

# **Submission to the Department of Transport, Tourism and Sport on the Review of the Regulatory Regime of Airport Charges in Ireland**

**16th September 2016**

## **Executive Summary**

Dublin Chamber welcomes the opportunity to contribute to the Department's consultation on the regulatory regime of airport charging. With 25 million people coming through Dublin Airport in 2015, a figure not originally forecast until 2019, it is clear that the airport is one of the most important pieces of infrastructure in Dublin, and indeed Ireland.

It is important that the airport is accessible to airlines operating flights to a range of destinations, to encourage both the increase in tourism that has been evident since 2013, and to maintain the connectivity required of both indigenous business expanding abroad and multinational enterprises engaged in FDI in Ireland.

With that in mind, it is important that the charges levied to airlines by the Dublin Airport Authority are reflective of the cost of providing the infrastructure used at the airport. This must include sufficient funding to cover operational expenses and investment in the airport to ensure that it is prepared to expand in line with its current passenger number forecasts.

In the review prepared by Indecon Economic Consultants, Dublin Airport is judged to be in a dominant market position. It is further judged that it should be subject to strict price regulation. Dublin Chamber believes this to be an incorrect assessment.

We further believe that the market is improperly defined in the Indecon review and does not adequately reflect the realistic catchment area for Dublin Airport.

Furthermore, with two of the airport's largest customers, Ryanair and Aer Lingus each accounting for 40% of the passenger numbers moving through the airport, it is clear that the countervailing power of airlines should be given significantly more weight than in the initial assessment.

The most appropriate form of regulatory regime for airport charges is price monitoring. The regulator would set a price above which the customer could ask for the price to be adjudicated upon but if both parties were content with a higher price, the regulator would not become involved.

This submission must also be read in the context of the Dublin Airport Authority consistently charging less than the allowed amount, and not being permitted to appeal for an increase in the event of increased expenditure due to unforeseen circumstances, such as increased security measures, until the price cap is scheduled for review.

## Market Power

### ***Do you agree with this finding on market definition? If not, what would you propose as a more appropriate definition?***

The definition of Dublin Airport's geographic market should not be limited to the Republic of Ireland. The second and third largest airports on the Island of Ireland - Belfast International Airport and Belfast City Airport - are located in Northern Ireland and have overlapping catchment areas with Dublin Airport<sup>1</sup>. Dublin Airport serves a growing number of passengers from Northern Ireland, with 864,000 of passengers originating from Northern Ireland in 2014<sup>2</sup>. In view of this, the geographic market definition should be expanded to include Northern Ireland.

In addition, it is reasonable to consider that Dublin Airport faces competition in the market for serving point-to-point low cost carriers from several UK and European airports. Point-to-point carriers, such as Ryanair, comprise a significant proportion of carriers served by Dublin Airport<sup>3</sup>. In their report on Airport Competition in Europe, Copenhagen Economics notes that airports throughout Europe face increasing competition caused by active switching by point-to-point carriers<sup>4</sup>.

Due to the footloose nature of their business model, point-to-point carriers are both willing and able to switch between airports, placing a strong competitive constraint on European airports<sup>5</sup>. Excluding UK and European airports from the geographic market definition ignores this effect and overestimates the ability of Dublin Airport to exercise market power.

We note that transfer passengers have a choice of several hub airports across Europe and so for this passenger segment the relevant geographic market is likely to extend well beyond the Republic of Ireland. Transfer passengers have an increasing number of realistic alternatives in their choice of airport and so would likely be sensitive to price changes<sup>6</sup>. The 2015 National Aviation Policy for Ireland aims to establish Dublin Airport as a secondary international hub, indicating that Dublin Airport will increasingly compete with airports throughout Europe to attract transfer passengers<sup>7</sup>. In light of this, it seems reasonable to expand the geographic market definition beyond the Island of Ireland.

### ***Do you concur with the view that only airports which hold significant market power should be subject to economic regulation?***

As acknowledged by the Indecon report,<sup>8</sup> there are inefficiencies and market distorting costs associated with economic regulation. The application of economic regulation to airports with little market power and whose charges are sufficiently constrained by market forces is therefore unnecessary and not in the interest of consumers.

### ***Do you agree with the finding that Dublin Airport holds significant market power, which necessitates airport charges regulation for that Airport?***

The finding that Dublin Airport holds significant market power is based upon a geographic market definition limited to the Republic of Ireland. As discussed above, this may not be an appropriate definition and so may overestimate the level of market power held by Dublin Airport.

The limiting of airport charges in Dublin Airport also places an effective cap on the charges which may be applied by other Irish airports. In order to remain competitive,

airports such as Cork and Shannon airports must keep their charges below the level set for Dublin. The regulation of charges for Dublin Airport therefore risks introducing a de facto regulation of other Irish airports which do not hold significant market power.

Dublin Airport is one of Europe's fastest growing airports and reached a record 25 million passengers in 2015.<sup>9</sup> The power to apply reasonable airport charges is necessary in order to accommodate this growth and allow for investment in infrastructure and facilities. For context, in a comparison of airport charges across thirteen European countries conducted by Aviation Economics, Irish airports had the third lowest average per passenger charge.<sup>10</sup>

Dublin Airport set its charges below the existing cap level,<sup>11</sup> indicating that it faces competition from other airports sufficient to curtail its pricing. In light of this, further regulation of airport charges for Dublin Airport is unnecessary as market forces are capable of preventing the exercising of market power without interference.

## Countervailing Power

***Do you agree with Indecon's assessment of the degree of countervailing power held by airlines?***

Indecon's assessment of the countervailing power exercised by airlines is inconsistent. The assessment of Dublin Airport's market power relies on the high concentration of the Irish Airport market, as measured by the HHI. The market for airlines operating in Ireland is similarly concentrated and so indicates that airlines also hold a high degree of countervailing power.

As an example, Ryanair and Aer Lingus together represent 80% of the passengers moving through Dublin Airport and so possess a high level of market power.<sup>12</sup> While the Indecon report partially bases its estimation of the degree of countervailing power held by airlines on historical levels of route-switching it largely ignores capacity switching. From peak (2008) to trough (2011) of the economic cycle, both Ryanair (30%) and Aer Lingus (17%) reduced their capacity at Dublin Airport, while their overall passenger numbers declined only slightly (Aer Lingus) or in fact increased (Ryanair), suggesting that Ryanair at least took the decision to base some of its Dublin aircraft in other airports.<sup>13</sup> This indicates that Ryanair has been capable of switching its capacity to other airports in the past and so would be capable of switching again in the face of increasing airport charges.

## Regulatory Regime

***Do you agree with the finding that price cap regulation, with a single till is most appropriate for the economic regulation of airport charges at Dublin Airport? If you disagree, what do you propose as the most appropriate approach?***

A price monitoring system, similar to that used in Gatwick airport, may be a more appropriate form of regulation for Dublin Airport. A price monitoring system allows for increased pricing flexibility to preserve Dublin Airport's ability to react to changing costs.

The use of a price monitoring system rather than a price cap at Gatwick is motivated by concerns that price caps will distort competition between airports and distort investment

decisions.<sup>14</sup> For the period of 2010-2014, Dublin Airport's investment spending was above the regulatory allowance provided for under the prevailing price cap.<sup>15</sup> A price monitoring scheme would allow for Dublin Airport to adequately account for its investment costs in its pricing. Persisting with a price cap system runs the risk of discouraging investment and discouraging Dublin Airport from adequately planning for future growth.

While Dublin Airport currently has a single till price cap system similar to that of Heathrow, a more flexible regulatory regime, similar to that used in Gatwick, may be more appropriate. A system of price monitoring would allow Dublin Airport to determine airport charges through negotiation with airlines, which may produce charges closer to the competitive level. Additionally, Dublin Airport exhibits no *a priori* requirement for heavy regulation similar to Heathrow to ensure reasonable pricing as, since 2010, Dublin Airport has been consistently pricing below the cap imposed by CAR.<sup>16</sup>

The use of price cap regulation also exposes Dublin Airport to additional risk. Price cap regulation prevents Dublin Airport from changing prices to reflect unexpected costs or changes in demand outside of its control. Instead, Dublin Airport must absorb these costs through losses in profits, potentially resulting in profit volatility. This concern is highlighted by the experience of the Australian Competition and Consumer Commission. In 2002, Australia moved from a price cap to a price monitoring system for its major airports, partly in response to increasing profit volatility, concerns over investment levels, and in the wake of unexpected demand shocks.<sup>17</sup>

Similarly, airports such as Brussels, Auckland, Düsseldorf and Copenhagen all successfully operate under lighter regulatory regimes. Oxera note that there is also a growing trend towards dual rather than single-till regimes, with Paris-Orly and Rome-Fiumicino Airports using dual-till systems and Brussels Airport progressing towards dual-till, with a current adjusted-till system.<sup>18</sup>

Introducing a system of price monitoring rather than a price cap would bring the regulatory regime at Dublin Airport more in line with other airports of a similar size and market power, reflect the international trend towards lighter regulation, and reduce the distortionary effects of price regulation. Price cap regulation requires detailed and intensive analysis of airport costs and capital expenditure and so imposes high informational and compliance costs on both the regulator and the airport. A move towards lighter-touch regulation may therefore be the most appropriate approach.

## Footnotes

- <sup>1</sup> “our research suggests individuals may be willing to travel a ground distance of up to around 120 km to take a flight” Indecon International Economic Consultants (2016), ‘Review of the Regulatory Regime for Airport Charges in Ireland’, 11 March, p. 11., P.5
- <sup>2</sup> <http://www.irishtimes.com/business/economy/northerners-using-dublin-airport-as-a-regional-hub-1.2615147>,
- <sup>3</sup> 85% of Dublin Airport passengers in 2015 travelled to/from the UK or Continental Europe (<http://www.dttas.ie/press-releases/2016/minister-donohoe-welcomes-creation-350-new-jobs-daa-due-increased-traffic>)
- <sup>4</sup> Copenhagen Economics report prepared for ACI Europe (2012), ‘Airport competition in Europe’, June, pp.23-24.
- <sup>5</sup> Copenhagen Economics report prepared for ACI Europe (2012), ‘Airport competition in Europe’, June, pp. 39-45.
- <sup>6</sup> Copenhagen Economics report prepared for ACI Europe (2012), ‘Airport competition in Europe’, June, p. 5.
- <sup>7</sup> Department of Transport, Tourism and Sport (2015), ‘A national aviation policy for Ireland’, August, p. 42.
- <sup>8</sup> Indecon International Economic Consultants (2016), ‘Review of the Regulatory Regime for Airport Charges in Ireland’, 11 March, p. 7.
- <sup>9</sup> Flying Ireland (2015), ‘Dublin Airport amongst fastest growing in Europe’, 7 Feb. See here: <http://flyinginireland.com/2016/02/dublin-airport-among-europes-fastest-growing-airports/>
- <sup>10</sup> Aviation Economics report prepared for Airlines 4 Europe (2016), ‘Analysis of Airport Charges’, Jan, p.3. See here: <http://a4e.eu/wp-content/uploads/2015/02/AvEc-Airport-Charge-Analysis-v1.5.pdf>
- <sup>11</sup> CAR (2015) ‘*Statement of Dublin Airport Price Cap, 2014 and 2016*’, 2nd Dec, p.1.
- <sup>12</sup> InterVISTAS Consulting Ltd. (2015) report prepared for Dublin Airport Authority, ‘Dublin Airport Economic Impact Study’, April, p.17.
- <sup>13</sup> DAA (2014) ‘Response to Airport Charges Decision Paper’, July, P.10
- <sup>14</sup> First Economics report prepared for the CAA (2012) ‘Price monitoring as an alternative to RAB based price caps’ Dec, p.16. See here: <https://www.caa.co.uk/WorkArea/DownloadAsset.aspx?id=4294972554>
- <sup>15</sup> CAR (2014) ‘Maximum Level of Airport Charges at Dublin Airport 2014 Determination’, 7th Oct, P.75
- <sup>16</sup> DAA (2014) ‘Response to Airport Charges Decision Paper’, July, P.10
- <sup>17</sup> Forsyth, P. (2004). ‘Replacing regulation: airport price monitoring in Australia’. The Economic Regulation of Airports, 3-22, P.6

<sup>18</sup> Oxera report prepared for Gatwick Airport (2013) 'Regulatory regimes at airports: An international comparison'. p.iii, P 30.