



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 the Secretariat)

SUMMARY

This paper discusses the purpose of economic oversight for airports and air navigation services and considers how to select the appropriate form of economic oversight. It reaffirms that economic oversight is a State's responsibility with various public policy objectives including the prevention of the risk that a service provider could abuse its dominant position. If economic oversight beyond competition law is deemed necessary, the degree of competition, the costs and benefits related to it, as well as the legal, institutional and governance frameworks should be taken into consideration. The paper proposes to amend the text in *ICAO's Policies on Charges for Airports and Air Navigation Services* (Doc 9082) to clarify the purpose, scope and selection of economic oversight.

Action by the Conference is in paragraph 5.

1. INTRODUCTION

1.1 States are ultimately responsible for safety, security and economic oversight of the operations of airports and air navigation services providers. The term "economic oversight" refers to monitoring by a State of the commercial and operational practices of service providers. Economic oversight may take several different forms, from a light-handed approach (such as the reliance on competition law) to more direct regulatory interventions in the economic decisions of service providers. States may perform their economic oversight function through "economic regulation", for example in the form of legislation or rule-making, and/or the establishment of a regulatory mechanism.

1.2 This paper discusses the purpose and form of economic oversight, and considers how to select the appropriate form of economic oversight, with respect to the specific circumstances in each State. It also reviews the current relevant text of *ICAO's Policies on Charges for Airports and Air Navigation Services* (Doc 9082). It should be mentioned that the issues related to "ownership, governance and control", including the separation of regulatory and operational functions, are dealt with in WPs/7 and 12.

2. DISCUSSION

2.1 Commercialization and privatization of airports and air navigation services have continued in recent years, bringing more competition and commercial pressure on service providers. In the case of airports, there has been a steady trend towards privatization. On the air navigation services side, the trend has been towards commercialization rather than privatization.

2.2 These developments, however, do not imply any changes to the responsibility of States regarding economic oversight of service providers. The market conditions and the degrees of competition are not uniform, and there is a risk that a service provider could abuse its dominant position. Even in competitive markets, the focus by service providers on competition and cost reduction may sometimes negatively impact the interests of certain categories of users. Furthermore, commercialization and privatization may have reduced the awareness of, and adherence by service providers to, States' international obligations including ICAO's policies on charges (see WP/17).

2.3 The objectives of economic oversight could include: ensuring that there is no abuse of dominant position by service providers; ensuring non-discrimination and transparency in the application of charges; providing incentives for service providers and users to reach agreements on charges; ensuring that appropriate performance management systems are developed and implemented by service providers (see WP/5); and assuring investments in capacity to meet future demand. The priority for each objective may vary depending on the specific circumstances in each State, and there should be a balance between such public policy objectives and the efforts of the autonomous/private entities to obtain the optimal effects of commercialization or privatization.

2.4 A list of possible forms of economic oversight is provided in the *Airport Economics Manual* (Doc 9562) and the *Manual on Air Navigation Services Economics* (Doc 9161). In summary, they include: a) application of competition law; b) fallback regulation, whereby regulatory interventions are limited to situations when the behavior of the regulated entity breaches publicly-stated "acceptable" bounds; c) institutional arrangements such as requirements on consultation with users (often supplemented by arbitration/dispute resolution procedures), information disclosure, and a particular ownership, control and financial structure; d) a third-party advisory commission, whereby a group of interested parties reviews pricing, investment and service levels proposals; e) contract regulation, whereby the State grants a contract, or concession, to provide airport or air navigation services under certain conditions; f) incentive-based or price-cap regulation; and g) cost of service or rate of return regulation.

2.5 It is possible to conceive variations to each of the approaches to economic oversight set out above. In some situations, the combination of two or more of the approaches may yield the best form of economic oversight. In general, the selection of the appropriate form depends, *inter alia*, on the degree of competition, and the legal, institutional and governance frameworks, including the roles, rights and responsibilities of the different parties involved, as well as the costs related to specific forms. Whatever approach is adopted, economic oversight should be performed in a transparent, efficient and cost-effective manner with a great degree of flexibility so that it can be adapted to changing circumstances.

2.6 In Doc 9082, however, there is little reference to (or acknowledgement of the fact that there exist) different forms of economic oversight. Furthermore, paragraph 15 of Doc 9082, which recommends the establishment of an independent mechanism for economic regulation, is not calibrated or graduated according to the form of economic oversight that has been adopted.

2.7 In contrast, the guidance material in Doc 9161 and Doc 9562 acknowledges that economic oversight through the application of competition law is likely to be adequate where competition

is “sufficiently strong”. One of the justifications for selecting other forms of economic oversight, therefore, requires that competition law would be insufficient to address the risk that a service provider could abuse its dominant position. The issue here is how to identify the circumstances in which competition or the threat of it would not be sufficiently strong. In general, the degree of competitive market constraints should be measured in terms of actual and potential competition from nearby service providers or from other modes of transport. The size of the entities and traffic volume relevant to the market are also factors to be taken into account.

2.8 Even where competition may not be considered sufficiently strong, there may be circumstances in which the need for specific regulatory interventions is less obvious. For example, the service providers, in collaboration with the users, are the parties best placed to determine the optimal service standards, charges system and the level of the charges in relation to the services rendered (see WP/6). The same may be true if the service provider is partly or fully owned by users. In such cases, the scope of economic oversight should be limited to encouraging that changes to the charges system and to the level of charges be made in agreement between the service provider and all categories of users. Regulatory interventions should be kept at a minimum and as required, for instance, when there is a disagreement between the parties.

2.9 Another important factor in assessing the most appropriate approach is the potential costs and benefits related to the alternative form of economic oversight. The operation and administration of economic oversight is not cost-free, and the cost associated to it may increase as the approach taken by a State moves from a light-handed (such as information disclosure requirements) to a more comprehensive scheme (such as rate of return regulation). In the extreme, the regulatory cost may outweigh the expected benefit. The choice of an appropriate form going beyond competition law is, therefore, a matter of searching the spectrum of options for protecting public interests at a minimum regulatory cost.

3. CONCLUSIONS

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

- a) States should bear in mind that economic oversight is the responsibility of States with the objectives, *inter alia*, to prevent the risk that a service provider could abuse its dominant position, to ensure non-discrimination and transparency in the application of charges, to provide incentives for consultation with users, to ensure the development of appropriate performance management systems, and to ascertain that capacity meets future demand, in balance with the efforts of the autonomous/private entities to obtain the optimal effects of commercialization or privatization.
- b) States should select the appropriate form of economic oversight according to their specific circumstances, while keeping 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.
- c) ICAO should amend Doc 9082 to clarify the purpose and scope of economic oversight for airports and air navigation services with reference to its different forms and the selection of the most appropriate form of oversight.

4. PROPOSED AMENDMENTS OF POLICIES

4.1 In accordance with conclusion c) of paragraph 3.1, it is proposed to insert the following two new paragraphs on economic oversight to Doc 9082 immediately before paragraph 15:

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 their dominant position;*
- ii) Ensure non-discrimination and transparency in the application of charges;*
- iii) Provide incentives for airports and providers of air navigation services, as well as users, to reach agreements on charges and service levels;*
- iv) Ensure that appropriate performance management systems are developed and implemented by airports and providers of air navigation services; 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.

4.2 Please note that, as a consequence of the new policy text proposed above, current paragraph 15 of Doc 9082 will need to be adjusted. The proposals in WPs/7 and 12 should be considered in this context.

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.