

AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION: ECONOMIC REGULATION OF AIRPORTS
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1 In matters relating to economic regulation there has been an unfortunate tendency to focus on the presumed benefits of regulation (generally addressing market power issues) but to neglect the disadvantages of regulation (which are much more extensive than merely the resource costs of administering and complying with regulation). Regulation, itself, can distort decision making on the part of the regulated firm, in particular with regard to investment; this I believe has been the case with regulated UK utility industries. It calls into question whether in the context of pursuing economic efficiency the notion of 'efficient regulation' is itself an oxymoron.

2 Australia is to be congratulated therefore in having eschewed since 2002 price cap (ex ante) regulation of its airports. I note the emphasis in the present enquiry terms of reference on minimising unnecessary compliance costs and facilitating commercial negotiated outcomes, although I was disappointed not to see a section in the *Issues Paper* setting out the costs and difficulties of regulation.

3 Australia's capital city airports, given in most instances their singularity, have *potential* market power (as does a whole raft of other economic activity that interfaces with the consumer market in a spatial context – gas stations and convenience stores being two such examples).

4 It is interesting to note in this context of market power that in late 2016 there was a vigorous debate when Qantas proposed a new non-stop air service (a monopoly direct route) between Perth and London predicated on the establishment of new facilities for servicing international flights as an adjunct to its domestic terminal facilities at Perth Airport (T3/T4). This called for a major reorganisation of operations, potentially at not insignificant cost, which the airport was reluctant to undertake and pay for. Nevertheless, pressures were brought to bear by the airline *and other interested parties* producing a satisfactory outcome for the airline; thus illustrating a degree of countervailing power airlines can draw upon as well as the benefits of negotiated solutions.

5 The issue therefore is: market power exercised by airports; in what way; to what extent; whether there are countervailing forces and, importantly, whether regulation will, at a reasonable cost, improve matters without distorting the market? Markets are imperfect but so is regulation.

6 In addressing these issues, I would draw attention to the new approach to the regulation of airports introduced in the UK with the 2012 Civil Aviation Act. The Act introduced three tests that must be met before the UK CAA can impose a licence (to regulate) with terms. Under 'Test A' the CAA must determine whether the airport has Substantial Market Power (SMP); if thus satisfied 'Test B' requires it to establish that competition law would not provide sufficient remedy. And, finally, 'Test C' requires the CAA to show that its proposed licence interventions generate net benefits to airport users. Decisions are reviewable by the UK Competition Appeals Tribunal. The three stage approach is therefore measured and sets a bar against easy recourse to implementing regulation.

7 Finally, I wish to suggest that if intervention is to take place and there is a focus on efficient investment, more attention be placed on first ensuring an efficient use of existing infrastructure capacity by examining the profile of aeronautical charges in relation to the variation in the use of existing infrastructure – as suggested in my 2002 Martin Kunz Memorial Lecture.

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