

Submission

by

Business|NZ

to the

Commerce Commission

on the

Draft Report

***Price Control Study of Airfield Activities at
Auckland, Wellington, and Christchurch
International Airports***

14 August 2001

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DRAFT REPORT

PRICE CONTROL STUDY OF AIRFIELD ACTIVITIES AT AUCKLAND, WELLINGTON, AND CHRISTCHURCH INTERNATIONAL AIRPORTS

SUBMISSION BY BUSINESS NEW ZEALAND

14 AUGUST 2001

1. INTRODUCTION

- 1.1 This submission is made on behalf of Business New Zealand, incorporating regional employers' and manufacturers' organisations. The regional organisations consist of the Employers and Manufacturers Association (Northern), Employers and Manufacturers' Federation (Central), Canterbury Manufacturers' Association, Canterbury Employers' Chambers of Commerce, and the Otago-Southland Employers' Association. Business New Zealand represents business and employer interests in all matters affecting the business and employment sectors.
- 1.2 One of Business New Zealand's key goals is to see the implementation of policies that would see New Zealand retain a first world national income and to regain a place in the top ten of the OECD. This ambition is shared by the Government, and was most recently articulated by the Prime Minister to the Knowledge Wave Conference. It is widely acknowledged that consistent growth in real GDP per capita of well in excess of 4% per annum (and probably closer to 7-8%) would be required to achieve this goal. Continued growth of around 2% (our long-run average) would only continue New Zealand's relative decline.
- 1.3 Business New Zealand appreciates the opportunity to comment on the Commerce Commission's Draft Report *Price Control Study of Airfield Activities at Auckland, Wellington, and Christchurch International Airports*. Airports play a significant role in the economy and it is of great importance that they operate efficiently, effectively and at reasonable cost. In its Draft Report, the Commission has found that Auckland International Airport Ltd (AIAL) should be subject to price control, but that implementing controls at Christchurch

International Airport Ltd (CIAL) and Wellington International Airport Ltd (WIAL) would not be appropriate.

- 1.4 Business New Zealand prefers minimal government intervention in the economy, although we recognise that in some cases generic competition law might not be sufficient to provide for free and fair competition and to protect and enhance the consumer interest. It would appear from the conclusions reached in the Draft Report that airfield activities may be a case in point.
- 1.5 We believe that should this initial finding be confirmed following the consultation process, a strengthening of the Airport Authorities Act 1966 and the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 would be preferable to the imposition of price control on AIAL alone. We believe that airports and their customers should reach negotiated agreements on price and service. The option of price control should be one of last resort.

2. IMPORTANCE OF AIRPORTS TO THE ECONOMY

- 2.1 Airports are critical infrastructure for the transport of freight and passengers, both internally and internationally. The following statistics (sourced from the Draft Report) note the relative importance of each of the three major international airports in New Zealand:

Statistics for Year Ended 30 June 2000

Airport	Aircraft Movements (000)			Passenger Numbers (000)			Freight Volumes (000 tonnes)		
	Domestic	International	Other	Domestic	International	Total	Domestic	International	Total
AIAL	95.7	26.3	25.8	3206.8	4799.2	8006.0	36.6	155.1	191.7
WIAL	107.6	5.1	12.6	3199.0	470.0	3669.0	--	--	--
CIAL	61.6	7.3	86.2	3017.9	1066.5	4084.4	--	38.1	--

Note: 'Other' aircraft movements are mainly 'general aviation'. International and domestic freight statistics are unavailable for WIAL, and domestic freight statistics are unavailable for CIAL.

- 2.2 Statistics New Zealand's Tourism Satellite Accounts for 1997 indicated an estimated \$8.3 billion 'tourism value added' to the New Zealand economy and some 149,000 total tourism employment. Almost all of New Zealand's 1.8 million visitor arrivals still enter the country through one of the three main

airports, with only a tiny proportion of arrivals flying into the regional airports (Hamilton, Palmerston North, Dunedin, and Queenstown) or arriving by ship.

- 2.3 Meanwhile, airfreight is particularly important for high value, low volume products, such as elaborately transformed manufactured goods. For the year ended March 2000, airfreight imports were worth \$6.5 billion (23% of total imports) and airfreight exports were worth \$4.2 billion (17% of total exports). The vast majority of New Zealand's international airfreight passes through AIAL.
- 2.4 The importance of airports to the economy is well illustrated by the example of AIAL. As the largest and busiest New Zealand airport, AIAL is a substantial contributor to the regional and national economy, and not only in terms of passengers and freight statistics. AIAL's website states that 7,500 people are employed on the airport, and it is New Zealand's second largest port by value of cargo handled. For the year ended 30 June 2000, AIAL had operating revenues of \$170 million, an after tax profit of \$51 million, and it paid company tax of \$25 million to the Government. It is also a major property manager and retail centre in its own right, with some 85 shops on site.
- 2.5 Airports are highly capital intensive and can be very large business undertakings. They have also been regarded as strategic assets of national importance by governments. For all of these reasons, airports have historically tended to be publicly owned worldwide, and were not always required to operate as successful businesses. In more recent years, however, there has been a worldwide trend towards corporatisation, with some airports being fully or partly privatised (including AIAL and WIAL, although local authorities retain significant interests in both airports). Airport companies now seek first and foremost to maximise profits to their owners (be they public or private). This objective is totally appropriate, but it has implications for the regulatory environment in which the companies operate.

COMMENT ON THE DRAFT REPORT

- 3.1 One of Business New Zealand's key policy outputs is to promote effective markets based on real competition and to champion effective and efficient infrastructure reforms.
- 3.2 As discussed earlier, airports are critical infrastructure for the movement of goods and people, both internally and internationally. It is important, considering their important role in a modern economy, that airports operate efficiently and effectively and do not impose significant and unjustifiable costs on their customers and hence the economy as a whole. Therefore, the regulatory environment must be conducive to this desired outcome. The Commerce Commission has implied in its Draft Report that it may not be. Certainly, the extent of historical over-recovery illustrated in the Draft Report (3.7% per annum for AIAL and 2.0% per annum for CIAL averaged over a decade) is of concern.
- 3.3 The Commerce Commission has found that there is often no commercially practical alternative to a particular airport, which means that competition in airfield activities is generally limited (with the exception of general aviation). We agree with the Commerce Commission's finding in this respect.
- 3.4 While the extent to which airlines can exercise countervailing power is less clear-cut, we also agree, on balance, that airlines do not generally have strong power in this respect. We note that this finding is something of a departure from the view of a 1990 Officials Committee, which found that airlines *did* have sufficient countervailing power and that section 36 of the Commerce Act was sufficient to prevent most discriminatory activities by airports. Countervailing power is a fundamental issue, particularly when assessing whether the existing consultation and information disclosure provisions of the existing legislation are sufficient to ensure that airports and airlines can reach a fair and equitable agreement on price and service levels. It could also have implications for other infrastructure industries, such as electricity.

- 3.5 We note that the Airport Authorities Act requires airports to 'consult' users before imposing price or service changes. Although the consultation provisions in the Airport Authorities Act were strengthened in 1997, what constitutes 'adequate consultation' has continued to be the subject of considerable contention and court litigation – the most recent example being Air New Zealand's recent commencement of proceedings against AIAL in regard to its consultation obligations and its announcements of increases in landing charges. We understand that the Ministry of Transport will shortly be reviewing how the consultation process has worked in process. We support such a review being undertaken.
- 3.6 We also note that the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 do not require the use of any specific pricing methodologies. Information disclosure is an important tool for ensuring that meaningful consultation and negotiation on prices and services can proceed. We understand that the Ministry of Transport will be reviewing the Regulations in the near future, including whether guidelines should be set for the valuation of assets, calculation of the Weighted Average Cost of Capital (WACC), and the allocation of revenues, costs, assets, and liabilities to airport activities. We support such a review being undertaken.
- 3.7 Overall, we can agree in principle with the key finding of the Commission's draft report that inefficiencies exist in the market for airfield activities caused by airports exercising their substantial market power. However, this is predicated on the assumption that the Commission's analysis is proven to be correct. While we do not wish to delve too much into the detail of what is a lengthy and complex report, we note that the Commission's conclusion would have been influenced by a number of assumptions that were made in the analysis, particularly in the asset valuation, calculation of rates of return, and the benefit cost analysis. These assumptions will be open to debate.
- 3.8 The Commission's approaches to the valuation of specialised airfield assets on historical cost basis and the optimisation of land held for further

development are fundamental when considering whether an airport is over-recovering. The practical implications are particularly significant for AIAL (the economic justification for price control on AIAL essentially hinges on one issue – the optimisation of the land set aside for a second runway). In principle, though, we agree with the Commission's approach on asset valuation and we believe that it should be applied consistently across other infrastructure industries, such as electricity, ports, gas etc.

- 3.9 Two smaller, but nonetheless quite important, issues are also worth raising. Firstly, in our view, the Commission's adopted figure of 1% of airfield expenses as a measure of 'productive inefficiency' is somewhat arbitrary (p. 151), and we believe that this issue must be properly assessed. Secondly, an appendix to the Draft Report (p. 379) lists several asset betas for utilities, but Transpower's asset beta is incorrectly listed as 0.30. According to Transpower's 1999/2000 Annual Report, its asset beta is actually 0.25. This lower benchmark should be considered when assessing whether the relatively higher betas assigned to the airport companies are appropriate.
- 3.10 Business New Zealand notes that the existing regulatory regime for airports relies on the provisions of the Commerce Act 1986. The remedy to prevent airports from taking advantage of their market power in the setting of prices is the imposition of price control pursuant to Part IV of the Commerce Act.
- 3.11 While it is important for the regulatory regime's credibility that the Commission and the Minister of Commerce are prepared to act decisively on firm evidence of abuse of market power, Business New Zealand does not believe that price control is necessarily a first-best solution to a problem of airports using their market power to impose price increases. For example, we have doubts about the ability of a government agency to effectively control prices that would be better set by a market, even one that is imperfect. Our position is that price control should be an avenue of last resort.
- 3.12 Additionally, in our view, imposing price control on AIAL alone would not immediately cater for what other airports may choose to do in the future – for

example, CIAL was found by the Commission to be over-recovering and WIAL could announce price increases in the near future that would have a detrimental impact on users and the wider economy, yet at this stage only AIAL would be subject to control. In our view this would seem to require regular, potentially lengthy and resource-intensive company specific reviews by the Commission.

3.13 If it is confirmed after consultation that there are indeed inefficiencies in markets for airfield activities, we believe that a more comprehensive alternative should first be considered – the creation of an environment where airports and airlines are able to *negotiate* as equals. We note that the Ministry of Transport’s reviews of the Airport Authorities Act consultation processes and the Information Disclosure Regulations should provide such an opportunity. While not seeking to prejudge the outcome of such a review, an enhanced regime might provide a better basis for negotiated outcomes than the current situation:

- a requirement for airports to *negotiate* on price and service (rather than merely to *consult*) subject to set pricing guidelines;
- a requirement for airports to *disclose information* relevant to airfield activities; and
- existence of an external body (such as the Commission) to act as an *arbitrator in disputes* over the outcome of negotiations.

3.14 Price control should be maintained as an option, but it should be one of last resort to be imposed only should the market participants be unable to reach an agreement.

3.15 This approach would be consistent with that proposed for the telecommunications industry, where the Government is currently legislating for several designated services to be overseen by the Commission, with powers provided to the Commission for the imposition of controls on those services, should the market participants be unable to agree on price and service issues by a set date.

4. RECOMMENDATION

4.1 Business New Zealand recommends that should the Draft Report's conclusions be confirmed following consultation, consideration for addressing inefficiencies in the airfield activities market should be pursued through the speedy creation of a process where airports and airlines are enabled to *negotiate* as equals. Although we do not favour the imposition of price controls, such an option should be held in reserve if a better process is not established within a reasonable timeframe. The Ministry of Transport's reviews of the Airport Authorities Act 1966 and the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 should therefore focus on the case for:

- requirements for airport authorities to negotiate on price and service (rather than merely to consult) subject to set pricing guidelines;
- requirements for airports to disclose information relevant to airfield activities (with guidelines set for the valuation of assets, calculation of the WACC, and the allocation of revenues, costs, assets, and liabilities to airport activities);
- provision for the Commerce Commission to act as an arbitrator in disputes over the outcome of negotiation; and
- provision for the Commerce Commission to impose price control if, by a certain date, the parties are unable to agree among themselves on price and service levels.