AIRPORTS COUNCIL INTERNATIONAL

AIRPORTS COUNCIL INTERNATIONAL (ACI) WORLD SUBMISSION ON THE PRODUCTIVITY COMMISSION INQUIRY INTO THE ECONOMIC REGULATION OF AIRPORTS IN AUSTRALIA

1. Foreword

1.1 Airports Council International (ACI) World is the global trade association of the world's airports. As of January 2018, ACI serves 641 members operating 1,953 airports in 176 countries. ACI is a non-profit organization whose prime purpose is to advance the interests of airports and to promote professional excellence in airport management and operations.

1.2 ACI welcomes the Australian Productivity Commission (PC) inquiry into the economic regulation of airports. ACI would like to comment on the following four points identified as potential signals for market power in aeronautical services:

- Excessive fees or charges for aeronautical services;
- Inefficient investment decisions and/or operation;
- Providing services of a low quality or a limited range; and
- The manner in which airports conduct commercial negotiations.

2. Excessive fees or charges for aeronautical services

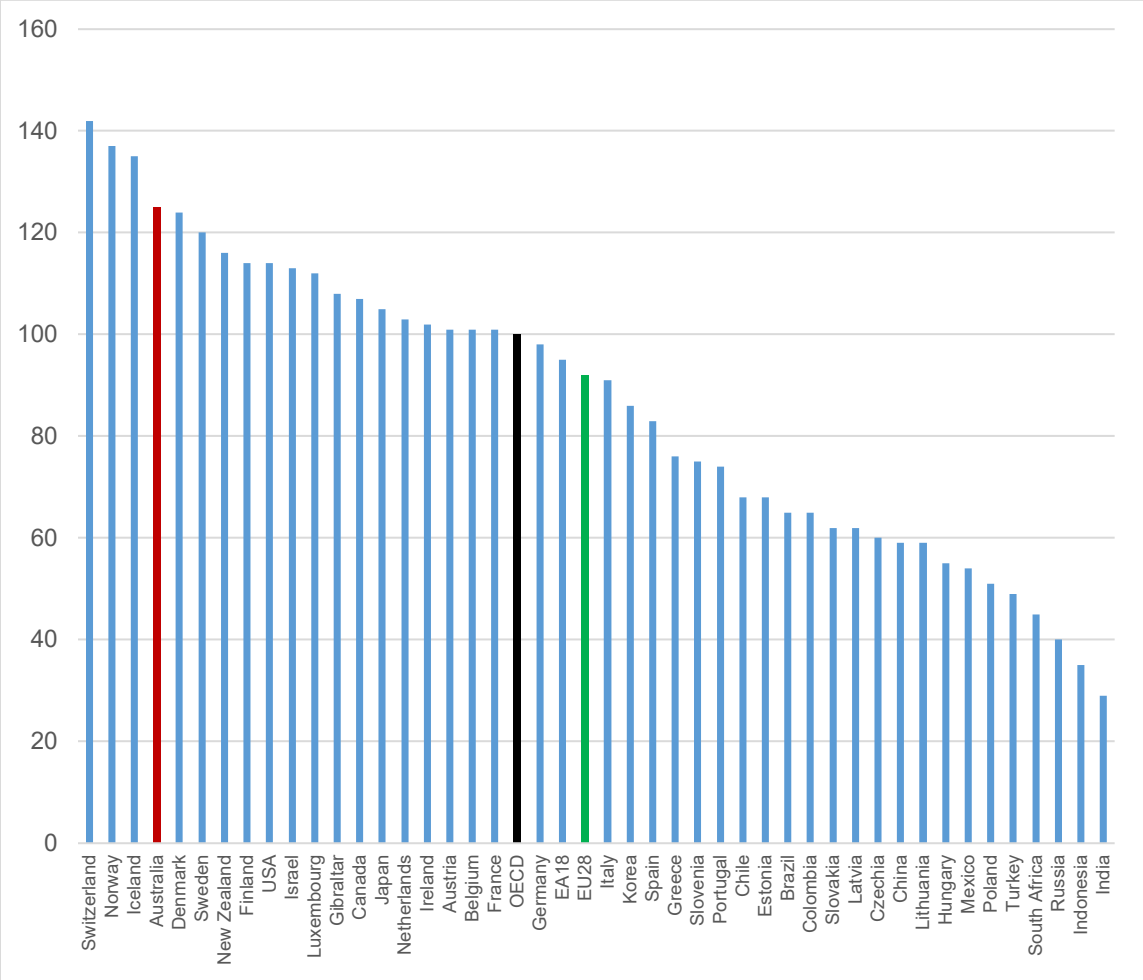
2.1 The airport industry in Australia is characterized by market dynamics and competition among the largest airports as well as significant airline buyer power at large but especially smaller airports. It does not have the structure of a near monopoly. As such, the airport does not hold significant market power.

2.2 In order to provide airport facilities and services, airports acquire a number of inputs at market prices. These include capital, labour, energy, materials and other supplies. The final prices for airport services reflect prices for the intermediary inputs and are in line with the overall price level in Australia.

Historically, the price level in Australia has been high for several reasons, including low population numbers as well as low density, remote geographical position and various socio-economic factors. The high price level is evident from the comparative price level indices provided by OECD, which are the ratios of purchasing power parities to market exchange rates. At the level of GDP, comparative price levels provide a measure of the differences in the general price levels of countries; the indicator is measured as an index.

Among the OECD[1] countries, Australia ranks as the fourth most expensive country following Switzerland, Norway and Iceland, with a price index of 125 versus the OECD average reference value of 100 and the EU-28 value of 92. In simple terms, Australia, on average, is 25% more expensive than the OECD countries altogether, and is 36% more expensive than Europe. Please refer to Chart 1 below:

Chart 1: Price level indices – OECD (2018)



Source: OECD (2018), Price level indices (indicator). doi: 10.1787/c0266784-en (Accessed on 26 July 2018)

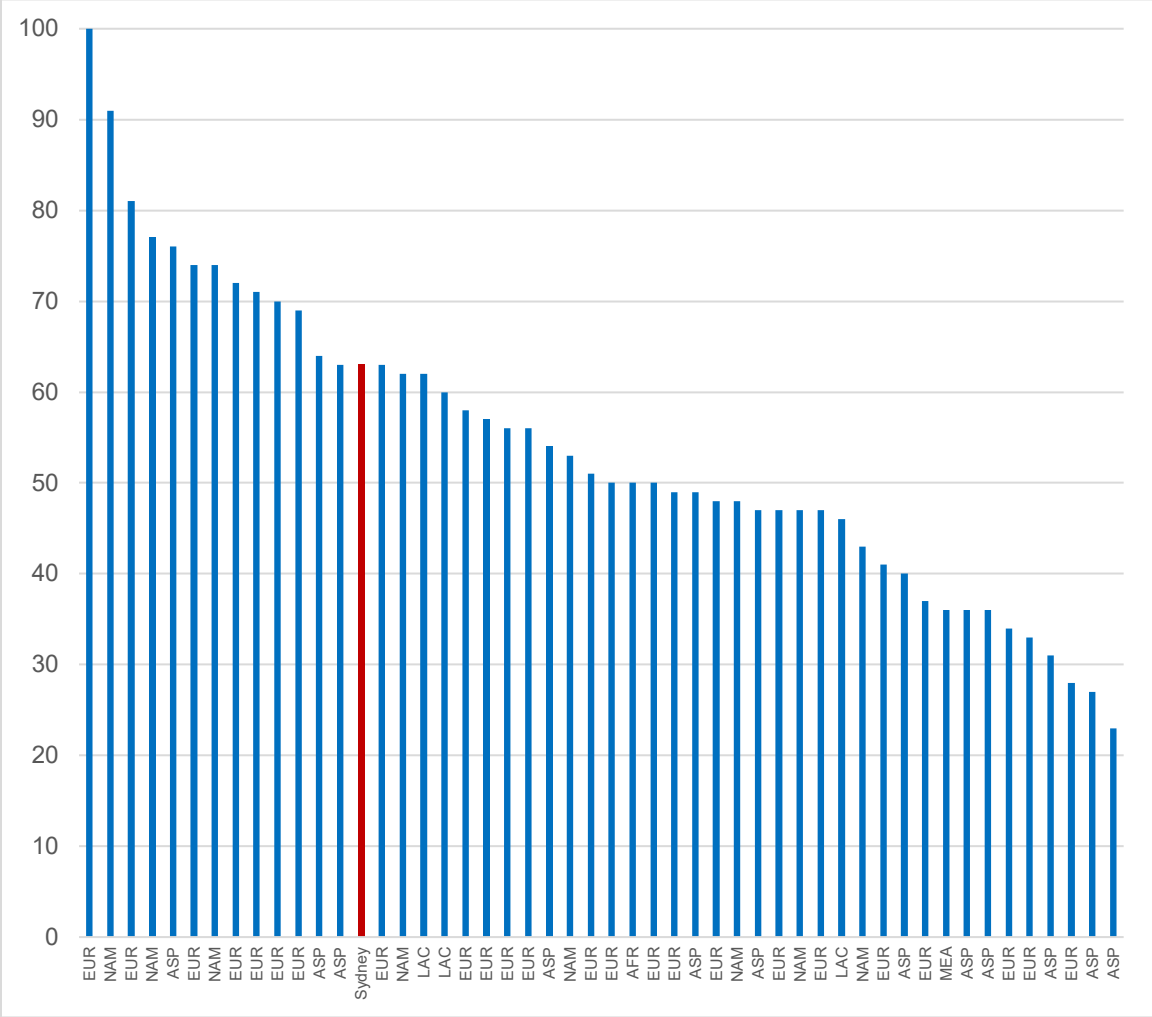
Additionally, despite the reasonable inflation rates in the last 15 years - the period of light-handed oversight – the price level in Australia went up 58% at CAGR of 3.1%. It is inevitable that increased prices for the key economic inputs result in higher price for final services, though partially offset by efficiency gains.

[1] Organisation for Economic Co-operation and Development is an intergovernmental economic organisation with 36-member countries, found in 1961 to stimulate economic progress and world trade. It is a forum of countries committed to the market economy Most OECD members are high-income economies.

2.3 According to the LeighFisher Review of Airport Charges, out of the 50 largest international airports in the world, Sydney airport applies reasonable level of charges given the general economic context of the country. The LeighFisher 2016 Review of Airport Charges details aeronautical charges (landing, parking, infrastructure, passenger service and security and terminal navigation charges) that would be imposed on a sample of eight different aircraft types making one landing and one departure at each of the 50 major international airports. Collectively, these 50 airports handled over 2 billion passengers in 2016 and represented 26.3% of all global passenger traffic. Total charges were expressed in special drawing right units (SDRs) and indexed whereas 100 stands for the most expensive airport, and all other airports progress downward in terms of charges ranking.

Among the 50 largest international airports, the charges indices range from 100 (the most expensive) to 23 (the least expensive). Sydney airport has an index of 63, above the median of 51. See Chart 2 below.

Chart 2: Index of charges at 50 major international airports (2016)



Source: LeighFisher Review of Airport Charges 2016

Summarizing the price level vis-à-vis the charges benchmark at high level, we can observe the following pattern (Table 1):

Table 1: Price index vis-à-vis airport charges index

	Price index	Airport charges index	Ratio
Europe	92	56	0.61
USA	114	59	0.52
Australia	125	63	0.50

Source: OECD (2018), Price level indices (indicator); LeighFisher Review of Airport Charges 2016

It is apparent that there is some correlation between the price level index and airport charges index. Additionally, one can observe that airport charges in Australia are competitive in the context of the general price level, revealed by the lowest ratio (0.50) as compared to Europe (0.61) and USA (0.52).

2.4 With regard to the methodology to determine the level of airport charges, ACI supports an overall cost-base approach by which the **full cost** of providing airport aeronautical facilities and services is recovered from users through aeronautical airport charges. The level of airport charges needs to be sufficient to cover the cost to operate the airport plus the long-term capital investment required to meet the current and anticipated demand. The level and structure of airport charges should be related to the full economic costs of airport operations, including a reasonable return on assets at a sufficient level to reward the airport operator for the risk taken and to ensure the development of appropriate reserves to deal with unforeseen adverse circumstances. The airport charge system should ensure that the airport sector is economically viable to enable it to sustain operations. It should be allowed to generate sufficient returns to attract future investors in such projects.

2.5 Several analyses conducted by ACI suggest that, over time, regardless of the ownership structure and the form of economic regulation adopted, the most important drivers of aeronautical charges have been investment in capital assets and market dynamics. Therefore, ACI urges the Productivity Commission to take a closer look into the level of capital expenditure at the major airports in Australia as well as the oligopolistic nature of the airline market dynamics.

3. Investment and operation efficiency

3.1 Airports in Australia invested significant amounts of money - $11.5 billion over the last decade - to support airline efficiency and airport operations. Three quarters of airport investment over the next 10 years is expected to be on aeronautical improvements. This will enable competition between international carriers to keep airfares low.

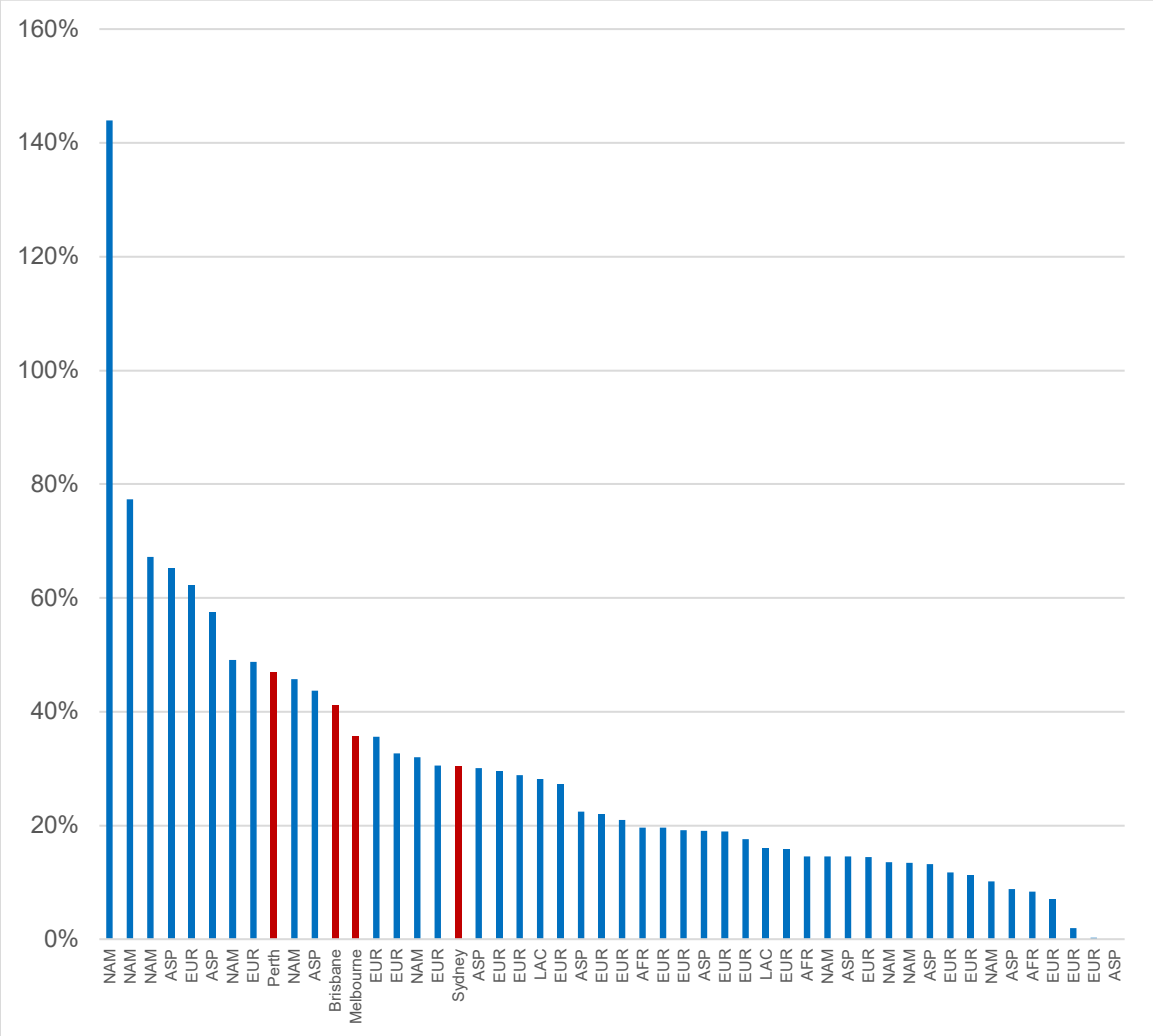
As private and commercially-driven organizations, the airport operators in Australia, bounded by stakeholder expectations, are committed to efficient investment in order to:

1. Ensure access and long-term capacity to its users (airlines) and end-users (passengers);

2. Foster airline competition and consumer benefits;
3. Offer a high-quality customer experience to make the passenger journey easier and more enjoyable;
4. Be able to perform day-to-day operations in an economically efficient manner.

3.2 In terms of investment efficiency, the Australian airports are one of the leading operators in the world when assessed by CAPEX in relation to total revenue. Expressed as a percentage of total revenues, capital expenditure at four large airports in Australia ranges from 30% at SYD to 47% at PER. See Chart 3 below:

Chart 3: Capital expenditure as a percentage of total revenue (2017)

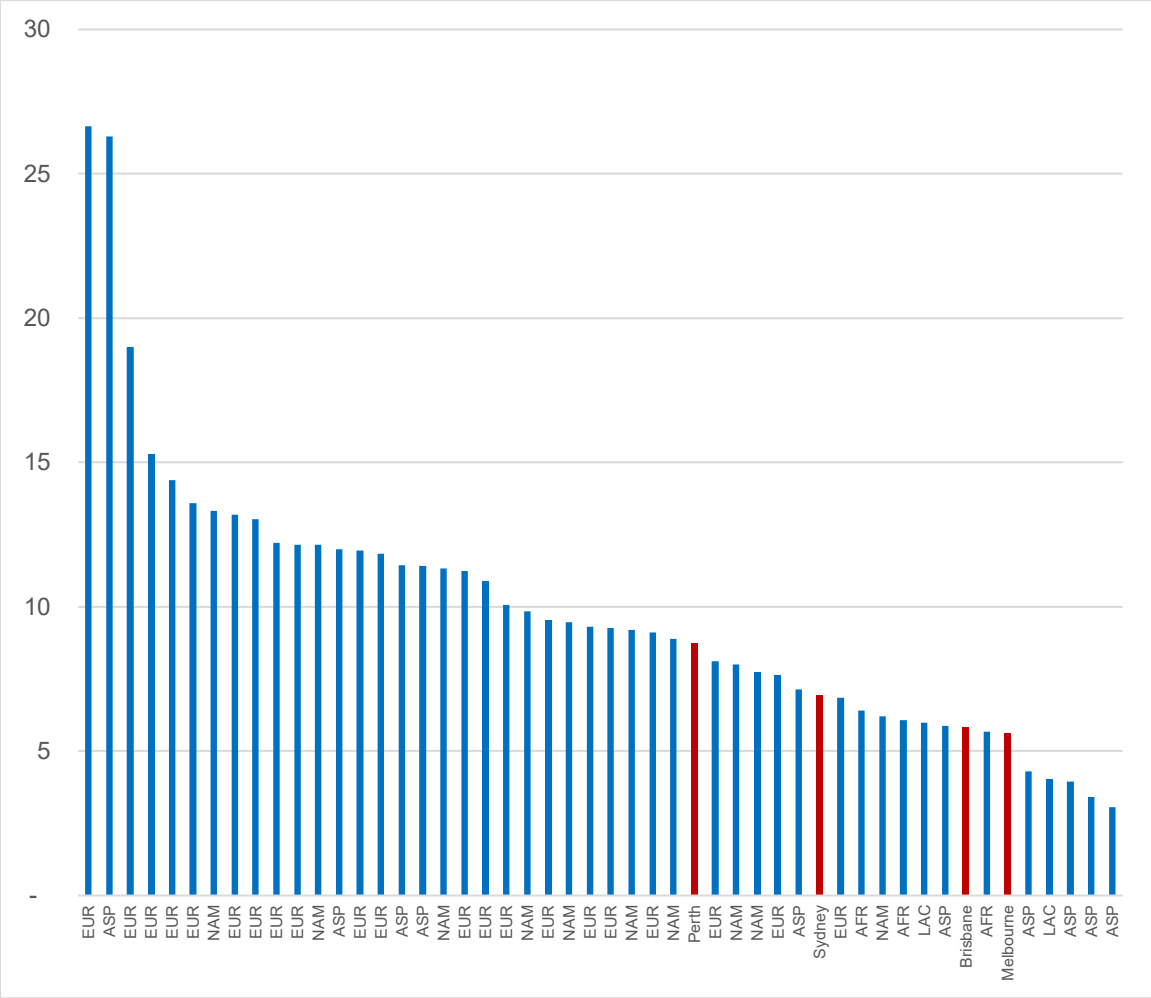


Source: LeighFisher Airport Performance Indicators 2017

3.3 In terms of costs and revenues efficiency, Sydney, Melbourne and Brisbane airports demonstrate high performance and efficiency in the independent LeighFisher Airport Performance Indicators report year after year, generating above-average levels of non-aeronautical revenues (close to 50% with the global average being 40%) and reasonable amounts in unit aeronautical revenues (on a per-movement and per-passenger bases).

3.4 From the cost perspective, the four large airports in Australia – Sydney, Melbourne, Brisbane and Perth rank among the most efficient in terms of total cost on a per-passenger basis in SDR units. See Chart 5 below:

Chart 4: Total cost per passenger (SDR, 2017)



Source: LeighFisher Airport Performance Indicators 2017

3.5 Consequently, the light-handed regulatory regime in Australia has enabled efficient investments in and efficient operations of Australian airports which do not abuse any significant residual market power they might have as regards capital and operating expenditures. Considering such success, the light-handed regulatory approach should be preserved.

4. Providing services of a low quality or a limited range

4.1 Australia's major airports are committed to provide the highest service quality to airport customers. Eight of Australia's ten busiest airports (by total passenger traffic) are part of the global ACI world Airport Service Quality (ASQ) network.

4.2 The ASQ programme is a worldwide tool to measure service quality and passenger satisfaction towards service quality. With more than 340 airports participating in the programme, ASQ is the only global benchmarking tool to measure passenger satisfaction in real time whilst the passenger is travelling in the airport.

4.3 While ACI World does not release the ASQ satisfaction scores of individual airports in a disaggregated manner, it can be said that Australian airports perform very well in general and at the same level of the world average score of participating airports.

4.4 Such dedication and achievement on the service quality front testify to the commitment of the Australian airports to provide the highest level of service quality as well as the widest possible range of services to all stakeholders.

5. The manner in which airports conduct commercial negotiations

5.1 Australian airports, as well as the entire airport community worldwide, are committed to ensuring the right level of transparency and that consultations with aircraft operators are carried out in setting charges and capital planning in a structured and meaningful way.

5.2 To this end, ACI World and its entire network of member airports jointly developed Recommended Practices on transparency and consultation with the airlines[2]. They demonstrate the commitment of the airport industry in general, and of the Australian airports in particular, to engage meaningfully with the airlines and build the right level of trust with all stakeholders.

6. Conclusions and way forward

6.1 Airports in Australia have a significant degree of dependence on two airline groups – Qantas Group and Virgin Australia Holdings. Qantas Airways itself as the nation's leading airline, operated close to 68.5 million seats in 2017, representing 33% of all capacity in Australia. Jetstar Airways – the subsidiary of Qantas Group – is the third largest airline serving the country with 35.3 million seats. Consequently, Qantas Group has over 50% market share for air transportation services in Australia. This is followed by Virgin Australia Airlines with 25% market share.

Airlines are consequently able to exercise a potential buyer power that fully offsets or countervails any market power the airport might enjoy. These factors have de facto prevented the airport operator from applying a monopolistic behaviour and setting excessive charges.

[2] The Recommended Practices can be found on the following webpage: http://www.aci.aero/About-ACI/Priorities/Economics/Documentation.

6.2 Taking into consideration the limited market power of the airport industry in Australia, ACI's position is that there are objective reasons to continue applying a light-handed regulation of airports, considering the disadvantages of the price cap approach in practice and the benefits of facilitating greater negotiation between airports and users.

6.3 Airport charges represent a relatively small item in the airlines' total cost structures, which has remained in the realm of 4% for the last several decades. The most recent independent study on the real determinants of airfares[3] notes such static nature of airport charges, which are set well in advance and do not vary for long periods of time, in contrast with the extremely dynamic pricing techniques used by airlines to set airfares, resulting in constant and significant ticket price variations reaching up to 700% for the same product. It is also found that lower airport charges are generally not passed-through to passengers in terms of lower airfares.

6.4 ACI advocates for regulatory certainty and consistency. With airports now being sophisticated businesses in their own right, sufficient levels of investment and charges are essential prerequisites if they are to continue to deliver increased capacity, quality and connectivity. Therefore, it is in the best interest of all aviation stakeholders to adhere to the current light-handed form of economic oversight.

6.5 Regulation does not necessarily mean the heavy-handed and intrusive application of detailed controls on individual prices that were put in place since the late 1980s under the price-cap regulation format, which has evolved into an onerous and expensive undertaking almost akin to traditional heavy-handed rate-of-return regulation.

6.6 Instead, when needed, regulation can be a process involving consultation between airports and airlines, with the regulator acting as a facilitator and/or backstop. Such regulation is less likely to distort or discourage market forces and has much lower administration costs. Several approaches have these characteristics, including:

- Consultation, to increase the dialogue with airlines and provide an input for stakeholders into decisions around pricing, investment and other aspects of airport development;
- Trigger regulation or price monitoring, where the regulator only intervenes where market power is abused, but the threat of such intervention moderates any attempted market power abuses; or
- Long-term contracts with the provision of adjustment tools, to reflect a bilateral agreement between an airport and its customers for establishing the level of airport charges and how they may change over time, eliminating the need for regulation.

[3] https://www.icf.com/resources/reports-and-research/2018/identifying-the-drivers-of-air-fares