

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**

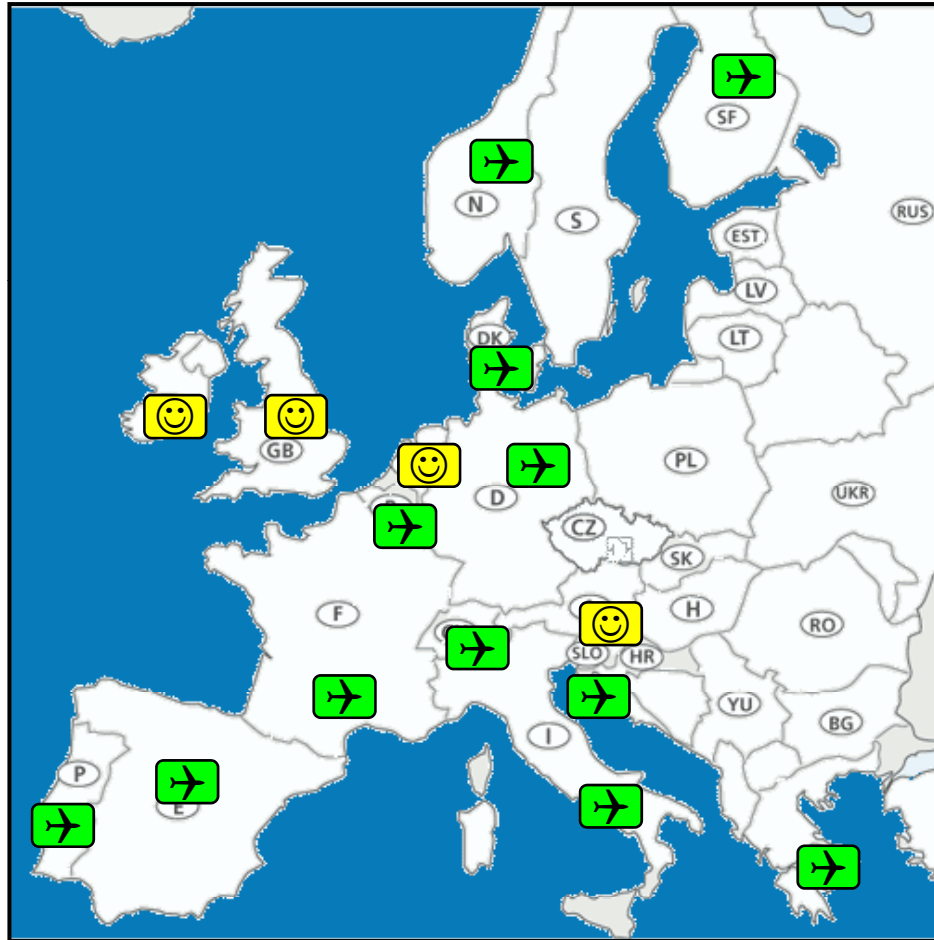
III. Why regulate airports?

- **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

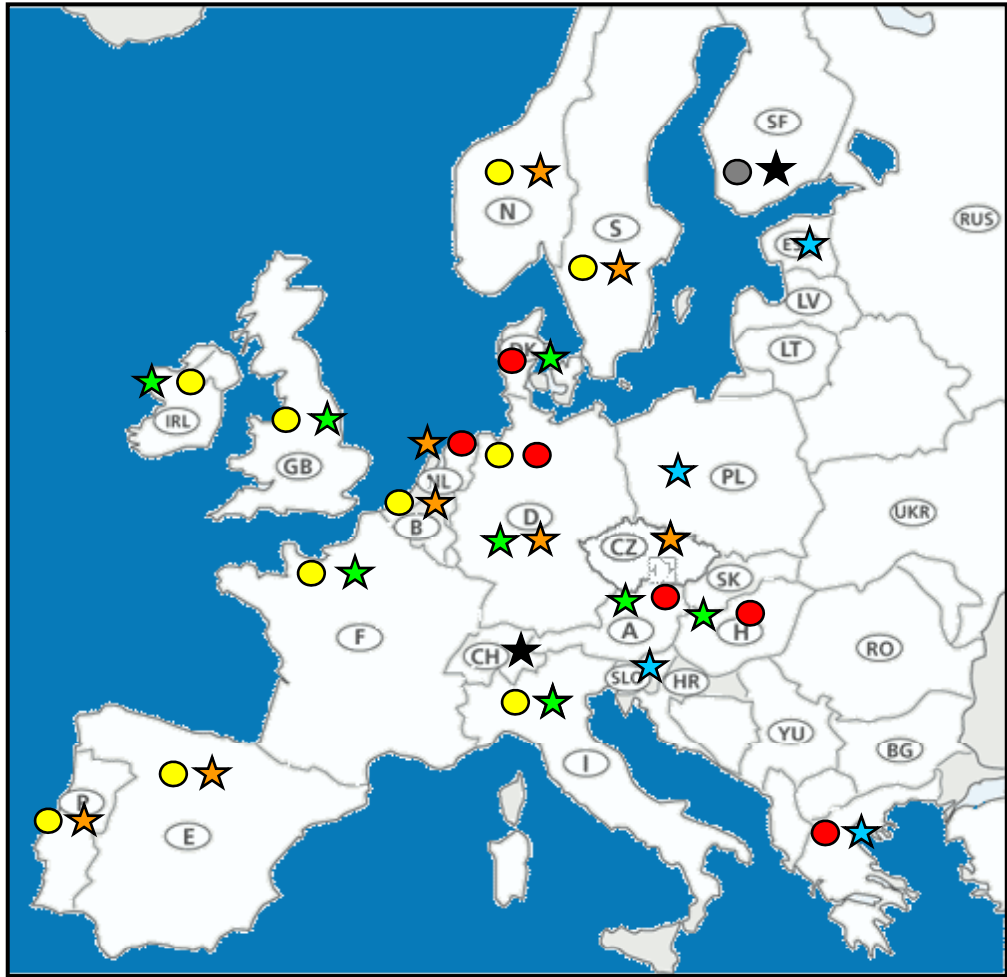
- Improved consultation
- **Lack of independent regulator**
- **Regulatory capture**

* 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.