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Economic regulation of privatised airports: Some lessons from UK experience

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ABSTRACT

This paper describes the evolution over time of policy, structure, competition and regulation of UK airports. Restructuring an airport sector at the time of privatisation will better enable airports to compete. If this is not done, the structure can be revised later, although by then the opposition will be greater. The appropriate form and focus of airport regulation will and should evolve over time, as experience accumulates and as economic and technical opportunities themselves evolve. As competition develops, the extent of airport regulation can with advantage be reduced over time, with a correspondingly increased role for airlines and their customers.

1. Introduction

Countries that are planning the construction of a new airport have a number of important decisions to make, including as to ownership, competition and the extent and type of regulation. This paper considers the experience of airport privatisation, competition and regulation in the UK, and identifies some lessons to be learned.

The British Airports Authority (BAA) was privatised in 1987 as a single entity. The regulatory framework for airports fell short in more than half a dozen respects of what became the ‘standard’ regulatory framework for other UK privatised sectors. Nevertheless, over the next 30 years, competition was promoted in the airport sector, not least between the original BAA airports. The problematic aspects of regulatory structure were gradually adjusted to bring them into line with the standard model. In addition, there have been several significant regulatory innovations. These have provided inspiration for actual and potential regulatory developments in other sectors.

This paper describes the evolution over time of policy, structure, competition and regulation of UK airports. There is benefit in restructuring an airport sector at the time of privatisation, to enable airports to compete. If this is not done, the structure can be revised later, although by then the opposition will be greater. The appropriate form and focus of airport regulation will and should evolve over time, as experience accumulates and as economic and technical opportunities themselves evolve. As competition develops, the extent of airport regulation can with advantage be reduced over time, with a correspondingly increased role for airports to negotiate with airlines and their customers.

2. This paper and the literature

There is now a considerable literature on ownership, competition and the economic regulation of privatised utilities. Kahn (1970, 1971) is the classic on US regulation. Joskow (2000) covers theory and empirical evidence over the next quarter century, mostly related to the US.

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Early analyses of privatisation in the UK context include [Vickers and Yarrow \(1988\)](#), [Veljanovski \(1989\)](#) and [Foster \(1992\)](#). Early developments and discussions of UK regulation include [Littlechild \(1983\)](#) on RPI-X, [Beesley and Littlechild \(1989\)](#), [Veljanovski \(1991\)](#), [Armstrong et al. \(1994\)](#), [Green and Rodriguez-Pardina \(1999\)](#) and [Baldwin and Cave \(1999\)](#).

There are numerous applications of these ideas and policies to UK airports. [Starkie and Thompson \(1985\)](#) argued for break-up of BAA. [NERA \(1986\)](#) reviewed the Department of Transport's initial proposals for regulation. [Parker \(2012, ch. 3\)](#) provides the official and detailed account of the BAA privatisation as part of his fascinating and monumental official history of all the UK privatisations. [Vickers and Yarrow \(1988, ch. 10\)](#) provided an early critique. [Toms \(1994, 2003, 2004\)](#) gave BAA's perspective, [Hendriks and Andrew \(2004\)](#) a regulatory perspective. [Starkie \(1994, 1999, 2001, 2002a,b, 2005a,b, 2008\)](#) argued for more competition and lighter-handed regulation in numerous respects. [Graham \(2008\)](#) concluded that “the regulatory and industry structure that were established twenty years ago is now outdated and in need of a full-scale coordinated review”.

[Kunz \(1999\)](#) reviews airport regulation with implications for Europe. For critical discussions of regulation in continental Europe, see [Niemeier \(2002, 2003, 2010, 2011\)](#) and [Gillen and Niemeier \(2008\)](#). [Oum et al. \(2006, 2008\)](#) and [Adler and Liebert \(2014\)](#) find that fully privatised airports and public airports perform better than airports with mixed ownership (such as partially privatised airports in Continental Europe).

Extensions to Australian and other international contexts include [Forsyth \(1997, 2002, 2003a\)](#), [Forsyth et al. \(2004\)](#), [Oum et al. \(2004, 2006\)](#), [Fu et al. \(2006\)](#), [Winston and de Rus \(2008\)](#), [Reinhold et al. \(2009\)](#), [Assaf and Gillen \(2012\)](#), [Biggar \(2012\)](#), [Scotti et al. \(2012\)](#), [Liebert and Niemeier \(2013\)](#), [Fasone et al. \(2014\)](#), [Adler et al. \(2015\)](#), [Phang \(2016\)](#), [Neto et al. \(2016\)](#), [Chen et al. \(2017\)](#), [Thelle and Sonne \(2017\)](#), [Cruz and Sarmento \(2017\)](#) and [Wiltshire \(2017\)](#). [Forsyth et al. \(2016\)](#) provide a recent overview on performance and regulation.

For analysis and review of North American settlements see [Wang \(2004\)](#) and [Doucet and Littlechild \(2006, 2009\)](#). [Littlechild \(2009, 2014a,b, 2017\)](#), [Bush and Earwaker \(2015\)](#) and [Hahn et al. \(2017\)](#) discuss customer engagement in the UK. [Starkie \(2012\)](#) explains airport-airline contracts in Europe. For light-handed regulation of airports in Australia see [Forsyth \(2003b, 2008\)](#), [O'Donnell et al. \(2011\)](#), [Littlechild \(2012\)](#), [Arblaster \(2014, 2016, 2017\)](#) and [Lohmann and Trischler \(2017\)](#). [Arblaster and Hooper \(2015\)](#) explore the scope for extending such an approach to the developing world.

3. Ownership and incentives

By the late 1970s, the UK was characterised by large scale public ownership of major sectors of the economy. Their investment programmes were costly to fund. Increasingly, concerns arose about the inefficiency of such nationalised industries, which imposed higher costs on the rest of the economy. The industries were also felt to be unresponsive to the needs of customers. Conservative Governments after 1979 increasingly came to see privatisation and (more gradually) competition as the most effective way to address these problems. Subsequent Governments generally accepted these privatisations, and focused on increasing competition and also regulation.

At first, the Government privatised a number of state-owned companies operating in competitive markets. In 1984, British Telecommunications (BT) was the first major utility and de facto monopoly to be privatised, with the aim of making it more efficient and more customer-responsive. This would include increasing the provision of telephones to customers: at that time there was a considerable waiting list and it could take months or in some cases even years to obtain a telephone. Private ownership and exposure to competition were also expected to make the company more innovative. The prospective privatisation of BT also prompted the development of a form of regulation (RPI-X, explained below) that would incentivise greater efficiency and innovation, which US regulation was considered not to do. ([Littlechild, 1983](#))

British Gas was privatised in 1986, also as a monopoly. This was quicker than breaking it up, and secured the company's support. The company was given a similar RPI-X incentive price control.

Subsequent evaluations have not generally challenged the potential benefits of privatising these companies, though they have often argued that more competition should have been introduced sooner, including by restructuring – that is, by breaking up the nationalised company before privatisation. ([Vickers and Yarrow, 1988](#); [Armstrong et al., 1994](#)) As explained below, British Gas was later induced to split itself into three separate companies. Despite calls to do so, BT was not subsequently restructured – but whether its telephone poles and cables business Openreach should be in separate ownership remains a live issue today.

Drivers of privatisation in other sectors included reducing the need for government finance. For example the prospective cost of investment needed to improve water quality to meet European Directives was so high that public funding would have been difficult. Privatisation of the water sector in 1989 was a means of accessing the private capital market. Privatisation reflected other aims too, including widening share ownership, reducing government involvement in enterprise decision-making, easing problems of public sector pay determination, and not least raising proceeds for the Treasury.

4. Airport privatisation

The Conservative Party's 1983 election manifesto contained a commitment to privatise “as many as possible” of the publicly owned airports in the UK. These included the 7 large ones operated by BAA (viz. Heathrow, Gatwick and Stansted in or near London

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