percent on inclusive tours. In April, 1975 a quasi-open system was begun, following the decision of four carriers to discontinue adherence to IATA's uniform intercarrier commission agreement. In December, 1975 the carriers regrouped and

* Professor of Economics, University of Virginia; Special Economic Assistant to the Assistant Attorney General, Antitrust Division, 1970-71. B.A. 1963, Kalamazoo College; M.A. 1966, Ph.D. 1967, Michigan State University. The author previously served as a consultant to the jointly represented carriers in CAB Docket No. 28672, Agreements Involving Agency Matters. The views expressed in this article are entirely his own.

¹ Agreements Among Members of the International Air Transport Association Involving Agency Matters, CAB Docket No. 28,672 [hereinafter cited as Agency Matters]; CAB Order Nos. 75-12-141 (Dec. 29, 1975) and 76-7-56 (July 16, 1976). [The Administrative Law Judge hearing the Agency Matters case served her initial decision after this article had been prepared for publication. Initial Decision, CAB Docket No. 28,672 (Mar. 15, 1978). The CAB has tentatively decided to reject the Initial Decision and adopt an "open rate" policy. WALL St. J., Jun. 9, 1978, at 11, col. 2 (S.W.ed.) Time did not permit revision of the article to review these developments.—Eds.]
adopted a new uniform commission rate. However, the Civil Aeronautics Board (CAB) did not immediately approve this IATA resolution under Section 412 of the Federal Aviation Act. Instead the CAB invited comments and heard oral arguments on the resolution. Since this procedure produced an inadequate factual record, the CAB, in July, 1976, ordered a full evidentiary hearing to determine what payment mechanism would best serve the public interest.

The question of commission determination is of interest to both the carriers and the agents because of the sizable financial stakes involved. Commissions are generally thought to be the third largest cost item for airlines, following labor and fuel expenses; a single percentage point increase in the commission rate entails over twenty million dollars in commission payments. The CAB's evidentiary hearing, which ended in May, 1977, is also of interest for reasons that transcend the narrow financial concerns of the parties. The hearing drew together in one place data on the structure and conduct of the travel agent industry. It is now possible to better understand the economic characteristics of this rapidly growing service industry and its relationship with its customers (the traveling public) and its clients (the international air transport industry). Section II of this paper describes the evolution and economics of this industry.

The evidentiary hearing, occurring during an era of strong deregulation sentiment, also provides a revealing case study of the potential dangers of deregulation whenever correlative regulations remain extant. Deregulation is purported to produce benefits for the consumer. But in this instance a naive deregulation proposal runs counter to the economic interests of the traveling public. Section III of this paper analyzes the different payment mech-

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8 The new proposed levels were eight percent on point-to-point travel, and 11% on inclusive tours, plus a four percent incentive override for agents booking at least 110% more business than the previous year. International Air Transport Association (IATA) Resolution No. 002z (Dec. 10, 1975).


4 CAB Order No. 75-12-141, supra note 1.

5 CAB Order No. 76-7-56, supra note 1.

6 United States carriers paid a total of $222.2 million in commissions in 1976, representing 9.22 percent of their total passenger revenues. AIR TRANSPORT WORLD, Oct., 1977, at 34. Twenty million dollars represents approximately one percent of current carrier revenues. See Table 1, note 8 infra.
anisms from the perspective of consumer welfare, in addition to their financial impact upon carriers and agents.

Finally the Agency Matters hearing\(^7\) raises again the question of the appropriate standards by which the CAB is to integrate the principles of antitrust with its own regulatory schema. Section IV discusses this issue and proposes a benchmark for dovetailing antitrust with CAB regulations.

II. THE TRAVEL AGENT INDUSTRY

The growth of the U.S. travel agent industry provides indirect evidence of the positive income elasticity of air travel since the demand for the services of this industry has outpaced the growth in national income.\(^8\) Table 1 depicts the number of IATA approved travel agents and the number of locations they have operated over a ten year period, as well as the value of U.S. agents' international air travel bookings for three recent years. The growth rate in agents and bookings exceeds that of the Gross National Product during this time.

The structure of the industry, \textit{sans} regulation, should engender competitive behavior. There are thousands of independent firms, so that collusion among all sellers would be extraordinarily difficult, if not impossible. Only in small and medium size cities might the number of rivals be so small as to raise the specter of joint behavior or tacit collusion. But supranormal returns on investment,

\footnotesize\textsuperscript{7} Supra note 1.


\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|c|}
\hline
\textbf{Year} & \textbf{Number of Agents} & \textbf{Number of Locations} & \textbf{Int'l Air Travel Bookings (000,000's)} & \textbf{GNP (billions) U.S.} \\
\hline
1966 & 4,425 & 5,701 & & \$ 981.0 \\
1967 & 4,785 & 6,041 & & 1,007.7 \\
1968 & 5,034 & 6,498 & & 1,051.8 \\
1969 & 5,362 & 6,994 & & 1,078.8 \\
1970 & 5,709 & 7,566 & \textdollar1,176 & 1,975.3 \\
1971 & 6,213 & 8,066 & & 1,107.5 \\
1972 & 6,422 & 8,790 & 1,733 & 1,171.1 \\
1973 & 7,057 & 9,774 & & 1,235.0 \\
1974 & 8,122 & 10,600 & 2,059 & 1,217.8 \\
1975 & 8,547 & 11,121 & & 1,202.1 \\
\hline
\end{tabular}
\caption{IATA AGENTS IN THE UNITED STATES}
\end{table}

even then, should not be sustained long because there are no significant barriers to entry by new firms. Only modest capital requirements must be met to open an agency.

Regulatory constraints, however, prevent this structural pattern of many firms and easy entry from generating rigorous price competition among travel agents. Indeed price competition between agents is prohibited by the anti-rebating provisions of Section 403(b) of the Federal Aviation Act. Agents may sell tickets only at the current filed tariff rate, regardless of the size of the commission they receive for writing the ticket. They cannot offer tickets at reduced prices, in the manner an ordinary merchant could choose to cut prices on merchandise. Nor can a ticket agent rebate or refund any portion of the ticket price back to the customer. The code of ethics of the largest association of domestic travel agents went even beyond this. Until recently, the American Society of Travel Agents' (ASTA) Code restrained competition by forbidding the provision of discounts, gifts or rebates on commissions where the product or service price is unregulated—such as hotels or rental cars. Recently this code of ethics was revised in response to a seventy-five million dollar class action antitrust suit on behalf of customers of ASTA agents who were financially penalized by the Code.

Even apart from their protection from price competition, travel agents are a hybrid form of middleman. Functionally they are retailers in that they sell to the ultimate consumer and collect final payment. But they are also brokers. Unlike retailers they do not break bulk or keep inventories and therefore do not bear the same risks as traditional retailers. Their brokerage function manifests itself in an array of commission schedules that yield the following classification:

a. *Basic*: commissions paid on point-to-point travel and inclusive tours.

b. *Bonus commissions*: extra payments on all tickets written

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for a particular route or fare. There are no group (or volume) requirements for this commission.

c. Volume incentives: extra payments to a travel agent producing more than a given volume of business for some designated time period.

d. Group overrides: extra payments for groups of specified sizes.

Through the 1960's and into the 1970's, it was the industry consensus, among both carriers and agents, that payments were being made to agents, and especially to tour operators, in excess of the rates set by IATA conference agreements. The exact amount of such overpayments, if any, is not known, although the Director General of IATA once asserted that they exceeded $100 million per year. The payments were in the form of special commissions, rebates or in-kind services. Some IATA members were later indicted for these practices.

Most travel agencies belong to a national federation of similar enterprises. These national federations constitute the membership of the Universal Federation of Travel Agents Associations (UFTAA). UFTAA is a worldwide assembly of seventy-five nations on six continents. UFTAA affiliated agents book approximately seventy percent of all international air travel. IATA recognizes UFTAA as the representative of travel agents in its collective dealings with agents.

The American Society of Travel Agents is the largest association of travel agents in the U.S. and holds permanent representation on the seventeen-member board of UFTAA. It has 6500 member agencies in the U.S. and Canada and over 1500 members elsewhere in the world.

The fact that larger agencies have a greater dollar volume per employee suggests that there are economies of scale in the operation of an agency. This is corroborated by the growing percent-

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13 American Society of Travel Agents (ASTA) exhibit ASTA-RT-3, at 3-4, Agency Matters, supra note 1 (testimony of John R. Balch).


age share of the market held by large agencies (over $1,000,000 in volume). In 1970 large agencies had fifty-eight percent of the market; by 1974 they had sixty-seven percent.\textsuperscript{16} Even with the growth in the scale of the optimum size plant, however, large agencies are nowhere near dominating the industry. Indeed the growth of the industry has been such that the absolute number of large agents almost doubled during the 1970-1974 period.\textsuperscript{17}

There are no published statistics on the rate of return on investment for the U.S. travel agent industry. Inferential data, however, portray the industry as quite profitable. Table 1\textsuperscript{18} is an example of such evidence. One can presume that if profits were only nominal (or falling) the rate of entry into the industry would not be so high (or would be negative). In 1975 the Department of Transportation (DOT) released a report on U.S. travel agents which gave the industry’s deletion and default rate.\textsuperscript{19} Both are very low. The deletion rate is the percentage of agents removed from the lists of approved agents of both the Air Traffic Conference (ATC, which deals with domestic flights) and IATA. From 1969 through 1973 it averaged only 2.5 percent.\textsuperscript{20} The default rate is the percentage of approved agents financially in default to either ATC or IATA during a twelve month period. It varied from 0.4 to 1.6 percent.\textsuperscript{21} Retail industries with lesser financial vitality would show much higher percentages than those cited in the DOT report.

Turning from the cost side of the agent industry to the demand side, there are two important characteristics of the industry that will be useful to delineate. One is the considerable discretion which agents have in advising their customers. Agents are not mere order takers. At the same time, the travel agent industry does not appear to affect the position of the demand curve for international air travel. Both of these characteristics are pertinent to the economic analysis in the next section.

The demand for air travel is a function of such factors as per

\textsuperscript{16} 1975 \textit{Harris Study}, \textit{supra} note 15, at 4.

\textsuperscript{17} \textit{Id.} The number of large agencies increased from 1,940 in 1970 to 3,795 in 1974.

\textsuperscript{18} Note 8 \textit{supra}.

\textsuperscript{19} \textit{UNITED STATES DEPT. OF TRANSPORTATION, REPORT ON U.S. TRAVEL AGENTS} 25-26 (1975).

\textsuperscript{20} \textit{Id}.

\textsuperscript{21} \textit{Id}.
capita income, the value of time, air ticket prices, and the cost of alternative modes of travel—all elements beyond the control of travel agents. Travel agents can only shift demand as between carriers—the overall market for travel is determined by forces exogenous to the industry. In their study of domestic air transport, George W. Douglas and James C. Miller saw no influence of travel agents on the demand for air travel, nor did Mahlon R. Straszheim in his study of international air travel.\(^2\)

The evidence on agent discretion is derived from a number of surveys of travel agents taken in recent years.\(^3\) These show that travellers place great reliance upon their agents for advice on mode of travel, schedules, choice of carrier, routing and even (in the case of pleasure travel) destinations. This reliance upon the agent’s discretion is especially pronounced in the case of international travel.

In domestic travel, customers are more frequent travelers and may develop some personal knowledge about preferences for certain routes, schedules and carriers. In international travel, which has a lower passenger frequency rate, a greater proportion of the customers are also of the personal/pleasure variety as compared to domestic air travel where the business proportion is higher.\(^4\)

Travel agents book the preponderance of overseas air travellers: from over fifty to eighty percent, depending upon the carrier.\(^5\) According to the evidence in industry surveys, the passenger typically relies upon the agent to choose the carrier. The Louis Harris surveys credit the agent with determining the carrier in sixty-four

\(\text{\(^2\) G. DOUGLAS & J. MILLER, ECONOMIC REGULATION OF DOMESTIC AIR TRANSPORT (1974); M. STRASZHEIM, THE INTERNATIONAL AIRLINE INDUSTRY (1969).\)}


\(\text{\(^4\) In domestic travel, business trips bring in almost as many dollars [to agents] as personal/pleasure trips; whereas in international travel, personal/pleasure bookings outearn business trips by more than 3:1. Domestic travel is obviously a market where the businessman is a very important factor, whereas the international market is heavily dominated by the vacationer.}\)

\(\text{\(^5\) 1973 Harris Study, supra note 15, at 12; see also 1975 Harris Study, supra note 15, at 9.}\)

\(\text{\(^5\) Exhibit JRC-T-3, at 16-17, Agency Matters, supra note 1 (written testimony of Alfred R. Stout); written Jointly Represented Carriers Exhibits JRC-416, 418, id.}\)
to seventy-five percent of the cases. In the retailing section this represents an unusual degree of influence in "brand" selection by the sales personnel.

The surveys also present evidence on the question of whether agents, in choosing among different travel alternatives, are influenced by the size of the commissions being offered. This aspect of agent conduct also has important bearing upon the economic analysis in the next section. During the time of these surveys, travel agents faced a generally uniform commission agreement, from both domestic and international air carriers. But commissions did differ as between destinations and hotels. A hotel's commission policy was considered "very important" by seventy percent of the agents as a selection factor. Forty-four percent of the agents rated commission rates as one of the top factors in choosing destinations for their customers.

In the CAB hearing on commissions (despite the agent's incentive to dissemble) evidence was produced indicating that some agents would deliberately misbook a passenger on a less than optimal flight in order to secure a higher commission made possible under open rates. The American Automobile Association surveyed its travel agents on the question of misbooking and found that sixty-one percent believed that their personnel would lose their impartiality when commission rates differed among carriers. The trade press contained stories about misbooking after the April, 1975 termination of uniform rates. One agent in Illinois claimed that he would route his Chicago-Rome passengers through New York, to secure Alitalia's higher commission, rather than select TWA's direct service from Chicago which paid a lower commission. Thomas Cook, the world's largest travel agency, now pays its employees cash bonuses, which are a reward for booking customers on airlines

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26 1971 Harris Study, supra note 15, at 10; 1973 Harris Study, id. at 19; 1975 Harris Study, id. at 40.
27 1975 Harris Study, supra note 15, at 73.
29 Agency Matters, supra note 1.
30 American Automobile Ass'n Exhibit, at 1, Agency Matters, supra note 1. See also TRAVEL TRADE, Feb. 28, 1977, at 2.
offering favorable commissions.\textsuperscript{33}

A Pan American-Alitalia episode evidences both the discretion agents have over their customer's choice of carrier and the responsiveness of agents to differing commission levels.\textsuperscript{34} When Pan American renounced the uniform commission rate in April, 1975 it informed travel agents that it would pay a two percent override commission on flights to Italy. Pan American's market share of the U.S.-Italy market then increased. Alitalia, its main rival, countered with a similar offer. Pan American then lost market share to Alitalia until it responded with an eight to fifteen percent override based on the agent's volume to and from Rome. Thereafter Alitalia's market share declined until it reacted with a fifteen percent override. An attorney for ASTA wrote: "It is clear from my conversations with Pan Am representatives, DOT and State Department officials that the reason Pan Am is experiencing this highly favorable traffic growth is because of increased support from travel agents."\textsuperscript{35} Only after Alitalia increased its commission level was this "support" shifted to Pan American's rival so it then was able to regain market share.\textsuperscript{36} During this time TWA also responded by raising its commission rates. It finally took the efforts of the Italian government, a supporter of uniform commission levels, to secure a partial rollback in these commission levels.\textsuperscript{37} A TWA marketing executive testified during the CAB hearings as to the mechanics of the bidding process engendered by open commissions. A portion of his description merits recounting:

The way our \textit{ad hoc} system works is as follows. A sales agent [travel agent] will typically call one of our sales managers to inform him that he wishes to book a group of passengers on a TWA flight at some point in the future. He will then ask what override we are willing to pay. When my office receives a report of such a call (we generally receive at least 30 such contacts a day and often as many as 60), we decide how much to offer in order to obtain the business. We look at the fare basis, the date of the

\textsuperscript{33} \textit{TRAVEL AGENT}, Oct. 28, 1976, at 4.
\textsuperscript{34} The Pan American-Alitalia incidents were narrated in the statement of Guido Vittori, Exhibit JRC-T-9, at 1-4, \textit{Agency Matters, supra}, note 1.
\textsuperscript{35} Exhibit JRC-442, \textit{Agency Matters, supra} note 1 (memo, Paul S. Quinn to American Society of Travel Agents Air Committee).
\textsuperscript{36} Statement of Guido Vittori, \textit{supra} note 33.
\textsuperscript{37} 230 \textit{AVIATION DAILY} 178 (1977).
flight, and the amount of the space already booked on that flight. We then check with our market planning staff to determine how many bookings are likely to be made on that flight, to determine the likelihood that we will be able to fill the seats in any event. Generally speaking, we know what the going rate is on any route, and if we decide that we need the business, we will make an offer. At a later point, the agent may come back to us and say that another airline has made him a better offer, and ask whether we wish to match it. We then will go through the same exercise, to determine how important this particular business is to us.37

This procedure is an expected one under a regime of open commissions given the peculiar price and cost characteristics of international air passenger transportation, a topic addressed in the following section.

III. THE ECONOMICS OF ALTERNATIVE PAYMENT MECHANISMS

A. The Carriers and Open Commissions

Carriers find open rates more costly because of three characteristics of their industry not generally found among sellers of other goods and services. These are: (1) carriers and their agents are prohibited by law from offering rebates on their tariff rates; (2) the product being sold, an airplane seat on a scheduled flight, cannot be inventoried if unsold; (3) the difference between the price and the marginal cost of the product (i.e., the cost of adding a passenger on an unfilled plane) is significant.38 Absent these characteristics, carriers likely would be indifferent to various travel agent payment mechanisms. They would pay approximately the same amount in aggregate commission costs under either open or closed rates.

Since these characteristics are not absent, however, a scenario familiar to the economist comes into play: the fallacy of composition. What is true of a part is considered to be also true for the whole. In a microcosm, each individual airline views its situation in this manner: assume an unsold seat on a particular flight pres-

37 Exhibit JRC-T-7, at 15-16, Agency Matters, supra note 1 (written testimony of Roger E. Chase, Jr.).

38 The marginal cost of adding a passenger to an unfilled plane is estimated to be only approximately thirty-eight dollars for a New York-London round trip flight. See Exhibit JRC-408. See also Exhibits JRC-409-410, Agency Matters, supra note 1.
ently exists; the seat, like generated electricity, cannot be "stored" for future sale; the cost to transport and service a passenger in that seat is $X; and the filed tariff for the flight is several multiples of $X. Since the airline cannot offer a lower price for that unfilled seat, there is a financial incentive to induce a travel agent to shift a customer to that carrier's flight from a rival's through the offer of a higher commission. As discussed in Section II supra, the passenger cannot lawfully share in this inducement. But as long as this payment is less than the difference between the carrier's marginal cost of adding a passenger and the ticket price for that flight, the carrier's profitability has been improved by the increased commission payment.

The assumption of the extra seat is not unrealistic. In the past decade the annual passenger load factor has never been above fifty-six percent on scheduled international service. The average passenger load factor for the decade 1966-1975 was 53.4 percent. This figure does not vary greatly from market to market. For example, the heavily travelled North Atlantic market has an average passenger load factor of about fifty-four percent; in the North Mid-Pacific the load factor was fifty-one percent.

As the individual carrier begins to fill seats on its scheduled flights, the immediate upshot is a greater payment to its agents and greater profits for itself. But what was rational economic behavior by one carrier becomes irrational as all carriers participate. As rival firms note the shift in their traffic, they too will (and must) escalate their commission payments. In the process costs increase for all carriers, profits decline for the industry and there is a transfer of dollars from carriers to agents.

In some industrial settings, the individual firms would perceive the overall irrationality of singularly rational behavior, join rank, and restrain their efforts. The fallacy of composition would not be operative. This is purportedly what might keep, say, an aluminum firm from cutting price on virgin ingot. But in the aluminum industry the ton of ingot, if not sold one day, is available for sale the next. The unfilled seat is not. Also, the difference between the ingot's market price and its cost of production is not pro-

39 Exhibits JRC-401-402, Agency Matters, supra note 1.
40 Exhibit JRC-402, id.
41 Id.
ounced. The marginal cost of another passenger is usually very modest compared to the ticket price. Moreover, in the airlines industry the propensity to break rank is exacerbated by the existence of nationalized carriers who have operating goals other than profit maximization. As a result of these factors, commission costs increased under the quasi-open rates situation of April, 1975, and thereafter.

The precise increase in commission costs attributable to open commissions proved difficult to calculate in the CAB’s investigation because the exact extent of unauthorized overpayments under the prior uniform rate scheme could not be ascertained. As mentioned, prior to the Pan American break, the CAB-approved uniform commission was seven percent for point-to-point travel with an additional three percent for inclusive tours. Taking that as the normal base prior to April, 1975, carriers filing commission schedules with the CAB now offer a base of at least eight percent (TWA, Alitalia, Air France and others offer ten percent, plus overrides), with maximum rates for major carriers generally exceeding twenty percent. LOT Polish Airlines, as of May, 1977, had on file a schedule setting commission levels up to thirty-one percent on New York-Warsaw flights. Korean Airlines offered a maximum incentive commission of thirty percent to be paid on top of its standard eleven percent for inclusive tour travel.

One estimate placed the additional cost of open commissions to U.S. carriers alone at $98 million for 1976. ASTA estimated that during 1978 commission rates would reach ten percent for point-to-point travel with a three percent override for inclusive tours. The carriers represented in the CAB hearing estimated that 1978 commission expenses would be over eleven percent of passenger revenues. This estimate is revealing when compared with the

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42 See note 38 supra.
43 M. Straszheim, supra note 22, at 8-30.
44 Examples of recent commission rates filed with the CAB pursuant to Part 253 of the Economic Regulations, 14 C.F.R. §§ 253.1-253.5 (1977), are found in Exhibits JRC-429-432, Agency Matters, supra note 1.
45 Filing pursuant to Part 253, note 44 supra, April 29, 1977.
46 Note 44 supra.
47 Agency Matters, supra note 25, at 44.
48 Agency Matters, supra note 1, at 2 (written testimony of Paul W. Faulkner).
49 Exhibit JRC-T-3, supra note 25, at 43.
experience of earlier years. In 1966 commissions to agents averaged only 4.2 percent of passenger revenues for international carriers; by 1974 this had risen to 5.7 percent, an annual growth rate of 3.9 percent. As open commissions came into play in 1975 and 1976, commission expenses were increasing at rates of over twenty percent per year.  

The record of bargaining between airlines and agents corroborates the hypothesis that commission costs escalate under open rates. The filings of international carriers show large increases in the quantity of special bonus commissions paid as open commissions became a part of the industry's economic conduct. In addition, the very fact that the carriers oppose while ASTA favors open commissions supports the hypothesis that commission payments are (and will be) larger under an open than a closed system.  

There are, however, three economic reservations from the general proposition that open rates will cause commission costs of carriers to escalate. The first is the potential tempering of the escalation by high carrier load factors. If load factors increase, then the number of seats for which the pronounced discrepancy between price and marginal costs exists will be low. The pressure for increased commissions would be dampened, although apparently not stymied. Even during the peak summer season of 1977, TWA and at least five other carriers jumped their point-to-point commission rate by twenty-five percent. ASTA claimed that the increased commissions they would receive under open rates could be used to advertise air travel, to the benefit of the airlines. But if there existed an unexploited market demand shift that could be  

50 Id. at 22.  
51 Id. at 23-26; Exhibit IRC-426, Agency Matters, supra note 1.  
52 For example, in September, 1976 British Airways paid only nineteen special bonuses. Reply Brief of the Jointly Represented Carriers at 12, Agency Matters, supra note 1. In October, 1976, the number had risen to 158. Id. British Airways' filing for August, 1977 cited almost 1300 such payments. Id.  
53 Compare Brief of the American Society of Travel Agents, Inc., at 51; Trial Brief of Jointly Represented Carriers, at 106, Agency Matters, supra note 1.  
54 Jointly Represented Carriers Proposed Findings of Fact at 78-79, Agency Matters, supra note 1. See also filings under Part 253, supra note 44, by Air France (July 5, 1977); TWA (July 11, 1977); Alitalia (July 18, 1977).  
55 Brief of the American Society of Travel Agents, Inc., supra note 53, at 43-44.
tapped by advertising, carriers themselves would have an incentive to undertake the promotional campaign. Airlines are more economical buyers of advertising than agencies.

Second, even though a regime of open commissions significantly increases carrier payments to the travel agent industry, agencies will not receive supranormal profits in the long run. Given the economic structure of the travel agent industry, the likely result of open commissions would be that the initial increase in profitability of the industry would attract even more entries to its ranks than before. Since agencies are prohibited from competing on the basis of price, non-price blandishments would be utilized (to the extent permitted by law) to attract customers. The result would be excess capacity in the travel agent industry and an inefficiently large amount of resources flowing into non-price rivalry.

The final reservation pertains to the role of monopsony power in the market for agent services. A considerable portion of the objections of the CAB’s Bureau of Operating Rights (BOR) to uniform commission agreements focused on this issue, and the BOR’s brief even included a technical appendix outlining monopsony theory for non-economist readers. The document provides a nice illustration of Kenneth Boulding’s famous assertion that a little economics can be a dangerous thing.

The monopsony issue can be put simply enough. A monopsonist is a buyer upon whom input sellers are so dependent that the buyer has significant control (or discretion) over the price it pays for its inputs. Economic theory holds that a monopsonist, if left to itself, will pay a price which is too low, and that as a result an inefficiently small quantity of resources will be drawn into the factor market. The BOR brief, drawing heavily upon George Stigler price theory text, adequately demonstrates this proposition. The BOR then concludes that since a monopsonist pays too little, IATA uniform commission rates were (and would be) too low; open commissions, because they produce higher commissions, yield an improvement in economic efficiency.

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68 Supra note 56.
69 Brief of the Bureau of Operating Rights, supra note 57.
What the BOR brief neglects, in spite of its focus upon the monopsony question, is to demonstrate that IATA has monopsony power in the purchase of agent services. This gap in the BOR's argument is explicable in that no such showing could be made. The non-human costs of a travel agency (such as office space, phones, and typewriters) are obviously not tied in any way to the peculiar nature of the travel agent industry. Therefore IATA could not pay a monopsonistic commission level and have such factors of production attracted away from alternative uses. The same applies for human inputs. The travel agent is not tied to his or her profession in the same manner as the employee in the common textbook examples of monopsony: the textile worker in the Southern mill town, the drafted professional athlete, the drafted soldier. Travel agent personnel have alternatives that bar their exploitation. The best proof of the absence of monopsony exploitation is that individuals not yet licensed as travel agents (and therefore not yet committed to the profession), but who are working for and can observe the compensation of existing travel agents, continue to decide to enter the profession. This behavior would be irrational if their compensation were below an open market level. Individuals do not voluntarily queue up to be exploited by monopsonists.

B. Consumers and Open Commissions

The quality of advice rendered by agents will be lower under open commissions than at an appropriate uniform commission level. Under uniform commissions an agent's incentive in advising customers as between airlines is unambiguous: discerning the customer's best interest is basically identical with the agent's financial interest. But under open rates, whenever commissions differ between carriers, the agent's interests may run at cross purposes with the traveler's. A higher commission on a less desirable flight provides a perverse incentive to the agent to misbook the passenger.

Misbooking will not occur in every potential instance. Agents benefit from repeat business, and, if afraid that the suboptimal booking will be later discovered, they may take the smaller commission against that chance. Business travellers will be suboptimally

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60 See generally the annual Harris Studies, supra note 15.
booked less than pleasure/personal passengers; domestic passengers will be suboptimally booked less than international travellers.\footnote{See notes 23-24 supra, and accompanying text.}

A supply curve for misbooking by travel agents would show the number of passengers misbooked as a function of the dollar differential in commission rates. This relationship would be a direct one and the supply curve would begin at the origin since, in the absence of differential commissions, there is no perverse incentives to misbook. The slope of the curve would be determined by the agent's professional ethics and the agent's expectation of the misbooking being discovered. For this latter reason, the supply elasticity will be larger for international air travel than domestic; that is, a given commission differential will provoke a larger quantity of misbooking in international travel because of greater consumer ignorance and lower travel frequency.\footnote{Id.} The size of the differential offered by one carrier relative to its rivals will be a function, in part, of load factors, the expected reaction times of rival carriers, and the extent to which agents will continue to favor the initiating carrier after others have matched the higher commission.

The financial inducement to misbook a single passenger can be significant. For example, in 1977 Alitalia paid a fifteen percent override on flights from the U.S. to Italy, resulting in a total commission of up to twenty-six percent of the ticket fare.\footnote{Id.} TWA was one carrier that did not match the increase. The result was that on a round trip economy flight from New York to Rome booked on Alitalia, the agent received a commission of $190.44; the same flight booked on TWA yielded only $90.38 in agency compensation.\footnote{Exhibit JRC-T-1 at 8-9, Agency Matters, supra note 1 (testimony of Kenneth G. Elzinga).}

Open rates affect consumers adversely not only by raising the probability of being misbooked, but also by increasing what economists call "search costs." Under uniform rates, the main incentive a traveller had to check with another agent on travel plans was the chance that the first agent had unconsciously misstated the alternatives. Under open rates, the traveller has an in-
centive to inquire with rival agencies to try and ascertain if the first agency purposely misstated the alternatives.

In spite of the misbooking problem, ASTA's position in the CAB hearing was that consumers could still benefit under open rates because, with the expanded commission revenues, their members would offer more amenities (flight bags, maps, etc.) and remain open longer hours in more locations.\(^{65}\) This, it was suggested, would more than offset any lessened quality of service or higher ticket prices which airlines would be forced to impose because of higher commission costs.\(^{66}\) The argument is flawed.

If consumers valued increased travel agent services more than airline services, it would have been in the economic self interest of IATA members voluntarily to raise the uniform commission rate which all members paid so that the travel agent industry could afford to make such services available. IATA members could then have exploited, in the form of increased air travel, some of the revenues from this untapped component of consumer preferences.

In addition to misbooking and search costs, there are other potential costs to consumers of open commissions. Air passengers may pay higher ticket prices, receive less service from the carriers, or some combination of the two as a result of open commissions. Unless carriers are able to pay the increased commission costs out of profits, or they are absorbed as losses by carrier owners, carriers will have no choice but to respond either with applications for higher fares, an increase in passenger load factors, or a reduction in flights or flight services. Carrier profitability in recent years has been modest. Since 1969 U.S. carriers have earned less than six percent on investment each year on the international segment of their business.\(^{67}\)

C. The Government and Open Commissions

The carriers and agents have an obvious interest in the dispute over commission payment mechanisms. Less apparent is the rationale of two government agencies which participated in the hearing: the Department of Transportation and the Antitrust Division

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\(^{65}\) Brief of the American Society of Travel Agents, Inc., supra note 53.

\(^{66}\) Id.

\(^{67}\) Exhibit JRC-T-3, supra note 25, at 10.
of the Department of Justice. Both opposed uniform commissions.68

DOT's support of open commissions is the more difficult to trace since that agency has from its inception had troubles bringing itself into focus. Its efforts on behalf of travel agents in this proceeding may be a manifestation of its inability to decide upon its position regarding the more general question of transportation deregulation.

One of the objections raised by DOT to uniform commissions was that, given the peculiar incentive structure faced by airlines, any uniform agreement rate would be breached, especially during times of low load factors.69 Unabated breaching, of course, results in a de facto open system, but conceptually this is not an objection to uniform rates. Under a fixed uniform commission, even with widespread breaches, there will be less loss to the public interest than would occur under an untrammeled open system. Even partial observance is better than none. The remedy for breaching is an improved system of detection and conviction.

Under the CAB's recent adoption of Part 253 of its Economic Regulations,70 the probability of deviations from filed commission rates is reduced. Each carrier now must fully disclose and file its commission schedule with the CAB. To deviate from this filed rate is an unfair method of competition and not, as previously was the case, only a violation of an IATA resolution. Part 253 applies to both open and uniform rates and serves to inhibit illegal rebating. In addition IATA has expanded its own enforcement staff. The recent indictment of some airlines for rebating71 also raises the deterrence against this practice. It should also be noted that most of the pre-1975 breaches of the IATA commission agreements involved payments to wholesale tour operators, not retail travel agents.72

Unlike DOT, the Antitrust Division of the Justice Department has had a rather clear view of what its role should be, who its

68 Brief of the United States Department of Transportation, at 3 and Brief of the United States Department of Justice, at 3, Agency Matters, supra note 1.
69 Brief of the United States Department of Transportation, supra note 68.
70 Supra note 44. Part 253 became effective September 1, 1976. See Regulations ER-961 (July 16, 1976); PS-70 (July 16, 1976).
71 See supra note 14.
72 See supra note 12.
constituency is, and what its goals are. Because of its past concern with the consumer's welfare, the Division's position in favor of open agency commissions\textsuperscript{23} is a curious one and worthy of inspection.

The Antitrust Division has had a long history of battling resale price maintenance (or fair trade) laws. In 1975 that battle was successfully consummated,\textsuperscript{14} with consumers much in debt to this agency for its efforts. Yet in the CAB's agency commission investigation, the Antitrust Division found itself supporting open commissions, in effect a form of resale price maintenance. The parallels are obvious. Price competition among travel agents is precluded by law. Therefore any rivalry among agencies must be of the non-price variety. One of the vices of resale price maintenance, according to traditional doctrine, is that non-price competition becomes excessive and not as beneficial to the consumer as the reduced prices which would be possible without fair trade. Consumers are forced to pay for services they do not value as much as the lower prices foregone. This type of excessive non-price competition will prevail in the travel agent industry under open rates, and the adverse economic effects will be exacerbated by the perverse incentive to misbook when commission rates differ among carriers. In addition, open rates, as shown earlier, raise the probability of higher ticket prices for consumers relative to those which would prevail under uniform rates. How then does the Antitrust Division support its position?

Students of the Antitrust Division realize that the Division tends to react reflexively and sometimes irrationally to certain words. "Concentration" and "regulation" are two of these terms. There are also acronyms that fall in this semantic category, such as IBM, GE, and AT&T. Taxonomically, IATA falls into this group as well. In the investigation of agreements among IATA members involving agency matters, the Antitrust Division's response may parallel that of Nathaniel, who upon hearing that Jesus of Nazareth was the awaited Messiah purportedly said, "Can there any good thing come out of Nazareth?"\textsuperscript{24} The Antitrust Division would wonder: can anything good come out of IATA?

\textsuperscript{23} Brief of the United States Department of Justice, supra note 68.
\textsuperscript{24} John 1:46.
Shorthand responses to economic questions can be rational. Rules of thumb can be helpful, but they also can lead to mistakes. The only intellectually redeeming aspect of the Antitrust Division's position might be strategic. That is, by supporting open commissions the Justice Department may recognize the costs it is imposing upon consumers, but find these costs outweighed by the chance that open commissions will so rend the economic fabric of IATA that in the long run its rate fixing powers will end and a completely free market in air transport will prevail.

In this instance, however, that end which may be hoped to justify the means will not be secured. While criticisms of IATA's joint rate making propensities have been common, no critic has been able to devise a scheme or policy whereby an open and efficient market could be substituted for the IATA mechanism. The reasons are rooted in the economic nature of markets. One of the preconditions for markets to function freely is that property rights be clearly defined and exchangeable. In some industries, governments exercise no restraint over property rights and international trade thrives. Calculators, watches and capital equipment are examples. But no government is likely to renounce sovereignty over its air space and permit unfettered exit from and entrance over its borders by way of air travel. Without this, a precondition for a genuine free market in air transport is unmet. The prospect for an efficient open market in international air transport is further lessened due to the subsidization by some foreign governments of their flag carriers.

IV. ANTITRUST PRINCIPLES AND THE UNREGULATED MIDDLEMAN

There is an unnamed law in economics: if one activity is regulated, then another will have to be too. The principle derives from the interdependence of economic phenomena—what economists call in another context "general equilibrium." For example, when it was deemed desirable to control the price of unfinished sheet ply-

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wood, this could not effectively be accomplished without controlling the price of finished plywood as well. Running unfinished plywood over a jointer put it in the (uncontrolled) finished product market. Such examples are familiar to economists formerly employed by the Office of Price Administration or its more recent successors.

The reverse of this law is also true: it can prove difficult to suitably deregulate one arena in the economy if nearby areas remain controlled. The Agency Matters proceeding is an example of this. Should commission costs be uniformly paid by all carriers and the level maintained by administrative fiat or determined "openly" by independent carrier action? In an era when the case for deregulation of domestic air transportation has been so carefully made, the question seems to answer itself, especially when open (or, more precisely, "flexible") commissions and markups are standard fare for middlemen marketing thousands of goods and services. Since a travel agent is generically no more than a middleman between a passenger and a carrier, an open payments mechanism might seem akin to the method most commonly in use.

The distinction lies in the correlative regulatory mechanisms still operating upon carriers and agents. As discussed earlier, the middleman-ticket agent cannot, by law, offer a lower price (or a rebate) to a passenger. In genuinely open markets, a middleman, financially induced by one seller to "push" that product, can offer a lower price to customers in response. Thus, in the case of most goods and services, if a manufacturer offers a lower price (or higher markup) to a retailer, the individual retailer has an incentive to promote that particular product. The incentive also exists to offer it at a lower price. Indeed, competition from other similarly situated retailers may dictate a price reduction to consumers. Genuinely open commissions would thus hold forth the prospects of lower prices to consumers.

This has been the impetus for other efforts by the Antitrust Division to open up previously blocked price competition among

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77 Note 1 supra.
middlemen, e.g., securities dealers, commodity brokers, and real estate agents. In each of these instances, the middlemen's fees, if competitively determined, held forth the prospect of a cost reduction to some if not all customers. The Antitrust Division has also entered consent decrees with other service industry associations that enjoin those associations from inhibiting their members from engaging in price competition. But any analogies between these situations and that of agents selling international air transportation are inapposite as long as ticket prices cannot be altered or adjusted by the travel agents. Instead, under the current regulatory framework regarding tariffs and rebates, "open" commissions hold forth the prospect of suboptimal booking, higher fares and lower flight quality for consumers.

In Section 102 of the Federal Aviation Act the CAB is directed to consider the "competitive impact" of its decisions. This is regularly construed to entail a balancing of antitrust principles of free competition against other public interest goals attainable only through collective or regulatory action. Much ink has been spilled about the appropriate balance and tradeoff.

In the Agency Matters investigation, the issue was raised as to whether uniform rates, because they entail collective action, are so repugnant to antitrust principles as to override any other possible public interest factors. In legal terms, the determination hinges initially on whether a rule of reason or a per se standard is to be the appropriate criterion. By the per se approach, the IATA agree-

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80 See Brief of United States as Intervenor, Thill Securities Corp. v. New York Stock Exchange, No. 63-C-264 (E.D. Wis. May 1, 1973).


82 United States v. American Institute of Architects, 1972 TRADE CASES (CCH) ¶ 73,981; United States v. American Soc. of Civil Engineers, 1972 TRADE CASES (CCH) ¶ 73,950; United States v. American Institute of Certified Public Accountants, Inc., 1972 TRADE CASES (CCH) ¶ 74,007.


84 Supra note 1.
ments are unpalatable on their face. The rule of reason standard permits a cost-benefit evaluation of uniform commission agreements.

There is little question that in markets devoid of regulatory constraints, the per se benchmark regarding the fixing of prices and rates is appropriate. But in markets or industries partially regulated, such as air transportation, the economic case for a rule of reason is forceful. As mentioned earlier, the interdependence of regulated behavior with "open" elements can negate the expected benefits of independent economic action. A rule of reason permits the CAB to be mindful of these interdependencies.

The ultimate performance goal of any industry, after all, is not adherence to antitrust principles. Antitrust is a means to a social end. One desired end of antitrust is the efficient use of resources as determined by consumer preferences. As Adam Smith put it long ago: "Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer."

In many industries forcing the economic actors to behave independently achieves efficiency. In the context of travel agent commissions, exactly the opposite is the case. To argue that independent action is dictated by "antitrust principles" when this results in inefficient resource utilization and detriment to the consumer is to stand the principles of antitrust on their heads. A far more workable and consistent focus for the CAB would be to adhere to rules of decision that yield the desired fruits of antitrust: consumer sovereignty and prices in line with alternative opportunity costs. Semantically, much legal confusion could be avoided if the CAB were to hold that pursuing the "principles of antitrust"

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65 The most robust presentation of the per se rule is United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).


67 The classic defense of the per se approach is Adams, The 'Rule of Reason': Workable Competition or Workable Monopoly, 63 YALE L.J. 348 (1954).


refers to the pursuit of ends, not means. The question before the Board then becomes, what is the impact of the action upon the consumer's welfare? In some market settings, then, the competitive market model adroitly will show collective action to be contrary to the pursuit of this end. But in regulated sectors, the pursuit of the ends of competition may require collective action. The decision to allow uniform action by carriers in this proceeding on the grounds of consumer welfare is simplified not only because this would be consistent with the "sound development of an air transportation system" but also because it provides a setting where retail travel agents have flourished and grown in numbers. In this regard, uniform commissions also further the "antitrust principle" of promoting small enterprise.

V. CONCLUSION

The CAB's investigation of travel agency commissions went only to the question of the desirability of a uniform versus an open commission regime. The optimal level of payments itself was not an issue in the proceeding (nor in this paper). If the CAB rules in favor of uniform commissions, then the question of the appropriate level or range of commission payments will have to be addressed.

If the CAB decides in favor of open commissions, then the various rates independently paid by carriers for the brokering of international air travel must be filed with the CAB and that agency must decide upon whatever compliance measures it deems appropriate to enforce them. Beyond this, no administrative determination of commission levels need be taken. The CAB could disallow proposed commissions as excessive, but to do so would eliminate one alleged advantage of open commissions (that their levels require no administrative evaluation or determination), and

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See United States v. Aluminum Corp. of America, 148 F.2d 416, 429 (2d Cir. 1945); Brown Shoe Co. v. United States, 370 U.S. 294, 316 (1962); Elzinga, note 88 supra, at 1196-1200.

"The investigation . . . is not to consider any additional questions . . . such as the appropriate level of commission rates." CAB Order No. 76-7-56, supra note 1, at 8. "The issue of whether the levels of the proposed commission rates are fair and equitable to all concerned is separate and distinct from the issue of whether the fixing of uniform rates of commissions to travel agents by agreement among the carriers is adverse to the public interest." Id. at n.24.
is a concession that an open rate regime, unlike a true open market, is not self-regulating.

Under open commissions, consumers and carriers would be the losers. Carrier costs would increase (as they already have), with no corresponding increase in the demand for their product. Consumers would lose the impartial advice available under uniform rates, as well as face the prospect of higher fares, poorer carrier service or both. Further, what carriers and consumers lose under open commissions is not matched by what agents gain. In the long run the transfer of revenues from carriers to agents would attract more agents into this service industry, and those agents would compete away excess profits through excess non-price rivalry.33

If open commissions are mandated, other changes in the industry can also be expected. The historic decline in the use of carrier-owned city ticket offices (CTO's) probably would be reversed. At present most carriers generate far less than half their bookings through CTO's.34 Still, under open commissions, CTO's would not come to dominate the retailing of tickets. In all but the largest of cities, the market is too thin for each international carrier to have a CTO situated therein. The use of toll-free numbers—an imperfect surrogate for a CTO—would be more extensively promoted by carriers seeking to circumvent the high commissions payable to retail agents under the open rate system.

Another likely outcome, as both carriers and passengers become disenchanted by the economic effects of open commissions, would be a move to a net fare concept. This would represent a true open commission regime, in contrast to that being considered by the CAB, which is open only on the supply but not on the demand side. Under a net fare system, a passenger for international air service would pay the retail travel agent an amount which is the sum of the filed tariff on the airline plus a commission for the agent's services. The agent then would return an amount equal to the filed tariff to the airline upon whom the ticket was written, and retain whatever commission it was able to charge. All

34 See Exhibit JRC-T-7, supra note 37, at 2; Exhibit JRC-T-6, Agency Matters, supra note 1 (written testimony of Russell Thayer); Exhibit JRC-416, Id.
agents would pay the same amount for a ticket on a particular carrier for a particular flight. But agents could attempt to charge whatever commission they desired for their services associated with booking the flight.

The structural characteristics of the travel agent industry, discussed in Section II above, would, in the absence of collusion, prevent the setting of excessive commission surcharges. In addition, commission charges would then vary to reflect different services proffered. A complicated itinerary, with numerous stopovers, would prompt a higher commission payment. In like fashion, agents offering extensive counseling or amenities for a given international flight could, in an open market, charge a higher price if consumers desired such services. But unlike the situation under an open commission system, consumers who do not value these extra services would not have to pay for them. The only economic complication would be a free-rider problem in some ticket sales. Under net fares, a passenger seeking extensive counseling could secure this at one agency, then purchase the ticket at another which charged a lower markup. This would induce agencies of the first sort to offer a suboptimal level of service since they would not capture the gains from their greater efforts. The circumvention of the free rider problem is one of the economic advantages of the IATA uniform commission proposal. The free rider problem, however, would not exist with respect to tangible amenities (flight bags, etc.) since they would not be extended except in the case of a sale.

Already, as the effects of open commissions have become apparent, the airline industry has begun to examine the net fare concept more seriously. Under open fares, airlines could offer tickets to their own (and other) CTO’s at the same price as to independ-

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65 In a world of costless information and zero transaction costs, the same results as a net fare concept could be approached under open commissions if the rebating restrictions on travel agents were removed. In such a frictionless market, competition would force agents to rebate part of any excessive commissions back to consumers, thereby lowering the real price paid for tickets. Given consumer ignorance of flight alternatives, however, the problem of agent impartiality, not present under either uniform commissions or net fares, would remain extant.

66 For an analysis of the "free rider" problem, see R. POSNER, ANTITRUST LAW 149-51, 160 (1976).

67 See 288 AVIATION DAILY 52 (1976); TRAVEL AGENT, Mar. 31, 1976, at 1.
ent retail agents so that CTO's would provide in some markets a source of competition to independent agents.

An examination of the sizable volume, *Agreeing Fares and Rates: A Survey of the Methods and Procedures Used by the Member Airlines of the International Air Transport Association,* is an interesting exercise. The IATA regulations show the interdependence of air routes and fares to different regions and countries, the labyrinthian procedures for resolving carrier differences, and the difficulties such an institution encounters when competitive strategies of one sort flare up because competitive actions of another kind are institutionally constrained. One is reminded that running any type of cartel is not an easy task.

In some cartel situations, the uncontrolled rivalry among cartel members may be a partial antidote for the consumer welfare lost by the collective constraints on competition. But not in every case. Due to the restraints on price competition and rebating, as well as other contributing characteristics peculiar to the international air travel industry, the replacement of uniform agreements on retail travel agent commissions by a regime of open commissions stimulates inter-carrier rivalry of a sort that is inefficient and contrary to the public interest.

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98 (2d ed. 1974).


100 See Stigler, supra note 93.