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The design of light-handed regulation of airports: Lessons from experience in Australia and New Zealand

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ABSTRACT

The difficulties experienced with traditional forms of economic regulation of airports involving direct control of prices have led to an interest in light-handed regulatory frameworks. Experience with light-handed regulation of airports is primarily confined to Australia and New Zealand. The paper examines the design features of light-handed regulation in Australia and New Zealand in relation to the stated objectives associated with the introduction of light-handed regulation. The paper identifies important aspects associated with the design of light-handed regulation including the incorporation of a credible threat of stronger regulation and the characteristics of this, and an apparent trade-off in objectives achieved with different approaches to light-handed regulation.

1. Introduction

Light-handed regulation (LHR), where prices are not directly determined by regulation unless specific circumstances arise, has characterized airport regulation in Australian since 2002 and in New Zealand since the late 1980s. The approaches used in both countries have attracted the interest of government organizations considering potential changes in airport regulatory frameworks as well as others interested in airport economics. Governments and airport regulators have shown an interest in alternative regulatory approaches to traditional regulation of airport services involving direct price setting, such as price cap or rate of return regulation. Some examples include the Commission for Aviation Regulation (CAR) (2001) in Ireland in consultations related to the development of regulatory arrangements and the Airports Economic Regulatory Authority of India (2009) in a *White Paper* which reviews alternative approaches to regulation for privatized airports in India.

Forsyth (2002, 2008) has examined the performance of light handed regulation in Australia and New Zealand. Domney et al. (2005) have explored the relationship between privatization, regulation, market power, profitability and technical efficiency of New Zealand and Australian airports under different regulatory regimes. Two papers, one by Schuster (2009) and one by O'Donnell et al. (2011) have reviewed the experience of LHR of Sydney Airport. Littlechild (2012) examines Australia's approach to airport regulation and the issues that were under review in the 2011 Productivity Commission inquiry.

The experience of LHR of airports in Australia and New Zealand is examined from a different perspective to previous authors. It is examined from the point of view of whether it can and has achieved the stated objectives associated with its introduction in each country. While there are often political and philosophical objectives associated with the introduction of LHR, it is the performance of LHR in relation to stated objectives associated with its introduction in Australia and New Zealand that is of concern here. By examining the evolution of LHR and the approaches taken to the design of LHR of airports in Australia and New Zealand an increased understanding of LHR and its effectiveness as a regulatory tool is achieved. Three distinct models of LHR are examined; the initial information disclosure regulation introduced in New Zealand in the late 1980s, price and quality of service monitoring introduced in Australia in 2002, and enhanced information disclosure regulation introduced in New Zealand in 2008. An examination of the design of alternative approaches to LHR offers an alternative way of understanding some of the advantages and disadvantages of different approaches to LHR. It is important for governments considering the application of LHR to airports with market power to understanding how different approaches to LHR have performed.

It is timely to undertake a review of LHR of airports in Australia and New Zealand because there have now been two independent reviews of the Australian regulation and a new approach to LHR has recently been implemented in New Zealand with two assessments of airport performance undertaken. The different approaches have

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mainly been assessed by drawing on the findings from independent inquiries on the regulatory frameworks (Productivity Commission, 2006, 2011; NZCC, 2002) and two reports on airport performance under the new information disclosure approach in New Zealand (NZCC, 2013a, 2013b). In addition, government documents and industry literature have been reviewed and discussions held with industry and government representatives in Australia and New Zealand.[1]

The focus of this paper is on LHR in the form of price and quality of service monitoring in Australia and information disclosure regulation in New Zealand. This regulation has three key design elements in common: information requirements, reporting arrangements, and a threat of stronger regulation. Approaches involving regulatory intervention to resolve disputes in the event that negotiations fail, including negotiate-arbitrate regulation, is another form of LHR that has been applied to airports in Australia. This approach is not the focus of this paper.

The paper is structured as follows. Background information on the characteristics of airports in Australia and New Zealand, their regulatory frameworks, and the reasons for adopting LHR in Australia and New Zealand are contained in Section 2. Section 3 describes and compares the design of LHR in Australia and New Zealand. Section 4 examines the assessed performance of LHR in Australia and New Zealand in relation to key objectives of LHR drawing on the design features of the different approaches. A summary and lessons learned on the design of LHR are provided in Section 5.

2. Background on light-handed regulation of airport services

2.1. Characteristics of major airports in Australia and New Zealand

Australia and New Zealand are politically, culturally and economically similar and as island nations are reliant on air transport. The major international airports in Australia and New Zealand which are subjected to LHR are privatized, or partially privatized. Each is separately owned. They are small to medium in size by world standards for international airports. Sydney Airport with 36 million passengers in 2010–2011 is significantly larger than other airports in Australia and New Zealand (Table 1). These airports have generally been considered to have significant market power, particularly in relation to domestic air transport (for example Productivity Commission, 2006, 2011, New Zealand, *Commerce Amendment Bill, 2008*. Explanatory Note).

In Australia price and quality of service monitoring of major airports is conducted by the national competition regulator, the Australian Competition and Consumer Commission (ACCC) under the *Competition and Consumer Act 2010* (CCA). In New Zealand the regulatory framework is contained in the *Airports Authorities Act 1966* (AAA), administered by the Ministry of Transport from 1999, and the *Commerce Act 1986* (the Commerce Act), administered by the New Zealand Commerce Commission (NZCC). In 2008 amendments to the Commerce Act introduced new arrangements for economic regulation in New Zealand, including enhanced information disclosure regulation which applies to New Zealand's major international airports in addition to existing requirements under the Airports Authorities Act 1966 (AAA).

[1] Discussions were held with representatives of Air New Zealand, Auckland International Airport, Board of Representatives of New Zealand, Commerce Commission, Ministry of Business, Innovation and Employment, and Wellington International Airport in New Zealand 1–6 November 2012 and at various times with representatives of the ACCC, Board of Airline Representatives, Melbourne Airport and the Productivity Commission.

Table 1
Characteristics of major airports in Australia and New Zealand subject to light handed regulation.

Airport	Passengers 2010–2011 millions	Ownership	Total airport revenue 2010–2011	Aeronautical revenue 2010–2011%
Sydney	36	Fully privatized in 2002 Map listed on ASX	$963 m	54
Melbourne	28	Fully privatized in 1997	$545 m	42
Brisbane	20	Fully privatized in 1997	$456 m	43
Perth	11	Fully privatized in 1997	$296 m	35
Adelaide	7	Fully privatized in 1998	$161 m	54
Auckland (AIAL)[a]	14	Privatized listed on NZX 1998	$398 m	45
Wellington (WIAL)[a]	5	Private co. 67% owned by Infratil	$94 m	61
Christchurch (CIAL)[b]	6	Partially privatized	$98 m	

[a] Auckland Council and Wellington Councils have minority shareholders with 22.4% and 33% shareholdings respectively.
[b] Christchurch Council has a 75% shareholding and the New Zealand Government has 25%.
Sources: Various including Productivity Commission (2011), ACCC (2012), 2011 Annual reports Auckland International Airport, Christchurch International Airport Limited and Wellington International Airport Limited.

2.2. Economic regulation of airports

Airports have a number of economic characteristics which are different, or at least different in degree, from other regulated industries. Airports can be subject to some competitive influences including the existence of secondary airports; there is substitutability in the location of some airport services, such as heavy maintenance; airlines may have countervailing buyer power and potentially non-aeronautical competitive services may influence the pricing of aeronautical services. For many airports competitive influences on airport prices imply that economic regulation is either not warranted, or that 'lighter' or less intrusive regulation is appropriate. Starkie (2008), for example, has raised the issue of the appropriateness of traditional approaches to regulation of airports involving direct controls on prices, such as price caps and rate of return regulation. He supports the use of lighter handed approaches or no regulation at all. Biggar (2011) has presented an alternative view and argues that economic regulation of airports is not about constraining the potential use of market power by airports and the consequent misallocation of resources, but rather the major purpose is the protection and promotion of sunk complementary investments by airport users. Biggar argues that if this is a primary purpose of airport regulation then control of prices in order to prevent price shocks is important for users.

The distinctive characteristics of airports also imply that the administration of traditional regulation involving direct controls on prices has particular challenges. Airports are complex businesses providing a wide variety of services to a wide variety of users. The demand for aviation services, and hence airport services, can be quite volatile and subject to shocks. An example of this is challenges for the Commission for Aviation in Ireland in determining five year price caps for Dublin Airport for the period 2010–2014 when there was a large capital expenditure project for a new airport terminal and very rapid changes in demand for airport services (Arblaster, 2010).

2.3. The introduction of light-handed regulation of airports in Australia and New Zealand

Australia and New Zealand have been leaders in the introduction of LHR to airports services. LHR of airport services arose for