SINGLE VERSUS DUAL TILL REGULATION: SUPPLEMENTARY SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO PRICE REGULATION OF AIRPORT SERVICES

prepared for

THE MTAA SUPERANNUATION FUND

by

ACCESS ECONOMICS

Canberra
April 2001

Single versus dual till price regulation

The issue of the single versus dual till approach to airport services regulation is not part of the Terms of Reference for this Inquiry and was not explicitly raised by the PC in its Issues Paper (PC, 2001). The issue was, nevertheless, raised in a number of submissions and was the topic of some discussion in the first round of the Commission's public hearings. In particular, during the presentation of the MTAA Superannuation Fund submission at the public hearing in Melbourne on 3 March 2001, the Chairman argued that:

> *"we've got … the airports advocating the dual till and the airlines advocating a single till, and that's not just in Australia that that occurs. Yet you appear at first blush to be breaking ranks here and in fact are advocating a single till." (3 March 2001 transcript, page 245.)*

We responded that:

> *"theoretically there's a case to be made - if there's going to be regulation - … for a single till approach. …*
>
> *… the answer to the conundrum that you've posed is that we are not advocating regulation, so therefore we are not advocating a single till. We're advocating a very light-handed form of oversight and because the current non-regulated aspects of the airports operations clearly are subject to considerable competitive pressures and therefore it would be inappropriate to include those within the regulations" (3 March 2001 transcript, page 246.)*

And that:

> *"Our submission is certainly not advancing the single till as the preferred outcome. Our preferred outcome is quite clear, which is a very minimal form of regulation." (3 March 2001 transcript, page 248.)*

This supplementary submission is intended to provide further clarification of our position on single versus dual till. In short, as stated above, the MTAA Superannuation Fund favours neither a single nor a dual till. Rather, Access Economics proposes as its advocate a "zero till" as part of a light handed approach to airport regulation.

In the post-privatisation regulatory regime the Government has not mandated applying a single till, but has notionally concentrated controls on the aeronautical component of a "dual-till"[1]. Although the Australian Competition and Consumer Commission (ACCC) has assessed profitability more widely in making some of its recent assessments of airport operations[2], regulation is supposed to focus only on the levels of cost recovery and profits in the provision of aeronautical services, as made clear by the Government's recent Direction in respect of pricing at Sydney Airport[3]. The terms "single till" and "dual till" are now shorthand references to, respectively, narrow (aeronautical only) and broad (all services) regulatory oversight of air services charges.

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[1] See the submission of the Minister for Transport and Regional Services to the ACCC review of *Sydney Airports Corporation Ltd., Aeronautical Pricing Proposal*, Anderson (2001).

[2] For instance, the ACCC's "halfway house" approach to the assessment in its Draft Decision on the pricing proposal by Sydney Airport Corporation Limited (ACCC, 2001).

[3] As contained in the Direction to the ACCC by the Minister for Financial Services and Regulation and reported in Hockey (2001).

The preference for the dual till approach is intended to contain regulatory intervention only to the markets or services where the potential for abuse of market power is strongest. This would help to contain the effects of regulatory failure to those markets and give the airport operators scope to earn market rates of return in the remaining (contestable) markets. However, this argument ignores the strong links between the costs and demands for aeronautical and non-aeronautical services which ensures that the efficient prices of both classes of services are intricately intertwined. In the absence of other distortions, efficiency (and, indeed, airport profitability) therefore hinges on joint consideration of the prices set for these services.

We argued in our original submission that, because it is restricted to aeronautical services, the present price cap creates an artificial divide between the regulated airports' sources of revenue that is likely to create distortions, such as a disincentive to invest in aeronautical services facilities. This follows because, in practice, the initial aeronautical services charges at many of the leased airports were set at below cost recovery levels. We also argued (in Section 4), the apparent need for, and ultimate failure of, the necessary new investment provisions in the airport price controls was a product of the imbalance between aeronautical and non-aeronautical services revenues embedded in the pricing policies of the Federal Airports Corporation prior to privatisation. Moreover, controlling charges for one set of services naturally imposes additional regulatory costs on the firm that reduces its return relative to the other, uncontrolled services. Because the returns on aeronautical services are already tightly controlled, the problems faced by airport operators in their attempts to gain regulatory approval for restructured charges, or charges for new services and facilities, impose costs that tip the balance of profitability and stifle pricing innovation and aeronautical investment.

In our view, there are two reasons for the Productivity Commission to consider the single- versus dual-till debate in the context of its current inquiry. The first reason is that it emphasises the difficulty and inefficiency of attempting artificially to divide vertically integrated businesses like airports and control the profitability of only one part without concern for the effects on the remainder of its operations or the broader efficiency consequences.

These shortcomings of the existing system do not mean that the narrow scope of the price cap should be broadened if price controls were to continue. Rather, they highlight the difficulty of applying regulation in practice and the economic costs that can, and do, arise in the practical application of regulation.

Further, the case for "light-handed" regulation is strengthened when the totality of an airport's business is considered. As discussed in detail in our original submission, the business stream in which airports have some capacity to exert monopoly power, the provision of aeronautical services, is a relatively small part of an airport's business. Retail trading and property development are the predominant sources of airport income (and for many, if not all, regulated airports, the only current source of profits). These business streams are clearly contestable and we do not believe that there is a sustainable economic case for any direct price or revenue regulation of them.

For these reasons, applying heavy-handed price or revenue regulation to the totality of an airport's business under a single-till approach would be likely to produce inferior economic outcomes and would therefore be a retrograde step.

Therefore, given that the price controls on the regulated airports remain less than ideal, it is better that the other distortions the controls create (as detailed in our original submission) are

restricted to as small a share of airport revenues as possible. It follows that, in the event that price controls continue after the initial five year period, price caps should focus only on aeronautical services revenues.

In summary, the so called "single- versus dual-till" debate highlights the practical problems of applying regulation in the real world and the net costs that even well-intended regulation can produce. For all of the reasons set out in our original submission, we believe that there is a strong case to suggest that economic outcomes would be enhanced if the current price controls were discontinued. We therefore favour a "zero till", with no explicit price controls and only limited monitoring and oversight of airport pricing and returns.

rThe MTAA Superannuation Fund and Access Economics thus ask that you record and render their views on this question as being in respect of a zero till rather than, as has occurred, a single or dual till. While this might be thought a small issue in the crowded debate on these concepts, it is important that we and our clients are correctly and accurately reported.

References

Access Economics (2001), *Submission to the Productivity Commission Inquiry into Price Regulation of Airport Services*, prepared for the MTAA Superannuation Fund, Submission No. 22, March.

Anderson, J. (2001), *Submission to the ACCC review of Sydney Airports Corporation Ltd., Aeronautical Pricing Proposal*, January, http://www.accc.gov.au/airport/sydney/Ltr_Hon_John_Anderson_MP.pdf.

Hockey, J. (2001), *Prices Oversight at Sydney Airport*, Minister for Financial Services and Regulation Press Release No. FSR/030, 20 April 2001, http://www.minfsr.treasury.gov.au/Pressreleases/2001/030.asp.

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