

Economic Regulation

 The case for independent economic regulation of airports and ANSPs is clear. It improves efficiency and productivity. It encourages timely and cost-effective new investment. It benefits all stakeholders, from the regulated airports and ANSPs to the customers and the wider economy.

IATA believes that independent economic regulation, where needed, should involve detailed price-cap regulation – based upon single-till procedures – and service quality standards. Such a system has been successful in improving efficiency where implemented and can be expanded to meet changing investment needs. It can be highly effective in improving the aviation industry for the benefit of all stakeholders.

The Scope of Economic Regulation

All airports and ANSPs must be subject to ICAO principles in setting user charges, including transparency, consultation and cost-relatedness. However, more detailed economic regulation of user charges and service quality is often required where market power exists and can be exploited. The need for good, independent economic regulation exists whether an airport or ANSP is publicly or privately owned.

Economic regulation should exist for all airports and ANSPs unless they face sufficient competitive power or are small operators in relation to the relevant market. As such, economic regulation should be imposed, or retained where it already exists, unless:

- (i) an airport or ANSP falls below an agreed threshold level based on their size relevant to the market,
or
- (ii) an airport or ANSP is above the threshold level, but a market contestability test demonstrates that they face sufficient competitive constraints to prevent them from exploiting any market power.

However, in the case of (ii), it is also important to ensure that a clear process is established for the test to be reviewed, especially after a change of airport or ANSP ownership, and for economic regulation to be re-imposed if conditions change.

The Mutual Benefits of Good Regulation

A well-designed and effective framework can provide benefits for both users and for regulated companies. An incentive-led process helps to improve efficiency, often through consultation with users who experience several aspects of service quality and can provide constructive help. It can also improve the business investment planning process, delivering capital investment in accordance with the needs of existing users while also safeguarding the rights of potential new users. Independent and transparent economic regulation can reduce uncertainty on both sides, helping to reduce investor risks and financing costs. The stability provided by an effective regulatory framework can also attract longer-term investment finance into the industry, avoiding the potential volatility in infrastructure asset prices driven by short-term speculative finance.

Key Principles of Independent Economic Regulation

Appropriateness: Regulation should focus on airports and ANSPs that have clear natural monopoly characteristics that allow them to exploit their market power in setting charges. The need for regulation should be considered on a case-by-case basis, and not imposed where the cost of regulation exceeds any potential benefits.

No cross-subsidisation: Regulation should be undertaken at an individual airport or ANSP level, with the decisions made on a basis appropriate to the key objectives in each case. System regulation, that sets a price cap for more than one airport or ANSP, can lead to sub-optimal decisions.

Non-discrimination: In accordance with ICAO policies, the regulatory structure should not distinguish between different types of users. The consultation process should be open to a range of stakeholders and the regulatory decisions should be applied on a non-discriminatory basis. Regulators should take into account the interests of existing users while safeguarding the rights of future potential users.

Key Recommendations for the Framework of Independent Economic Regulation

Independence: Economic regulation should be independent from direct control by governments or airport authorities. An economic regulator should be established with clear objectives, or statutory duties and then provided with the resources and operational independence to meet these principles.

Transparency: This should be achieved for both the process by which regulatory decisions are made and for the expenditure and investment plans of the regulated company. Information on key historic and forecast performance indicators, business strategies and planned investments should be available for consideration.

Consultation: There should be a full and timely consultation process with airlines users on operational and investment plans. The regulatory system should include measures (both incentive based and penalty related) to ensure that airports and ANSPs approach the consultation in an open and constructive manner.

Flexibility: The structure should have a degree of flexibility to adapt to significant external shocks, appropriate to the level of risk the company can reasonably be expected to bear. However, this flexibility, if used, should not undermine the longer-term credibility of regulation.

A neutral dispute settlement mechanism: The regulated companies and the airline and other users should have a mechanism for appealing against the regulator's decisions. Typically the neutral body will be the national competition authority. This helps to minimize the risk that the regulatory body itself can reach sub-optimal decisions.

Regulatory Benchmarking: There will be many common aspects between the regulatory process for different airports and ANSPs. As such, a forum should be available for best-practice benchmarking, both in terms of revealing additional information for the regulator and for regulated companies and users to assess the performance of their regulators.

Key Recommendations for Regulatory Practice

Price-Cap Regulation: The CPI-X mechanism, or a variant of it, is the most appropriate mechanism for incentivising improvements in efficiency. However, the mechanism must also be designed to provide a balance between the risk of excessive administration costs and the risk of setting charges on the basis of historic rather than potential costs.

Single-Till Regulation: A single till approach determines the level of revenue and return required and the user charges to be set on the basis of all services at an airport, irrespective of whether they are aeronautical or non-aeronautical. Single-till regulation provides strong incentives for efficiency and productivity improvements.

Valuation of the asset base set according to investment and risk: It is essential that the asset base on which airports and ANSPs are allowed to earn regulated returns is set in accordance with the investment undertaken and the risk borne. Artificial increases in asset values should not be lead to increases in charges, they simply hand a windfall gain to an airport or ANSP.

Greater accuracy for the Cost of Capital return: The cost of capital needs to take closer account of actual financing costs. In several cases, investment has been remunerated at a cost of capital incorporating an equity component, even though it was wholly debt funded. As such, the cost of capital should be set on the basis of projected or optimal gearing levels rather than historic levels.

Commercial negotiations for investment: Airline users should be closely involved in the planning, design and timing of new investment decisions. A mechanism should be in place that allows commercial negotiations to take the lead but provides regulatory oversight to ensure discussions can proceed on a fair and transparent basis.

Avoidance of user pre-financing of investment: While it is important to involve airline users in the definition and design of new investment, the investment risks should not be wholly passed on to airlines through a pre-financing mechanism. Airlines should only pay for investment once the assets are in operational use or, in the case of large investments, clearly defined milestones have been completed.

FULL REPORT

For a copy of the full report and further economic analysis of the airline industry, please visit:
www.iata.org/economics



An economic regulatory structure that incorporates the recommendations above can improve the constructive engagement between airports, ANSPs and users, to the clear benefit of all stakeholders in the industry.