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Airport competition: Reality or myth?

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ABSTRACT

This paper examines the extent to which the trend towards increasing corporatization and privatization of the airports sector has altered the dynamic between airports, airlines and most importantly the end-customer, the air passenger or the cargo-shipper.

Observed passenger behaviour shows that in spite of increasing use of secondary airports, in particular by low cost carriers, passengers' preference to use their local airport is stronger than is predicted by isochrones analysis. The paper finds no evidence of an increasing rate of route openings or closures; passengers face significant switching costs in terms of surface access time and money while for airlines switching costs take the form of investment in facilities, staff recruitment and foregone revenue. Where airlines' do exit a market, the paper finds that they will be replaced if there is sufficient demand, but not if there is an insufficient consumer base to support viable commercial operations.

In conclusion, the paper finds limited evidence of secondary airports being able to compete effectively with their larger neighbours. The recent trend for airlines, including low-cost carriers, to migrate services from secondary to primary airports supports this conclusion, implying an ongoing need for robust economic regulation at primary airports across Europe.

1. Introduction

Airports are a key link in the air transport journey chain. On short-haul journeys in particular, passengers may spend as much, or even more, time at the airport as they do in the air. And on arrival at their destination, the airport contributes to their first impression of a city or country.

Airports can therefore play a critical role for economic development on local, national and regional levels. As Morrell (2010) notes, the potential for airports to bring considerable benefits to their surrounding areas is one reason why many airports in Europe remain in public ownership.

However, there is an increasing trend towards full or partial privatization of airports, and even where airports remain in public ownership they have often been corporatized, with financial targets akin to a fully-private, profit-maximising entity. As with utilities such as telecommunications and energy provision, one would expect the privatization or corporatization of airports, with at least some characteristics of natural monopolies, to be accompanied with appropriate, independent economic regulation.

1.1. Why regulate?

The rationale for economic regulation is to counterbalance the existence and use of airport market power resulting from airports not being subject to competitive forces. As Forsyth et al. (2010) note the two primary reasons why airports may not be subject to market forces are: locational reasons and natural monopoly reasons.

The locational explanation argues that for most airports there are no close substitutes as attractive locations are limited. The natural monopoly argument relies on economies of scale in airport provision. Thus, a monopoly is efficient as two or more airports would lead to higher average costs.

1.2. Economic regulation of airports in Europe

The 2009 Airport Charges Directive applies to all airports handling more than 5 million passengers per annum. Around 70 EU airports fall within the scope of the Directive; representing just under 80% of EU passenger traffic. The Directive sets out minimum transparency requirements around how charges are calculated and mandating airports to consult airlines. However, a 2014 review of the Directive by the European Commission (2014) found that while there have been some positive results, implementation of even such a light-touch framework has been inconsistent.

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At a national level, there is also considerable variability, ranging from sophisticated financial analysis at one end of the spectrum through simple, inflation-linked changes in charges to full deregulation at the other.

Unsurprisingly, the airports themselves favour deregulation, arguing that as a result of liberalisation in both airline and airport markets, the flexibility and choices available to airlines and passengers now constrain the commercial behaviour of airports. The airports consider that airports now have to compete with one another on price and service quality in order to retain and attract the traffic they need as both passengers and airlines are now 'footloose', rendering economic regulation unnecessary at many airports.

On the other hand, as noted by Müller-Rostin et al. (2010), there is little empirical evidence on the intensity of competition among airports leading them to conclude that despite changes in both airport and airline sector "competition [between airports] is still minimal and not sufficient to prevent airports from abusing their market power". The purpose of this paper is to examine a number of the indicators which might signal either the existence of competition between airports or the ability of airlines to constrain airport behaviour or alternatively the presence of airport market power.

2. Airport charges

Perhaps the most obvious indicator of the extent to which a business is or is not subject to competitive pressure comes from its pricing behaviour, in this case airport charges. For example, evidence of airports lowering charges might suggest that their pricing power is constrained by competitive pressure.

However, as Fig. 1 shows the opposite has been true in recent years. While airlines' controllable operational costs declined significantly between 2001 and 2011 (and separate evidence shows that inflation-adjusted air fares fell by even more), airport infrastructure costs increased by over 70% in the same period.

Fig. 2 shows the evolution in the level of airport charges levied at airports in Europe between 2009 and 2012.

As can be seen, in 2009 half of airports did indeed reduce their charges as the global economic crisis hit Europe. However, only two years later, with the European economy as a whole still struggling and many major economies in recession, three-quarters of airports increased their charges. There appears to be very limited evidence of a strong constraint on airports' power, even in a very challenging macroeconomic environment.

2.1. Countervailing power

For the largest airports in Europe, Leigh Fisher (2012) report that 21 of the 24 largest airports increased their charges in 2010 and in 2011, 23 out of 24 put their charges up. These airports include the home hubs of many Europe's major network carriers, many of whom account for over 50% of traffic at their hubs. Some authors (see, for example, Haskel et al. (2011)) and many airports have argued that airlines at some airports are able to exercise buyer market power in order to constrain airport pricing. The Leigh Fisher data do not support this hypothesis.

2.2. Airport entry and threat of entry

The entry or even the threat of entry of new airports into a market might be expected to have some effect in constraining the pricing behaviour of incumbent airports. Müller-Rostin et al. (2010) found that during the period 1995–2005 only 22 airports entered the market entries occurring during this period. The study concluded that entry and exit in the airport industry is not so much driven by commercial opportunity, but rather by the desire of public airports to increase economic activity for the surrounding region. Most of the new entries were reported to only serve only airline, generally a low-cost carrier.

3. Passenger behaviour – competition between neighbouring airports

As observed by Forsyth et al. (2010), 'traveller and shipper choice lies at the heart of the airport competition issue – the strength of this competition depends on how good as substitutes travellers regard different airports to be'.

This section examines passenger behaviour with regard to airports choice, and reviews a range of approaches in considering whether there is evidence of increased willingness to travel to alternative airports which might be indicative of airports being subjected to increased competitive pressure by their neighbours.

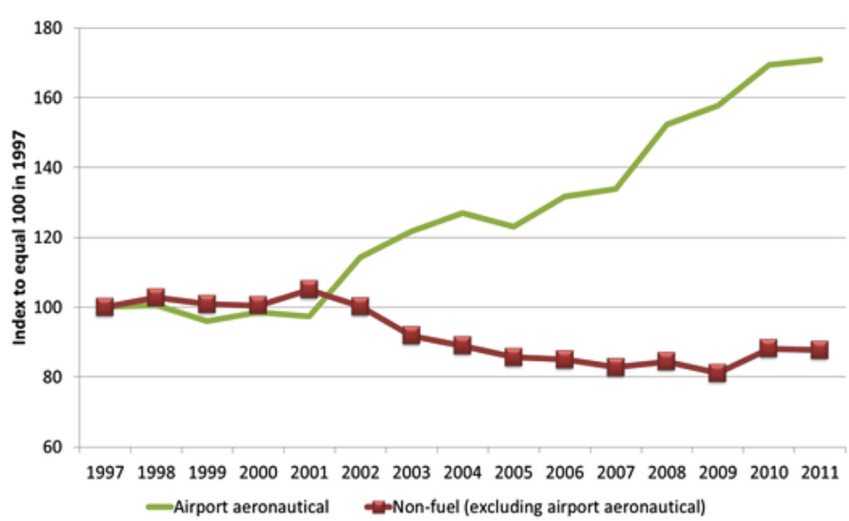

Fig. 1. Airport infrastructure unit costs vs other non-fuel unit costs per ASK.
Sources: ICAO, IATA and ACI. Note: figures are USD exchange rate adjusted

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