

Regulation by Negotiation: Stephen Littlechild's Contribution

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Issues

What is the importance of benchmarking in a light handed system of regulation?

Options for Light Handed regulation

How well will Light Handed Regulation work when airports are subject to demand greater than capacity?

1 Benchmarking- Do we need it?

- **Littlechild sceptical?**
- **The issue-benchmarking performance in terms of prices, profits, costs and productivity**
- **The need for benchmarking is controversial in Australia**
- **This issue is highlighted with the Productivity Commission Review**
- **Airports are difficult to benchmark**
- **But not that difficult**
- **Overseas- several studies academic, consultant**
- **But not for Australia**

Benchmarking the System

- How well does the Australia system work as a whole?
- *I think OK-*
- **But I don't really know**
- **But it is possible to find out**
- **How has productivity changed over the last ten years?**
- **How did productivity change when airports were price capped (1997-2001)?**
- **The PC has a lot of experience in benchmarking**
- **Can it make a credible assessment of the performance of the system if it does not consider all the evidence?**

Benchmarking Performance

- **Has the performance of the individual Australian airports been good or bad?**
- **A task for the PC review, taking into account government Aeronautical Pricing Principles of 2007**
- **Are individual airports producing efficiently?**
- **Are they allowing costs to rise?**
- **Are the prices of Sydney Airport consistent with productive efficiency?**
- **Has Adelaide Airport invested excessively and thus put up its prices?**

2 Options for Light Handed Regulation

- **There are several aspects to light handed regulation**
- **Not all need be present**

What is Light Handed Regulation?

- **Not the same as deregulation**
- **No ex-ante price path set**
- **Criteria for poor performance- and sanctions?**
- **Dispute resolution mechanism? And criteria?**
- **An efficiency test- if it is efficient, then it is OK? (PC,2002; Costello, 2007)**
- **Emphasis in negotiation between parties (eg airlines and airport)**
- **More flexibility for the seller over prices**

Two Models of LH Regulation

1 Principles and Review

An independent body reviews performance according to set principles and if performance is not satisfactory, a sanction is imposed (eg, regulation)

2 Negotiate and arbitrate

Parties negotiate and if necessary and independent arbitrator is called in (preferred by Littlechild)

Substitutes- which is better?

Principles Approach

- **The current Australian approach (with a little bit of help from IIA)**
- **Principles need to be clear (are they)?**
- **What sanctions for poor performance- are they credible and sufficient?**
- **Assessing performance is essential- i.e., benchmarking is essential**
- **Dispute resolution not needed**

Negotiate/ Arbitrate

- **Independent dispute resolution essential (Littlechild)**
- **Less need for benchmarking**
- **Approach favoured by ACCC, airlines**
- **Need to specify criteria for the arbitrator carefully**
- **To avoid too active an involvement by the arbitrator**
- **But not pricing principles**

The Choice?

- **Both can have dangers**
- **Such as degenerating into cost plus regulation**
- **If present system is continued, needs to be more attention paid to principles and sanctions**

3 Light Handed Regulation and Excess Demand

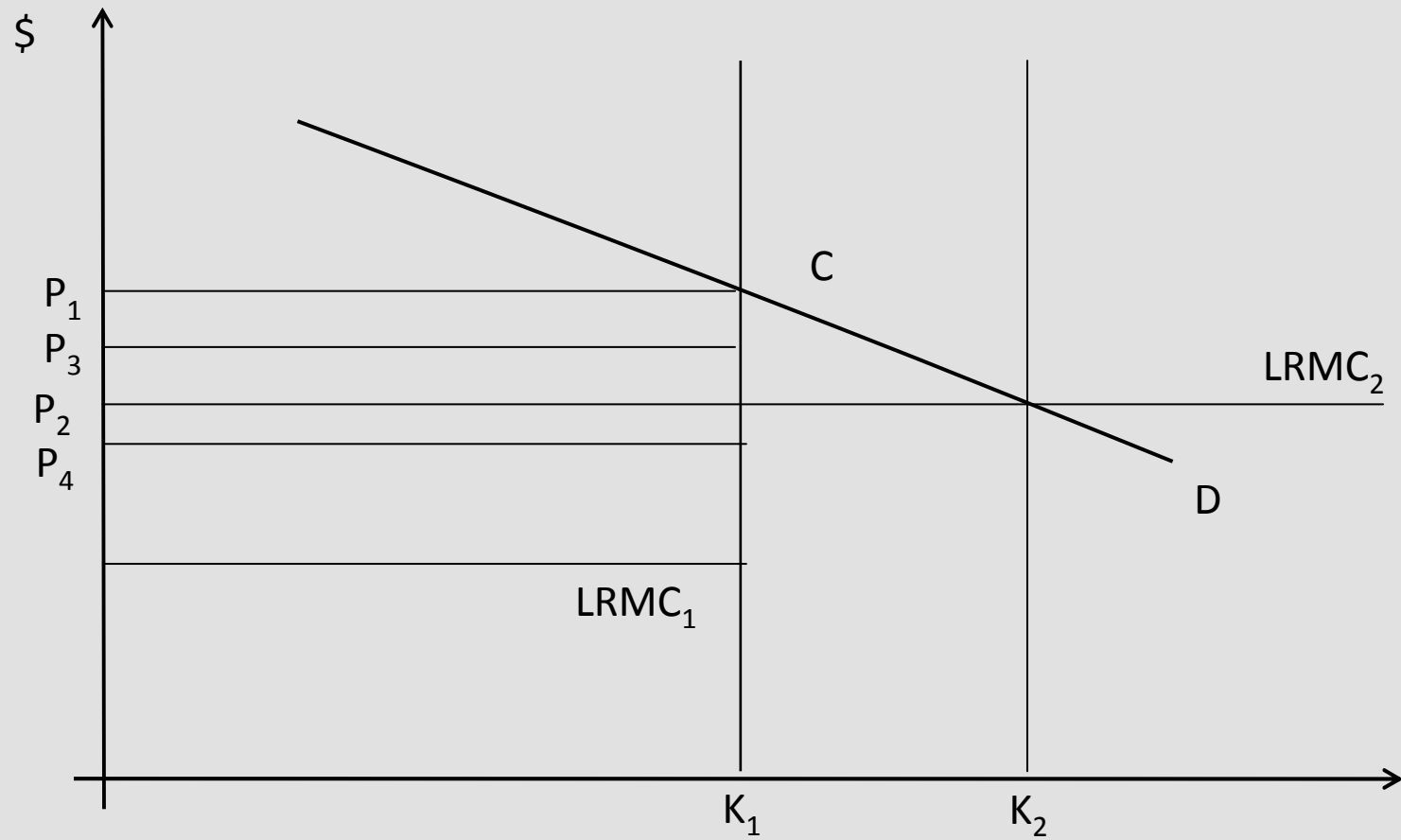
- **Sydney will be the first (later Brisbane)**
- **No other airport has been subjected to LH regulation and excess demand**
- **Some airports have excess demand, and are subjected to price caps and R of R regulation**
- **Such as London, Paris**
- **LH regulation means that several issues will develop at Sydney (and Brisbane)**
- **What implications for the various versions of LH regulation?**
- **Will negotiation work efficiently?**

The Long Run Problem

- **Short Run problems can be handled OK**
- **Will the airport face incentives to invest efficiently over the long run?**
- **Leave aside planning, political and site selection problems**

Investment

- **Fig 1 shows the case of additional investment**
- **With D1, investment is worthwhile**
- **Even though LRMC rises from LRMC1 to LRMC2**
- **In SR price is P1 (landing charges or slots)**
- **Efficient to increase capacity from K1 to K2**
- **New price = LRMC2**



Under LH Regulation

- **At P1, (airport gets the rents) airlines would favour investment**
- **Would like to have prices at P2**
- **As do passengers**
- **But airport would prefer to have a price of P1 (subject to elasticities)**
- **Investment does not go ahead**

If Airlines have Some Power...

- **Airport can offer a price of P_3 to the airlines**
- **Then the airlines gain slot rents**
- **Which are NOT passed on to their passengers**
- **Airport gains profits**
- **Airlines gain profits**
- **So both airlines and airport prefer K1 to K2**
- **But passengers are worse off compared to K2**

- **Because of the slot system, the customer - the airlines- gains scarcity rents**

Are Airline and Passenger Interests Aligned?

- **No incentive for airlines and airport to negotiate an efficient solution**
- **In this case, airline and passenger interests are not aligned**
- **Is the buyer of airports services the airline or its passengers (normally it does not matter)?**
- **Both the airport and the airline will argue “expansion is not needed”**
- **Under LH regulation, efficiency does not come about**
- **(Did this happen with BAA’s London Heathrow airport?)**



Achieving Efficient Investment

- **Need some mechanism to ensure investment**
- **Periodic (simple) cost benefit analyses to determine whether airport's performance is acceptable?**
- **Let's face it, there will be CBAs done to determine if major capacity investments are needed**

Thank You!

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