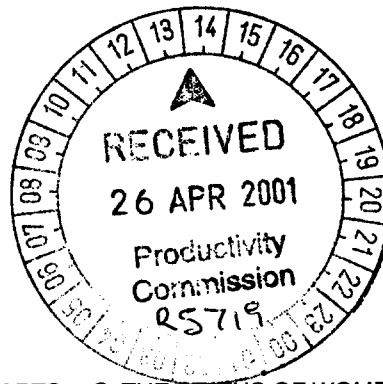




**The Hon Diana Laidlaw BA MLC**

MINISTER FOR

■ TRANSPORT AND URBAN PLANNING ▲ THE ARTS ○ THE STATUS OF WOMEN



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Professor Richard Snape  
Presiding Commissioner  
Productivity Commission  
Airports Inquiry  
LB2, Collins Street East  
MELBOURNE VIC 8003

Dear Professor Snape,

**Inquiry into Price Regulation of Airport Services**

Thank you for the opportunity to provide input to your inquiry. The views of the South Australian Government can be summarised as follows.

The South Australian Government's primary objectives for Adelaide Airport relate to the development of appropriate aeronautical infrastructure and new air services to support its economic and social goals. The Government has accordingly developed a cooperative and effective working relationship with Adelaide Airport Limited and its airline customers to help facilitate air services growth. The importance of Regional, Interstate and International air access to Regional economies has been fully explained in the South Australian Government's previous submission to the Industry Commission Inquiry into International Air Services.

The South Australian Government recognises nevertheless that the major sources of revenue at Adelaide Airport are not derived from aeronautical charges, and that Adelaide Airport Limited, together with other airport operators, will seek to maximise non aeronautical airport commercial developments. The South Australian Government's objective in this regard is to ensure that commercial land uses at Adelaide Airport are fully compatible with the State's Development Strategy.

The following comments about the current airport pricing regulatory environment, and possible changes to it, are made in the context of these objectives.

***Is Prices Regulation needed?***

While the South Australian Government wants to ensure that consumers are not disadvantaged by Adelaide Airport exploiting any market power it may derive as a natural monopoly, the South Australian Government considers that there may be some benefit from adopting a lighter form of regulation, such as transparent price monitoring, rather than through the continuation of direct prices regulation via a price cap.

The Government has arrived at this view because:

- Anecdotal evidence suggests that the existing prices regulation has been expensive for the airports, the airlines and the regulator;
- It appears that the countervailing power available to the large airlines makes unfettered exercise of market power by the airport unlikely;
- Adelaide Airport has offered discounts on aeronautical charges to airlines starting up new services, which suggests that the airport recognises the importance of keeping aeronautical prices low in order to grow its business;
- A CPI-X cap on aeronautical prices, rather than providing an incentive to be more efficient, may provide an incentive for the airport to pursue commercial developments which may conflict with State Planning objectives in order to compensate for the effect of the cap.

However, although there is evidence which suggests that the large airlines are in a position through the extent of their activity relative to the Adelaide Airport's total throughput, to restrain any escalation in aeronautical prices, they are not in a position to substitute supply. This suggests that there may be the potential for airports to exercise market power in certain areas and the Commonwealth Government should be in a position to strengthen price regulation should it become necessary. The South Australian Government therefore favours the following position in relation to Adelaide Airport:

- In recognition of commercial activities generally encountering sufficient competition from "off airport" business, the Commonwealth chose not to regulate prices in this area. The South Australian Government has no evidence to suggest this practice should change;
- However, aviation support activities (as defined in Declaration 84) and aeronautical charges should be subject to prices monitoring by an appropriate regulatory body. Monitoring should be less costly for all parties, but provide an incentive for airports to be responsible in setting of prices within a transparent framework that clearly allows for tighter control if the Commonwealth Government considered an abuse of market power was occurring.

In undertaking airport prices monitoring the regulator should be mindful that consolidation of airport ownership might lead to a significant increase in the market power of airports, and any reduction in the present level of competition between airlines may lead to an increased willingness of airlines to pass increased airport costs on to consumers.

Adelaide Airport's market power is presently mostly confined to domestic and regional services. Although domestic airlines do not have countervailing market power in the sense of being able to substitute sources of airport supply as noted above, Qantas and Ansett, due to their size and volume of business, do have significant industry strength and the resources to counter airport market power in setting prices.

In addition, competition between airlines, particularly with the recent start up of new domestic passenger airlines, helps ensure that airlines will not be content to accept higher charges and to pass them on to consumers. Absorbing increases in charges while their yields are eroded by heightened levels of competition is not an option attractive to the airlines either. Increases in airport prices under these circumstances are likely to impact directly on airline profits and provide a strong incentive for airlines to seek to contain airport prices.

The regional airlines affiliated with Qantas and Ansett will usually have the benefit of the larger airlines' industry strength in negotiating airport charges. Further, the prices negotiated by the larger airlines should establish a benchmark price - even for unaffiliated regional carriers which lack significant countervailing power of any sort themselves.

Adelaide Airport has virtually no market power in setting prices for international air services because of competition between Australian gateways for international traffic.

For these reasons the South Australian Government believes that a lighter regulatory hand than that which currently exists is justified for Adelaide, and considers that transparent price monitoring is the most appropriate form of regulation. Price monitoring has the advantage of being the most efficient form of price regulation.

### ***Current Prices Regulation and its associated effects***

If the Commonwealth were to continue its price capping of aeronautical charges, the South Australian Government would encourage the continuation of the existing mechanism which allows for Necessary New Investment to pass through the price cap, when there is general stakeholder support. The mechanism should not allow manipulation of the system by any one airline to gain or maintain a competitive advantage.

This Necessary New Investment mechanism has enabled Adelaide Airport Limited to gain approval for a passenger facilitation charge to fund new terminal development. The Multi User Integrated Terminal (MUIT) is a prime objective of the State's transport policy. Adelaide Airport's proposed charge of \$6 per international passenger movement compares favourably with the charge of \$9 per international passenger movement currently being sought by Sydney Airport through application to the ACCC.

However, a number of other issues have contributed to the South Australian Government's view that prices monitoring at Adelaide Airport should replace the CPI-X formula:

- The South Australian Government supports the complimentary regulation of safety, planning and level of service standards through the Airports Act and the Civil Aviation Act. These matters would not be compromised by the absence of an aeronautical prices cap.
- A comparison of airport landing charges for mainland major airports indicates that Adelaide Airport landing charges are competitive, especially given the lower traffic volumes compared to Melbourne, Brisbane and Sydney. In fact higher landing charges at Brisbane and Melbourne suggest that there may be site specific costs influencing these charges, or perhaps different levels of cross subsidisation. Sydney has much lower landing charges, but this should be expected given that Sydney has more than three times the aircraft movements of Adelaide.
- The South Australian Government is concerned that the current price cap, which has locked in the cross subsidisation of aeronautical services by commercial services in place at the time of sale, might result in some undesirable effects. Such effects include possible incentives for the airport to undertake commercial development which is at odds with the State Development Strategy, or disincentives to upgrade needed commercial facilities.

- For instance, on the planning side, the airport may argue that commercial land uses such as bulky goods retailing, which is contrary to State retail centres planning policy, is necessary to subsidise losses on the aeronautical business. While these issues are presently being resolved amicably between the parties, the South Australian Government is concerned that the current method of aeronautical price regulation may result in increased conflict between the Airport and the State in relation to the type of “on-airport” commercial development which occurs.
- The Federal Airports Corporation operated on the principle of a “single till”, where commercial revenues subsidised aeronautical costs. If, for example, this subsidy was sourced from the revenues of a ground level public car park, the airport might face funding constraints if increased passenger traffic made it necessary to construct a multi-storey car park because car parking revenue had been directed to subsidising aeronautical costs. Options for funding aeronautical costs would then be limited to increasing car parking charges or undertaking some other commercial development to replace the subsidy. The current form of price regulation may therefore inhibit future commercial development, or result in commercial development which is undesirable from a State point of view.

### ***Future Prices Regulation***

The South Australian Government considers that monitoring of airport prices rather than prices capping is the appropriate form of regulation for the reasons provided above. Monitoring would be assisted by benchmarking the basis of airport prices for all major airports to allow easy comparison by consumers and stakeholders.

However, if the Commission considers that a stricter form of price regulation is required, the South Australian Government believes that such regulation should be in accordance with the following principles:

- regulation should be confined to aeronautical prices;
- regulation should not be prescriptive in a single till financial model, but should allow airports to recover all aeronautical costs from aeronautical charges;
- regulation should continue to allow increases in aeronautical charges to pay for necessary new investment, but should not allow individual stakeholders to block necessary new investment because they consider it contrary to their particular competitive interest;
- regulation should not disadvantage regional airlines or any particular airline sector;
- prices regulation should coexist with other regulatory mechanisms to ensure that standards of safety, level of service and planning are not compromised.

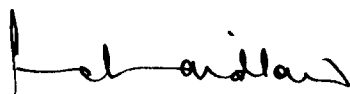
## ***Conclusion***

In light of these factors the South Australian Government considers that:

- prices monitoring of aeronautical charges and aviation support services is sufficient for Adelaide Airport. This form of regulation would meet the objective of minimising compliance costs;
- the balance of evidence suggests that Adelaide Airport has insufficient market power to extract excessive profits from aeronautical prices because sufficient countervailing industry strength resides with the airlines to prevent it;
- there is sufficient pressure from airlines, improvements in aircraft technology and airline load factor management to ensure that airports are motivated to maximise their efficiency; and
- the introduction of prices benchmarking between airports would facilitate prices monitoring.

If you require further information about the South Australian Government's views on these matters, please contact Mr Mike Milln, Senior Adviser – Aviation at Transport SA. He can be reached at 08 8343-2793 or by e-mail at [mike.milln@transport.sa.gov.au](mailto:mike.milln@transport.sa.gov.au).

Yours sincerely



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**MINISTER FOR TRANSPORT AND URBAN PLANNING**

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