ANSConf-WP/80
5/6/00
ITEM 5.2
(English, French and Spanish only)

CONFERENCE ON THE ECONOMICS OF AIRPORTS AND AIR NAVIGATION SERVICES

(Montreal, 19 - 28 June 2000)

Agenda Item 5.2: Elements for consideration with regard to ICAO policy

MARGINAL PRICING

(Presented by the International Air Transport Association)

SUMMARY

Marginal cost pricing for airports and ANS providers is difficult to implement, ineffective in addressing capacity problems, and may result in discriminatory practices.

1. Introduction

1.1 In practice, the implementation of a pricing strategy of cost recovery and non-discrimination has led to average cost pricing combined with ability to pay considerations based on the weight of an aircraft. As described in paragraph 5.11 of Doc 9161/3, unit cost is determined by dividing the cost base by the estimated charging units, and thus the charges structure involves the averaging out of costs among the various users, irrespective of the costs that individual users impose.

1.2 However, it is felt by a number of charging authorities that average cost pricing does not lead to an optimisation of the allocation of resources nor provide an incentive to investing in additional capacity. Accordingly, various studies have been initiated into pricing mechanisms that may promote the best use of airspace capacity.

2. Marginal cost pricing

2.1 It has long been maintained that the pricing policy which most likely will lead to an efficient allocation of resources would be one where the price of a good or service is set equal to the marginal cost of providing that good or service. The marginal cost being the cost that would be incurred in providing an additional unit of output. The economic rationale for marginal cost pricing is that only those users who value a facility or service at least as much as the cost of providing it will pay the price for using it.

2.2 It should be noted that marginal cost pricing is concerned with current and future costs and not with past sunk costs, which remain unaffected by an additional user. A distinction should be made, however, between short-run marginal costs and long-run marginal costs. Short-run marginal costs can be varied to meet changes in demand, e.g. extra security, handling or maintenance staff. Long-run marginal costs, on the other hand, are those costs such as investment costs in additional facilities that can be varied over time to satisfy additional or marginal demand. It is for this reason that long-run marginal cost pricing has been advocated for capital intensive industries, which is the case for airports and ANS entities.

2.3 However, implementing long-run marginal cost pricing poses difficulties. First, investments in infrastructure are large and lumpy and are not truly marginal since they have the effect of boosting capacity significantly once the investment plan is complete, e.g. an investment in a new runway or terminal can double an airport's capacity. Second, in the case of airports, a multitude of facilities and services are provided, which makes long-run marginal pricing complicated to implement. And third, demand for airport or ANS facilities and services vary from time of day, day of the week, or season, thus adding another complication.

2.4 Strict application of marginal cost pricing, however, will not necessarily produce sufficient revenue to cover full costs, including depreciation and interest charges. This is so because marginal cost pricing considers current and future costs and not accounting costs. Only if long-run marginal costs are rising and above average costs will revenue normally exceed total current costs. Strict application of marginal cost pricing will likely lead to accounting losses and must therefore be combined with some other pricing strategy.

2.5 Any change in policy guidance in the area of airport and air navigation service charges that would represent a departure from average cost pricing should seek to improve efficiency and increase capacity of the infrastructure. Such a charging scheme should ensure that the required capacity is provided and that it is provided in the most cost-efficient manner possible. Therefore, marginal cost pricing, if implemented, should challenge the charging authority as opposed to "sending the right signal" to the users.

3. The IATA Position

3.1 Marginal cost pricing difficult if not impossible to implement due to the complexity involved and the administrative sophistication required. It is questionable whether marginal cost pricing will result in additional capacity and in an efficient utilisation of resources. To the contrary, aside from the concern that marginal cost pricing could possibly result in discriminatory practices, it will likely result in additional revenues for the charging authority without necessarily resulting in additional capacity.

3.2 Any charging policy should be consistent with the basic ICAO principles on user charges – non-discrimination, transparency, cost-relationship and meaningful consultation – and subject to economic regulation.

4. Action by the Conference

4.1 IATA invites the Conference to note the IATA position that marginal pricing should not be applied in the setting of user charges.

— END —