



WORKING PAPER

**CONFERENCE ON THE ECONOMICS OF AIRPORTS AND
AIR NAVIGATION SERVICES**

Montréal, 15 to 20 September 2008

Agenda Item 1: Issues involving interaction between States, providers and users

1.1: Economic oversight

ECONOMIC OVERSIGHT

(Presented by Airports Council International (ACI))

SUMMARY

Over the past decade airports have continuously improved in terms of quality of service, efficiency and cost-effectiveness. They have also come under considerable commercial pressure from passengers, aircraft operators, new airline business models, and from their peers. Any potential market failure issues (e.g. abuse of dominant position) that may occur should first and foremost be addressed by national competition law within the framework of the State's responsibility for economic oversight. The ultimate purpose of competition law as part of the economic oversight process is to protect the interests of the end user, the consumer.

Applying similar standards to airport and air navigation services providers ignores the differences between the two providers in terms of their competitive situation, their customers and stakeholders, their diversity, their assets, and their social and economic benefits.

Any regulatory interventions should be kept at a minimum, be subject to a cost/ benefit analysis, and ensure sufficient investment to meet future demand.

Action by the Conference is in paragraph 5.

1. INTRODUCTION

1.1 The transformation of the airport industry during the past two decades from a publicly owned infrastructure provider to a partially privatized or corporatized and widely commercialized service industry has been driven by sustained strong air traffic demand and growth stimulated by route liberalization and growing economies, especially in emerging markets. The resulting need to invest

¹ Language versions are provided by ACI.

significant amounts in required new infrastructure upgrades and expansions has called for new airport governance and ownership structures and private investors. As governments retreated from management and ownership of airports, these new entities need to be monitored with regard to their pricing and planning within the framework of national economic oversight to address the varying risks of abuse of dominant positions.

1.2 Airport operators today are focused on serving their passengers and communities, and are recognized for the important contributions they make to national and local economies. Airports have evolved as self-sufficient economic value generators financing themselves with the permission and necessity to generate profits.

1.3 Airports as part of the aviation system connect and advance the global economy and are key contributors to tourism, the world's largest industry. The airport industry retains its long term perspective on industry growth and needs to prepare for future demand which will continue to rise in the long term. Adding capacity to the air traffic system remains a major task and responsibility of the airport industry and requires a flexible and adaptable approach on national economic oversight.

2. DISCUSSION

2.1 Over the past decade, airports have come under considerable commercial pressure from passengers, aircraft operators, new airline business models such as low cost carriers and alliances, and from their industry peers. Airports are vying for passengers and airlines alike competing with other airports for origin/destination and connecting traffic. At the same time, many airports are facing dominant carriers or groups of carriers with large market shares putting pressure on airport pricing and efficiency, and often posing an entry barrier to other carriers limiting competition to the detriment of the consumer.

2.2 Apart from putting pressure on user charges, airlines and airline alliances have become more demanding with regard to terminal services, design and layout requiring tailored services and terminal facilities or customized terminal areas. The operational and financial implications for the airport operator are frequently accepted and absorbed in order to retain or expand the airline operation and not to lose it to competing airports.

2.3 Passengers have also become more demanding with regard to airport processes, services, terminal design and commercial activities at airports. Airports need to respond to these rising expectations to remain attractive as origin, destination or transit points in the interest of the passengers and the airline industry. As airlines continue to make significant efforts to enhance the onboard experience, airports similarly need to invest in the ground experience.

2.4 Airports are no longer mono-line businesses as they have evolved from mere infrastructure providers to services providers, retailers, real estate managers and developers, etc. The focus of the airport management to a significant degree is now on the satisfaction of the passenger as the airport experience has become a critical factor in travel planning directly reflecting on the satisfaction with the airlines.

2.5 As of August 2008, over 120 airports worldwide have embarked on a customer satisfaction benchmarking programme offered by ACI. The programme measures customer satisfaction in over 30 service areas and provides critical data and analysis on how to improve satisfaction most effectively. The programme continues to grow rapidly, a development that would not be explicable if it were not for airports feeling the pressure from passengers and airlines to constantly improve their services and performance.

2.6 The demand for air travel continues to rise. Airlines have made record orders for new aircraft to be delivered during the next 10 years bracing themselves for a predicted doubling of air traffic by 2025. It is evident that the current ground capacity is not sufficient to accommodate such growth. Failing to provide new infrastructure will inevitably result in high costs to the economy, the environment, and the stakeholders and users of airports. Scarce capacity will also reduce the level of competitiveness among, and competition between, airports as congestion prevents airports from attracting new business and more passengers.

2.7 Economic oversight needs to consider airport planning cycles which are fundamentally different from those of airlines. While airlines can and need to adapt to economic cycles on a rather short term basis by reducing capacity and decommissioning aircraft, airports, given the nature of their assets, are required to take a long term view on the future market development possibly covering up to 20 years. When planning future investment and the associated cost, airports take a long term view on the economy and demand, and consumer and community interests.

2.8 The purpose of economic oversight is to protect the current and future interests of the consumer and the general public (welfare). More stringent forms of economic oversight (e.g. price and asset regulation) should only be applied after assessing the degree of competition and exhausting the legal, institutional and government framework (i.e. national competition law). Any regulatory intervention should be kept at a minimum and needs to be cost-efficient, more specifically the direct and indirect cost of regulation must not outweigh its benefits.

2.9 Applying similar economic standards to airports and air navigation services providers (ANSPs) may be misleading and should be done very cautiously. The two industries are fundamentally different in terms of their degree of commercialization and privatization, their user base, their diversity, their services, their assets and their market position. ANSPs are not in competition with each other, they do not have local community relations nor do they directly serve passengers. ANSPs exert sovereignty over national airspace, organize and protect it. The incentives for ANSPs to increase efficiency are limited as their users have no choice or alternatives. As the respective ICAO policies to be amended are widely identical and shall continue to apply to both groups of providers, the future policies need to be sufficiently universal and generic so that it does not intervene unduly in either of the two industries.

2.10 The proposed conclusions and proposed amendments referring to more specific forms of economic oversight or general charging principles need to be consistent with the underlying assumption of this paper that airports fundamentally operate in a competitive environment. The proposed objectives of Economic Oversight in Doc 9082 should therefore not imply any obligation of the State to undertake measures that go beyond its existing legal, institutional and governance framework.

3. CONCLUSIONS

3.1 From the foregoing discussion, the following conclusions may be drawn:

- a) States should ensure that Economic Oversight is applied to all services providers with the objective to avoid the abuse of a dominant position in the interest of consumers and welfare.
- b) States should determine the appropriate form of economic oversight on a case-by-case basis depending on the degree of competition, and should take into account their national legal, institutional and governance framework, first and foremost, competition law. Any regulatory interventions should be kept at a

minimum and need to be cost-effective, more specifically the direct and indirect cost of regulation should not outweigh its benefits.

- c) States should adopt a long term view on the aviation industry and consumer demand and ensure that airports have the financial ability and viability to invest adequately and in a timely manner in future infrastructure which constitutes the basis of future growth and will foster competition and competitiveness within the airport and airline industry.
- d) States should bear in mind that the ICAO policy on Economic Oversight to be amended already applies to both airports and ANSPs and will continue to do so. Thus, any amendments to the current ICAO policy should take into account the distinct differences between the two providers, in particular the divergent degree of competition.
- e) ICAO should take into account that the proposed conclusions and proposed amendments referring to more specific forms of economic oversight or general charging principles need to be consistent with the underlying assumption of this paper that airports do not *per se* have a dominant market position. The definition of public policy objectives within the scope of Economic Oversight should therefore not imply, prescribe or constitute any obligation of States beyond its existing national legal, institutional and governance framework.

4. PROPOSED AMENDMENTS OF POLICIES

4.1 In accordance with conclusion e) of paragraph 3.1, it is proposed to amend the new text of Doc 9082 on economic oversight proposed by the ICAO Secretariat in WP/4 as follows:

Economic oversight

- xx *The Council recommends that with the continued trend towards commercialization and privatization in the provision and operation of airports and air navigation services, economic oversight should seek to achieve a balance between the efforts of the autonomous or private entities to obtain the optimal effects of commercialization or privatization and those public policy objectives that include, but are not limited to, the following:*
 - i) *Prevent airports and providers of air navigation services from anti-competitive practices or from abusing a dominant position;*
 - ii) *Ensure non-discrimination and transparency in the application of charges;*
 - iii) *~~Provide incentives for~~ Encourage airports and providers of air navigation services, as well as users, to reach agreements on charges and service levels;*
 - iv) *~~Ensure that~~ Encourage the development of appropriate performance management systems are developed and implemented by airports and providers of air navigation services indicators by all service providers; and*
 - v) *Assure investments in capacity to meet future demand.*

yy. *The Council also recommends that States should keep economic regulatory interventions at a minimum and as required. When deciding whether economic oversight beyond competition law is necessary, the degree of competition, the costs and benefits related to alternative oversight forms, as well as the legal, institutional and governance frameworks should be taken into consideration. It is in the interest of all interested parties that economic oversight is set up in a transparent, efficient and cost-effective manner.*

5. ACTION BY THE CONFERENCE

5.1 The Conference is invited to:

- a) review and adopt the conclusions in paragraph 3.1; and
- b) review and endorse the proposed amendments of Doc 9082 in paragraph 4.1.

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