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Pro-competition rules in airport privatization: International experience and the Brazilian case

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ABSTRACT

This article aims to demonstrate the importance of establishing pro-competition rules in the concession of multiple airports to private companies by describing the recent Brazilian experience. More specifically, it addresses: (i) how the economic literature deals with potential competition among different airports, and how this competition was dealt with in the concession programs of Australia, Mexico and the United Kingdom; and (ii) Brazil's recent experience with airport concessions, where international benchmarking led to cross-ownership restrictions. As a conclusion, this paper defends that governments should design regulatory restrictions that account for the existence of competition among airports. Nevertheless, these restrictions must be carefully planned and designed to achieve their goals.

1. Introduction[1]

Brazil has recently joined the group of countries that have large airports operated by private companies. In 2011, the greenfield project of the International Airport of São Gonçalo do Amarante, in the metropolitan region of Natal (Rio Grande do Norte), was awarded to a private company. In 2012, three different private consortiums won the concession contracts for the International Airports of Viracopos (VCP, at Campinas, São Paulo), Governador André Franco Montoro (GRU, at Guarulhos, São Paulo) and Brasilia - Presidente Juscelino Kubitschek (BSB, in the Federal District). Finally, in 2013, the Brazilian government granted to private parties the International Airport of Rio de Janeiro/Galeao - Antonio Carlos Jobim (GIG) and Tancredo Neves International Airport (CFN, located in the metropolitan area of Belo Horizonte, Minas Gerais).

The recent Brazilian experience contained a noteworthy particularity: bidding rules were specifically designed to prevent cross-ownership among different airport operators. In the first round of biddings (in 2012), no single private entity could be awarded more than one airport concession. Moreover, the bidding rules of the second round (in 2013) provided that corporate groups responsible for operating one of the airports granted in the first round could not hold more than a 15% stake at a consortium bidding for an airport in the second round.[2]

These restrictions were designed to foster more intense competition among different airports, especially in the

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[1] Abbreviations used: AICM – Mexican City International Airport; ANAC – Brazilian Civil Aviation Regulator; ASA – Mexican Aeropuertos y Servicios Auxiliares; ASUR – Mexican Aeropuertos del Sureste de México; BAA – British Airports Authority; BSB – International Airport of Brasilia; CC – United Kingdom former Competition Commission; CFC – Former Mexican Comisión Federal de Competencia (antitrust authority); CFN – International Airport of Minas Belo Horizonte; FAC – Australian Federal Aviation Corporation; GAP – Mexican Grupo Aeroportuario del Pacífico; GIG – International Airport of Rio de Janeiro; GRU – International Airport of Guarulhos/São Paulo; ITT – Invitation to Tender; p/y – Passenger per year (usually expressed in millions); OFT – United Kingdom former Office of Fair Trading; OMA – Mexican Grupo Aeroportuario del Centro Norte; VCP – International Airport of Campinas/São Paulo.

[2] Please refer to items 3.18 and 3.19 (Brazilian National Civil Aviation Regulatory Agency - ANAC, 2013a) A summary of the bidding rules and concession contracts for GIG and CFN airports maybe be found in English at http://www.epl.gov.br/airports2 under the links "Contract Signed".

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development of national and international hubs. During the preparation of the invitation to tender (ITT), there was intense discussion among government agencies and interested bidders on the scope and effects of such restrictions. Many argued that they would lower the competitiveness of the tenders by limiting the number of bidders. Ultimately, cross-ownership restrictions were adopted, and not only were the value of the awards significant, but the tenders attracted some of the world's most prominent airport operators.

Given this context, this article discusses the benefits of policies adopted in concession programs to increase future competition among airports. In order to do so, it is divided in three parts: I) this short introduction; II) a summary of the relevant economic aspects concerning competition among airports, including a brief description of three relevant examples of international experience (Australia, Mexico and the UK); and III) an analysis of the Brazilian airport concession program, including (a) the review of data that supports the finding of potential competition among the airports; (b) the legal challenges that surrounded the biddings and how these were addressed; and (c) a critical analysis on how the process was conducted. By learning from international experience, the conclusions are that the pro-competition rules adopted in Brazil were an important tool to assure the good results of the Brazilian tenders and will lead to important benefits in the future. However, the analysis was limited in many areas, in particular those relating to soft agreements between airlines and airports and the participation of the State-owned player INFRAERO in all consortia.

2. Competition among airports: economic aspects and international privatization experience

a. Economic aspects of airport competition: catchment areas and hubs

For many years, airports were considered natural monopolies.[3] The prevailing idea was that effective competition among different airports was prevented by the large investments needed for the construction of terminals, runways and other infrastructure, which ultimately led to the large economies of scale and scope involved in the provision of airport services.[4]

More recently, this view is slowly being replaced by a pragmatic approach that acknowledges effective or potential competition among airports – especially those that operate in similar catchment areas and/or can serve as hubs for certain regions.[5] Such an approach rests on the recognition that airport operators are active in two-sided markets. By defining services and rates, they seek to attract both *airlines* and *passengers*. Moreover, decisions of these two groups of agents (passengers and airlines) are interconnected. Air transport companies want to operate in airports "catching" as many potential passengers as possible; while, passengers will choose terminals offering the cheapest and most convenient flights, as well as greater destination diversity.[6]

Considering this framework, a first relevant variable to identify competition among airports is the time passengers are willing to spend to reach them, which defines the respective "*catchment area*". This catchment area is not fixed, but rather changes according to the type of travel (short or long-haul), passenger type (business or tourist) and other preferences within groups (i.e. price elasticity).[7] These preferences also change over time. For example, the catchment areas of short haul flights have been expanded by low cost carriers – i.e., certain passengers are willing to spend more time to reach an airport further away in order to benefit from lower ticket prices.[8]

As for long haul flights, especially international ones, consumers normally tolerate travelling for longer distances to reach an airport, implying larger catchment areas. They also tend to accept more connecting flights to reach a final destination, as the time loss in a connection becomes a smaller percentage of the total travelling time. This represents another dimension of rivalry among airports, namely the competition between those that concentrate short-haul flights from several locations (known as "*hubs*"). Therefore, passengers' long haul choices include a selection of both an airline and, if applicable, connection hubs – which provide different types and levels of quality in their services.

From the airline's perspective, different airports may serve as a hub. For any airport, becoming a hub of a major airline means having a higher level of demand for both local and international flights, which increases revenues from services provided to airlines and other commercial activities (rents from shops, parking lots, etc.). Thus, airports can strongly compete for the preference of airlines' international operations, mostly by offering lower fares and better services. Moreover, such competition can be a main driver of investments and quality differentiation, as terminals try to improve their services to attract one or more carriers and their passengers.[9]

As seen, there are good grounds for the establishment of rules ensuring that different companies control different competing airports. This view is also supported by the international experience summarized below.[10]

b. Inspiration to the Brazilian program of airport privatization: the experience of Australia, Mexico and the UK

While designing its own airport concession program, Brazilian government officials took note of the experience of other countries, most notably Australia, Mexico and the UK. The first two represent ex-ante approaches, where bidding rules forbade significant cross-ownership. In the UK, competition issues were addressed ex-post, notably through a review by the national antitrust authorities. This has led to significant challenges associated with the need to adjust the regulatory framework after privatization had taken place.

In 1994, the Australian Government decided to privatize its main airports, formerly under the control of a state enterprise called Federal Airports Corporation ("FAC"). [11] Following the privatization decision, FAC was then split up into 22 new companies, so as to facilitate the concession of specific airports. The privatization process was designed considering the strategic importance

[3] See (Copenhagen Economics, 2012), p. 3.
[4] See (Organization for Economic Co-operation and Development - OECD, 1997), p. 7.
[5] See (Copenhagen Economics, 2012), p. 3.
[6] See (Copenhagen Economics, 2012), p. 20; and (Fiuza and Pioneer, 2009), p. 40–41.
[7] For example, UK authorities have concluded that except in special circumstances, passengers will only travel between 60 and 120 min to catch a flight, depending on the type of passenger involved and the destination – with the usual passenger regularly travelling up to 90 min (UK Civil Aviation Authority, 2012), p. 37–46.
[8] (Copenhagen Economics, 2012), p. 15. and (McKinsey and Company, 2010), p. 267.
[9] An example of how competition can increase investments is the one found between the terminals of Frankfurt, Munich and Dusseldorf to become Lufthansa's hub, described in (Copenhagen Economics, 2012), p. 37–38.
[10] (Gonçalves, 2010), p. 22.
[11] For further information on the strategic importance of airports in Australia, the current state of airports and sector planning for the future, see (Australian Government - Department of Infrastructure and Transport, 2009).