CONFERENCE ON THE ECONOMICS OF AIRPORTS AND AIR NAVIGATION SERVICES

(Montreal, 19 - 28 June 2000)

Agenda Item 4: Determinants of the economic regulation of airports and air navigation services

AIRPORT COSTS AND AIRLINE REVENUES

(Presented by Malaysia)

1. Introduction

1.1 Airport users, primarily airlines, pay the amount necessary to cover the cost of running the airport. At large airports, about two-thirds of the airports' revenue consists of airline fees. Parking and rental car fees are also significant sources of income – generating 25% or more of the airport's revenue. Food and beverage and retail concessions generate between 7% and 11%. [1]

1.2 While fierce competition among airlines has resulted in declining fares and intense pressure on all aspects of the airline cost structure, airport costs have continued to rise. The result has been increasing friction between airports and airlines.

2. Current Situation

2.1 A possible explanation for the greater cost increases at airports is a greater need for infrastructure at these airports.

2.2 However, the significant increases in operating costs at major airports is of particular concern, since it suggests that the expansion/modernization programs are not accompanied by any significant increase in operating efficiency.

2.3 Airlines generally agree that infrastructure needs have driven a significant portion of airport cost increases. The debt service associated with major airport development projects necessary to replace aging facilities inevitably increases total costs. However, most airlines are convinced that the system of airport rate regulation has itself made possible and, in some ways, encouraged the rapid growth of airport costs at major airports.

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[1] "Airport Rate-Making 101 – The Basics of Setting Rates and Charges," Leigh Fisher Associates, July 18, 1994, presentation outline.

2.4 This conclusion is based on the observation that most privatized airports are natural monopolies, which provide an essential service, and are therefore best thought of as public utilities. However, unlike other public utilities, whose rates are reviewed regularly by government agencies, the federal law of most States has permitted airports to define their rate base broadly and to set rates to provide full recovery of all of their costs, without any meaningful scrutiny.

2.5 The conflict between decreasing airfares and increasing airport costs has been compounded by the airlines' inability to deal with the airports' monopoly position.

2.6 A prominent University of Chicago economist, Lester Telser, [2] suggests that some industries, such as the airline industry, may be incapable of reaching economic equilibrium. The fixed costs of operating an aircraft are so high in relation to the variable costs associated with carrying an additional passenger that destructive fare wars are inevitable.

2.7 The costs of airport and air navigation development projects such as the CNS/ATM and radar installation that increase the safety and efficiency of the airline industry should be implemented and charged to the users, specifically to the airlines. However, costs of excessive artwork, elaborate atriums, waterfalls and fountains, and other accessories at airports will end up as higher costs to the airlines, and ultimately the consumer.

3. Action by the Conference

3.1 The Conference is invited to urge States' Civil Aviation Authority to monitor and regulate the airport fee structure that will not include the non-aviation development infrastructure costs.

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[2] See Telser, "The Usefulness of Core Theory in Economics," *Journal of Economic Perspectives*, Vol. 8, No. 2, Spring 1994, pp. 151-164.