# REFLECTIONS ON THE DRAFT PC REPORT OF FEBRUARY 2019

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## Introduction

I have been commissioned by the Australian Airports Association (AAA) to offer my thoughts to the Productivity Commission (PC) on its draft report on the economic regulation of airports.[1] I do so as former Board member for economic regulation at the UK Civil Aviation Authority (CAA) from 2003 to 2010, and as an independent advisor to regulators, regulated companies and trade associations since then. I have also been a non-executive director of a major London teaching hospital and the UK's en route air traffic provider (NATS) - both entities economically and quality/safety regulated. In a prior career I was a long-time official at H M Treasury.

In my comments I do not propose to cover the whole waterfront analysed by the PC but rather to focus on its general regulatory approach and relevant comparisons with the situation in the UK and Europe more generally, and on issues where the PC has requested further information and views. In particular, I offer some thoughts on pre- financing and consultation guidelines

## Regulatory approach

The evidence analysed by the PC suggests that the Australian system of airport economic regulation has delivered outcomes which have been good for consumers and the community generally. It has done so in the presence of admitted market power without the panoply of interventions often used elsewhere. There are, of course, some rough edges and some resulting proposals from the PC to augment monitoring information. This will have the effect of bolstering the threat of regulation by making it more feasible following a future review.

At the core of the PC's approach is the identification market power. This is a feature it shares with the UK where market power tests are one key element in whether airports should be regulated or not. The result is that only two airports in the UK are now regulated, and only Heathrow in the classic regulatory asset base (RAB) building block way. At Gatwick there is more reliance on an overall airport 'Commitment' framework and contracting between the airport and individual airlines (albeit with regulatory monitoring of price and service performance against a CAA 'fair price' benchmark). At other airports competition and the associated airline countervailing power renders intrusive regulation redundant.[2] The European Union, in contrast to both Australia and the UK, has yet to grapple with the implementation of testing for airport market power, though the issue is live in the current review by the European Commission of the Airport Charges Directive (ACD) , and both the Netherlands (Schiphol Airport) and Ireland (Dublin Airport) have assessed the market power of their largest national airports.

The more limited nature of airport competition in the more geographically extensive and economically distinct Australian space relative to the UK (where airports also currently compete with European airports serviced by geographically mobile pan-European airlines) means there are more airports in Australia than in the UK with market power. But what accounts for the different solutions

[1] Productivity Commission, Economic Regulation of Airports, Draft Report, February 2019

[2] UK airports with a throughput in excess of 5m passengers are subject to the transparency and consultation requirements of the EU's Airport Charges Directive. These requirements are discussed below.

to market power envisaged in the two jurisdictions - with a more intrusive approach taken in the UK, at least at the two airports which have been assessed as having significant market power?

As the deregulation of Manchester and Stansted, as well as the Gatwick example, show the UK system is capable of regulatory innovation. However, the approach is relatively cautious, and the broad approach to regulation of Heathrow remains relatively unchanged in recent decades. That may in part be due to the sheer economic dominance of Heathrow, its importance to the UK economy and the scale of the future issues impacting its development. But there also strike me to be two elements of the Australian system that the UK lacks.

First, the now relatively lengthy history of light-handed regulation in Australia means that the PC is able to focus on actual behaviours by airports with market power. It is clear that where an airport has market power the PC is 'primarily concerned with whether the airport is exercising that market power'.[3] In the UK case, where the starting point for market power tests has been a history of regulation, the approach appears more precautionary. Letting go of intrusive regulation when airport behaviours have previously been constrained by regulation can appear difficult and contentious. There is a perception of risk, particularly given the difficulty of assessing market power when intrusive regulation is so clearly driving the outcomes. The lighter touch approach at Gatwick is therefore a useful experiment in this regard.

The second point concerns the role of the PC itself. In the UK decisions about whether to regulate and, even in a broad strategic sense, how to regulate are generally left to regulators as the expert bodies. One does not need to parody such bodies as turkeys that will never vote for Christmas to discern a tendency often to 'believe' in regulation and to fail to stand back sufficiently to identify whether it is required in all its manifestations. That is often evident in the increasing complexity and cost of regulation. Legislators have attempted to build in countervailing pressures in the regulatory statutes, which require promotion of competition-based solutions, cost benefit assessments of proposals to regulate, and general requirements to be proportionate. However, these tests are typically self-assessed (and passed) by each regulator.

There is a particular risk around the spread of what is often termed 'best practice' regulation. It is in principle right that regulators should learn from one another. But there is a risk of this leading to copycat regulation that does not sufficiently engage with the specific circumstances of the sector concerned. This is a particular risk for airports which differ significantly from traditional pipes and wires utilities. The PC has been commendably clear that regulation is there to deal with specific problems not because of a read-across from another sector.[4] To my mind the bringing in, every so often, of a body which stands independent of all the parties to regulatory arrangements and is not (as with the Competition and Markets Authority in the UK) itself a regulatory player with the resulting inbuilt assumptions, has the enormous strength of outside perspective.[5]

The results of the Australian regulatory system suggest that periodic independent review and threat of regulation are powerful tools to ensure that market power is not systematically exploited. That airports will seek to ensure that their commercial and bargaining approaches do not transgress such as to prompt more interventionist regulation should be no surprise. This is because the costs of regulation to a company in terms of diversion of management effort and focus can be very significant indeed, as management of the regulator displaces a more commercial focus. Regulatory

[3] PC, p 67
[4] PC, p 278
[5] The UK's CMA can be appealed to by parties to sector regulators' decisions and it can conduct market studies as it did with the UK airport market which ended with the break-up of the BAA.

intervention may also create more risk for shareholders than commercial negotiation with potential detriment to access to capital for future development. There is also a risk, as I argue below, of the regulator's presence compromising commercial airport/airline relationships. Of course, periodic PC reviews will themselves impose some resourcing burden but I would venture that this is nowhere near as great as would result from more intrusive ongoing regulation including, potentially, cost focussed reviews.

## Airport/airline relationships

Perspective can provide context for some features of the airport sector, in particular the behaviours that are often evinced and complained of. The PC rightly emphasises the importance of commercial interaction between airports and airlines to securing good outcomes in the airport sector. But it also has a realistic appreciation of the potential for friction this creates. There is a lot of 'argy bargy' to use the PC's term. But such frictions are not confined to the aviation sector. Nor do more traditional regulatory arrangements provide a panacea. The parties will, in my experience, use the regulator's periodic price reviews to further their commercial and policy agendas. Regulators in my experience have to deal with a lot of noise. Against this background, it is refreshing to see the PC's realistic view of how commercial relationships pan out, not just in the airport sector, and its focus on whether there is real evidence of the behaviours complained of. Too often complaints or opinion (relative to evidence) can be given undue weight in regulatory discussions. The PC has applied a refreshingly real-world perspective.

The PC has thereby been able to overlay its economic analysis with a more 'behavioural' approach. This is evident also in its analysis of the superficially attractive option of negotiate/arbitrate. In principle, it appears to make sense that where parties fail to reach agreement there should be automatic recourse to an arbitrator. The PC has considered this option carefully. Had it found evidence of systematic abuse of market power by airports the balance of cost and benefit might have been different, though even then the dynamics over time of the negotiate-arbitrate option might have precluded it relative to other options. Certainly, in the market and regulatory context analysed elsewhere in the report the negotiate-arbitrate approach would be both disproportionate and have unintended consequences. I was struck particularly by the difficulties an arbitrator would have in dealing with an individual complaint without considering the wider context, bringing to this solution a degree of unintended complexity. There is also the risk of creating shadow regulation, in part because of the arbitrator's need to look at the airport more widely in its decision-making but also because the arbitrator's likely reactions and views would impact on prior negotiating positions. The regulatory context so created would condition negotiating positions and likely constrain the give and take required for agreement in place of determination by a superior body.

There are some lessons here from the conduct of 'constructive engagement' in UK airport regulation. This is a process I introduced at the CAA in the run-up to the 2008 airports price review. The context was the fractured state of airport /airline relations following the contentious 2003 regulatory review dominated by the proposed modernisation of Heathrow via a new (expensive) Terminal 5. At this time, the three main London airports were all owned by one company, BAA, the privatised former state-owned company. The idea of constructive engagement was that airports and airlines should discuss key issues of investment and service prior to their coming to the regulator, so introducing a degree of commercial negotiation into the regulatory process. I had hoped - rather naively perhaps - for a greater degree of agreement than materialised. There were a number of reasons for this particular to this first exercise, including issues around the 'rules of the game' (on

which more below), but successive rounds of enhanced constructive engagement have produced relatively limited overall agreement, although they have improved airport/airline relations and understanding somewhat and helped refine information and options for the regulator. There has therefore been an improvement in the quality of regulatory discourse. The exercise has definitely been worthwhile, as evidenced by its embedding in airport regulation, its use in the regulation of NERL, the UK's provider of en route air traffic services, and the spread of (very differently formulated) 'customer engagement' to other regulated sectors.[6]

One overarching problem in moving further towards agreement has been that these discussions have taken place within a regulatory context where final decisions are reserved to the regulator. Negotiations therefore take place with an eye towards that end game. The regulator does not actually have to be in the room to have a chilling effect on the give and take commerciality of negotiation. Some confirmation of this has come from the Gatwick experience with its Contracts and Commitments framework. The Commitments element provides a backstop price and service element for all airlines. It is then open to airlines individually to contract with the airport for different bundles of price/service and lengths of time. The regulator does not intervene or arbitrate. Interestingly, the process of contracts being concluded really took off once the regulator blessed the general framework but otherwise vacated the commercial space. By December 2016, Gatwick had agreed bilateral contracts with airlines representing more than 85 per cent of passengers.[7]

The point here is not particularly to rehearse the issues that the UK has faced but rather to confirm from that experience the PC's concern that arbitration could have spill-over effects into prior negotiations and potentially undermine what has been achieved under the light-handed regime. It is important that any refinements that are sought by parties are not inconsistent with the thrust of the regulatory framework.

The PC has therefore indicated its strong preference that Government not become involved in commercial negotiations between airports and airlines, concluding that a degree of asymmetry in information tends to be a feature of commercial negotiations and that it is not the role of public intervention to ensure that each side has a 'balance of bargaining power': where airports are not systematically abusing their market power to general detriment, 'there is no case to improve airlines' bargaining position'. Aside from these powerful a priori arguments, there are clearly risks of interventions creating a one -size fits all framework which would ossify negotiating structures and conduct and lead to new areas of dispute as performance against the framework becomes in itself a bone of contention. However, I do wonder whether, consistent with the light-handed approach, the PC might do a little more to create the conditions for more frictionless negotiation while containing the risks that I allude to above.

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[6] As well as the CAA's constructive engagement experiments, Professor Stephen Littlechild's work has played a big part here. The most comprehensive review of UK customer engagement practice to date is to be found in The Future Role of Customer and Stakeholder Engagement in the Water Industry, a report for UK Water Industry Research, 2015, by Harry Bush and John Earwaker. The lessons from engagement in UK regulatory sectors are covered in pp25-58, with aviation covered specifically in pp38-50

[7] UK CAA, CAP1502: Economic regulation: A review of Gatwick Airport Limited's commitments framework – Findings and conclusions, December 2016. The CAA's 'mid-term' review of the process concluded that many aspects of the new framework appeared to be working well. Notably, GAL had held its charges below the 'fair price' benchmark established in 2014 and met most of its service quality targets; and none of the airlines argued for a return to the form of regulation previously applied to GAL (and still applied to Heathrow). There were some issues identified by the regulator (timeliness of airfield investment in the face of growing traffic, on time performance, and difficult operational relationships with airlines) which the airport has proceeded to rectify.

My take on this is, once again, conditioned by my experience as a regulator in introducing 'constructive engagement' at airports. As recounted above, the first attempt at this for the 2008 price review was not as successful as hoped. One reason for this was the difficulties the parties had in reaching an understanding about the conduct of the discussions. I had assumed that they would be able to establish their own 'rules of the game' between themselves. In fact, this proved difficult and there were constant 'process' complaints. The lessons from this were learned for the subsequent NERL price review, where the provider/customer consultation went better. There were, again, a number of reasons for this but the clearer framework for the discussions was one of them. Subsequent airport reviews have incorporated more CAA-structured constructive engagement processes.

There have been a number of other attempts to establish more general rules or guidance for airport/airline consultation. These include the European Union's ACD, which is mainly focussed on consultation transparency and process and national rules established by regulators or civil aviation authorities. Furthermore, industry has developed its own guidance documents from ACI World and IATA. The resulting rules and guidance vary in prescription. The ACD, for example, gives a very clear timetable for an annual process. However, it is important to recognise, as the ACI document clearly does, that these frameworks are about consultation, rather than the commercial negotiation that sits under the Australian regulatory framework.[8] They are about ensuring due process, appropriate (mutual) transparency and information flow, and demonstration that the views of airlines have been taken into account in any airport decision, which in itself may be appealable to a regulatory body. In contrast, commercial negotiations are intended to result in agreements between the parties, may differ in length and coverage and will vary between airports and airlines depending on circumstances. They are more difficult to fit into consultation-type frameworks and there is a real risk of process straitjackets undermining the dynamism and flexibility that should be their hallmark.

That said, there did seem to be in the constructive submissions by BARA and AAA a willingness to think about some overarching principles or guidance that could assist in creating greater trust and reducing friction, reducing in the words of AAA any 'mismatch of expectations'. Of course, it is open to the two parties to embark on such discussions under their own auspices. But the PC could provide the umbrella under which that could fruitfully be done. That might simply take the form of a general recommendation or identifying a number of areas where the PC might hope that progress could be made. It would be important that expectations are not unduly raised, nor that failure to reach agreement becomes a regulatory black mark at future PC reviews. Some of the 'commercial principles' advocated by BARA (for example, guidance on the WACC) would risk introduction of backdoor regulation. But thoughts around the construction of 'boilerplate clauses' look a potentially sensible way forward so long it is clearly recognised that these form the basis for discussion at individual airports rather than in all cases the end of it. I was also attracted by BARA's idea that airport proposals should focus more on service impacts. Airports might not accept BARA's characterisation of the capex focussed nature of current discussions but general acceptance that the service dimension, including for passengers, needs to be fully illustrated would be a step forward. Indeed, it could give a nudge towards a more fruitful approach to airport- airline negotiations generally.

I was struck, in references in various documents, by the apparent reliance in Australia on building block approaches to pricing so long after price caps have been terminated. I can understand that they may provide a comfort blanket for commercial parties but they seem rather at odds with the service approach advocated by BARA and with where individual airports in a commercial

[8] ACI, Recommended Practices on Transparency and Consultations with Airlines on Setting Airport Charges, p2

environment should be seeking to focus their efforts. A more natural place would be for the commercial parties to be negotiating on a service/price basis, with airlines focussed on whether what they are being offered reflects value and where it does not how it can be improved, as opposed to second-guessing the airport's costs, including the contentious area of WACC. It should be for the PC periodically to check (assisted by the ACCC's annual monitoring reports), as it does now, that an airport's costs and returns are broadly consistent with comparators and do not represent an exercise of market power.

This would represent a more natural division of responsibilities between regulatory and commercial parties. Airports would be guided towards identifying a range of feasible options for meeting service needs, including those that may be less capital-focussed, and also how performance can be assessed and made more resilient, particularly as airports grow. Such issues can often, through appropriate on time performance and passenger service quality, contribute as much if not more to airline finances while providing a more constructive area for discussion and debate between contracting parties than the more traditional and rebarbative focus on charges.

## Pre-financing

The PC has asked for further information on 'instances where airport users have pre-financed capital projects and why this did or did not represent a reasonable sharing of risk'.[9] I offer here some perspectives on this issue, including from UK experience.

While pre-financing did not feature greatly in either airport or airline submissions, it is a topic that arouses strong emotions, in particular on the airline side. Peter Forsyth[10] in his 2018 article has pointed to two possible reasons. First, the distributional consequences as between current airlines, which will be contributing towards a facility they may not use, and future airlines that will meet less of the cost than if charging began when a new facility becomes operational. However, it is important to put this distributional argument in context. It would be strange to focus so strongly on the charging consequences of one particular part of the airport infrastructure when, in the nature of a long-lived asset, current airport users may themselves be enjoying facilities paid for by past users and now fully or partly depreciated.

The second reason for airline agitation is the potential hit from pre-financing to airline profits where the costs cannot be passed on to passengers. However, in the nature of the sort of investment that is likely to cause a sizeable impact on profits airlines may well be earning scarcity rents due to the congestion for which the new investment is the remedy. Precise impacts depend, as Forsyth identifies, on the particular circumstances but it seems to me important to set the pre-financing debate within its economic context.

While pre-financing can apply to airport investment generally (and in the UK the remuneration of assets in the course of construction has long been a feature of the airport regulatory scheme) it will be most contentious where the sums at stake are significant. This is most likely where there needs to be major enhancement investment to expand capacity. In such cases the excess demand that creates the case for capacity-enhancing investment means that there are likely to be underlying scarcity rents. Where airport charges are set through strict cost-based regulation or, under lighter handed systems, broadly in line with cost-based principles those scarcity rents tend to accrue to

[9] PC, p33

[10] Peter Forsyth, Pre-financing airport investments, efficiency and distribution: Do airlines really lose?, JATM, 2018

airlines rather than the airport. Were those rents to accrue to the airport then the arguments for specific pre-financing mechanisms would fall away. The financial impacts of congestion would then provide the airport with both the business case for, and the initial financing of, additional airport facilities. Seen through this prism the contention around pre-financing is a construct of cost-based pricing. Alternative regulatory or pricing approaches which permitted airports a price path reflecting increased scarcity and the incremental costs of dealing with it would largely negate the pre-financing requirement. Another option, which might apply to some forms of capacity enhancement, would be for the airport to pre-sell rights to capacity.[11] Such regulatory and policy approaches tend not to find favour with airlines. However, the corollary of this position needs to be an openness to pre-financing, not least as these are costs that the airport is required to meet in the current period.

It is important also to be clear in this debate that the ability of an airport to pre-finance, either through the permission given by a regulator or because of permissive lighter handed regimes, does not depend on market power. Such airports may indeed have market power but the PC has drawn a distinction (in its discussion of Sydney airport) between the pricing impacts that result from scarcity and those that may indicate exercise of market power[12]. It seems to me that it is the former that are most relevant to the discussion of pre-financing. Indeed, such scarcity rents can arise in functioning competitive markets (otherwise, where would be the business case for ever expanding capacity). They are a natural consequence of the lumpiness of major airport investment, whether on the airfield or relating to terminals. Lumpiness is likely to mean under-use at the beginning of an investment's life and over-use and/or the choking off of excess demand later on. Indeed, the Commission has suggested that a level of scarcity may be optimal given the lumpiness of airport investment.[13] Such scarcity creates the case for future investment.

The most extreme case of this phenomenon is perhaps found in London where planning and political constraints have delayed the building of additional runway capacity. Not only has this created a degree of runway scheduling which tests the operational expertise of the airport and air traffic control operators, it has led to very significantly higher air fares through the generation of scarcity rents.[14] These were central to the analysis undertaken by the Government's independent Airports Commission.[15] Indeed, it is the reduction of these rents that is crucial to the cost-benefit case for new runway capacity.

The question is sometimes raised as to why airports need to pre-finance when, as privately-owned entities, they have access to equity and debt markets. However, such markets are likely to more easily and cheaply provide finance where the airport can demonstrate that it can achieve the necessary return on - and, importantly, of - invested capital. If it is unable to tap the scarcity rents that are already arising due to congestion that hardly represents a vote of confidence in its ability to raise the necessary charges later. Pre-financing therefore establishes a price path which both improves credibility with investors and prepares the ground with airlines for the higher charges to

[11] In the UK and EU, slot regulations determine allocation of new airport capacity, So, where investment increases airfield movements, the airport cannot finance the necessary investment by pre-selling the capacity to be created. Slots are allocated for free, according to rules favouring new entrants. This contrasts with the UK energy sector where investment in new capacity has been financed by future customers of the capacity.
[12] PC, p17. Similar distinctions arise in the context of the discussion of car parking.
[13] PC, p71
[14] Frontier Economics, Impact of airport expansion options on competition and choice: A Report prepared for Heathrow Airport, April 2014
[15] Airports Commission, Final Report, July 2015, Chapter 3. The Commission also identified other costs that passengers were likely to bear from congestion, for instance delay and reduced route choice

come. In its absence, prices will tend to rise more than otherwise just at the point where capacity becomes more plentiful.

These elements can be seen in the UK's approach to pre-financing.[16] Aside from the regular remuneration of assets in the course of construction, the sheer scale of the T5 project in the early 2000s required the bringing forward of revenues, on a NPV neutral basis, into the project's construction period.[17] These revenues were rebated to airlines in the subsequent regulatory period. In part, this represented an attempt to create a smoother price path and to build regulatory credibility for the scale of charge increases that the new facility would require. In the absence of this exceptional pre-financing the regulator would have had to impose much sharper price increases in the post-construction period, so sharp that there might have been a question-mark over the willingness and ability to do so. Certainly, having banked any lack of pre-financing in the construction phase the airlines could have been relied upon strongly to oppose the sharper increases required in later regulatory periods. They are not necessarily to be blamed for this: such behaviour would have been in their short-term commercial interest. But regulators need to fashion their policies to take account of such real-world behaviours. The UK CAA has indicated an openness to revenue profiling for Heathrow's new runway.[18]

How far pre-financing is required and its scale depends on the circumstances and the broader regulatory environment. The more strictly the airport is tied to or otherwise practices cost based charging the more justifiable pre-financing becomes - the airport in such circumstances may not be throwing off the surplus cash to contribute to the financing of a new project. Also, the larger a project relative to the existing asset base the more likely pre-financing will be justified. This is partly a matter of the scale of financing required but also of establishing the credibility of a pricing path. Few projects in Australia are likely to be in the T5 category, which represented an effective doubling of Heathrow's asset base,[19] but lesser projects may also raise financing and credibility issues.

In short, pre-financing may not be required everywhere in all circumstances but it makes sense for it to be part of the regulatory and airport toolbox to be deployed where needed. Regulatory frameworks should therefore in a practical way:

-recognise the centrality of the investment cycle to airport economics and seek to accommodate the periodic lumpiness of airport investment

-ensure that airports entering a heavy investment period should have the cash flows that assist in making the investment financeable and underpin the business case for third party financiers

-enable a price profile which is consistent with the higher costs likely to be generated by sizeable investments

[16] Pre-funding is also a feature of regulation in Germany, Latvia, Switzerland, France and Ireland (according to a recent study for the European Commission conducted by consultants Steer Davies Gleave). European Commission, Support study to the Ex-post evaluation of Directive 2009/12/EC on Airport Charges, December 2017, Table 6.4. The position in some other EU member States is less clear-cut. Many had 'no specific rules on pre-financing' but 'sometimes followed' the ICAO guidelines (which of course permit it subject to safeguards).

[17] CAA, Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003-2008 CAA Decision, February 2003, para 4.11

[18] CAA, Consultation on core elements of the regulatory framework to support capacity expansion at Heathrow, June 2017; CAA, Economic regulation of capacity expansion at Heathrow: policy update and conclusion, April 2018

[19] CAA, Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003-2008 CAA Decision, February 2003, para 4.25

Aside from the arguments explored above on the intrinsic merits of pre-financing, this is a matter also of making the regulatory framework conducive to needed efficient investment. In many jurisdictions, including the UK and the rest of Europe, the timely delivery of required capacity is likely to be the principal determinant of passenger experience and welfare. The London system shows in an extreme way the costs that passengers bear in terms of operational delay and higher fares from failure to deliver investment in a timely way. The European Commission and EUROCONTROL have also warned of a looming European capacity crunch,[20] which is likely to have similar directional impacts to those experienced in the UK. Against this background, it makes sense to ensure that airports are eager to pursue and able promptly to finance the investment that planning authorities are prepared to permit. Pre-financing can play a part here. The issues around allocative efficiency are not large, as Peter Forsyth has pointed out[21]; the distributional consequences between generations of airport users need to be seen in the broader context of a continuously evolving airport facility; and any short term profit impact on airlines (the longer term impact being dealt with through NPV neutrality over time) needs to be analysed in the context of scarcity rents likely to be accruing to them from any shortage of capacity that the investment is intended to remedy. This means that where building block pricing methodologies are employed they need as a general matter to be implemented pragmatically, in ways consistent with the encouragement of needed investment and the generation of a price path that reflects long term efficient pricing for the airport.

## Other regulatory issues

There are a number of areas where the PC will have helped contribute to the regulatory debate more generally. I have already, in the preceding text, identified the distinction that is clearly made between the pricing impacts arising from scarcity as opposed to exercise of market power. This distinction is not always appreciated and bedevils discussion of airport pricing. As discussed above on pre-financing, it can be economically efficient for airports to price in accordance with scarcity better both to ration available capacity (including through peak pricing or similar mechanisms) but also to test the demand (and therefore the case for) investment needed to rectify capacity deficits. Where airports compete, the absence of pricing to scarcity at one airport may harm the market overall and impact the viability of services and investment at other airports.

So, a greater understanding of these dynamics is helpful in a world where the continuing relatively rapid growth of aviation is likely to lead to more constrained capacity over time, and the need to pursue and justify investments. The PC is also clear about the effect of scarcity on fares and the extent to which airlines benefit financially where airport charges are controlled (reflected in the value of slots where these can be traded). Increases in airport charges in such circumstances represent a shifting of rents between two commercial parties rather than an additional burden on passengers. Again, these arguments are not always understood.

The PC has sought to benchmark Australian airports' performance. This can often be problematic given the significant differences between airports across a number of dimensions. Such comparisons are therefore best suited to drawing broad conclusions of the sort the PC has attempted rather than the derivation of precise regulatory numbers for the purpose of setting regulatory pricing or service levels. One area of comparison where the PC's output is particularly welcome is in the clarity of its views on the assessment of airport profitability.

[20] European Commission, An Aviation Strategy for Europe, 2015; EUROCONTROL, European Aviation in 2040: Challenges of Growth, 2018, pp24-9

[21] Forsyth, op cit, p263

Discussion in this area has been bedevilled by the inappropriate use of EBITDA, both to compare between airports and with other sectors. Airports as capital-intensive businesses will need to generate high operating margins relative to less capital-intensive sectors to remunerate and repay the capital investment they have made. Crude comparisons with other sectors can therefore be highly misleading. They provide attractive sound bites but add nothing to the substantive discussion. And, as between airports, where individual airports sit in their investment cycles will be a major determinant of their operating margin requirements. I therefore welcome the PC's advice to the ACCC to give less prominence to EBITDA figures. I hope that this clarity might also be reflected in other jurisdictions and the general debate about airport economics.