



WORLDWIDE AIR TRANSPORT CONFERENCE (ATCONF)

SIXTH MEETING

Montréal, 18 to 22 March 2013

Agenda Item 2: Examination of key issues and related regulatory framework

Agenda Item 2.7: Economics of airports and air navigation services

ECONOMICS OF AIRPORTS

(Presented by the Airports Council International (ACI))

EXECUTIVE SUMMARY

This working paper presents an economic perspective from the airport industry. Airports worldwide have evolved from infrastructure providers into sophisticated, business-oriented service providers. Despite this transformation, the great majority of airports worldwide do not have the critical mass to generate sufficient revenue to cover operating costs. A variety of ownership and governance models have proven to be successful and many States have turned to the private sector for financing the operation of airport infrastructure. The revenue generated from non-aeronautical activities often determines the financial viability of airports. Any regulatory or economic oversight interventions should be kept to a minimum and the right economic incentives should be in place in order to encourage investments in airport infrastructure.

Action: The Conference is invited to agree to the recommendations in paragraph 10.

References: ATConf/6 reference material is available at www.icao.int/meetings/atconf6.

1. A NEW BUSINESS MODEL

1.1 Over the past 20 years, airports have evolved from being public-sector infrastructure providers into sophisticated, business-oriented service providers. This transformation has occurred as a result of the emergence of airport competition and the realization by governments around the world that airports are major engines of socio-economic growth; and, that with the right management in place, they can be run efficiently and in many instances can be self-sufficient.

2. AIRPORT COMPETITION

2.1 A fundamental element of airport economics must now concern airport competition. While airports used to be considered as something akin to natural monopolies, this is no longer the case.

2.2 Airports must now compete for both passengers and airlines, which have significantly more choice than in the past. Airports have become more commercially focused and the result has been a more competitive and dynamic airport market. However, airports are still too often regarded as monopoly infrastructure providers when the commercial reality is evidently very different.

2.3 Policy-makers and regulators have yet to appreciate the extent of the changes that have taken place. This is partly a matter of catching up with a still fast moving market, but also because the data have not been brought together in a comprehensive way. The Airports Council International (ACI) has prepared a working paper on airport competition (ATConf/6-WP/90) with further information.

3. AIRPORT OWNERSHIP

3.1 A variety of airport ownership and governance models have proven successful. In many States, governments have decided that, under the right economic conditions, they can successfully turn to the private sector for the financing and operation of airport infrastructure. Private sector participation can be found in different countries around the world. For example, 25 airport companies are listed on stock exchanges, of which five are Chinese, three Mexican and two are from Southeast Asia, with the balance being in Australasia and Europe.

3.2 Airports should be permitted to operate under any type of ownership and any participation by private capital may vary from airport to airport depending on local circumstances. The most common types of private sector participation include: outright ownership, short or long-term concessions, public-private-partnership (PPP) schemes, and management contracts. The type of ownership at any individual airport should allow the airport flexibility in its business, and ensure that the interests of airport users are protected by the application of sound economic principles, which are proportionate to the airport's market position.

3.3 According to the 2012 ACI Economics Report, 450 airports had some form of private sector participation. The most common being concessions (251 airports), followed by outright ownership (152 airports) and management contracts (47 airports).

3.4 Considering the increasing reliance on the private sector to secure much needed airport infrastructure investments, it is important to ensure that States provide the right regulatory incentives to attract private sector participation, as well as a reliable legal framework to ensure a stable relationship throughout the concession period.

4. AIRPORT INFRASTRUCTURE

4.1 The aviation community agrees that multi-billion dollar airport infrastructure investments are needed globally to accommodate growth of the industry, and ensure the social and economic benefits that aviation brings.

4.2 The nature of investment in airport infrastructure is such that capacity is added in large increments, and this combined with the long planning lead in times (see paragraphs 5.4 and 5.5) means that airports are exposed to considerable risk when undertaking capacity expansion projects. Shifts in economic fortunes or political decisions can leave an airport with 'stranded assets' or sunk costs which cannot be recovered via aeronautical and non-aeronautical revenues within a reasonable timeframe. It must be recognised that airport investment contains inherent risk, which cannot be fully managed and which must be reflected in sufficient returns on capital.

4.3 While the constant pressure to invest in new capacity can perhaps be seen as a universal demand on aviation, environmental issues are more localized. Regional, national and local planning laws and noise regulations can be a source of competitive advantage or disadvantage for an airport as much as the location of the airport itself.

4.4 Funding additions to capacity is only one of the challenges faced by airport operators. The addition of capacity also requires planning permission and sparks a political debate that is often, in the case of large projects, conducted at government level.

4.5 Planning inquiries themselves often impose severe delays on the development process. For this reason, there is often a period in the development of an airport when bottlenecks form until new capacity can be added. Adding new runway capacity is contentious, and it is often difficult to provide adequate capacity in a timely way. For example, it took five years for the fifth runway at Amsterdam's Schiphol Airport to be agreed and for construction to commence. Meanwhile, in the United Kingdom, discussion for the need of a new runway in the South East of England continues. The only new runway built in the area since the Second World War was at London City Airport in 1987.

5. SOURCE OF INVESTMENT IN AIRPORTS

5.1 The scale of current and forecast demand at many airports clearly indicates a need for increasing levels of investment to maintain and enhance capacity at an appropriate service quality. Airport charges and non-aeronautical revenues are major sources of funds for investment. Airports should be permitted to retain and invest these revenues to finance future investments. Any action to restrict the use of revenues, or to require all commercial revenues to be used solely to reduce current user charges, could conflict with this objective, inhibit much needed investment and not serve the interest of the ultimate end user – the passenger.

5.2 Airports must also be allowed access to sufficient funds to finance the investments needed to meet projected demand. In some cases, pre-financing of airport infrastructure projects through raising airport charges during or before the period of construction is appropriate, in line with the guidelines in *ICAO's Policies on Charges for Airports and Air Navigation Services* (Doc 9082).

5.3 There is ample evidence that airport users do not pay the full cost of the infrastructure they use. Indeed airport users currently benefit from under-recovery of capital costs, at the expense of the owners of the airports. Moreover, increasing competition between airports results in a growing trend of cross-subsidization between non-aeronautical and aeronautical revenues, to the benefit of the latter. This reflects the fact that today airports have no interest in overcharging airlines but rather seek to offer competitive charging levels to attract and retain traffic so as to secure future growth.

5.4 Alongside competitive pressures, airports are also incentivized to reduce aeronautical charges via commercial revenues, as they face a two-sided market. Reducing aeronautical charges stimulates demand not only for those services, but also for non-aeronautical offerings such as retail, car parking, etc. Profit-seeking airport operators will develop pricing strategies, which adjust cross-subsidization to a point that maximizes overall margins. There is therefore a natural market equilibrium, which balances the interests of the airport, airlines and the passenger. Unnecessary regulatory intervention should not be allowed to distort this.

6. SOURCE OF REVENUE AND THE IMPORTANCE OF NON-AERONAUTICAL REVENUES

6.1 As noted, airports finance their own operating and development costs. Airports have diversified their sources of revenue, relying not only on the traditional aeronautical revenues made up of airport charges, but also increasingly on a variety of other revenues including retail, parking, real estate, and other commercial activities.

6.2 According to the 2012 ACI Economics Report, non-aeronautical revenues (including non-operating revenues) represented 44 per cent of total income as an average for world airports. In Asia, non-aeronautical income can be as high as 51 per cent.

6.3 Non-aeronautical revenues are a vital component in the economics of airports. During the economic downturn the diversification of airport revenues cushioned the impact of lower passenger and freight volumes and safeguarded operating profits. Non-aeronautical revenues may critically determine the financial viability of an airport as they can generate higher profit margins than aeronautical activities.

6.4 Non-aeronautical revenues can also significantly reduce operating costs for aircraft operators at an airport with a “dual-till” operating environment where aeronautical and non-aeronautical revenues are kept separate. Profits from non-aeronautical revenues are reinvested in airport infrastructure reducing capital needs and costs for the airport.

6.5 The largest proportion of aeronautical income is generated from charges that apply directly to passengers (i.e. passenger service charges, security and transfer charges). These passenger-based revenues represent 63 per cent of total aeronautical income, with the 37 per cent balance being charges that apply directly to aircraft operators (landing, parking, boarding bridges, lighting and airport-related navigational aid charges).

6.6 It is important to highlight the shift away from aircraft to passenger-based charging. Passenger-related charges do not become part of the airlines’ costs in terms of their balance sheets, they are pass-through items, so the actual operating cost of carriers is reduced by shifting charges to passengers. By applying this charging scheme, airports share the risk of decreasing traffic with the carriers as revenues are dependent on the actual number of passengers departing from the airport and less on the number of aircraft movements or aircraft size.

6.7 The introduction of new measures by some airlines, like the one-bag rule, (which limits the amount of baggage to be taken on-board and consequently may reduce the sales of duty free goods) can have a major impact on non-aeronautical revenues and thus on the capacity to invest.

7. FINANCIAL PERFORMANCE

7.1 According to the 2012 ACI Economics Report, in financial year 2011 the world’s airports generated income of USD 105 billion.

7.2 Whereas the airport industry as a whole generated net profits of USD 14 billion, the great majority of airports, on an individual basis, generated losses. ACI estimates that 69 per cent of the world’s airports are loss-making. Moreover, the great majority of airports with one million passengers or less are inherently unprofitable, primarily due to the nature of the cost structure they face.

8. ECONOMIC REGULATION

8.1 Economic oversight and regulation of airports should be applied at an optimal level balancing the interests of the public, stakeholders and the airport operator. Competition issues should be addressed first and foremost by national competition law within the framework of the State's responsibility for economic oversight.

8.2 The application of economic regulation (as one specific form of economic oversight) should only be applied if the airport has demonstrable market power (assessed on a case-by-case basis). 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.

8.3 Formal economic regulation should only be introduced where there is significant risk or evidence of market failure. The ultimate purpose of competition law as part of the economic oversight process is to protect the interests of the end-user, the consumer – that is passengers and shippers. The interests of aircraft operators do not always equate to the interests of passengers or other airport users and should not supersede them.

8.4 There should be no requirement to use non-aeronautical revenues to reduce airport user charges through a “single till”, although some airports may deem a full or partial use of non-aeronautical revenues to defray aeronautical charges as appropriate or necessary to increase their competitiveness or to meet not-for-profit requirements.

8.5 Including non-aeronautical revenues in the cost basis for the calculation of airport charges can constitute an unwarranted subsidy to air carriers from the airport operator. The “single-till” principle also acts as a disincentive to airports to develop non-aeronautical revenues, and sends inappropriate pricing signals, particularly at airports with capacity constraints. As referenced in paragraph 6.4, the optimal degree of cross subsidization can be determined by the market – unnecessary regulatory intervention should not be allowed to distort this.

9. CONCLUSION

9.1 The private sector has been and continues to be essential for the development of airport infrastructure worldwide.

9.2 The majority of airports worldwide are loss-making (69 per cent), with most airports with traffic under 1 million passengers not breaking-even.

9.3 ACI agrees with the principles set out in the last edition of ICAO's policies on charges in Doc 9082, particularly in relation to the cost basis for airport charges.

9.4 Non-aeronautical revenues are essential for the financial sustainability of airports worldwide.

10. RECOMMENDATIONS

10.1 The following recommendations are proposed for consideration by the Conference:

- a) airports should be permitted to retain and invest non-aeronautical revenues to finance future investments. Any action to restrict this use of revenues, or to require all commercial revenues to be used solely to reduce current user charges, could conflict with this objective and inhibit much needed investment;
- b) there should be no requirement to use non-aeronautical revenues to reduce airport user charges through a “single-till” arrangement, although some airports may deem a full or partial use of non-aeronautical to defray aeronautical charges as appropriate or necessary to increase their competitiveness or to meet not-for-profit requirements;
- c) any regulatory or economic oversight interventions should be kept to a minimum and economic incentives should be in place in order to encourage investments in airport infrastructure from the private or public sector, whilst maintaining the competitive advantages of air transport;
- d) the ultimate purpose of competition law, as part of the economic oversight process, is to protect the interests of the end-user, the consumer. The interests of aircraft operators do not always equate to the interests of passengers, shippers or other airport users, and should not supersede them;
- e) any charges, levies or fees imposed by a government authority on air transport should benefit the air transport industry and should not be used for other purposes, while maintaining compliance with ICAO policies on charges;
- f) ICAO’s policies on charges should facilitate the timely development of air transport infrastructure in order to accommodate the growth of the air transport industry and ensure the social and economic benefits that aviation brings; and
- g) these policies on charges also should encourage the development of sustainable air transport infrastructure commensurate with the actual needs of the regions served and based on operational requirements of the airlines that use the infrastructure.

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