

Airports and the Private Sector

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Objectives

- To outline how the private sector is involved in airports
- To explore the regulatory and contractual issues this creates
- To examine how these have been resolved

Outline

- Background on private involvement in airports
- Market power and competition
- The investment problem
- Handling risks
- Options for terminals
- Synthesis

Themes in Airport Policy and Management

- Achieving efficient operation and pricing
- Getting investment right
- Handling risks
- Will not deal with the first today

Privatisation

- Full privatisation common now- London, 1980s, Australia, NZ
- Partial privatisation (Vienna, Düsseldorf, Hamburg)
- Private operators (London Luton)
- Private terminals (US, Australia)
- Local government
- Community- not for profit airports
- Construction

Competition or Regulation?

- Most major airports have a locational monopoly
- Some scope for hub competition (US, Europe, SE Asia)
- Competition between airports for low cost carriers (LCCs)
- E.g. Charleroi vs Brussels
- Competition not strong enough to discipline pricing
- Regulation of some form necessary

Types of Regulation

- Several types in place for airports
- Cost plus (Amsterdam, Düsseldorf, Sydney pre 2002)
- Incentives for excess investment, high costs
- Incentive regulation- e.g. price-caps (Australia pre 2002, London, Hamburg)
- Efficient, but poses problems for investment, quality and risk
- Price monitoring (Australia since 2002)
- What is poor performance? Are sanctions strong enough?

Investment Incentives

- Regulation critically alters the incentives for investment
- Cost plus regulation- excessive investment, “gold plating”, “marble halls”
- Incentive regulation- too little investment, basic quality

Other Investment Complexities

- Congestion- faced by the users, not the airport- does it have the right incentives to reduce this?
- Slot controls on airports (London, Frankfurt)- does anyone have an incentive to provide more capacity?
- Environmental limits to operation and expansion

Role of Regulator

- All this means that government/regulator have a big say in investment
- Smaller investments- can allow for these in the price formula (Australia to 2002)
- Regulator still has discretion- price increases to fund investment *may* be permitted
- Regulator evaluates and approves major investments, approves price rises
- London Heathrow- price increases to fund Terminal 5
- Regulated airports only have minor discretion over investments

Further Investment Issues

- What scope for contracts between airlines and airports?
- Used in US, Frankfurt
- Works best with few main users
- Cross subsidisation- will airport use one airport (Heathrow) to fund expansion of another (Stansted)?
- Does capacity get provided at the right place?
- What guarantee that quality provided will be right?
- LCCs want only basic, cheap, facilities
- Investing to accommodate the A380- who pays?

Risk

- Many risk issues the same as for other infrastructure
- Who is best at handling specific risks- public or private sector?
- Can risks be identified, allowed for in contracts or regulation?
- Risks of changing government policy- especially on the environment
- Regulatory risks- opportunistic regulators and stranded assets (big sunk costs)

Incentive Regulation and Risk

- Risk is the price of incentives
- Incentive regulation imposes high risks on firms, especially when they are highly geared
- Regulator sets fixed prices, which do not vary with the firm's performance or changing circumstances
- The firm keeps all the profits, or faces all the losses
- When circumstances are volatile (Asian financial crisis, 9/11, Ansett collapse), returns become very volatile

Responses to Risks

- Some regulators move towards cost plus regulation, weakening the incentives
- When crises occur, governments drop or modify regulation
- Hamburg Airport, UK Air Traffic Control after 9/11
- In Australia- Ansett collapse, 9/11 caused a crisis for airports- government modified regulation(2001) then replaced it with monitoring (2002)

Getting the Balance Right

- Handling risks has proven a real challenge for regulators
- Often moved towards cost plus regulation
- Who is best placed to bear these risks- airports, airlines, passengers?
- Have airports been too highly geared?
- Design regulation which handles unexpected circumstances more flexibly, yet preserves good incentives?

Options for Terminals

- Wider range of options for terminals
- Separate financially from rest of airport, less of an indivisibility
- Private terminals at public/community airports (US; Australia pre privatisation)
- Airline or investor owned

Airlines as Terminal Owners

- Have a strong incentive to get investment/quality right
- Make a commitment to the airport by sinking costs in it
- Incentive to operate efficiently
- Competition policy concerns- incentive to keep competitors out
- Has been a problem- e.g. Australia after deregulation of airlines in 1990

Investor Owned Terminals

- Can bring finance and expertise (e.g. Amsterdam Schiphol, BAA)
- What market power do they have?
- Competition between terminals?
- Sydney- two owners, both with market power
- Monopoly element- gives rise to same problems as airport monopolies
- May enter contracts with airlines

Synthesis

- Variety of different forms of private sector involvement in airports, but full/partial privatisation dominates
- Can have private investment of parts of the system-e.g.. terminals
- Private airports or facilities are typically subject to some types of regulation
- Regulation varies a lot, but there is a preference for incentive regulation, with some compromises

Synthesis

- Key decisionmaker on most investments remains the government or regulator, not the airport or investor
- The usual risk allocation/management issues arise, but regulation poses additional ones
- Incentive regulation imposes high risks on airports- yet to be sorted out how to handle these best
- It has been easier to achieve private investment in the terminals segment, though these often raise most of the issues present with airports as a whole

Thank You

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