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PSA Inquiry
Productivity Commission
LB2 Collins Street East PO
Melbourne VIC 8003

Dear Sir

The Board of Airline Representatives of Australia (BARA) wishes to present the following submission to the Productivity Commission inquiry into the *Prices Surveillance Act 1983* (PSA). I apologise for the lateness of the BARA submission.

1. Introduction

BARA is the industry association representing the interests of international airlines operating to and from Australia. BARA has been established as an incorporated body for ten years. Prior to that BARA operated for many years as an unincorporated body. BARA's membership currently comprises 49 scheduled international airlines, including the Australian airlines, Qantas and Ansett.

BARA aims to establish a recognised means of communication between member airlines and statutory and other organisations whose interests and actions influence or affect member airlines and the aviation industry. Its purpose is to act on issues affecting the aviation industry in Australia and to provide a single concerted voice on policy and other matters when dealing with the Federal and State governments and other aviation industry stakeholders.

BARA members are substantial users of services provided by Australian airports. As noted in the Productivity Commission *Issues Paper*, a variety of airport services have been declared for the purposes of prices surveillance or monitoring under the PSA. In addition, services provided by Airservices Australia are subject to prices surveillance by the Australian Competition and Consumer Commission (ACCC) under the PSA. Any recommendations to amend or repeal the PSA will impact directly on BARA's members. The removal of price control over various airport services or services provided by Airservices Australia could have significant adverse financial consequences on BARA members and, ultimately, their customers. This submission does not address specifically the issue of price regulation of services provided by Airservices Australia. However, comments made in relation to airports are also relevant to Airservices Australia.

This submission addresses three issues relevant to the PSA inquiry:

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- the market power of airports in the provision of many of their services;
- the role and effectiveness of regulating prices of airport services under the PSA; and
- alternative methods of regulating prices of airport services.

2. Market Power of Airports

BARA holds the strong view that price regulation, either via the PSA or other legislation, should apply to industries which have natural monopoly characteristics and very substantial market power. In this regard, it is widely accepted by a variety of economic regulatory bodies that the major Australian airports have substantial market power over a range of airport services. This market power arises from the natural monopoly characteristics possessed by those airports.

Typical of the findings of regulatory bodies in relation to airports' market power is the inquiry by the Prices Surveillance Authority into the aeronautical and non-aeronautical charges of the Federal Airports Corporation (Report No 48, 1993). The Prices Surveillance Authority commented:

> *'Airport service markets are largely non-contestable: provision of airport services tends to be characterised by very large sunk costs and high barriers to entry. In addition, there appear to be economies of scale in the provision of airport services and significant economies of utilisation over a range of levels of airport activity, which ensure natural monopoly status. Airports, like other utilities, exhibit joint and common production cost characteristics in the production of multiple services. Airports generally can be considered to be local monopolies in the provision of aeronautical services. Finally, the characteristics of airports has led to regulation of airport charges in several countries, including the United Kingdom.'* (pp 47-48).

In the same report, the Prices Surveillance Authority considered the extent of competition between airports. It concluded that:

> *'…. the major airports in Australia are not particularly good substitutes for each other. Apart from a few areas where there are effective alternative airports in close proximity, such as the New South Wales north coast, most destination regions offer only one airport. In the capital cities, only the major airports are capable of handling large jet aircraft used by RPT [Regular Passenger Transport] airlines.'* (p51).

BARA is able to identify examples of the use of market power by airports to achieve monopoly prices in areas which are unregulated or inadequately regulated. Probably the most recent example is the proposal by Sydney Airports Corporation Limited (SACL) to increase aeronautical charges from $98 million to $212 million per annum commencing 1 November 2000.

3. Role and Effectiveness of Regulation Under the PSA

BARA notes that the PSA assigns three functions to the ACCC – prices surveillance, prices monitoring and holding price inquiries. The PSA does not contain specific powers of price control or regulation. Nevertheless, in relation to the airport industry, the PSA is being used to control and regulate prices for airport services. Under instruments issued pursuant to the PSA, all major Australian airports (other than Sydney Airport) are subject to a price cap of the CPI-X form. Although the ACCC does not have express legislative power to enforce the price cap, the conduct of all airports to date indicates that they accept the price cap as binding.

Although there is no CPI-X price cap applicable at Sydney Airport, its aeronautical services are declared under the PSA and it is required to notify the ACCC of any price increases. Under an instrument issued pursuant to the PSA, the ACCC has been directed to take into account certain matters in considering whether to approve any proposed price increase, including the starting point prices at the time of transfer of the airport assets from the Federal Airports Corporation to SACL.

Airports have been subject to regulation under the PSA for a relatively short time. Phase 1 airports were privatised in 1997. Hence, the effectiveness of the airports regulation is still being tested. For privatised airports, the PSA together with the instruments issued under it, have prevented price increases for declared services other than for necessary new investment. However, the effectiveness of the PSA in regulating or controlling prices at airports can be questioned in a number of areas. These are set out below.

3.1 Scope of declared services -

BARA maintains that the scope of services subject to price regulation is unsatisfactory. The definition of 'aeronautical services' is unclear. Further, the basis for distinguishing between aeronautical, aeronautical-related and non-aeronautical services is not stated expressly in the regulatory instruments.

BARA believes that, in order to improve regulatory outcomes and clarify the scope of airport services subject to price regulation, the existing scope should be broadened. There may be an advantage in a body such as the ACCC having power to determine that additional services provided by airports should be regulated, and to regulate those services accordingly. It is BARA's view that there are good economic reasons for the entire business of an airport operator to be regulated. Such an approach has been adopted at many airports around the world.

For further details regarding the difficulties of the existing definitions of aeronautical and aeronautical-related services under the existing PSA regulation of airports, BARA refers the Productivity Commission to in the ACCC's report concerning Fuel Throughput Levies (December 1998).

3.2 ACCC's lack of regulatory powers -

As noted above, the PSA does not empower the ACCC to enforce a price cap. Instead, it relies on voluntary compliance. To date, no privatised airport has ignored the price cap.

However, comments made by SACL in relation to its current aeronautical pricing proposal are a matter of concern for airlines. SACL has indicated that it will abide by any decision of the ACCC in relation to the proposed price increase, However, SACL also has stated that it does not consider the specific new investment criteria in the direction to the ACCC made under the PSA to be relevant to SACL's proposed price increase SACL has adopted this view despite the fact that SACL is clearly seeking a return on and a return of new capital in its proposal. SACL also has not given any significance in its proposal to the starting point prices.

BARA maintains that the PSA should be strengthened to ensure that prices for services which are declared under the Act are not increased without ACCC approval.

Further, BARA maintains that the ACCC's prices surveillance role is too restrictive and is deficient. The ACCC is confined under the PSA to assessing compliance with a price cap (for privatised

airports) or proposed price increases (for Sydney Airport). The ACCC cannot perform a proper regulatory role. For example, if an airport ceases to supply a range of aeronautical services, the ACCC is not empowered to lower the price cap. Hence, airport operators have considerable freedom to exercise market power by reducing the quantity or quality of services free from regulatory oversight.

The ACCC report concerning Fuel Throughput Levies (December 1998) referenced above, stated that there was a strong case to argue that, by introducing fuel throughput fees, the airports were taking advantage of market power. The report also stated that the introduction of the fees, together with a number of other factors, could erode some or all of the intended benefits of the price cap and potentially compromise the effectiveness of the present prices oversight arrangements. The ACCC's report recommended to the Treasurer that aircraft refuelling services be included within a CPI-X price cap. Approximately 18 months later, those services are still not subject to a cap and BARA understands that the fuel companies have passed the charges through to airlines.

The Fuel Throughput Levy example strengthens the argument that the ACCC should be given the power to determine that additional services provided by airports should be regulated and to regulate those services.

3.3 Regulatory criteria -

BARA believes that the PSA regulation is also deficient in the regulatory criteria to be applied by the ACCC in making price decisions.

The *Issues Paper* outlines the primary statutory criteria which must be taken into account by the ACCC (section 17(3) of the PSA), being the need to:

- maintain investment and employment, including the influence of profitability on investment and employment;
- discourage an organisation with market power from taking advantage of that power when setting prices; and
- discourage cost increases which stem from wage increases or changes in employment conditions that are inconsistent with the principles established by relevant industrial tribunals.

In addition, the Minister may also direct the ACCC to give special consideration to additional matters. Specific directions have been given to the ACCC for the airport industry. For all airports other than Sydney Airport, those directions include compliance with the price cap. In addition, for all airports the ACCC has been directed to consider specific criteria when assessing proposed price increases resulting from new investment.

Whilst the specific directions to the ACCC applicable at privatised airports, particularly the price cap, have played an important role, section 17(3) of the Act probably requires re-consideration. The second criterion above remains relevant to organisations with market power. However, the first and last criteria are now dated, having not been amended since the enactment of the PSA in 1983. BARA maintains that the criteria in section 17(3) are insufficient to guide the regulation of prices in an industry that exhibits natural monopoly characteristics.

In this regard, BARA refers the Productivity Commission to the outcomes the ACCC must seek in performing its price regulatory function under the National Electricity Code, viz.:

(a) an efficient and cost effective regulatory environment;
(b) an incentive based regulatory regime which:
    (i) provides an equitable allocation between asset users and asset owners of efficiency gains reasonably expected to be achievable by the asset owner; and
    (ii) provides for a sustainable commercial revenue stream which includes a fair and reasonable rate of return to the asset owner on efficient investment, given efficient operating and maintenance practices;
(c) prevention of monopoly rent extraction by the asset owner;
(d) an environment which fosters an efficient level of investment;
(e) an environment which fosters efficient operating and maintenance practices;
(f) an environment which fosters efficient use of existing infrastructure;
(g) reasonable recognition of pre-existing policies of government regarding asset values, revenue paths and prices;
(h) promotion of competition in upstream and downstream markets;
(i) reasonable regulatory accountability through transparency and public disclosure of regulatory processes and the basis of regulatory decisions;
(j) reasonable certainty and consistency over time of the outcomes of regulatory processes;
(k) reasonable and well defined regulatory discretion which permits an acceptable balancing of the interests of asset owners and asset users,

(Clause 6.2.2 of the National Electricity Code).

BARA considers that the airport industry should be subject to the same types of provisions as set out in the National Electricity Code.

4. Alternative Methods of Price Regulation

The Productivity Commission *Issues Paper* questions whether Part IIIA of the Trade Practices Act (TPA) is a sufficient substitute for price regulation under the PSA. BARA believes there is clear evidence that Part IIIA is not an appropriate method of regulating prices in an industry with strong natural monopoly characteristics. Further, airports are quite different to other regulated monopoly industries – such as telecommunications, electricity transmission and distribution, gas transmission and distribution – because of the range of services at and users of airports. Hence, some form of price regulation in addition to Part IIIA is necessary.

BARA sees a number of significant deficiencies in the access regime created by Part IIIA.

First, the process for having bottleneck facilities declared for the purposes of Part IIIA is slow and complex. The recent decision by the Australian Competition Tribunal in March 2000 to declare specific services at Sydney International Airport was made approximately three and a half years after an application for access to the services was first made to the National Competition Council.

This deficiency has been overcome within the regulatory regimes governing other industries. In the airport industry, section 192 of the *Airports Act* is intended in part to overcome this deficiency of Part IIIA. However, it is an imperfect solution. It requires the ACCC, before arbitrating a dispute, to form a judgement about the economic duplication of facilities (a similar test which exists within Part IIIA) and about the necessity of the service for civil aviation. The first determination made by the ACCC under section 192 took approximately 12 months to conclude (Delta Car Rentals 1999).

Any delay is clearly to the advantage of the monopoly service provider. Access seekers on the other hand must accept the airport's proposed monopoly price if the service is required for their businesses. Rents for airline lounges and office space at airports are good examples.

Secondly, the TPA does not protect users who obtain services from other airport users which are themselves monopolies. For example with fuel throughput levies, charges are levied by airports on the Joint User Hydrant Installation and passed onto oil companies and then airlines. Airlines are unable to take action themselves in relation to the airports' charges as the airlines seek the service from the oil companies and not from the airport. The oil companies have little incentive to fight the charges as they can be passed on to the airlines.

Finally, the access regime contained in Part IIIA provides for price decisions to be made individually for each service user. For example, if Part IIIA were the only regulatory instrument controlling prices for airport services, each airport user would need to negotiate directly with airports and, in the event of disputes, notify the disputes to the ACCC. The ACCC would then be required to arbitrate each individual dispute.

The reality is that commercial activity at airports is characterised by a large number of users (comprising airlines and other commercial entities, such as ground handling agents, catering suppliers, refuellers, car rental companies, etc) acquiring a large range of services from the airport operator. Accordingly, there are a large number of commercial transactions which occur at the airport. In these circumstances, the transaction costs of requiring each user to negotiate terms and conditions of access to services within the framework of Part IIIA of the TPA would be substantial. Such a regulatory approach would place enormous burdens on Australia's aviation industry, reducing its efficiency.

In contrast, in other industries (eg electricity transmission) the government or a regulator sets a revenue or price cap applicable to all or some of the commercial activities undertaken by the monopoly provider. The maximum revenue is then allocated between services and users. Such an approach is desirable because it ensures that the monopoly provider recovers its costs only once. The pricing is efficient and fair. The PSA, together with the Ministerial directions for privatised airports, go some way to achieving this, since the declared services are subject to a price cap.

Whilst there are deficiencies with the PSA, it is preferable to relying solely on Part IIIA. However, Part IIIA is an important supplement to the PSA. Part IIIA can be used to address instances of monopoly pricing in respect of individual services (even though the airport may remain within the price cap). Also, disputes between airport operators and users may arise in respect of terms and conditions of access to airport services and facilities. These issues are not addressed under the PSA. As the legislation currently stands both Part IIIA and the PSA are required for the regulation of airports.

5. Conclusion

In conclusion, BARA affirms that:

(i) BARA members are substantial users of airport services and the services of Airservices Australia,

(ii) a variety of these services are currently subject to regulation under the PSA and amendment or repeal of the PSA would have a detrimental impact on BARA's members, unless a new and improved form of regulation is implemented,

(iii) price regulation of airport services under the PSA has a number of deficiencies, so improvements to the PSA or alternative regulatory frameworks for airport services are necessary,

(iv) the access regime under Part IIIA of the TPA is not an adequate or appropriate framework for price regulation of airport services,

(v) the use of such a regime would create substantial transaction costs for the large number of users of airport services while the delays in determination of any access applications under such a regime probably would result in the scheme not being used and the monopoly prices of airports having to be accepted.

Members of the BARA Airports and Government Charges Committee would be pleased to meet with the Productivity Commission to discuss the matters addressed in this submission.

Yours sincerely

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