

Issues and Challenges of Airport Privatisation: European and Australasian Experiences

Peter Forsyth

Monash University

Objectives

- Outline the extent and patterns of airport privatisation
- Identify the issues it has created
- Examine how these are being handled
- Assess how well privatisation has been working out

Outline

- Background
- Description and rationales
- Market power and price regulation
- Issues
- Assessment so far

Airport Privatisation

- Most major airports publicly owned in Europe and Australasia prior to 1980s
- Some were locally owned (Cairns in Australia)
- North American airports tend to be locally owned (not for profit corporations)
- Privatisation began in mid 1980s with BAA (London and Scottish) airports

Privatisations Since BAA

- New Zealand (partial, then full)
- Australia (full)
- Austria (partial)
- Germany (partial)
- Greece(Partial)
- Italy (partial)
- Netherlands (planned)
- Private terminal developments

Partial Privatisation

- Large number of privatisations are partial-retain majority public ownership
- The European way?
- A step towards full privatisation (NZ)?
- Retain public influence/ moderate behaviour?
- Facilitate major investments?

Rationales for Privatisation

- Cash (consistent with partial privatisation)
- To drive cost efficiencies
- Develop a more commercial ethos- drive retail developments
- Obtain funding for major expansions

Issues 1- Market Power

- Airports possess strong market power- a central problem to be resolved
- Airports usually have locational monopolies
- Only limited competition between airports (as hubs, or for low cost carriers)

Issues 1- Market Power

- Airlines do not have much countervailing power- they have little alternative but to use the airport
- Profits from concessions encourages them to maximise passengers- moderates the incentive to use market power
- Airports have the scope- and incentive- to charge high prices if completely unregulated

Price Regulation

- Hence price regulation- or alternatives- are implemented (in all cases?)
- Regulation can take three main forms:
 - 1 Price caps- incentive regulation
 - 2 Cost based regulation- e.g. rate of return
 - 3 Monitoring with sanctions for poor performance

Price Caps/Incentive Regulation

- Pioneered in the UK
- Applied to BAA's London airports since privatisation
- Applied in Australia till 2002, Hamburg, elsewhere

Price Caps/Incentive Regulation

- In theory, incentives for cost reduction will be strong
- In practice may become more cost based, with weaker incentives
- The rigidity of price caps can make profit volatile (e.g. sensitivity to crisis in 2001)
- Tend to get modified or replaced at times of crisis (Australia, Hamburg, UK NATS)

Cost Plus Regulation

- Charges approved on the basis fo the airport's own costs
- Most German airports
- Sydney (sort of) before privatisation
- Weak incentives for cost reduction
- Incentives for empire building (build Taj Mahals of terminals and pass the cost on to airlines and passengers)

Monitoring with Sanctions

- Attempt at light handed regulation
- Monitor prices-then review them
- Implement sanctions if performance has been unacceptable
- New Zealand: Auckland airport prices judged to be too high- price regulation to be introduced

Monitoring with Sanctions

- Wellington airport prices not too high- not regulated
- Australia moved to this approach, 2002
- More flexible- airports, airlines can negotiate
- What is the criterion for poor performance?
- What are the sanctions and will they moderate poor performance?
- Litigation and lobbying more likely
- Likely to be a fuzzy system, which gives the reviewer/regulator a lot of discretion

Issues 2-Investment

- Airports capital intensive- getting investment right is crucial
- Cost based regulation encourages excessive investment
- Price caps- encourage inadequate investment and quality

Issues 2-Investment

- Can build in mechanisms to correct this
- Allow charges increases to cover the cost of investments which improve quality, e.g. runway extension (Australian system)
- Give airports incentives to increase output and invest- CAA proposed this for London airports
- Inevitably, regulators have a big saying what investments go ahead

Issues 2-Investment

- Can airlines be given an effective say?
- (Do they always have the best motives?)
- Not a long track record of privatised airports investing

Issues 3-Crises and Risks

- Aviation subject to sharp demand swings- 9/11, SARS
- Airline and airport revenues can be volatile
- Airports have major sunk costs- but they are often financed with a lot of debt, which must be serviced

Issues 3-Crises and Risks

- Airports become unprofitable as demand slips- some face cash flow crises
- Should regulators allow them to raise charges?
- Germany, Australia, UK (NATS)
- But this just shifts the risk on to the airlines, which are also suffering a crisis

Issues 4-Performance

- Has privatisation improved airport performance?
- Not much empirical evidence on this yet
- Some evidence of improved productivity
- Privatised airports have become more commercial (retail opportunities)
- Are they providing a better service for airlines?

Issues 5-Congestion at Busy Airports

- How well are privatised/regulated airports coping with excess demand and congestion?
- London, Frankfurt, Schiphol when privatised
- Slots do much of the rationing; charges are kept down by regulation
- But charging systems could be improved

Issues 5-Congestion at Busy Airports

- Should be more *movement* (not passenger or eight) related when it is the capacity to handle *movements* which is scarce
- System handled by capacity regulators and scheduling committees

Issues 5-Congestion at Busy Airports

- Do busy airports have enough incentive to increase capacity?
- Do hub airlines at slot constrained airports have an incentive to push for more capacity (they get most of the profits from scarce capacity)?

Issues 6-Airport Alliances

- Airline alliances a big issue
- Airport alliances- do they make sense?
- Anti competitive issues- don't want potentially competitive airports to monopolise a region
- Not normally much of a problem
- Product integration- not nearly as much of an issue as for airlines
- Transfer of managerial, technical marketing expertise; financial advantages?
- Not really much of an issue

Privatisation- an Assessment

- Not much yet by way of assessment
- Improved performance- probably
- Has made airport issues much more public transparent

Privatisation- an Assessment

- The choice of regulatory systems is very mixed, and in most countries has not settled down to a preferred model
- Handling investment at privatised/regulated airports is problematic- and still involves considerable government involvement
- But the issues are much more in the open than with public airports

Privatisation- an Assessment

- The goal of light handed regulation has not been achieved
- Well specified monitoring systems may result in light handed regulation, but they will still involve substantial regulatory discretion