BARNZ

VOICE OF THE AIRLINE INDUSTRY

Submission

Economic Regulation of Australian airports

To Australian
Productivity Commission

25 March 2019

Introduction

1. This is the response of the Board of Airline Representatives New Zealand (BARNZ) to the Productivity Commission on its draft report *Economic Regulation of Airports*.
2. This submission is made on behalf of the BARNZ member airlines, listed in the Appendix. Some members may make their own submissions.
3. BARNZ's Executive Director, Justin Tighe-Umbers, will be attending the hearing in Melbourne on 29 March.
4. In this submission we do not respond in detail to the conclusions and analysis in the draft report – we leave that to our Australian counterparts and our member airlines that choose to make a submission. Our focus is to provide information on and draw out lessons from the New Zealand experience that may be of interest for Australian airport regulation.

Consumer benefits from price reductions

5. The Draft Report appears to hold a view that even if the regulatory regime was reformed to more evenly balance the negotiating position between airlines and airports (through negotiate/arbitrate regulation), this may not benefit consumers. The Draft Report suggests this is because airlines may not pass on any cost savings to their passengers (e.g. p.101/102), or because an imbalance of negotiating power in itself does not cause harm to the community (p.272).
6. We find these views difficult to reconcile with our experience of New Zealand airport pricing decisions. It is the imbalance in negotiating power between airports and airlines in New Zealand that has enabled airports here to target excessive profits. While Wellington Airport in 2014 and Auckland Airport in 2019 have returned some of the excessive profits to customers, they both kept a portion of the excess returns, to the detriment of consumers. A stronger negotiating power for airlines could have mitigated this impact.
7. Also, in New Zealand, airlines seek reductions in airport charges (and government taxes on air travel) because these costs flow through to airline tickets and impact people's propensity to travel – putting a brake on passenger volumes and making it harder to maintain cost efficient load factors. It is not feasible for airlines to retain the cost reductions for themselves, given the very strong competition in place for air travel. In New Zealand we have over 30 international airlines offering services to 46 destinations around the world. We understand the Australian international and domestic markets are even more competitive.
8. To us it seems self-evident, and is confirmed by feedback from our member airlines, that where a monopoly service provider has a stronger bargaining position when negotiating with service users that are in strong competition with each other, a reduction in the stronger bargaining position will benefit consumers, because any rents gained by the competitive sector will be competed away in short order. We ask the Productivity Commission to reconsider its view that an increase in airline countervailing power may not benefit consumers in an environment where airlines are in strong competition with each

other, because this does not fit the experience of our members or describe how competitive markets should operate.

Information requirements alone are insufficient

9. Major Australian airports publish detailed information on their costs, revenues and profits. In some areas, the Productivity Commission's draft report identifies gaps in the information that mean in some cases it is not possible to be certain whether market power is being exercised by the major airports. The Productivity Commission's recommended solution (Draft Recommendation 10.4) lists the additional information that each airport should provide.
10. The New Zealand experience is that a requirement to publish information is not, by itself, a constraint on airport market power. However, we have found that when airports publish information <u>and</u> a regulator reviews the information and publishes a view on whether the airport's prices are reasonable, this can lead to improved outcomes.
11. Wellington Airport in 2014 and Auckland Airport in 2019 have both agreed to reduce their prices in response to a finding by the regulator, the Commerce Commission, that their returns were not justified and the airports may be targeting excessive profits.
12. These results were not achieved by the publication of the information on its own, although that was a necessary input. They were achieved by two factors:
    a. The Commerce Commission determining a benchmark reasonable cost of capital for a provider of airport services.
    b. The Commission then reviewing the airports' target returns for the pricing period against the benchmark and the rationale for any deviation. The Commission published its findings and, with support from government Ministers, this led both Wellington Airport in 2014 and Auckland Airport in 2019 to reduce their prices.

The New Zealand 'regulatory benchmark' approach

13. We have found that what matters, in a price monitoring / information disclosure regime, is that the information can be reviewed and conclusions drawn <u>with a clear relation to the prices being charged</u> (which can then be changed if necessary).
14. As the Productivity Commission is aware, the New Zealand airport regulatory regime involves the publication of information at each price setting event, which is then reviewed by the regulator against pre-determined benchmarks, in particular a reasonable rate of return. The regulator publishes its report. At this stage it is a matter for the airports to decide whether, and if so how, to change their prices in response to the report.
15. It is important to recognise that the current New Zealand approach is not the preferred outcome for airlines operating in New Zealand. Like our Australian counterparts, we also have a clear preference for a negotiate/arbitrate regulatory regime as we believe that will best address the problem of an unbalanced playing field where the airport has power to set prices as it sees fit and airlines then have no option other than to pay the prices and hope for regulatory support. The light-handed regime in New Zealand has not delivered

optimal outcomes in recent years and we have seen a poor link between price and quality, some unjustifiably high pricing and the prioritisation of shareholder returns over investment. These are all issues we believe a well-designed negotiate/arbitrate regime would help to address.

16. However, we offer some observations below to indicate how, in the absence of negotiate/arbitrate regulation, there are some aspects of the current New Zealand regime that are beneficial and could deliver improvements in the Australian context also.

17. The Draft Report does not recommend the adoption of the New Zealand approach of the regulator setting a benchmark cost of capital for the major airports. We respond to each of the reasons given in the Draft Report (pages 308-309) in the table below:

Draft Report reasoning	Response
"the Commission has not found evidence that airports have systematically exercised their market power..., so there is no need for heavier-handed regulation"	Based on our New Zealand experience, we do not believe the publication of a benchmark return and a review of whether airports are exceeding that return to be 'heavier handed'. The benchmark simply provides a starting point for airports, airlines and the regulator to use when assessing an airport's profitability. The publication of the benchmark, in itself, does not impose any additional regulation on the airport.
"setting benchmark returns is complex and contested, and the costs of doing so are not justified in the Australian context"	Setting benchmark returns may be complex and contested, but it is also done in multiple regulatory regimes around the world across multiple industries and there are standard models that can be applied and benchmarks that can be referred to. What we have found in the New Zealand context is the initial benchmark decisions were contested, but once that initial decision was made, subsequent decisions have not been challenged – the establishment of the benchmark provides certainty for all parties and helps to narrow the range of debates. Also, as the Draft Report acknowledges, the current price setting process for airports is "time consuming, resource intensive and costly" (page 124). We suggest the Productivity Commission consider whether processes may be easier and cheaper for all parties if there was a clear benchmark to start from.

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Draft Report reasoning	Response
	In other words, any up-front costs of setting the benchmark are likely to be more than compensated for over time by reducing levels of dispute and disagreement between the parties.
"the approach would impose significant additional compliance and administration costs on the monitored airports and the ACCC"	As discussed above, there would be a cost in setting the initial benchmark. However, once this is done we do not see why additional costs would be incurred that are materially above the costs already in place for airports to publish information and the ACCC to produce a monitoring report.
"the appropriate forum to assess whether airports have systematically exercised their market power is in the periodic reviews by the Productivity Commission"	The Productivity Commission carries out a broader five-yearly inquiry into the regulatory system. The New Zealand experience suggests that a more effective approach is to review the targeted returns of each airport when it sets prices – this provides a quicker response to any exercise of market power and ties findings to a particular pricing period in which the airport can then reduce its prices if required.

Contact details

18. We trust this submission has been of assistance. If you have any further questions, please contact:

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Appendix – List of BARNZ Members

Airline Members	
Air Calin	Air China
Air New Zealand	Air Tahiti Nui
Air Vanuatu	Airwork
American Airlines	Cathay Pacific Airways
China Airlines	China Eastern Airlines
China Southern Airlines	Emirates
Fiji Airways	Hainan Airlines
Hong Kong Airlines	Jetstar
Korean Air	LATAM Airlines
Malaysia Airlines	Philippine Airlines
Qantas Airways	Qatar Airways
Sichuan Airlines	Singapore Airlines
Tasman Cargo Airlines	Thai Airways International
Tianjin Airlines	United Airlines
Virgin Australia Airlines	

Non-Airline Members	
Menzies Aviation (NZ)	OCS Group NZ
Swissport	Glidepath