



15 October 2001

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Ms Michelle Cross
Productivity Commission
Airports Inquiry
LB2 Collins Street East
Melbourne VIC 8003
Australia

Fax: (613) 9653 2302

Dear Ms Cross,

**IATA's Submission in response to the Productivity Commission's Draft Report on
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 finalising recommendations on future price regulation of airport services.

The IATA User Charges Panel and the IATA Fuel Trade Panel have been mandated by the IATA Board of Governors to represent the airline industry in airport and air navigation user charges matters and matters related to aviation fuel respectively, on a world-wide basis. The IATA UCP and the IATA FTP (together 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's response is comprised of two parts. Part 1, is on issues related to the regulation of prices for airport services while Part 2, is specifically on matters related to pricing of aviation fuel.

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

Enclosed: 1. IATA's Submission in response to the Productivity Commission's Draft Report on Pricing Regulation of Airport Services, Part 1 & 2.
2. Attachments 1 through 4.

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International Air Transport Association

**International Air Transport Association's Submission
in response to the Productivity Commission's Draft Report
on Price Regulation of Airport Services**

Part 1

1 Introduction

IATA welcomes this opportunity to submit its comments in response to the Productivity Commission's Draft Report on Pricing Regulation of Airport Services. IATA's comments are based on the requirements of, and practices in, international civil aviation and hence are from an international perspective. This submission is presented on behalf of all IATA Member airlines.

IATA is pleased to note that the Productivity Commission has recognised that the majority of the major airports in Australia are natural monopolies with significant market power.

However, the Productivity Commission does not seem to offer any protection to the users against such market power. Instead the Commission has proposed price monitoring based on efficient pricing for a five-year period as the preferred option. We are very disturbed that the Commission's decision may have been influenced by the claims made by airport operators that they paid large amounts of money to the Commonwealth Government in purchasing the right to operate the airports.

The Commission appears to argue that efficient airport pricing would lead to a more economically efficient aviation industry. This could be interpreted as an attempt at regulating the airline industry through the manipulation of airport prices. The airline industry is and should be regulated by the market.

IATA does not consider that efficient airport pricing would lead to any benefits to the users, passengers or shippers. We are of the view that operational requirements and market demand dictate airlines schedules, which in turn creates scarcity rents if efficient pricing is to be applied. We object to any attempts at making such scarcity rents the prerogative of the supplier, who has not contributed to that value.

IATA therefore, strongly believes that price regulation should be applied to all monopoly suppliers, which is the next best solution to free market conditions, primarily to protect the interest of the users against possible abuse.

Furthermore, the Commission has recognised the interdependencies of aeronautical and non-aeronautical services, but rejects the single till or any contribution system because of the negative influence on efficient pricing. As demonstrated above such argument is not acceptable to IATA.

The Airports Council International (ACI), the representative body of the International Airports and IATA have agreed after extensive discussion and support by the International Civil Aviation Organisation (ICAO), on a contribution system, which recognises the role played both by the airlines and the airport in the development of non-aeronautical income.

IATA urges the Commission to recognise this internationally accepted policy designed to ensure fair play.

The aeronautical infrastructure at an airport is essential for airline operations. These services need to be provided at reasonable costs to the users if air transport is to continue to develop to the benefit of the end users, the passengers and shippers, and to enable continued significant contributions to local, regional and world economic growth.

IATA supports the objective of most States, to make air transport more accessible and affordable to the travelling public, and to allow prosperity of the other industries that are dependent on air transport. We have welcomed the privatisation of airlines and the introduction of competition in the airline industry. The airlines have also accepted the commercialisation of airports and air navigation services, which we believe, could lead to better results if properly implemented. However, it is totally unacceptable by IATA to allow a monopoly provider of an essential service to maximise profits at the expense of the users and the consumers.

The recent tragic events and the ensuing effects have been devastating to the aviation industry. Particularly bad hit are the airlines, which are faced with enormous financial pressures. Many airlines have been forced to defer capital investments, reduce their workforces, and curtail operations. Some airlines have not been able to withstand these pressures and a number of others are also on the verge of collapse.

In this situation, IATA does not believe that experiments should be undertaken, which will inevitably result in a further deterioration of the plight of the airlines. Such an eventuality has already been confirmed by the attempts of Australian airports to raise prices over and above the allowable levels. The current climate in the aviation industry may even lead some States to reconsider their views on the provision of essential infrastructure.

In light of all of the above, IATA urges the Productivity Commission to re-evaluate its position and recommend direct regulation of prices for airport services. IATA is pleased to note that the Productivity Commission has identified the CPI-X to be the most appropriate form of regulation of those that are currently in practice. In the following chapters, we wish to provide more detailed comments on some of the views expressed in the Draft Report, which we believe would assist the Productivity Commission to arrive at such conclusion.

2 Price Discrimination and Congestion Pricing

The Draft Report seems to suggest that allowing an airport to price discrimination would lead to more efficient use of facilities.

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.

Further, during times of low demand, the airlines usually do not have the possibility to generate the required levels of revenue to adequately cover their full costs. Hence, the surplus revenue during high demand is essential for airlines to generate the normal profits or

in some cases, just to cover full costs of operating a specific route. If indeed the airlines were to be deprived of generating surplus revenue during times and seasons of high demand, then they would be compelled to eliminate the losses they accumulate during low demand by reducing capacity offered during such periods, while maximising capacity during the peak. Therefore, monopoly pricing during congestion could lead to escalating the problems of congestion and not resolving them.

The Commission appears to have recognised this fact when it states on page 175 – 176 of the Draft Report that

“The transfer of scarcity rents from the airlines to airports also could have repercussions for an airline’s operations if such scarcity rents were used to cover the fixed costs of services on other routes.”

As demonstrated above, a similar result could occur even on the same route during low demand.

In view of all of the above, we strongly urge the Productivity Commission to recommend that congestion pricing not be allowed, and not leave such decision in the hands of the monopoly service providers.

IATA position on Peak/Off Peak pricing and Marginal Pricing is given in attachments 1 and 2 respectively.

3 Discounts and Rebates

Airports have offered discounts as an incentive to develop their business, and airlines have taken advantage of any such incentives. Start-up cost support through assistance with incentives for a limited time for new city-pairs, for example, is acceptable and appreciated. IATA, however, only supports rebates or discounts that are cost-related and non-discriminatory. Any other rebates could be regarded as anti-competitive or a distortion of the market.

However, discounts or rebates can be said to distort the cost-relationship, and viewed as selective subsidies, which contravene the spirit of Article 15 of the Convention on International Civil Aviation that states that there should be no discrimination between users of aeronautical facilities. The non-discriminatory element should include the requirement for such incentives to be published.

The IATA position on Charges Discounts is in attachment 3.

4 Interdependency of Aeronautical and Non-Aeronautical Activities

The aeronautical and non-aeronautical activities undertaken at airports are highly inter-dependent. Input from the aeronautical services is necessary for the non-aeronautical services, such as retail concessionaires, to succeed.

IATA is happy to note that the Commission has recognised the interdependencies of aeronautical and non-aeronautical services.

In Draft Finding 7.1 the Commission states that:

“Profits from non-aeronautical activities at most core-regulated airports appear significant, especially when compared with current earnings from regulated aeronautical charges. Though this earnings disparity might be expected to narrow somewhat if pricing regulation of aeronautical services were removed, there is an incentive for airports to temper prices (particularly prices for new-entrants) for aeronautical services, improve quality and/or increase aeronautical capacity in order to encourage passenger growth.”

However, in Draft Finding 7.3, the Commission states that:

“The ability of airlines to discriminate in pricing in a quite sophisticated manner, coupled with aircraft weight-based charges levied by most airports, and low entry prices for marginal flights and new airlines, may reduce the efficiency impact of airport charges set above marginal cost, whether or not these charges are above efficient cost-recovery levels.”

Our understanding of Draft Finding 7.1 and 7.3 are that:

- the opportunity to generate significant profits from non-aeronautical activities will motivate airports to reduce aeronautical charges, improve quality and/or increase aeronautical capacity;
- airport charges set above marginal costs, whether or not they are above efficient cost-recovery levels will not have any significant impact on traffic growth.

If indeed the market is significantly inelastic and traffic growth will continue even if the services were priced above efficient levels, then what incentive would the airport operator have to subsidise aeronautical charges or use non-aeronautical profits to improve quality and increase capacity.

It is IATA’s view that monopoly service providers with market power would only use the opportunity to maximise profits, in both aeronautical and non-aeronautical activities, if price regulation were to be removed.

Therefore, IATA begs to differ with the Commissions Draft Finding 10.2 where it states that:

“Profits earned in non-aeronautical activities should not be taken into account in setting this price cap.”

This matter has also been one of the key issues debated within ICAO and also with certain airports and their regulators world-wide. IATA is happy to note that the international civil aviation community continues to support the concept of subsidising aeronautical activities using the surplus from non-aeronautical services. Paragraph 21 of the revised ICAO Document 9082/6 “ICAO’s Policies on Charges for Airport and Air Navigation Services” states that:

“the cost to be shared is the full cost of providing the airport and its essential ancillary services, including appropriate amounts for cost of capital and depreciation of assets, as well as the cost of maintenance and operation and management and

administration expenses, but allowing for all aeronautical revenue plus contributions from non-aeronautical revenues [emphasis added] accruing from the operation of the airport to its operators.”

IATA and the Airports Council International, the representative body of the International Airports on the request of ICAO, has jointly interpreted the above statement, which is attached for the consideration by the Productivity Commission (attachment 4).

Given that the Commission has recognised the interdependency of aeronautical and non-aeronautical activities, IATA urges the Commission to recommend the internationally accepted policy of contributions from non-aeronautical income to subsidise aeronautical charges without leaving room for any ambiguity. Such recommendation we believe would eliminate conflict between the provider and user of facilities and eliminate the need for “gaming”.

5 Dual Till

It is unfortunate that considerations other than economics was yet again to overturn the ACCC’s more economically sound decision on the issue of the dual till for Sydney Airport. To now try to justify the application of a dual till on the basis that such concept is already in force is to move away from an economic argument.

Further, there does not seem to be any evidence to suggest that the current framework for regulating airport prices in Australia, including the CPI-X regime, has resulted in fewer incentives for investments, particularly given that there is a provision for necessary new investment cost pass through.

Given the lack of transparency of airport financial information, it is difficult to determine whether or not aeronautical services are in fact being subsidised through non-aeronautical surpluses. IATA has not sought for full disclosure of financial information at airports where the single till is applied, as having access to detailed information was not perceived to add any further value to determining aeronautical prices. However, if a dual till approach were to be introduced, then the Commission should recommend that full financial details are made available to the users.

The information to the users and the regulator should provide details of cost allocation between aeronautical and non-aeronautical activities as well as between airside (landing, parking, etc.) and passenger processing activities. The airlines should also have the right to verify such information to satisfy themselves of their accuracy and relevance.

Further, there are a number of functions such as immigration and customs checks and quarantine that are performed at airports that are not required by international civil aviation but are requirements of Governments. Such functions, while performed by Government officials, occupy, in most cases, prime locations of the terminal buildings. Cost of such locations and related resources should not be included in the aeronautical cost base.

Further, the provision of security within Australia is the responsibility of the Australian Government. Acts of terrorism are not directed at airlines or their passengers. They are in general, expressions against States. Currently, the airlines are being made to bear the cost of providing security at Australian Airports. These costs should not be borne by the airlines or their passengers.

6 Valuation of Land

Most of the land required for aviation use is already in the hands of airport service providers, or their respective governments. In nearly all cases, land has appreciated in value. The acquisition of new land by airports can cost significant amounts of money. Land should be treated as a non-interest bearing investment by its owners, with no cost being borne by aeronautical users, either through direct charges, or through diversion of revenues.

In recent times, some airports have been proposing an opportunity cost approach to determine the value of existing land to be used in constructing the asset base, which then results in higher returns for the airport investors at the expense of the users of the airport. IATA considers that this approach is flawed.

In most countries, due to environmental protection and other related regulations, land used for new airport facilities are those that do not have any other useful purpose. Hence, the initial value of airport land is the least costly in the region. Due to the economic activity and the provision of better access in most cases, land around airports appreciate with time. It should be recognised that this is a result of activities by both the airport and the airlines. Therefore, it is incorrect for airports to re-value existing land based on current market prices, prices which the airport has not paid for. It is even worse when one party uses the benefits of such increased value to the detriment of the other contributing party.

IATA's view is that the value of the land in current use by airports to provide aeronautical services should be zero value. As for land required for expansion, an airport would only have an incentive to expand aeronautical facilities onto land adjoining the airport if it can recover the cost of doing so. Therefore, IATA is agreeable to allow any additional land purchased for such purpose to be valued at its efficiently incurred purchase price for setting aeronautical charges.

7 Price Monitoring – does not work

The Commission recommends:

“Mandatory price monitoring by the ACCC of Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra, and Darwin airports. The monitoring regime should continue for five years. During this probationary period, the regulator should not have the power to alter the monitoring regime or impose price regulation”.

The Commission also recommends that:

“An annual report presenting all monitored information should be made available, with commentary by the ACCC (and auditors) where considered warranted, but without overall assessment of success or otherwise of monitoring”.

These recommendations in IATA's view amounts to deregulation for five years and leaves the airlines, passengers and shippers at the mercy of a monopoly provider of an essential service.

As the Commission is aware a somewhat similar approach taken by the Government of New Zealand does not appear to have succeeded. The Commerce Commission of New Zealand in

its preliminary conclusions found that both Auckland and Christchurch airports have used their market power in airfield activities by raising prices above the competitive level in a sustained fashion. The analysis by the Commerce Commission did not take into account any increase in prices that may result from Wellington Airport's upcoming consultation. Suggesting that in the event Wellington Airport were to exploit its market power in establishing prices, then the Commerce Commission would consider recommending price controls.

In its Draft Report the Commerce Commission has concluded that Auckland Airport should be put under price control. The reason for Christchurch Airport not to have been recommended for price control is that the "Net Efficiency Benefit" analysis undertaken by the Commerce Commission had not indicated major benefits to the acquirers of airfield activities by doing so.

Further, the regime has relied on airlines taking legal action against the airports on a number of occasions. In our view such light-handed regulation or non-regulation does not augur well for the relationship between a monopoly service provider and its dependent users. It would be in the interest of both parties if clearly defined price regulation were in place.

8 Recent action by airports and airlines

The current down turn in the world economy and the tragic events of 11 September 2001 are having very serious consequences for the air transport industry. The most severely affected are the airlines. Some airlines have not been able to withstand these pressures and a number of others are also on the verge of collapse.

The approach taken by the airlines to face this situation has been to reduce all costs under their control. The airlines have deferred capital investments, reduced their workforces, and even curtailed their operations. The number of airline staff that have been laid-off work is currently estimated to exceed 150,000.

Many airlines have reduced fares to stimulate the market and others have carried displaced passengers either for free or at substantially discounted fares.

In this light it is interesting to compare the responses of the airports. Due to pressure from the Australian airports the Government has agreed to relax the price regulation regimes at most airports, while Melbourne, Brisbane and Perth have been granted the opportunity to have immediate price increases of up to 6.2%, 6.7% and 7.2% respectively. We also understand that Coolangatta Airport proposes to increase aeronautical charges by more than 170%, while Canberra Airport proposes to double aeronautical charges.

IATA urges the Productivity Commission to take note of the differences in approach to business taken by airlines and airports and give due consideration when making its final recommendations to the Government.

9 ICAO Policies on Airport Charges

Matters affecting International Civil Aviation should be addressed from a global perspective. The International Civil Aviation Organisation (ICAO), in which Australia is a Member State provides guidance on most civil Aviation related matters.

The Convention on International Civil Aviation, to which Australia is a signatory, in Article 15 states that:

“Every airport in a contracting State which is open to public use by its national aircraft shall likewise, subject to the provisions of Article 68, be open under uniform conditions to the aircraft of all the other contracting States. The like uniform conditions shall apply to the use, by aircraft of every contracting State, of all air navigation facilities, including radio and meteorological services, which may be provided for public use for the safety and expedition of air navigation.

Any changes that may be imposed or permitted to be imposed by a contracting State for the use of such airports and air navigation facilities by the aircraft of any other contracting State shall not be higher,

- (a) As to aircraft not engaged in scheduled international air services, than those that would be paid by its national aircraft of the same class engaged in similar operations, and*
- (b) As to aircraft engaged in scheduled international air services, than those that would be paid by its national aircraft engaged in similar international air services.*

All such charges shall be published and communicated to the International Civil Aviation Organization: provided that, upon representation by an interested contracting State, the charges imposed for the use of airports and other facilities shall be subject to review by the Council, which shall report and make recommendations thereon for the consideration of the State or States concerned. No fees, dues or other charged shall be imposed by any contracting State in respect solely of the right of transit over or entry into or exit from its territory of any aircraft of a contracting State or persons or property thereon.”

This article requires that discriminatory pricing be not permitted by Member States.

ICAO Document 9082/6 “ICAO Policies on Charges for Airports and Air Navigation Services” provides further guidance. IATA believes that any pricing policy for International Airports in Australia should be in line with the Convention on International Civil Aviation and ICAO policies on charges.

International Air Transport Association's Submission in response to the Productivity Commission's Draft Report on Price Regulation of Airport Services.

Part 2

Fuel Fees and Related Issues

The International Air Transport Association opposed the introduction of fuel levies at Brisbane and Perth, and commented accordingly to the ACCC in its review in 1998.

The airlines recognise, and accept, that charges and/or fees may be levied for the fuel services required and used to support their operations, but believe that such activities should be treated as "aeronautical" in nature. Thus, any such fees should be transparent, equitable, non-discriminatory and cost-related. This is consistent with ICAO policy as specified in Document 9082/6.

Furthermore, in addressing this issue, the **total** revenue generated for the airports from **all** fuel related activity should be taken into account. This includes not just the explicit fuel fees, as currently levied at Brisbane, and Perth for international uplifts only (although it is understood that the fee will be extended to domestic uplifts shortly), but also the variety of hidden elements built into Supplier lease agreements etc, as these are all ultimately reflected in the fuel price to the airlines.

IATA endorses the finding of the Productivity Commission Report the Price Regulation of Airport Services that the airports have significant market power in the area of refuelling services. IATA argues this for the following reasons :

- Jet fuel is essential to support airline operations.
- The ability to "tanker" fuel (i.e., uplift at other cheaper locations) is limited – especially at the more remote airports, and for longer flight sectors – and is undesirable on environmental grounds as it wastes fuel.
- Alternative supply to aircraft at airports is both uneconomic, and totally impractical operationally.

IATA, therefore, supports the findings and recommendations of the ACCC Report – namely that there should be "stricter forms of prices oversight", with "refuelling services included within a CPI-x price cap".

In particular, IATA would request the Productivity Commission specifically require all Australian Airports to fully cost-justify any, and all fees charges levied on the supply of Jet fuel, with an obligation for consultation with the users (Airlines plus Suppliers and their Agents) to ensure there is transparency, equity and non-discrimination, in line with ICAO policy.

PEAK/OFF-PEAK CHARGING

SUMMARY

IATA objects to any system of peak/off-peak charging, a system that only arbitrarily redistributes costs between different users. An airline has no opportunity to adjust to such a system in an efficient way due to the complex task of scheduling its operations.

1. Introduction

1.1 Few airports around the world have introduced peak/off-peak charging schemes, while others have abandoned them. Certain congested airports believe that peak pricing can be a good management tool to eliminate congestion. Air Navigation Services (ANS) providers have so far not introduced peak pricing, but discussions regarding the principles for such a charging scheme have taken place in various fora.

1.2 Basic ICAO principles prescribe that charges levied to recover the costs to build, maintain and operate airports and ANS facilities should be cost-related and non-discriminatory. This has invariably resulted in an average cost pricing regime whereby the charge is set by calculating a unit price that is based on the cost for the provision of specific services, divided by the expected number of traffic-units. Accordingly, all operators at an airport or in a specific airspace pay the same unit price for the same type of service.

2. Discussion

2.1 A peak/off-peak pricing scheme means that different charges are levied during different time periods. The known schemes are supposedly revenue neutral for the airport. Such charges are therefore just a reallocation of the cost burden from the users operating during the off-peak hours to those operating during the peak with the intent of shifting operations from the peak.

2.2 Airline scheduling is dictated by the market. 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 utilization 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 periods to off-peak periods.

2.3 Were an airline to reschedule its flights to avoid peak periods at one airport, it may well encounter a peak period at the destination airport, or en route. Further, a previous off-peak period at an airport may well become a peak period, or vice versa.

2.4 The shortage in airport capacity is handled worldwide by “slot-allocation” procedures when demand exceeds supply. A charges system would not add any value to this procedure; slot coordination takes a global view in addressing capacity shortages at airports.

2.5 Capacity costs should be considered as joint costs to all users; it is difficult to allocate capacity fairly without influencing all users. They benefit jointly from the availability of an airport or ATC system that has not been developed for any single user. All users should contribute their fair share to the joint costs. Therefore, an average cost pricing regime, as employed in general practice, is considered the most fair, transparent and equitable charging regime.

3. IATA Position on Peak/off-Peak Charging

3.1 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/ANS charges deteriorates with peak/off-peak charges.

MARGINAL PRICING

SUMMARY

Marginal cost pricing for airports and ANS providers is difficult to implement, ineffective in addressing capacity problems, and may result in discriminatory practices.

1. Introduction

1.1. In practice, the implementation of a pricing strategy of cost recovery and non-discrimination has led to average cost pricing combined with ability to pay considerations based on the weight of an aircraft. As described in paragraph 5.11 of Doc 9161/3, unit cost is determined by dividing the cost base by the estimated charging units, and thus the charges structure involves the averaging out of costs among the various users, irrespective of the costs that individual users impose.

1.2. However, it is felt by a number of charging authorities that average cost pricing does not lead to an optimisation of the allocation of resources nor provide an incentive to investing in additional capacity. Accordingly, various studies have been initiated into pricing mechanisms that may promote the best use of airspace capacity.

2. Marginal cost pricing

2.1. It has long been maintained that the pricing policy which most likely will lead to an efficient allocation of resources would be one where the price of a good or service is set equal to the marginal cost of providing that good or service. The marginal cost being the cost that would be incurred in providing an additional unit of output. The economic rationale for marginal cost pricing is that only those users who value a facility or service at least as much as the cost of providing it will pay the price for using it.

2.2. It should be noted that marginal cost pricing is concerned with current and future costs and not with past sunk costs, which remain unaffected by an additional user. A distinction should be made, however, between short-run marginal costs and long-run marginal costs. Short-run marginal costs can be varied to meet changes in demand, e.g. extra security, handling or maintenance staff. Long-run marginal costs, on the other hand, are those costs such as investment costs in additional facilities that can be varied over time to satisfy additional or marginal demand. It is for this reason that long-run marginal cost pricing has been advocated for capital intensive industries, which is the case for airports and ANS entities.

2.3. However, implementing long-run marginal cost pricing poses difficulties. First, investments in infrastructure are large and lumpy and are not truly marginal since they have the effect of boosting capacity significantly once the investment plan is complete, e.g. an investment

in a new runway or terminal can double an airport's capacity. Second, in the case of airports, a multitude of facilities and services are provided, which makes long-run marginal pricing complicated to implement. And third, demand for airport or ANS facilities and services vary from time of day, day of the week, or season, thus adding another complication.

2.4. Strict application of marginal cost pricing, however, will not necessarily produce sufficient revenue to cover full costs, including depreciation and interest charges. This is so because marginal cost pricing considers current and future costs and not accounting costs. Only if long-run marginal costs are rising and above average costs will revenue normally exceed total current costs. Strict application of marginal cost pricing will likely lead to accounting losses and must therefore be combined with some other pricing strategy.

2.5 Any change in policy guidance in the area of airport and air navigation service charges that would represent a departure from average cost pricing should seek to improve efficiency and increase capacity of the infrastructure. Such a charging scheme should ensure that the required capacity is provided and that it is provided in the most cost-efficient manner possible. Therefore, marginal cost pricing, if implemented, should challenge the charging authority as opposed to "sending the right signal" to the users.

3. The IATA Position

3.1 Marginal cost pricing is difficult if not impossible to implement due to the complexity involved and the administrative sophistication required. It is questionable whether marginal cost pricing will result in additional capacity and in an efficient utilisation of resources. To the contrary, aside from the concern that marginal cost pricing could possibly result in discriminatory practices, it will likely result in additional revenues for the charging authority without necessarily resulting in additional capacity.

3.2 Any charging policy should be consistent with the basic ICAO principles on user charges – non-discrimination, transparency, cost-relationship and meaningful consultation – and subject to economic regulation

CHARGES DISCOUNTS

SUMMARY

A number of airports offer discounts or rebates, mainly to stimulate new or increased traffic. This paper presents IATA's view that discounts or rebates are acceptable only under certain conditions.

1. Introduction

1.1 A number of airports offer discounts on charges, which can also be referred to as rebates. Some are officially published, while others are not. Most are used as marketing tools to increase volume or attract new traffic. The argument in favour of such discounts is that they are aimed at increasing the total business, thereby benefiting all users, especially where the "single-till" principle is applied.

2. Discussion

2.1 According to existing ICAO and IATA principles, charges should be cost-related, non-discriminatory, and equitably applied. Charges structures should ideally be simple, and preferably a single charge should be applied. Further, IATA maintains that no group of users should be given special treatment with regard to charges.

2.2 Airports have offered discounts as an incentive to develop their business, and airlines have taken advantage of any such incentives. Start-up cost support through assistance with incentives for a limited time for new city-pairs, for example, is acceptable and appreciated. IATA, however, only supports rebates or discounts that are cost-related and non-discriminatory. Any other rebates could be regarded as anti-competitive or a distortion of the market.

2.3 Discounts or rebates can be said to distort the cost-relationship, and viewed as selective subsidies, which contravene the spirit of Article 15 of the Chicago Convention that states that there should be no discrimination between users of aeronautical facilities. The non-discriminatory element should include the requirement for such incentives to be published.

3. The IATA view

3.1 If discounts are to be offered, they should comply with the following principles:

- Any discount or rebate offered must be available to **all** operators and should be published

- Discounts should not distort competition
 - Discounts that are intended to stimulate traffic should be time limited
 - Existing user charges must not increase as a result of discounts being granted to new operators or introduction into operation of “no-frills” facilities
- 3.3 IATA can accept discounts or rebates if they comply with the principles outlined above, but at any rate strongly objects to volume discounts or rebates.

**ACI/IATA common interpretation of
ICAO Doc 9082/6, paragraphs 22.i and 22.vii**

The interpretation and application of Doc 9082/6, paragraphs 22.i and 22.vii are based on the acknowledgement of the mutually dependent relationship that exists between airports and airlines, and in keeping with the fundamental spirit of ICAO's policies on charges. In interpreting these two paragraphs, the following should apply:

1. The existence of air traffic activity is a necessary precondition for the generation of airport non-aeronautical revenues. Such revenues are then generated through management initiatives in offering suitable products and prices. All aeronautical and non-aeronautical revenues from the operation of an airport accrue, in the first instance, to the airport. Reaching a common understanding on the contributions of non-aeronautical revenues to defray the cost base for charges is an acknowledgement of the partnership between airports and users.
2. The non-aeronautical revenues in question do not normally include revenues earned by airport operators from activities undertaken off-airport or those undertaken by the airport in full competition with other suppliers.
3. Given the different local circumstances and fast changing conditions with respect to airport ownership and management, as well as regulatory regimes, there are likely to be a range of different appropriate treatments of non-aeronautical income by airports.
4. When determining the contributions from non-aeronautical revenues, high priority should be given to the investment needs of airports, taking into account paragraph 24 of Doc 9082/6, which addresses pre-funding of projects, while recognising that there may be many alternatives to finance infrastructure development.
5. The appropriate return on aeronautical activities should reflect differences in the level of risk from non-aeronautical activities. Further, in order to provide incentives to the airport operator, high levels of service and efficiency in aeronautical activities may be rewarded with higher returns and vice versa.
6. When defining the contributions from non-aeronautical revenues, an accounting system should be in place to identify the relationship between costs and revenues of non-aeronautical and aeronautical activities (refer to Doc 9082/6, paragraph 17.iv).
7. As stated in point 4 above, it may be appropriate for airports to retain non-aeronautical revenues rather than use such revenues to defray charges. However, there is no requirement for airports to do so and, in appropriate circumstances, there may be solid grounds for charges to be lower, consistent with Doc 9082/6, paragraph 22.viii.
8. None of the foregoing should be interpreted as encouragement to airports to unreasonably exploit their market position relative to users.