

KEY POLICY ISSUE

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LIGHT-HANDED REGULATION OF AIRPORTS: THE AUSTRALIAN EXPERIENCE

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Australia has been experimenting with light handed regulation of its major airports, and there are still unanswered questions as to how the system will work, especially after recent court decisions. There remains ambiguity as to what the system seeks to achieve, whether it be efficient provision of airport services, or keeping charges to a minimum. While the system is described as “light handed” it may turn out to be quite different from the model originally envisaged.

From Price Caps to Monitoring

A system of light handed regulation of major airports was introduced in 2002. Previously Australia had implemented CPI-X regulation for about four or five years after the airports were privatised. This regulation had provisions for quality monitoring, and it also had mechanisms by which airports could obtain approval to increase prices to fund investment. This system of regulation came to an end over 2001/2002. There were several factors behind the shift. There had been provision for a review of regulation at the end of five years, and the review, by the Productivity Commission, the government’s main microeconomic advisor, was critical of price regulation on the grounds that it was likely to degenerate into cost plus regulation with poor incentives for efficiency. In 2001 several airports had experienced a sharp revenue crisis, provoked by the collapse of the second largest airline, Ansett, and the 9/11 events. The government responded by suspending price caps for some airports and relaxing those for others. Airports were also critical of the high compliance costs associated with the investment provisions. The largest airport, Sydney, was privatised in June, just after the announcement of the regulatory changes.

The government broadly accepted the Productivity Commission’s recommendations (Productivity Commission, 2002) and implemented a light handed form of regulation from July 2002 onward, with provision for a review in five years time (Forsyth, 2004). The system adopted was a monitor / review/ sanction one. The seven major airports, including Sydney, were to be subjected to monitoring of prices, costs, and profits by the competition authority, the Australian Competition and Consumer Commission (ACCC). If the review determined that an airport had performed unsatisfactorily, it could recommend reimposition of direct regulation. Granted that the airports had found regulation onerous, this was not a trivial threat. There was a hope that airlines and airports would negotiate over charges. In addition, airports would be subject to general competition regulation, including Part IIIA of the Trade Practices Act governing access to essential services.

Light Handed Regulation in Practice

Airports can possess market power. In Australia, cities are widely separated, and most major cities have only one airport capable of serving airline traffic, with the closest alternative airport often being hundreds of kilometres away. In this situation, the airports do have market power, and airlines do not have much leverage in negotiations with airports. Thus the threat of re-regulation, and the more amorphous threat of the use of Part IIIA, have been the main disciplines on airport pricing.

The ACCC monitored prices, costs, and profits. In 2006, the Productivity Commission undertook a review of airport performance under the new regime. Generally, the airports supported the current arrangements, while the airlines argued that it did not restrain the use of market power sufficiently. The ACCC also was critical of current arrangements, agreeing with the airlines that restraints on the use of market power were unspecific and too weak (ACCC, 2006). Suggestions were made by various parties for a dispute resolution mechanism, providing for arbitration of airport charges. The Productivity Commission concluded, in a Draft Report (Productivity Commission, 2006), that performance had been satisfactory, given the guidelines which had been set, and recommended that the arrangements continue, subject to some small changes. The Commission has submitted its Report to the government, which has yet to respond to it or publish it.

A serious limitation of the Australian system is that the guidelines to which the review is expected to work are extremely vague. Thus it is stated that "... *efficient prices broadly should generate expected revenue that is not significantly above the long-run costs of efficiently providing aeronautical services ...*" (Productivity Commission, 2006, p v). These words can mean all things to all people – no guidance is given on how efficiently providing aeronautical services can be assessed. Indeed, how to determine what efficient levels of costs are is a problem which has bedevilled regulators for decades. The guidelines are consistent with incentive regulation or cost plus regulation, and much in between.

There has not been much by way of assessment of performance during the period since the move to monitoring. The ACCC indicates that average revenues per passenger rose considerably for several, though not all, airports during the period. Airports have not used their market power to anything like its full extent however- monopoly charges would be much higher. This suggests that pricing is restrained, though not necessarily to keep prices at a minimum consistent with cost recovery. There has been little assessment of productivity performance (Forsyth, 2006) – the Australian airports appear to be good though not top performers in this regard (ATRS, 2005). There has been no assessment of how efficiently investments have been carried out. There have been some sharp increases in charges at some airports to fund major investments- but were these investments adequate or excessive?

The assessment of light handed regulation depends on what it is expected to achieve. From a broad efficiency perspective, it has performed well, so far as one can tell, though it has not been without problems, especially those associated with investment. If the objective is to keep prices close to cost, and minimise the use of market power, the system may be seen as less successful.

Access Provisions and Airport Regulation

In parallel with the monitoring regime, there have been other developments with potentially major implications for airport regulation. As noted above, airports are subject to general competition law, and this includes access provisions, Part IIIA. This makes it possible for a firm which seeks access to essential infrastructure to obtain ACCC arbitration on charges, if this would promote competition. Thus if a mobile phone company wants access to the local loop possessed by a telecom monopoly, it can use Part IIIA to gain ACCC arbitration if it cannot negotiate terms which it considers satisfactory. Australia's second largest airline, Virgin Blue, has sought to use these provisions to secure ACCC arbitration of charges at Sydney airport. This led to a protracted series of court hearings which concluded in it being granted the right to arbitration. It has asked the ACCC to arbitrate, and the matter is now with the ACCC. Granted that ACCC regards the light handed regulation as too weak to discipline the use of market power, this could result in it requiring Sydney airport to reduce its charges.

Thus the environment which is emerging is a peculiar one. It is possible that the ACCC will be re-instated, de facto, as the primary airport regulator. Airlines which do not agree with an airport's charges can request arbitration. This would make the monitoring / sanctions regime redundant- light handed regulation would have been replaced. The principles which the ACCC chooses to implement, which are likely to emphasise the minimisation of the use of market power and keeping charges close to cost, will become the effective determinant of airport charging. Airports will be forced, by actual access actions or the threat of them, to levy charges at around the level which they think the ACCC would approve.

Future Directions

Thus the Australian airport regulatory environment is entering something of a nether region between light handed and more explicit regulation. What is likely to emerge as, effectively, a system of regulation of market power, is based on legal provisions dealing with access to essential services designed to promote competition in related markets. Airports might or might not be subjected to detailed regulation, depending on which applications are made to use Part IIIA. While it is not clear what principles the ACCC will use when arbitrating charges, experience of other industries suggests that it will take a fairly cost based approach, and its processes will not be particularly light handed. This system will not amount to full regulation, but it will be a long way from light handed regulation as originally envisaged.

Regardless of the extent to which essential facilities regulation is used as a pathway to regulation of airports market power, there are other questions to be resolved, as there are problems with the way the system is evolving. Specifically, the criteria for unsatisfactory performance, and thus the invocation of sanctions such as re-regulation, are vague. In addition, the system as it stands provides no guidance on investment- a critical omission if efficiency in capacity provision is to be achieved. Hence whatever view one takes about the approach to regulation, the current Australian arrangements pose unresolved questions. If it is considered that ACCC arbitration of airport charges is the best way to go, the legal basis should be made less dependent on essential facilities access provisions, and the principles to guide such arbitration should be set out. If an alternative dispute resolution mechanism is preferred, this needs to be established, and the recourse to Part IIIA removed. If a review/sanction approach is to be continued without arbitration, clearer principles and sanctions need to be established for it to work more effectively.

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