Economic Regulation of Airports Inquiry Submission

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About Prosper:
Prosper Australia is an independent, not-for-profit organisation campaigning for economic justice. Our reform agenda derives from the work of nineteenth century philosopher, Henry George. Prosper's mission is to influence revenue policy by educating policy makers and the general public in the economics of locational advantage. We argue for lower costs and greater efficiencies through the removal of deadweight taxes, and the utilisation of the most efficient and equitable tax bases available to Governments; property rights in land and natural resources.

Prosper Australia welcomes the Productivity Commission's inquiry into the economic regulation of airports.

As a matter of principle, Prosper opposes the privatisation of natural monopolies - including airports. Natural monopolies are not subject to the dynamic of market competition which is so beneficial to commerce. Natural monopolies enable the abuse of market power and extraction of monopoly rents for private profit. This is antithetical to the public interest. Australia's airport corporations appear to be engaging in this behaviour.

Public ownership of airports would once again allow direct control over optimal investment, pricing decisions and dividends taken by Government. However, as this inquiry focuses on regulatory responses to the existing private leases, we have responded accordingly.

The issue paper points out that EBITDA (Earnings Before Interest, Depreciation, Taxation and Amortisation) reveal very high profit margins, up to 46% for aeronautical, and up to 70% for car parking operations. We agree that excessive profit margins reflect a monopoly rent, and a concomitant abuse of market power.

There is clearly an issue with these margins even adjusting for risk. Endeavours with high capital risk, such as property development, generally accept profit margins of 20-25%. Profit margins above this are unlikely in a genuinely competitive industry with well developed markets.

Table 1: Financial results of aeronautical and car parking services of the monitored airports, 2016-17

	Brisbane	Melbourne	Perth	Sydney
Aeronautical operations				
Revenue ($m)	290.5	438.2	225.7	782.3
Operating profit ($m)	136.0	182.0	78.8	360.8
Profit margin (%)	46.8	41.5	34.9	46.1
Car parking operations				
Revenue ($m)	93.5	145.1	63.0	134.8
Operating profit ($m)	63.7	86.7	33.0	97.0
Profit margin (%)	68.2	59.7	52.4	71.9

https://www.accc.gov.au/media-release/airport-profits-continue-to-grow

Profit margins in many instances are similar (if not greater) to what major Australian banks can achieve. It is clear that major banks benefit from implicit sovereign government guarantees where they are judged "too big to fail" and essential to the payments system. Where the public is the lender of last resort, taxation of super profits via a federal bank levy does not seem unreasonable. A similar case can be made for airports. Airports are critical infrastructure. Arguably airports also benefit from implicit sovereign guarantee. For example, should an airport face some sort of major catastrophe, the Federal Government will ultimately need to ensure that critical airport infrastructure is kept functional. Competing airports are also not commissioned unless existing airports can no longer handle demand. Additionally airports benefit from a wide variety of indirect public subsidies, especially via land linkage public infrastructure.

Some have argued that the collective bargaining power of (oligopoly) airlines can suppress airport monopoly power. Yet this claim is dubious for major airports, as airlines are subject to intense global competition. The threshold for threatening to pull services from a major airport is also very high, given the loss to the airline's customer base.

As such major airports can generally charge what the market will bear.

The existing price regulation regime for NSW regional airline services has arguably been effective. A modified version of the scheme could potentially be extended to the four major airports. However price controls do not necessarily prevent market power being redirected into poorer service and underinvestment, so price regulation can only be seen as a partial solution.

The terms of reference include airline services, parking and landslide access, transport links, and competition in jet fuel. Yet property (and retail) arms of airports, which also make up a substantial portion of revenue, fall outside the scope of the inquiry. Issues such as basic consumer goods having vastly inflated prices (e.g. a 1L bottle of water costing up to $5) are effectively out of the terms of reference. Such prices reflect high rents and the monopoly of location. We note that because airports sit on Commonwealth land, they are exempt from land tax. As such the land rents derived from airport land remain undertaxed and not captured by the lease. While landholding falls outside the scope of this inquiry, monopoly landholding within airport precincts obviously has implications for rents and prices within airports.

In fact, many of the issues highlighted in the discussion paper relate fundamentally to land monopoly and land rents extracted by airports. The greatest examples of these are in car parks and landslide access.

A method to ascertain a competitive margin for airport car parking would survey major car park profit margins (EBITDA) in areas of high demand with competing car parks, unrelated to airports e.g. the CDB. We suspect that once profit margins for airport car parks are examined against car parks in other locations, that profit margins will be substantially lower - although prices may vary given the opportunity cost of the land.

Excess profits made by airport car parks cannot be attributed to the business of running car parks. Rather they are surplus land rents made available to the airport by virtue of monopoly landholding in that location. In addition airport car parks are exempt from land tax and rates - meaning these land rents are not shared with the public. On this basis, using price controls to regulate car parking fees at airport car parks may not be a sound strategy. Airport carpark fees should genuinely reflect the opportunity cost of the land. Car park services ought to charge what the market will bear (to achieve full capacity usage) given the *completely inelastic supply* of car parks at that location.

Instead, government should devise strategies for redistributing surplus profits obtained by operating airport car parks. Such strategies might include investment contribution obligations (levies) towards competing public land transport linkages (e.g. rail links), or super profits taxes.

That is to say, instead of regulating the price of parking at airports, the government ought to tax away the monopoly rents for reinvestment in, say, a competing publicly owned airport rail link. It is crucial that public mass transit alternatives (e.g. Melbourne's Airport rail link) also be given free access to private airports. Otherwise private airports can further extract monopoly rents, which imbeds into the costs of these alternatives and entrenches market power - not to mention coming at an absorbent cost to the public. *Direct competition free of the monopoly price is the only effective way to reduce market power.*

A similar issue with landslides is apparent. Because of their monopoly on the location and land rents of those landslides, airports have the capacity to extract the maximum market rent that users can bear. Again the best solution to this issue is not necessarily price controls, but rather mechanisms that mandate surplus profits made from using this market power are directed into subsidising public transport linkages that erode market power. Free public transport linkages access should be mandated.

Jet fuel supply shares the heavy capital costs and natural monopoly "right of way" characteristics of basic utilities, such as "poles and wires" electricity networks. It seems highly questionable to run jet fuel distribution without price regulation. At the very least such infrastructure should be regulated in the same way private electricity transmission and distribution operators are regulated e.g. in Victoria.

To conclude, we believe price regulations for aeronautical services are worth considering. However, this would need to be accompanied by minimum service and investment standards. A regulatory model for the "right of way" infrastructure component of the jet fuel supply chain should be adopted, based off private electricity distribution and transmission. Finally, the best response to monopoly rents from location is not usually price controls, given willingness to pay.

We propose the following solutions to reduce market power in car parking and landslide access:

- Mandate that private airports be obligated to provide free landslide access to public mass transit options
- Raise levies/contributions, or mandate proportions of profits (based on EBITDA) from major airport car park and landslide revenues be directed into subsidising the development and operation of low cost public mass transit alternatives.