

Airport Ownership, Management and Price Regulation

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Conclusions

1. A strong growth industry with continue need for investment capital

This paper has looked at alternative models of airport governance and regulation. These were discussed in a general format and then information on the specifics regarding Canada were put forth. Here some conclusions are drawn.

- First, it must be noted that aviation is a strong growth industry. Passenger traffic grows at double the rate of the economy, while cargo traffic grows at triple the rate.
- The consequence of the continuing strong growth of aviation is the need for ever increasing financial capital for airport infrastructure expansion.
- Government financing of the continual need for airport investment clashed with public priorities in the 1980s and 1990s. Limitations on demands on federal treasuries led governments around the world to solve the problem by privatization of airports, thus transferring the financing burden to users and private capital markets.

2. Governance models

Like other nations, Canada transferred its airports from government to private sector operation. The transfer model chosen was to private but not-for-profit airport corporations (referred to as airport authorities) which were locally based and controlled. Some comments:

- Canadian airport transfers to private not-for-profit and locally based corporations was part of a global trend to privatize airports.
- The specific model chosen by Canada has been unique. All other airport privatizations have been to for-profit corporations. No subsequent nation has adopted a not-for-profit format.
- The use of a lease of airport assets rather than sale is not unique. Australia and much of the developing world has adopted this format while the UK, New Zealand and Germany have sold the airport assets.
- Canada is relatively unique in requiring on-going lease payments. Most other airports used either out right sale (UK, Germany, NZ, etc.) or prepaid leases (Australia and much of Latin America). As a result, ongoing public debate about the level of lease payments is not present with other privatized regimes.
- A consequence of the not-for-profit format chosen in Canada was the introduction of airport improvement fees (AIFs). Canada's airport authorities have no ability to raise equity via share sales. This would have limited their ability to undertake major capital projects. Long established pricing policies prevent raising charges on airlines prior to investments being put into productive use. Hence, charges were placed on passengers in advance of deployment of new productive capacity in order to generated needed equity capital (retained earnings). The UK and Australia, for example have in general not been compelled to adopt such fees. AIFs are likely to continue in Canada until airport

authorities have amassed a sufficiently large retained earnings base to enable the debt markets to fully finance incremental airport investment in infrastructure.

3. Price Regulation

In many, but not all cases, airport privatization was accompanied by the introduction of a price regulation regime to control what was perceived to be potential monopoly power.

- To date, Canada has not put a price regulation regime in place for airports. With airports operated by not-for-profit corporations, it is not clear that price regulation would achieve any improvements in economic efficiency. If anything, the record in Canada is one of airports seeking to expand traffic rather than restrict it in order to achieve monopoly profits.
- Elsewhere in the world, price regulation has often, but not always (e.g., New Zealand) been put in place to curb potential monopoly power of airports. Where regulation has been introduced it has been of the price cap regulation form which has been employed with other infrastructure industries.
- The UK has the longest record with price cap regulation of airports. There, a new view is emerging among its leading transport economists that such regulation (single till format) has not been beneficial. To the contrary, it has resulted in perverse outcomes where highly congested airports have declining prices which are approaching zero. Economic efficiency would dictate the opposite: prices should rise to discourage use of congested facilities. Two leading UK economists, including the one who was instrumental in the design of UK privatization and price cap regulation are of the opinion that economic efficiency would be better served with no regulation of airport prices. They argue that airports have the incentive to develop non-aeronautical commercial revenues. But these revenues depend primarily on the level of traffic an airport has. Airports thus have incentives to hold price increases for aeronautical services to a minimum in order to encourage traffic development.

Part of the debate on airport price regulation recognizes a number of other characteristics of modern airports:

- There is an emerging view, put forward here, that airports have important segments of their traffic base which is subject to competition.
- Airlines have significant countervail powers. They have withheld payments of fees and have (varying degrees of) veto power over airport capital programs.
- As well, a global industry standard has emerged (self regulation) that aeronautical charges should be cost based. Airlines have strongly pursued any airport which attempted to deviate from this industry standard, one that has been adopted by the airport industry itself.

It is my conclusion that any consideration of the introduction of airport price regulation should be done carefully. There are significant countervail powers of the airlines, criticism by leading economists that single till price cap regulation in the UK has produced economically perverse results, and a strong industry standard (self regulation) that aeronautical charges should be cost based. Combining these with the not-for-profit governance of airport authorities in Canada raises the question as to what, if anything the introduction of a price regulation would achieve.

While there may be some elements of airport services which have monopoly elements, major portions of their revenue base are subject to some form of competition. The monopolistic elements are subject to strong countervail powers of the airlines. In Canada, airlines have strong capital project veto or delaying powers via the AIF collection agreements that many airports have entered into with their airline customers. All but the largest airports in Canada are struggling with achieving break even and capital investment self sufficiency. For these, price regulation would have no effect as prices are at or below costs.

If price regulation is contemplated, it should focus only on the largest airports. But even here, the following questions would need to be examined:

- Do the airlines have countervail power?
- Have the airport and its airlines entered into long term contractual relationships which embrace fees and charges principles and procedures?
- Does the airport adhere to the industry standard that aeronautical charges be cost based?
- Is the airport behaving in a manner results in higher charges and restriction of traffic to achieve monopoly returns, or is its behavior such that it seeks to expand its traffic base and raise aeronautical charges only when absolutely necessary?

Only if the answer to all of the above are “no” should a price regulation regime be considered.