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Ms Margo Hone
PRODUCTIVITY COMMISSION
Airports Inquiry
LB2 Collins Street East
Melbourne VIC 8003
Australia
Fax: (613) 9653 2302

Dear Ms Hone,

Pricing Regulation of Airport Services

IATA, the trade association of the world's air transport industry, is pleased to have the opportunity to provide the views of its Member airlines for consideration by the Productivity Commission of Australia in its task of developing and recommending the future price regulation of airport services.

The IATA User Charges Panel (UCP) has been mandated by the IATA Board of Governors to represent the airline industry in airport and air navigation user charges matters on a world-wide basis. The IATA UCP (hereinafter referred to as IATA) has been undertaking this task with diligence and its views reflect those of the airline industry as a whole and not that of any individual carrier.

IATA has been made to understand that the Productivity Commission will entertain submissions of views on key issues relevant to its inquiry throughout the inquiry process. Therefore, IATA wishes to make use of this opportunity to provide further submissions on such issues as deemed appropriate by its Member airlines. This initial submission is an attempt at providing the Productivity Commission with direct responses to its Issues Paper of January 2001.

Thank you once again for providing IATA with the opportunity to participate and we trust our views will be taken into consideration.

Yours sincerely,

Lasantha Subasinghe
Assistant Director User Charges

- enc. 1. IATA's initial submission.
2. IATA's position on economic regulation of airport services. (IATA's Paper to ICAO ANS Conf, June 2000)

PRICE REGULATION OF AIRPORT SERVICES

QUESTION	RESPONSE
<p>2.1 WHY REGULATE PRICES OF SERVICE PROVIDED BY AIRPORTS?</p>	<p>Airport specific regulation is more consistent with ICAO principles of site-specific costs and charging and ensures better transparency, which IATA fully supports. The regulation of individual airports should reflect the differences between their operations, assets, and levels of return, which better helps to compensate for the lack of realistic and viable competition.</p>
<p>a) Is the potential for abuse of market power an appropriate rational for airport-specific regulation of airport services? Are there other appropriate rationales?</p>	<p>In most cases airport services are price inelastic particularly for international passenger traffic. There are a few cases where changes in traffic patterns have been observed. However, it is very difficult to identify the exact cause of the change due to the interplay of many variables. For short distance travel the impact could be higher depending on the distance and total travel time. There have been a few instances where some low-cost carriers have chosen alternate low-cost airports in order that they can offer lower fares than if they were operating at capital city airports.</p>
<p>b) How sensitive is demand for a particular airport's services to any change in the prices charged, or the services offered, by that airport? What alternatives do consumers have (e.g. other airports or transport/communication modes)? How does this price elasticity of demand vary between the short to medium term and the long term?</p>	<p>Hubbing is a strategy decision of the airline. It generally is not an airport decision unless the market has been fully or at least significantly de-regulated. With regard to international traffic except for a very few locations such as Dubai and Singapore few airports have the potential to use hubbing as a strategy without it being the same objective of the base carrier. Passengers generally do not select the airport that they would like to transit in but choose the airline they wish to fly with.</p>
<p>c) How important is the port of entry/exit to international tourists? How important is hubbing through a particular airport en route to another destination?</p>	<p>The biggest concern to the airlines would be safety, security and operating efficiency. The passengers would avoid using airports mainly if there were to be security concerns regarding the airport or the locality. Other service standards will have a direct impact on customer satisfaction and have long-term effects on customer perception of the airline as most customers continue to believe that the airline has control over all services that are being provided.</p>
<p>d) How sensitive is demand for airport services to changes in the quality of those services?</p>	

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QUESTION	RESPONSE
<p>e) What is likely to happen to competition in future? What factors, other than regulation, are likely to be most influential in curtailing/promoting competition?</p>	<p>Competition between airports is virtually non-existent. If the airports particularly those in the Sydney basin were owned and managed separately there could be some room for competition.</p>
<p>2.11 Assessing the extent of market power of airports— What is an efficient pricing benchmark?</p>	
<p>a) What is an appropriate price benchmark (for example, in relation to costs, particularly opportunity costs of the use of facilities) against which to assess potential abuse of market power by airports?</p>	<p>IATA does not support price comparison between airports as the costs and their structure, quality of service, types of service, type and volume of traffic differ from one to the other. However, IATA supports and urges airports and their regulators to compare each airport's performance over time. Further, IATA endorses ICAO's policies on the cost-based relationship of charges, and therefore does not support pricing policies based on opportunity costs.</p>
<p>b) What is an efficient level and structure of prices in airports? Would a two-part pricing system combining the sale of take-off and landing slots with charges for use of facilities be a feasible and efficient pricing policy?</p>	<p>The shortage in airport capacity is handled world-wide by "slot-allocation" procedures. A charges system would not add any value to this procedure; slot co-ordination takes a global view in addressing capacity shortages at airports.</p> <p>There have been some proposals to introduce the sale of take-off and landing slots or the sale of slots in combination with charges for use of facilities. Although the sale of slots may improve capacity utilisation, the price per peak slot may become prohibitive for the operators of smaller aircraft. Hence will lead to denial of market access, discrimination, and raise issues such as the principle for fair and equal opportunity, and consistency with Article 15 of the Convention on International Civil Aviation. It may also be inconsistent with some Bilateral Air Services Agreements between States.</p> <p>Therefore, IATA is opposed to the sale of take-off and landing slots by airports.</p>

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QUESTION

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c) What is likely to happen to the level and structure of prices in airports under review if prices regulation were removed? Are there any constraints on efficient pricing of airport services? Would removal of prices regulation result in airports earning excess profits?

Potential abuse from predominant position could result in excessive prices, lower productivity/efficiency, and insufficient investment in aeronautical infrastructure.

d) What expected rate of return is required to attract new investment in existing airports? In new airports?

Airports are an integral part of the air transport industry. Therefore, IATA believes that it would not be equitable if airports were to be allowed excessive profits using its dominant position at the expense of the airlines and the other users.

IATA does not object to a reasonable rate of return that takes into account the monopolistic nature and the very low risk involved in the airport's core activities. The rate of return should be such that it could attract private capital but at a lower cost than the rate at which the airport is able to borrow from the financial markets.

e) Do airlines and/or other users have any countervailing buying power when negotiating with airports? Is there any relevant Australian or overseas experience?

Conditions of use at many airports are mostly obligations to the airlines and few rights. Airlines have little power to negotiate prices with the airports. Any assistance that the airlines have would depend on the regulatory regime and any laws enacted to protect consumers. Even when legal proceedings have been invoked by the airlines it has been at great costs to the participants.

f) Are there any constraints on, or disincentives to, airlines and other users exercising such power?

Airline discussions with the monopoly provider of airport services can not be termed as a negotiation between free consenting parties by any stretch of the imagination. In most cases, particularly in the absence of proper regulation, the airlines do not even get the information required to be able to assess the reasonableness of the airports level of charges. In such situations airlines would have to resort to legal action or sensitise the general population. These are costly exercises and at times lead to the deterioration of the relationship between the provider and the user.

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QUESTION

g) How vigorously do airports compete for airlines and other users?

In most cases airports are not in a position to attract new airlines or new route services, although some airports prefer to consider that they are in competition in trying to achieve that. It is the market that determines the airline schedules and which destinations to operate. There are a few cases where airports have offered incentives to airlines operating new destinations or to new airlines to the airport. However, with some exceptions, such techniques do not generate substantial additional traffic, although it helps the airlines in a smoother implementation of the initial phase of a decision it has already made based on market demand.

RESPONSE

2.12 Potential effects on efficiency and income distribution of airport market power?

a) Are airports with market power in a position to discriminate between buyers of their services? Is such price discrimination precluded by regulation? Is there evidence of price discrimination by airports in Australia or overseas?

There is evidence that certain airports apply charges differentials that are not cost-related and therefore can be considered as discriminatory and anti-competitive.

b) Is there any evidence that airports tend to be inefficient in production? Do they have a tendency to under- or over-invest in new capacity and quality?

Government-owned and managed airports have a tendency to over invest at times for reasons other than to serve the needs of the users of the facilities. Certain privatised airports have been seen to be under investing in aeronautical facilities. In order to ensure that the investments are as per user requirements it is necessary that proper consultation with users in both the formulation and execution of any capital investment programme be undertaken.

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QUESTION	RESPONSE
<p>2.13 Are airports different from other industries?</p>	
<p>a) Are airports different from, or likely to have more market power than, other industries with some natural monopoly characteristics? In what respect, if any, do airports differ?</p>	<p>The difference is with customers/users: around 50% of airport users are visitors to the region. Hence, any dissatisfaction of the users causes very little concern to the decision makers in the region and is also politically less significant.</p>
<p>2.3 EFFECTS OF CURRENT PRICES REGULATION</p>	
<p>2.31 Congestion and demand management</p>	
<p>a) Does the current regulatory and price regime encourage efficient pricing of available capacity? What constraints are there on airports adopting pricing policies such as congestion charges and peak load pricing?</p>	<p>The market dictates airline scheduling. Schedules are constructed in response to passenger and cargo demand. Scheduling is one of the most difficult tasks an airline has – trying to optimise aircraft utilisation within the constraints of airport curfews, increasing environmental restrictions, crew availability, and many other factors. Experience has shown that where peak/off-peak charges have existed, it has not had a significant effect on the distribution of traffic from peak to off-peak periods. It should be noted that some airports that had introduced peak/off-peak charges have abandoned them due to this lack of effectiveness.</p> <p>IATA strongly opposes any system of peak/off-peak charging. Such demand-altering pricing schemes could only have an effect if users have control over their demand patterns. This is not the case. Peak charges will therefore only increase the costs for those users operating during the peak periods and may discriminate against certain users. Further, the transparency of airport charges deteriorates with peak/off-peak charges.</p>

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QUESTION	RESPONSE
<p>2.32 Quality</p> <p>a) Is quality monitoring necessary? Why or why not? What has been the impact of quality monitoring?</p>	<p>Quality monitoring is essential. If not airports will attempt at maximising profits through the provision of sub-standard services. This would particularly be the case for services under price regulation.</p>
<p>2.33 Other issues</p>	
<p>a) What are the types of externalities involved in airport operations? Should incentives for the reduction of negative externalities be included within the price cap? Have they been adequately addressed in the present price cap?</p>	<p>Externalities should not be included in the airports cost base for charging. Hence it should not be included within the price cap. Inclusion will lead to distortion and reduce transparency of the airport's performance and cost effectiveness.</p> <p>ICAO is charged with establishment of global standards on aviation related environmental matters. Since airlines operate globally, it is essential that global standards be established and accepted as the baseline.</p> <p>With respect to noise, the Government should first rely on ICAO noise certification standards. If further noise reduction is necessary, a balanced approach should be undertaken in consultation with relevant stakeholders, with the emphasis upon voluntary agreements rather than punitive measures imposed solely upon airlines and operators. Regarding emissions that affect local air quality (NO_x, CO, HC, etc.) the Government should in the first instance rely on the stringent standards set out in ICAO Annex 16, Vol.2. With respect to CO₂ emissions, its approach should be in line with ICAO CAEP recommendations, which identified open emissions trading as a cost-effective solution for CO₂ reductions in the long term. ICAO CAEP further encouraged short-term action by States to limit or reduce aviation emissions, in particular through voluntary mechanisms.</p>

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QUESTION	RESPONSE
<p>2.4 FUTURE PRICES REGULATION</p>	
<p>2.41 Options for future airport prices regulation</p>	
<p>a) Should regulation be specifically tailored to the airports sector or should more general regulation be relied upon?</p>	<p>Airports that provide services to international civil aviation are required not only to comply by local laws and regulations but also international requirements. The bilateral air services agreements between states may also have an impact on the range, quality and price of services provided at such airports. Therefore IATA believes that it would be essential for airport specific regulations.</p> <p>Further, experience shows that most other regulated utilities would be under close public scrutiny and the slightest drop in quality or increase in price would result in a public outcry with the possibility to easily sensitise political opinion. Airport services would not have the same level of public attention. Therefore it is IATA's view that airport specific regulation, which takes account of international requirements as well as the local requirements is necessary and would allow the authorities to take appropriate measures to protect the users form the dominant position of the airport.</p>
<p>b) What services provided at airports should be covered by price regulation? In particular, should charges such as rent for retail premises, where there are significant off-airport alternatives, be treated differently from charges for aeronautical activities? Should they be regulated?</p>	<p>All aeronautical and aeronautical-related activities (e.g. airline space, rentals, handling, etc.) provided by a monopoly should be subject to regulation.</p>
<p>c) Do overseas regulatory experiences provide useful models of price regulation for Australian airports? What lessons do these experiences provide in applying airport price regulation?</p>	<p>None of the existing formulae for airport price regulation can be considered perfect. Refer to Questions n) and o) below.</p>

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QUESTION	RESPONSE
<p>d) Do international agreements place any constraints on approaches that might be adopted for regulating prices at Australian airports?</p>	<p>The most important international agreement is the Convention on International Civil Aviation, which promotes non-discrimination. Certain bilateral agreements may also have some provisions with respect to charges. IATA also believes that states should follow ICAO policies when setting charges.</p>
<p>e) Which regulatory option is likely best to promote these objectives?</p>	<p>It has been observed that the efficiency and cost effectiveness of the price regulated airports such as Melbourne, Brisbane and Perth are much better than SACL. The examination raises serious concerns on the possible decline of operating performance if airports were to be free of price regulation.</p> <p>SACL's aeronautical operating expenditure per passenger, aircraft movement and landed tonne were higher than those at the core-regulated airports. SACL's labour costs were also higher.</p>
<p>f) Can benchmarking of airports be used to assist in promoting efficient operation of airports and establishing appropriate prices for airport services? How does the performance (price and quality) of Australian airports compare with those overseas?</p>	<p>IATA does not support price comparison between airports as the costs and their structure, quality of service, types of service, type and volume of traffic differ from one to the other. However, IATA supports and urges airports and their regulators to compare each airports performance over time. The trend of changes in an airport's cost base and unit costs could be compared with other similar airports or industries. A price cap on aeronautical and related services has been seen as a good incentive to airport service providers to improve efficiency and effectiveness.</p>
<p>g) What should be the objective(s) in setting prices for airport services? How are these best achieved?</p>	<p>IATA believes that price regulation should provide:</p> <ol style="list-style-type: none"> incentives to the airport services provider to improve efficiency, continuously reduce costs to the principal users with traffic growth (economies of scale), ensure acceptable quality of service, timely and cost-effective infrastructure development.

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h) How should appropriate price levels or price increases be assessed in the post CPI-X era?

ATA is of the view that for any regulatory formula on pricing to have the desired effects the following should be put in place:

- ensure that the initial cost base is correct and justified,
- ensure that the asset base has been valued correctly (IATA believes that value of land should not form part of the charges cost base),
- traffic figures and forecast are accurate, reasonable rate of return taking into account the monopolistic, low risk nature of the airport business and the public utility nature of airport infrastructure.

IATA's position on economic regulation of airport services is attached.

i) How should prices regulation be applied to encourage efficient operation and levels of investment in airport facilities?

Investments in infrastructure should be first discussed and agreed with the airlines if the airport plans to recover the investments through airport charges. Airports should be compelled to provide detailed information on mid-term capital expenditure plans.

j) What role should pricing play in allocating scarce capacity amongst the competing users of airports? How should the distributional aspects of any such pricing increases be handled?

The market dictates airline scheduling. Schedules are constructed in response to passenger and cargo demand. Scheduling is one of the most difficult tasks an airline has -- trying to optimise aircraft utilisation within the constraints of airport curfews, increasing environmental restrictions, crew availability, and many other factors. Experience has shown that where peak/off-peak charges have existed, it has not had a significant effect on the distribution of traffic from peak to off-peak periods. It should be noted that some airports that had introduced peak/off-peak charges have abandoned them due to this lack of effectiveness.

IATA strongly opposes any system of peak/off-peak charging. Such demand-altering pricing schemes could only have an effect if users have control over their demand patterns. This is not the case. Peak charges will therefore only increase the costs for those users operating during the peak periods and may discriminate against certain users. Further, the transparency of airport charges deteriorates with peak/off-peak charges.

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k) How should discrimination against small users or new entrants be identified and protected against?

Regulation should ensure that discriminatory pricing such as volume rebates, peak/off-peak charges, and any other forms of non-cost related charges are not permitted.

l) Should quality monitoring be part of any prices regulation regime? If so, how should regulation of service quality be carried out?

Any price regulatory regime without quality assurance will lead to deterioration of service standards and increased operating cost to the airlines. Therefore IATA is of the view that service quality should be monitored and linked to the price with penalties to the airport in case of non-performance.