

# Regulation of large airports – status quo and options for reform

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# Issues

- **Airline airport relationship under stress:**
  - “Airports are exploiting, in many cases, their natural monopoly position” (IATA, 2007)
  - “Airports are in tough competition” (ADV, 2007)
- **OECD: Need for rational dialogue**
- **Evaluate current regulation**
- **Options for regulatory reform**

# Agenda

- I. Criteria for a rational dialogue on airport regulation**
- II. How have airports performed?**
- III. Why regulate airports?**
- IV. Can competition substitute for regulation?**
- V. How are airports regulated?**
- VI. What are the options of reform?**
- VII. Conclusions**

# I. Criteria

- **Airport should**
  - set prices at competitive levels
  - Seek to minimize total costs
  - ration demand efficiently
  - invest an optimal amount
  
- **Regulatory process should be**
  - based on a legislative democratic mandate
  - fair, accessible and open
  - avoid high bureaucratic costs

## II. Airport performance

- **Poor cost control particularly at partially privatised airports and vertically integrated airports**
- **Allocative efficiency: misdirected pricing!**
  - **Ample capacity: Inefficient weight based charges**
  - **Capacity constrained airports**
    - **Weight based charges - welfare loss of \$ 6 billion for US-airports in 2005.**
    - **32 bn € for European Airports in 2025**
      - **No market based slot allocation**
      - **Arbitrary slot limit**
      - **Weight based charges discriminate**
- **Over investment in areas with lack of demand and underinvestment at regions with excess demand**

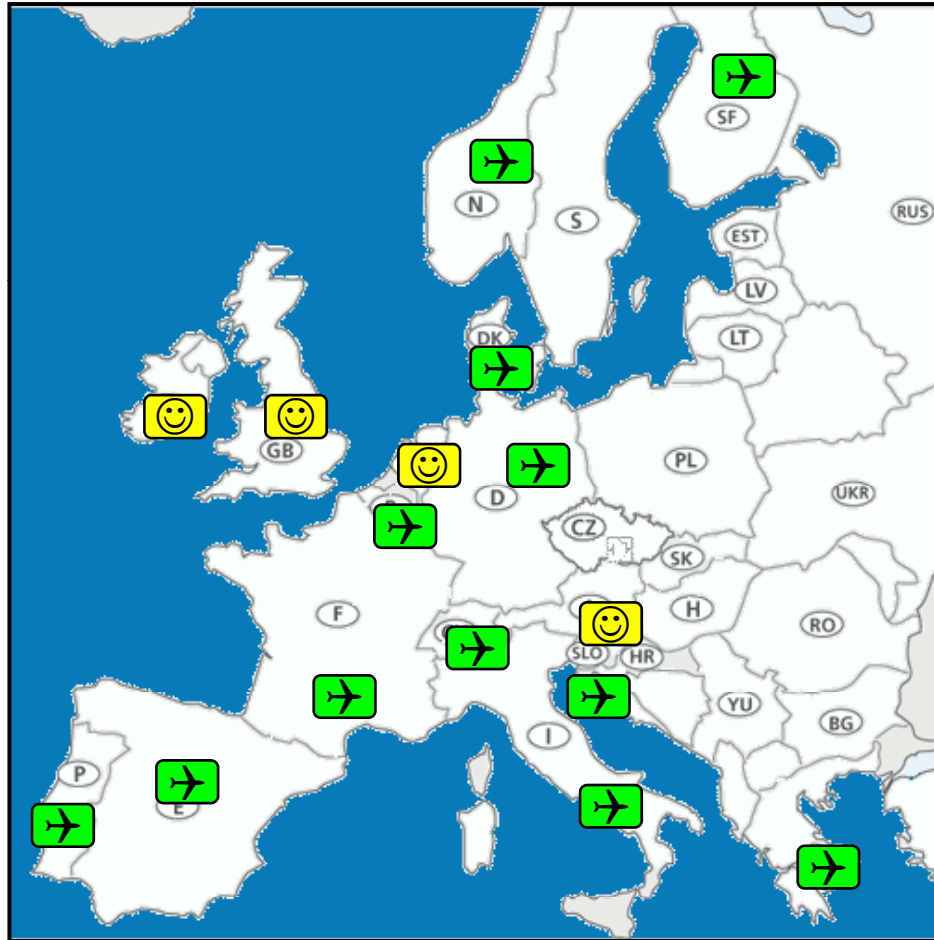
# III. Why regulate airports?

- **Market power can arise**
  - from a locational monopoly due to planning restrictions.
  - natural monopolies with sunk costs. Economies of scale might range from 3 to 12 perhaps even 90 million pax.
- **Implications for the design of regulation**
  - Not the airport industry as a whole has market power, but only some airports
  - regulation must be complementary to competition
  - rationale for regulation must be revisited on timely basis:
    - is it necessary at all?
    - which airports should be designated?
    - which airports should be subject to the threat of regulation?

# IV. Airport competition

- **Three Forms:**
  - Hub competition (Schiphol versus ADP)
  - Hub and secondary hub (Fraport versus Munich versus Stuttgart)
  - Primary and secondary airport (Vienna and Bratislava)
- Competition currently not strong enough to make regulation completely redundant.
- Competition could be more intense
  - tradable slots
  - Open skies

# Regulation of European Airports



☺ Independent regulator (all with user consultation)

✈ User consultation without independent regulator

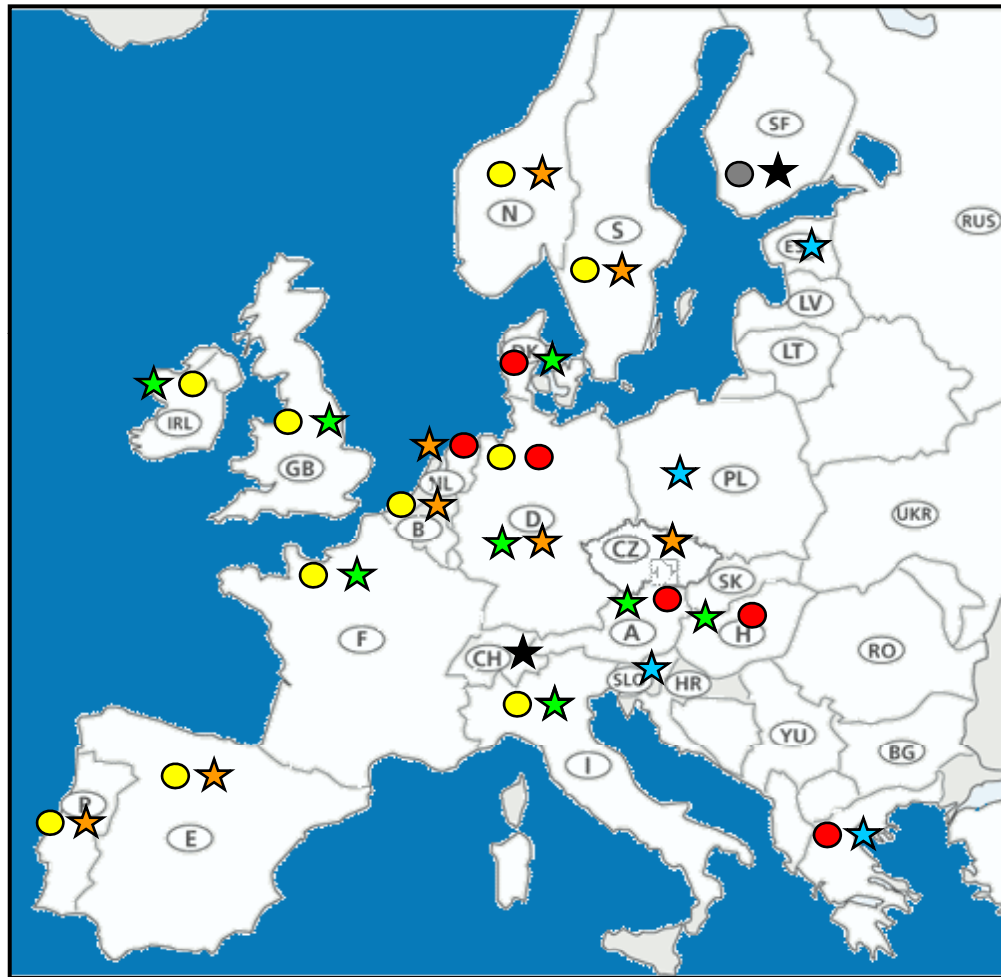
- Improved consultation
- **Lack of independent regulator**
- **Regulatory capture**

\* User consultation at Malta International Airport

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Source: Gillen & Niemi, 2006

# Type of Regulation at European Airports



- ★ Type of price cap
- ★ Charges set by airport
- ★ Cost plus regulation
- ★ No regulation

## *Single or dual till system*

- Single till
- Dual till
- No till system

\* Malta International Airport has a price cap and a dual till system in place.

# V. Airport regulation

- **Scope: Too narrow and too wide:**
  - In some countries regulation of charges does not include central infrastructure fees for ground handling
  - Single till still dominates though slowly changing towards a dual till system
- **Types of Regulation:**
  - Cost based regulation in majority of countries
  - Slow move to hybrid price caps
  - Some revenue sharing agreements
  - Monitoring: Australia and New Zealand

# V. Airport regulation

- **Information asymmetry.**
  - Regulator does not know demand, costs functions, but airport does.
  - Airport does not know how the regulator behaves
- **Tasks of Regulation**
  - More than reducing the level of prices, because this will increase excess demand at busy airports.
  - Additional problem of rationing demand efficiently and setting incentives for investment. Hence
    - structure of charges
    - allocation mechanism and
    - incentives for investment

# VI. Options for reform

- **Cost based regulation**
  - sets incentives for gold plating, high costs and inefficient price structure leading to allocative inefficiency
- **Price caps**
  - have substantially lower price levels in Australia, UK and at some European airports
  - set incentives to balance price structure in the direction of efficiently rationing peak and excess demand
  - Hybrid caps could be improved by benchmarking
- **Monitoring**
  - mixed results in Australia and New Zealand
  - Unclearly defined objectives
  - Loosely defined cost plus regulation
  - Independent regulator with credible threat to reregulate

# VI. Options of reform

- **Investment regulation**
  - Slot rents are created by airports but reaped by airlines. Hence airports and regulators do not know slot prices.
  - If additional capacity comes at a higher cost, price cap must allow for higher charges and can but not necessarily lead to optimal investment.
  - Price cap might lead to underinvestment if regulator cannot credible commit not to behave opportunistically which so far has not been the case.
- **Airport competition**
  - Independent regulators to create a fair playing field.
  - Cost based regulation and monitoring are incompatible with competition.
  - Price caps set upper limits and firms can also lower price levels in order to compete.

## VII. Conclusions

- Regulate less and reduce the scope of regulation, but more effectively with fair and democratic processes and institutions. Use a credible threat of regulation.
- Regulate and increase competitive forces.
- Implement simple price cap with strong incentives for cost savings, efficient pricing and investment.
- Foster competition by open skies, less horizontal integration and slot markets.