



Review of Regulatory Framework for UK Airports

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Outline

- Background
- Assessing the performance of economic regulation
- Options for regulation, and their consequences
- Summary



Current statutory framework

- CAA's role as an economic regulator established with the Airports Act 1986 which requires the CAA:
 - To set maximum limits on airport charges
 - at designated airports (initially Heathrow, Gatwick, Stansted and Manchester airports)
 - every 5 (or 6) years
 - with automatic reference to the Competition Commission
 - To deal with complaints of anti-competitive behaviour
 - To oversee the provision of accounting information
- Requires the CAA to discharge its functions in manner best calculated:
 - To further the reasonable interests of users of UK airports
 - To promote the economic, efficient and profitable operation of UK airports
 - To encourage investment in time to satisfy anticipated demand;
 - To impose the minimum restrictions necessarywhile having regard to specified international obligations.

Views are mixed on the nature of the problem ...

Some say

Airport charges are too high

RAB-based regulation encourages 'gold-plating'

BAA is inefficient

There should be more competition between BAA's London airports

Others say ...

Airport charges are too low

BAA has under-invested, and the fabric of airports is poor

BAA should not exploit commercial opportunities

There should be more regulation of BAA's London airports

... so careful analysis of the evidence required:

- observed outcomes are consequence of multiple factors
- with implications for burden of proof
- bear in mind that many parties have vested commercial interests

CAA thinks that economic regulation has brought benefits:

- strong incentives to make best use of available runway and terminal capacity
- strong incentives to invest
- limits on airport charges have prevented excessive prices
- stand-alone regulation has prevented potentially anti-competitive behaviour
- significant – and strengthening – financial incentives/penalties around service quality
- strong incentives operating efficiency (and incentives to grow commercial operations)

... though we recognise that regulation is far from perfect:

- strong incentives to maximise passengers served might have exacerbated congestion
- incentives to invest are insufficiently differentiated according to value of different investments
- price controls could dampen investment incentives at other (non-regulated) airports
- end-users/consumers may not have benefited from limits on airport charges
- strong incentives to develop commercial operation could detract from service offered
- regulation can subdue innovation

Yet, overall, economic regulation has brought net benefits compared to relevant counter-factual (i.e. joint ownership without regulation)

Is there a market solution?

- Good evidence to suggest there is a market solution:
 - while airports are highly capital intensive, the industry is not a natural monopoly
 - there is competition between many UK airports all within planning and airspace restrictions
- But is it different in the South East of England?
 - under common ownership?
 - in separate ownership?
- And would Heathrow (or Gatwick) need to be regulated under separate ownership?
- Difficult to answer 'No' – definitively – in the abstract ...
- Sensible to return to this question once the Competition Commission has completed its market investigation.

If there is a need for regulatory intervention, what form should it take?



- Standard form of independent economic regulation:
 - Parliament sets clear – and enduring – statutory duties on regulator
 - These focus on protecting consumer interests over time by promoting competition
 - Independent economic regulator is granted powers to act in a manner best calculated to meet these duties
- See no clear reason to depart significantly from this model
- Though adopting standard approach would entail modifying the Airports Act 1986 in a number of ways:
 - Clarify duties to focus on consumers, not users
 - Grant CAA concurrent powers to enforce competition law
- And adequate checks, e.g. appropriate appeals procedures, and safeguards against ‘regulatory creep’

Is there a case for additional Government intervention?

- **To address perceived shortcomings in the ‘passenger experience’?**
- Perhaps, but:
 - would it be necessary/desirable for both Government and the regulator to regulate service quality?
 - would intervention to regulate, say, airlines or baggage handlers be consistent with competition between airlines?

Is there is a case for additional Government intervention ...

- **To mandate – or direct – airport operators and/or the regulator to deliver particular investments?**

Perhaps, but:

- would Government direct airport operators or the regulator?
- how would such investment be justified? Would positive externalities need to be demonstrated?
- how would the additional costs be met? State funding? Cross-subsidy administered by the regulator? 'System'? Airport development fund?
- would such a regime be consistent with: state aid rules? European competition law? International obligations?
- would it be consistent with providing a stable, long term regime?

Summary

- Regulation has brought benefits; but it is by no means perfect
- It is difficult to judge – at this stage – whether competition and competition law likely to be adequate at this stage
- If regulation is required, then the standard model of independent economic regulation likely to be an appropriate basis for regulation in future, with:
 - a clear focus on protecting consumers
 - greater flexibility to tailor regulation to different circumstances across airports
 - adequate checks & balances
- Possible case for Government intervention over and above independent regulation, but this begs a number of questions, most obviously: who would pay?