

## COMMENTS ON PRODUCTIVITY COMMISSION REPORT OF AUGUST 2011

In general I support the draft conclusions of the report and its basic thrust. I have a few brief comments as follows.

I considered it particularly useful that there is a reminder on p189 that the airport industry is not exceptional and that commercial negotiation is rarely conducted between equals. Most markets exhibit imperfections to varying degrees and there is a tendency, when a (quasi) regulatory framework for an industry has been established to approach that industry from a narrow perspective and to magnify its problems. In the context of commercial negotiations, as the Commission points out, these have not been operating for very long and it takes time for the necessary cultural shift to occur; the airline industry has a long history of government support and intervention and it will take time for attitudes to change.

To add flexibility to commercial negotiations, airports in particular might wish to consider introducing re-assignment clauses in some of the contracts (similar to those in commercial property leases). This would give added flexibility to negotiated contracts, encourage their use and add depth to the commercial market. It could be a potentially useful way of helping to reconcile the different time horizons of airports and airlines noted on page 203 of the Report. These points are set out in the following short publication: <http://www.airneth.nl/index.php/columns/airport-airline-relationships-and-contracts-a-proposal.html>

Information requests regarding non-aeronautical revenues relating to draft findings 4.1 and 4.2: it will be useful to have some analysis of the proportion of total airport revenues that are earned from non-aeronautical sources for different airports (although in some cases these might be difficult to obtain). Interpretation of the data will also need to take into account planning restrictions that might limit the ability of the airports to develop such revenue streams and in this context I note the reference to Avalon on p36. It might be useful also to develop data regarding the pace of investment in non-aeronautical revenues relative to the growth of such revenues. A combination of strong non-aeronautical revenue growth, significant investment in relevant assets and an increasing share of total revenues from these sources could suggest that the ability to earn such revenues does constrain aeronautical charges.

Draft recommendation 11.1 and 11.3: one should not automatically conclude that returns in excess of a reasonably expected band of outcomes are *prima facie* evidence of the exercise of significant market power. Such returns could of course reflect a particularly innovative approach by an airport or its ability to out-perform others with regards to productivity. In this context, one should also adopt a cautious approach with regards to cost-reflectiveness because, as the Commission points out, airports are multi-product firms and recent developments in economic theory referred to as 'two-sided market theory' has emphasised the interdependencies between different consumer groups each with its own demand characteristics, so that a set of efficient prices might lead to prices on one side of the market being zero or even negative and those on the other side being (well) above costs. An explanation of the theory in relation to airports can be found in Gillen (2010) in the Report's References and in the following on the UK CAA's website.

<http://www.caa.co.uk/docs/5/ergdocs/Gatwick2SidedPlatforms.pdf>

<http://www.caa.co.uk/docs/5/ergdocs/MarketDefAirports.pdf> (pages12-17)

Finally, it might be useful for the Commission to stress the importance of entry into the airport market and that the use of current general aviation airports for *marginal* entry by scheduled air services could provide a usefully constraint on the behaviour of the main airports.

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