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The design of light-handed regulation of airports: Lessons from experience in Australia and New Zealand

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ABSTRACT

The difficulties experienced with traditional forms of economic regulation of airports involving direct control of prices have led to an interest in light-handed regulatory frameworks. Experience with light-handed regulation of airports is primarily confined to Australia and New Zealand. The paper examines the design features of light-handed regulation in Australia and New Zealand in relation to the stated objectives associated with the introduction of light-handed regulation. The paper identifies important aspects associated with the design of light-handed regulation including the incorporation of a credible threat of stronger regulation and the characteristics of this, and an apparent trade-off in objectives achieved with different approaches to light-handed regulation.

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1. Introduction

Light-handed regulation (LHR), where prices are not directly determined by regulation unless specific circumstances arise, has characterized airport regulation in Australian since 2002 and in New Zealand since the late 1980s. The approaches used in both countries have attracted the interest of government organizations considering potential changes in airport regulatory frameworks as well as others interested in airport economics. Governments and airport regulators have shown an interest in alternative regulatory approaches to traditional regulation of airport services involving direct price setting, such as price cap or rate of return regulation. Some examples include the Commission for Aviation Regulation (CAR) (2001) in Ireland in consultations related to the development of regulatory arrangements and the Airports Economic Regulatory Authority of India (2009) in a White Paper which reviews alternative approaches to regulation for privatized airports in India.

Forsyth (2002, 2008) has examined the performance of light-handed regulation in Australia and New Zealand. Donney et al. (2005) have explored the relationship between privatization, regulation, market power, profitability and technical efficiency of New Zealand and Australian airports under different regulatory regimes. Two papers, one by Schuster (2009) and one by O’Donnell et al. (2011) have reviewed the experience of LHR of Sydney Airport. Littlechild (2012) examines Australia’s approach to airport regulation and the issues that were under review in the 2011 Productivity Commission inquiry.

The experience of LHR of airports in Australia and New Zealand is examined from a different perspective to previous authors. It is examined from the point of view of whether it can and has achieved the stated objectives associated with its introduction in each country. While there are often political and philosophical objectives associated with the introduction of LHR, it is the performance of LHR in relation to stated objectives associated with its introduction in Australia and New Zealand that is of concern here. By examining the evolution of LHR and the approaches taken to the design of LHR of airports in Australia and New Zealand an increased understanding of LHR and its effectiveness as a regulatory tool is achieved. Three distinct models of LHR are examined; the initial information disclosure regulation introduced in New Zealand in the late 1980s, price and quality of service monitoring introduced in Australia in 2002, and enhanced information disclosure regulation introduced in New Zealand in 2008. An examination of the design of alternative approaches to LHR offers an alternative way of understanding some of the advantages and disadvantages of different approaches to LHR. It is important for governments considering the application of LHR to airports with market power to understanding how different approaches to LHR have performed.

It is timely to undertake a review of LHR of airports in Australia and New Zealand because there have now been two independent reviews of the Australian regulation and a new approach to LHR has recently been implemented in New Zealand with two assessments of airport performance undertaken. The different approaches have...
mainly been assessed by drawing on the findings from independent inquiries on the regulatory frameworks (Productivity Commission, 2006, 2011; NZCC, 2002) and two reports on airport performance under the new information disclosure approach in New Zealand (NZCC, 2013a, 2013b). In addition, government documents and industry literature have been reviewed and discussions held with industry and government representatives in Australia and New Zealand.1

The focus of this paper is on LHR in the form of price and quality of service monitoring in Australia and information disclosure regulation in New Zealand. This regulation has three key design elements in common: information requirements, reporting arrangements, and a threat of stronger regulation. Approaches involving regulatory intervention to resolve disputes in the event that negotiations fail, including negotiate-arbitrate regulation, is another form of LHR that has been applied to airports in Australia. This approach is not the focus of this paper.

The paper is structured as follows. Background information on the characteristics of airports in Australia and New Zealand, their regulatory frameworks, and the reasons for adopting LHR in Australia and New Zealand are contained in Section 2. Section 3 describes and compares the design of LHR in Australia and New Zealand in relation to key objectives of LHR drawing on the design features of the different approaches. A summary and lessons learned on the design of LHR are provided in Section 5.

2. Background on light-handed regulation of airport services

2.1. Characteristics of major airports in Australia and New Zealand

Australia and New Zealand are politically, culturally and economically similar and as island nations are reliant on air transport. The major international airports in Australia and New Zealand which are subject to LHR are privatized, or partially privatized. Each is separately owned. They are small to medium in size by world standards for international airports. Sydney Airport with 36 million passengers in 2010–2011 is significantly larger than other airports in Australia and New Zealand (Table 1). These airports have generally been considered to have significant market power, particularly in relation to domestic air transport (for example Productivity Commission, 2006, 2011, New Zealand, Commerce Amendment Bill, 2008, Explanatory Note).

In Australia price and quality of service monitoring of major airports is conducted by the national competition regulator, the Australian Competition and Consumer Commission (ACCC) under the Competition and Consumer Act 2010 (CCA). In New Zealand the regulatory framework is contained in the Airports Authorities Act 1966 (AAA), administered by the Ministry of Transport from 1999, and the Commerce Act 1986 (the Commerce Act), administered by the New Zealand Commerce Commission (NZCC). In 2008 amendments to the Commerce Act introduced new arrangements for economic regulation in New Zealand, including enhanced information disclosure regulation which applies to New Zealand’s major international airports in addition to existing requirements under the Airports Authorities Act 1966 (AAA).

Table 1

| Airport | Passengers 2010–2011 millions | Ownership | Total airport revenue 2010–2011 | Aero-
|---------|-------------------------------|-----------|---------------------------------| nautical revenue 2010–2011 |
| Sydney  | 36                            | Fully privatized in 2002 | $963 m | 54 |
| Melbourne | 28                           | Fully privatized in 1997 | $545 m | 42 |
| Brisbane | 20                           | Fully privatized in 1997 | $456 m | 43 |
| Perth    | 11                           | Fully privatized in 1997 | $296 m | 35 |
| Adelaide | 7                            | Fully privatized in 1998 | $161 m | 54 |
| Auckland | 14                           | Privatized listed on NZX 1998 | $398 m | 45 |
| Wellington | 5                      | Private co. 67% owned by Infratil | $94 m | 61 |
| Christchurch | 6                  | Partially privatized by Infratil | $98 m | |

1 Discussions were held with representatives of Air New Zealand, Auckland International Airport, Board of Representatives of New Zealand, Commerce Commission, Ministry of Business, Innovation and Employment, and Wellington International Airport in New Zealand 1–6 November 2012 and at various times with representatives of the ACCC, Board of Airline Representatives, Melbourne Airport and the Productivity Commission.

2.2. Economic regulation of airports

Airports have a number of economic characteristics which are different, or at least different in degree, from other regulated industries. Airports can be subject to some competitive influences including the existence of secondary airports; there is substitutability in the location of some airport services, such as heavy maintenance; airlines may have countervailing buyer power and potentially non-aeronautical competitive services may influence the pricing of aeronautical services. For many airports competitive influences on airport prices imply that economic regulation is either not warranted, or that ‘lighter’ or less intrusive regulation is appropriate. Starkie (2008), for example, has raised the issue of the appropriateness of traditional approaches to regulation of airports involving direct controls on prices, such as price caps and rate of return regulation. He supports the use of lighter handed approaches or no regulation at all. Biggar (2011) has presented an alternative view and argues that economic regulation of airports is not about constraining the potential use of market power by airports and the consequent misallocation of resources, rather the major purpose is the protection and promotion of sunk complementary investments by airport users. Biggar argues that if this is a primary purpose of airport regulation then control of prices in order to prevent price shocks is important for users.

The distinctive characteristics of airports also imply that the administration of traditional regulation involving direct controls on prices has particular challenges. Airports are complex businesses providing a wide variety of services to a wide variety of users. The demand for aviation services, and hence airport services, can be quite volatile and subject to shocks. An example of this is challenges for the Commission for Aviation in Ireland in determining five year price caps for Dublin Airport for the period 2010–2014 when there was a large capital expenditure project for a new airport terminal and very rapid changes in demand for airport services (Arblaster, 2010).

2.3. The introduction of light-handed regulation of airports in Australia and New Zealand

Australia and New Zealand have been leaders in the introduction of LHR to airports services. LHR of airport services arose for
different reasons in each country. In New Zealand there was a general preference for light handed approaches to regulation in situations where economic regulation was warranted following a wide-ranging reform program in the late 1980s (Bollard and Pickford, 1995). According to Small (2000) policy-makers in post-1984 New Zealand saw deficiencies in regulation and chose the absence of regulation at least in its traditional form. Prior to 2010 airport operators were required to consult with their major airline customers when setting charges and required to disclose specified information under the AAA. In addition they were subject to general competition law under the Commerce Act which included the threat of price control.

In Australia changes to airport regulation followed reforms to competition policy which began in the 1990s. As part of the reform process Australia adopted a United Kingdom style approach to regulation of structurally separated monopoly elements in utilities. Airport regulation included price caps on aeronautical services as well as other complementary measures. Price cap regulation raised a number of issues for the ACCC and the aviation industry. Regulatory provisions covering “necessary new investment” which allowed for increases in prices outside the cap were ill-defined and difficult to interpret. The exact coverage of the price cap was unclear and arbitrary because of the definition of aeronautical services, i.e. what was in and out of the price cap was based on the method of charging at the time of privatization. The new investment and other provisions led to a multitude of price determinations which resulted in price cap regulation being more interventionist than originally envisaged. A culmination of events in 2001, the terrorist attacks in the United States followed by the Severe Acute Respiratory Syndrome epidemic and the demise of a major domestic airline, Ansett Australia, led to a downturn in air traffic and ensuing falls in airport revenues. Immediately following these events Australian airports reported reductions in traffic of 30–40 per cent (Productivity Commission, 2002). The Government replaced price caps with price monitoring consistent with recommendations in a Productivity Commission review (Productivity Commission, 2002).

Significant changes were made to information disclosure regulation in New Zealand in 2008 following concerns that the information disclosure regime under the AAA did not constrain the exercise of substantial market power in setting airport charges. A Commerce Committee reviewing the Commerce Amendment Bill considered that “the information disclosure regime currently provided for under the AAA is not effective because there are no detailed rules on how information disclosure must be compiled, and there is no monitoring by a regulator of the disclosed information.” (New Zealand Parliament, 2008, p. 13) In addition, the airline industry had argued that larger airports had been charging excessive prices.

A comprehensive review of regulatory provisions in the Commerce Act in 2008 resulted in new regulatory instruments, including enhanced information disclosure regulation which applies to airports. The new approach to information disclosure covers a broader range of information and incorporates ‘Input Methodologies’, i.e. binding methodologies, rules and processes, which are applicable to historical information disclosure. A significant change is that the NZCC is required to analyze and report on the information disclosed.

2.4. Aims and objectives of light-handed regulation

In Australia the aims and objectives of LHR can be traced back to the original goals associated with privatization of airports. The Government sought to have a regulatory framework which allowed for the development of direct negotiations between airport operators and their customers involving low costs of administration while at the same time producing good economic outcomes. These objectives were not achieved with price cap regulation and LHR was seen as a way to avoid the difficulties experienced. Objectives of LHR of airport services in Australia are expressed in the Government’s terms of reference for two Productivity Commission inquiries and include promotion of “economically efficient and timely operation, use of and investment in airports and related industries”, “minimizing unnecessary compliance costs on airport operators and the Government”; and “facilitating commercially negotiated outcomes in airport operations” (Productivity Commission, 2006, p. iv and 2011, p. v).

The New Zealand Government’s objectives for LHR of airports were stated in a review of New Zealand Airport Regulations in 1995. The objectives were that:

- “prices support an economically efficient allocation of resources, that is the prices reflect the long-run marginal cost of providing the service and in the cases where capacity is constrained the service is used by those who value it most; pricing provides signals for economically efficient capital decision making; regulation provides certainty for airports and airport users with regard to the requirement to consult and information disclosure; and the regulatory regime takes account of the costs of compliance with regulations.” (New Zealand, Ministry of Transport, 1995, p. 21)

Under the amended Commerce Act the objective of regulation is “to promote the long-term benefit of consumers” in specified markets “by promoting outcomes that are consistent with outcomes produced in competitive markets” (Commerce Act, Purpose Statement (part 4, S.52A (1))). Information disclosure regulation has a specified purpose which is “to ensure that sufficient information is readily available to interested parties to assess whether the purpose of this Part is being met” (Commerce Act, s.53A). There is a concern to tailor regulation “to New Zealand’s small size (with small firms and limited resources)” (Commerce Amendment Bill, Explanatory note, p. 3). In developing the new arrangements the NZCC has taken an approach “to ensure a cost effective but robust regime” by relying on Airports’ existing information gathering practices, providing for a degree of flexibility and by having regard to the airports’ responsibilities in relation to the AAA. (NZCC, 2010, p. 3).

The promotion of economically efficient airport performance in the long term including incentives for economically efficient investment is a common objective in Australia and New Zealand. Economic efficiency is a broad concept involving a number of dimensions including productive (or operational) efficiency, dynamic efficiency (relating to performance to meet future consumer needs) and allocative efficiency (which relates to the level of prices and quality in accordance with efficient costs and user demands).

In Australia the promotion of commercial negotiation of airport charges has been a consistent and explicit objective of the

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2 These observations on the degree of intervention have been made on the basis of the author’s experience and are evidenced from the Price assessments to 30 June 2002 section on ACCC website at http://www.accc.gov.au/content/index.phtml/itemid/752728.

3 The price cap was to “apply to all charges for aeronautical services as presently covered by the definition in the FAC Act” (Australian Government, Department of Transport and Regional Development, 1996, p. 2)
regulatory framework. While not formally stated as an objective in the New Zealand regulatory framework the expectation that price and quality of service will be negotiated is clearly reflected in NZCC and other government consultation documents including the framework design (for example NZCC, 2009). Low compliance and administration costs over time are another common objective of LHR in Australia and New Zealand.

3. How does light-handed regulation work?

LHR is considered to work by providing incentives to achieve outcomes consistent with those found in workably competitive markets. The incentives are provided by a combination of transparency about how well a supplier is performing over time and the threat of further regulation. In New Zealand it has been argued that greater transparency enhances consumers’ countervailing power, provides owners with better information to help them govern their business more effectively, and incentivizes management of regulated suppliers to improve their performance (NZCC, 2013a). Further, that “[t]he threat of further regulation incentivizes suppliers to ensure their performance is consistent with desired outcomes from workably competitive markets” (NZCC, 2013a, p. 16).

The designs of LHR in Australia and New Zealand have three main components in common; the collection of data and other information about airport operations; requirements for reporting or disclosure of information collected; and a mechanism for further action if reported or disclosed information reveals an adverse performance outcome.

3.1. Information requirements

The information requirements associated with LHR critically affect the effectiveness of regulation and the extent to which LHR can achieve the objectives sought from it. Table 2 identifies the key types of information required under price and quality of service monitoring in Australia and, in the case of New Zealand, the requirements under the initial information disclosure regulation which operated under the AAA and the enhanced information disclosure requirements under the Commerce Act implemented in 2011.

The earlier information disclosure regime in New Zealand and price monitoring in Australia primarily have relied on historical financial accounting information and required significantly less information than the new information disclosure regime in New Zealand. The requirement for airports to provide forward looking information related to price determination is a distinguishing characteristic of the new information disclosure regime in New Zealand. In addition, this regime also requires more information to be supplied in each information category and there is more prescription in the way the information is provided. For example, the methodology for passenger surveys is prescribed in a regulatory determination in New Zealand but not in Australia. The use of Input Methodologies for key economic variables facilitates the NZCC’s analysis of airport profitability.

The treatment of aeronautical asset values has been a significant issue for the Australian price monitoring regime. At the time of privatization explicit values were not established for airport assets for regulatory purposes, with the exception of Sydney Airport where the value of aeronautical assets was determined through a regulatory price determination process. Asset values used in the ACCC monitoring report until 2006–2007 reflected significant revaluations that occurred at most of the airports after privatization. Airport profitability measures became distorted and some airports sought to justify higher airport charges on the basis of revalued assets. This created industry tensions and undermined the value of reported information. Following a recommendation of the Productivity Commission a “line in the sand” approach to asset valuation was adopted whereby asset values reflected the value of assets at 30 June 2005 plus adjustments for new investment (Productivity Commission, 2006; ACCC, 2010).

3.2. Reporting requirements

Table 3 compares reporting requirements under LHR in Australia and New Zealand. The key distinguishing characteristic of the information disclosure framework operating under the AAA in New Zealand prior to 2011 was that there was no review and public reporting on the information disclosed by an independent government agency. The Australian monitoring framework permits the ACCC to make judgments on trends on historical financial information indicators of costs, profits and prices. By comparison, the

Table 2
Comparison of information requirements for airports in Australia and New Zealand.

| Type of information                                      | Australia — price monitoring as at June 2009 | New Zealand — Airports Authorities Act framework | New Zealand — enhanced information disclosure |
|----------------------------------------------------------|----------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| Historical information                                   | Audited financial accounting statements separated into aeronautical and non-aeronautical services. Supporting information on aeronautical cost allocations, asset valuations | Audited financial accounting statements for specified airport services | Specified reports on return on investment, profit, tax allowance, asset base, segment information, consolidated information, asset allocations, cost allocations, reconciliation of actual to forecast capital expenditure |
| Historical airport quality of service information        | Indicators of the availability and standard of service. Surveys of passengers, airlines surveys and Government services | Information on planned and unplanned service interruptions for four key airport services | Reports on reliability measures, capacity utilization indicators, operational improvement indicators and passenger satisfaction surveys |
| Forecast future revenue requirements and supporting information | Nil                                           | ‘Financial forecasts’ may be requested by the Government | Total revenue, value of assets, cost of capital, operational expenditure, capital expenditure, depreciation and taxation |
| Information related to disclosure of pricing information  | Standard prices and volumes for aeronautical services, car parking charges | Current charges for identified airport activities and the methodology used to determine them | Standard prices, volumes and detailed methodology used to determine them |

a The methodology for passenger surveys is prescribed. 
b Provided 40 days after a price setting event.

Sources: ACCC (2009, 2008), New Zealand Airports Authorities Regulations, 1999 version 2011, and New Zealand Commerce Commission (2012).
new regulatory framework in New Zealand gives the NZCC a more active role in assessing information disclosed by airports.

3.3. Mechanisms for further regulatory action

3.3.1. The significance of a threat of stronger regulatory action

The threat of stronger regulation is expected to influence the performance of airports under LHR as the second Productivity Commission review observed:

“Fundamental to the effectiveness of the light handed approach is the credible threat of sanction for airports that abuse their market power.” (Productivity Commission, 2011, p. XXXV)

The credibility of a threat of a stronger regulatory measure has been an issue of concern under LHR in Australia and New Zealand. Bollard and Pickford (1995) comment that while the Commerce Commission could recommend to the government that it impose price control the New Zealand government had “shorn no desire to reintroduce such controls in the newly deregulated environment” (p. 418). Small (2000) identifies factors which contributed to the lack of credibility of a threat of stronger regulation in New Zealand. These factors included a lack of regulatory capacity; poorly defined boundaries between what is regarded as acceptable outcomes consistent with the government's objectives; that in practice threats were a political tool because implementation would have required new legislation; and that government officials had no way of using disclosed information to determine whether regulation would be beneficial.

In Australia the issue of the credibility of a threat of re-regulation was initially raised in an appeal process under Australia's third party access legislation involving a dispute between Virgin Blue and Sydney Airport over domestic landing charges. The Australian Competition Tribunal (ACT) concluded that “we are satisfied that any threat of re-regulation is, in reality, quite limited.” (ACT, 2005, p. 129). Factors that contributed to the ACT conclusion were that no conduct on the part of Sydney Airport had to-date “stimulated any further Government action or interest” and that there was:

“no firm basis upon which there can be any conclusion as to what the Commonwealth Government's policy would be at any particular time in the future, that there would be a delay of at least several years before stronger regulation came into operation, if stronger regulation came into operation it would not operate retrospectively and so airlines would not be able to redress the consequences of Sydney Airport's market power”. (ACT, 2005, p. 129)

The issue of the credibility of the threat of stronger regulation has been a key issue for the two reviews of LHR by the Productivity Commission in Australia. Both inquiries have recommended additional procedures to increase the credibility of a threat of stronger regulation referred to as a ‘show cause’ mechanism (Productivity Commission, 2006, 2011). The proposed 'show cause' mechanisms involved the initiation of further inquiries with associated delays and uncertainty (Arblaster, 2011). Following negative industry reaction the Australian Government did not implement the 'show cause' mechanism recommended by the 2006 inquiry (National Aviation Policy Review, 2009) nor did it implement the 2011 recommendation to introduce a 'show cause' mechanism (Australian Government, 2012). Airlines have seen the credibility of threat of stronger regulation as a crucial element of LHR (Airline Industry, 2011).

3.3.2. Characteristics of a credible threat under LHR in Australia and New Zealand

Based on Bollard and Pickford (1995), Small (2000), Australian Competition Tribunal (2005) the characteristics which contribute to the credibility of a threat of stronger regulation can be discerned. Firstly, the ability to make an assessment of airport performance from information obtained under LHR is important. If information disclosed does not provide a good indication of airport performance or is insufficient to trigger further review then the probability of a stronger regulatory measure being invoked is likely to be low.

The potential for political influence to affect a decision on whether stronger regulatory action should be invoked is a further characteristic. If a political process is either not involved, or is involved to a minimal degree or with strong accountability safeguards when regulatory decisions are made the credibility of a threat of stronger regulation is likely to be greater. In this respect the existence of an independent agency which reviews and assesses information disclosed through LHR is likely to be important. Similarly, the availability of suitable alternative regulatory measures which can be invoked if poor performance is identified; and relatively short, or at least not excessive timeframes required for invoking stronger regulatory measures are further important factors. This latter characteristic will be influenced by whether stronger regulatory measures are already available under legislation and therefore do not require a time consuming legislative process to be adopted and whether there is an independent agency with the necessary regulatory skills to administer an alternative regulatory measure.

The key characteristics which seem important for a credible threat of stronger regulatory measures and whether they are present in the Australian monitoring regime and the New Zealand information disclosure frameworks are listed in Table 4.

The enhanced information disclosure framework introduced in New Zealand has a number of characteristics which are likely to provide a credible threat of stronger regulation in comparison to

Table 4

Comparison of reporting arrangements under LHR in Australia and New Zealand.

| Characteristic                        | Australia – price monitoring | New Zealand – Airports Authorities Act framework | New Zealand – enhanced information disclosure |
|--------------------------------------|------------------------------|--------------------------------------------------|------------------------------------------------|
| Frequency of public reporting        | Annually                     | Annually and after a price determination          | NZCC                                           |
| Entity monitoring and reporting on airport information | ACCC                          | Minister of Transport receives information but does not publicly report None required | NZCC must summarize and assess information and report after new prices are set |
| Assessment and/or public commentary  | Comments on trends in data and aggregate indicators over time | | |

Sources: Various including review of ACCC monitoring reports, Australian Competition and Consumer Act, 2010, New Zealand Commerce Amendment Act, 2008 No. 70, New Zealand Airport Authorities Act 1966 (as at 10 May 2011).

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4 Virgin Airlines had appealed the Government’s decision not to declare domestic landing charges at Sydney Airport subject to the national access provisions.
the Australian and the earlier New Zealand frameworks. Information disclosed allows a more accurate assessment of whether airport performance is economically efficient or approximates a workably competitive outcome. Other factors contributing to a more credible threat are that an inquiry into airport performance can be initiated by the NZCC, there are accountability measures for Ministerial decisions on inquiry recommendations, a range of alternative regulatory measures are already in legislation and relatively little additional information would be required in the implementation of a stronger regulatory measure.

4. Does the design of light-handed regulation in Australia and New Zealand contribute to meeting its objectives?

The design of light LHR of airports in Australia and New Zealand in relation to the key objectives which have been sought is examined below.

4.1. Promotion of economically efficient airport performance

4.1.1. Information relevant to an assessment of airport performance

The limited ability of the initial approach to LHR in New Zealand to enable an assessment of airport performance is reflected in the experience of the Airfields Pricing Inquiry under the Commerce Act initiated in 1998. The NZCC was required to report on whether a recommendation should be made resulting in the imposition of price controls over airfield activities at any of the three major airports. This assessment involved examining airport performance from the point of view of economic efficiency (NZCC, 2002). A large amount of additional data that was not available from the information disclosure framework was required. Analysis on the performance of the three major airports took place over a four year timeframe.5

LHR in Australia provides information on historical trends on broad financial indicators. As the information provided is not governed by detailed prescribed methodologies designed to provide information on economic costs and revenues it is not possible to make conclusive assessments of whether airports are economically efficient from ACCC monitoring reports. The 2006, 2011 Productivity Commission inquiries did not undertake their own empirical analysis of the performance outcomes at each of the monitored airports. In the 2006 report the Productivity Commission sought to provide “an indicative picture” of experience under LHR (Productivity Commission, 2006, p. 12). In a submission to the 2011 Inquiry Forsyth and Niemeier (2011) argue measurements and analysis have not been done to assess whether “the airports have been performing well in the critical aspects of productivity and the use of market power” and so they “cannot conclude that the airports are operating and pricing efficiently” (p. 5). The Productivity Commission’s views about the performance of monitored airports in the 2011 Inquiry were largely based on existing international benchmarking studies including studies undertaken by the Air Transport Research Society (ATRS) and submissions from participants to the inquiry.

The information requirements associated with the enhanced information disclosure regulation of airports in New Zealand are comprehensive, rigorous and incorporate forecast information (Table 2). The NZCC has already been able to undertake assessments of whether airports performance has been efficient and consistent with a workably competitive outcome in respect of the level prices and some other dimensions of efficiency. The reports on Wellington and Auckland airports involve quantitative assessments of the level of airport prices determined in 2012 relative to estimated efficient levels (NZCC, 2013a, 2013b).

4.1.2. Airport performance under light-handed regulation

Based on the detailed analysis of the Airfields Inquiry the NZCC (2002) concluded that Auckland Airport and Wellington Airport had earned excess returns historically and that there was a trend of increasing returns in the case of Auckland Airport and, to a lesser extent, Wellington Airport, that there was room for improvement in productive efficiency at all three airports, there was evidence of dynamic inefficiency at Auckland Airport and insufficient constraint on the market power of Auckland Airport. In the case of Auckland Airport the majority of commissioners considered that there would be a net benefit from the application of price controls. A minority of commissioners disagreed with the finding because of a different view on the methodology used to assess the value of specialized airport assets. Similar conclusions to the majority Inquiry Report about Auckland Airport were reached by Donnley et al. (2005) who carried out a study using data envelopment analysis. They found that Auckland Airport, with significant market power, had consistently increased profitability, while not showing a corresponding increase in efficiency. Both the 2006 and 2011 Productivity Commission Inquiries have not made definitive conclusions on whether airport performance

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5 The Inquiry was initially required to report by 14 December 1999 but later extended to 27 August 2002.
could be considered economically efficient under light handed regulation, in particular in relation to the use of airport market power and the level of airport prices. The conclusions related to economic efficiency have been largely based on qualitative evidence, or the absence of positive findings. For example, the 2011 Inquiry found that:

“Australian airports’ aeronautical charges, revenues, costs, profits and investment outcomes remain within the performance range of their overseas counterparts.” (Productivity Commission, 2011, Finding 4.1 p. XLVI)

While ACCC monitoring reports since 2008–2009 have pointed to the possibility that some airports might have earned monopoly rents and undertaken insufficient investment, the 2011 Inquiry merely concludes that “taken in context, these (price) increases do not indicate systematic misuse of market power” and that the Commission “has not found evidence that airports have exercised their market power to the detriment of the community.” (Productivity Commission, 2011, p. XLVIII and p. XXXIV)

In contrast, the NZCC is in a better position to assess airport performance given the superior information provided under the new information disclosure framework. They conclude:

“Based on the charges that Wellington Airport set last year, our conclusion is that information disclosure regulation is not limiting excessive profits, as Wellington Airport is expected to over-recover at least $38 million from airport users over the current five-year pricing period.” (NZCC, 2013a, p. 3)

In the case of Auckland Airport a finding by the NZCC is that its expected return from prices set for 2013–2017 is within a reasonable range (NZCC, 2013b).

4.2. Facilitation of commercially negotiated outcomes

Major airports in New Zealand have been required under the AAA to consult their major customers but have the freedom to set charges. The minimal information disclosure requirements in the initial regulation led to the possibility of airports prescribing charges with minimal constraints. Dissatisfied with this approach Air New Zealand challenged Wellington Airport in the High Court on the interpretation of ‘consultation’ (New Zealand High Court, 1993). In Australia airports have determined charges since the removal of price caps in 2002. Airlines favor a negotiated approach and do not support a return to price regulation (Airline Industry, 2011). They consider that “re-regulation would only increase costs for all parties and lead to inefficient outcomes” (p. 1).

While the Productivity Commission and the industry consider that negotiations have improved relative to the price cap period under the Australian price and quality of service monitoring framework, difficulties in negotiations under LHR have been identified in the 2006 and 2011 Productivity Commission reviews. The 2006 review observed that “relationships between some airports and their customers have been strained” and that there is still some way to go in the transition to a commercial environment (Productivity Commission, 2006, p. 43). The 2011 Productivity Inquiry report considers that “there is considerable scope to improve commercial negotiation — particularly with regard to contract formation — as it has yet achieved the level of maturity envisaged with the lifting of price regulation nearly a decade ago.” (Productivity Commission, 2011, Finding 8.4, p. 177). Airlines have expressed the view that “the current regime does not facilitate truly commercial negotiations between airlines and airports due to the inequitable bargaining position airlines experience as a result of airports’ substantial market power” (Airline Industry, 2011, p. 3). They sought a set of guidelines to address key issues raised in negotiations and the ability to use binding arbitration and independent arbitration for disputes over the terms and conditions in the event that commercial negotiations fail.

Although New Zealand’s new approach is prescriptive with respect to information requirements and reporting, airports are free to determine their prices. They have taken different approaches to the first price determination following the introduction of the new approach (NZCC, 2013a, 2013b). The greater transparency associated with the new approach enhances airlines’ countervailing power and as a consequence could be expected to facilitate their negotiation with airport operators.

4.3. Compliance and administrative costs

The information requirements for price monitoring under the Australian regulatory framework are restricted to historical information in a format which is largely consistent with statutory reporting requirements and which is not prescriptive with respect to methodological issues, such as cost allocations and asset valuation. The Productivity Commission has found that compliance costs for the monitoring program are low (Productivity Commission, 2011, Finding 10.1). The initial information disclosure regulation in New Zealand similarly involved minimal compliance requirements on airports and low administrative costs for the Government (Tables 2 and 3).

The development of the new information disclosure framework in New Zealand was resource intensive taking place over a two year period. Enhanced information disclosure requires the disclosure of extensive additional information in addition to that required under the AAA and in comparison to the Australian regime (Table 2). Taking into account the relatively small size of New Zealand’s major airports, especially Wellington and Christchurch airports with around 6 million passengers each (Table 1), the compliance and administrative costs of the new information disclosure framework are relatively high (Table 2).

5. Alternative approaches to light-handed regulation

During the 2011 Inquiry the possibility of increasing access to binding dispute resolution prior to contract formation, with or without price and quality of service monitoring, was canvassed. In Australia there is a general regulatory framework under the Competition and Consumer Act 2010 which governs access to essential facilities with monopoly characteristics which include provision for interested parties to seek declaration of infrastructure services, such as aeronautical services. A declaration process can be initiated by an airline or another interested party. Declaration of a service allows negotiation of terms of access to the service with the ability to seek legally binding arbitration by the ACCC if agreement cannot be reached. Under negotiate-arbitrate regulation (NAR) the prospect of an arbitration acts as a credible threat of a stronger regulatory measure. However, the role of the government is limited to making a decision on a recommendation for declaration of a service. Littlechild (2012) considers that in general LHR has worked well in Australia but the adoption of independent dispute resolution processes would lead to the alleviation of some airline concerns about regulation. The Australian Government accepted the recommendation from the 2011 Productivity Commission inquiry
for a continuation of monitoring (Australian Government, Department of Infrastructure and Transport, 2012). However, the Government’s response to the 2011 Productivity Inquiry noted the expected review of the national access provisions by the Productivity Commission. This was commenced late in 2012. Submissions to the review from airlines and Australian Government organizations support the continuation of the national access framework with changes to its design to increase its effectiveness.7

NAR contained in the national access regime is a possible alternative, or complementary, approach to price and quality of service monitoring by the ACCC. NAR provides targeted regulation to identified concerns about the possible use of airport market power. A credible threat of stronger regulation is provided in the form of arbitration provisions.

Under amendments to the Commerce Act NAR could be invoked for airports services in New Zealand if a public inquiry recommended it and the Government adopted that recommendation.8 While this framework is yet to apply to airports in New Zealand, it could be invoked in addition to information disclosure regulation or in conjunction with a lowering of the requirements associated with information disclosure regulation as applied to particular airports.

The potential for airport users to adopt binding dispute resolution increases the bargaining power of users while at the same time avoiding the costs and intrusion associated with traditional regulatory approaches and more prescriptive information intensive approaches to LHR, such as the new approach in New Zealand.

6. Conclusion

LHR of airports has been reviewed through examining the design features of the main regulatory frameworks applying to major international airports in Australia and New Zealand. These airports are all privatized, or partly privatized, and are generally regarded as having a high degree of market power. As they are not particularly large by world standards, with the possible exception of Sydney Airport, the administrative and compliance costs of regulation are relatively important.

In Australia, the price and quality of service monitoring approach to LHR provides indicative information but does not permit an assessment of whether airports are economically efficient or whether they have used their market power. The credibility of a threat of stronger regulatory action has been considered weak. Negotiations between airports and airlines at some airports are considered difficult. However, the compliance and administrative costs associated with the framework are generally considered low.

Information disclosure under the initial New Zealand approach was insufficient to assess airport performance. Airlines claimed to have major difficulties in negotiations with airports and the costs of administration and compliance (excluding the cost of the Airfields Inquiry) were low. The new enhanced information disclosure approach to LHR is designed to assess the economic performance of airports and whether they are using their market power. Some initial assessments have already been made primarily using information from the framework. The threat of stronger regulation in New Zealand is more credible than before because suitable alternative regulatory measures are already contained in legislation under the Commerce Act and because of the information base that exists through enhanced information disclosure. However, in comparison to the earlier New Zealand approach and the Australian approach to LHR, the new approach in New Zealand has high administrative and compliance costs.

A lesson from the experience of these LHR frameworks in Australia and New Zealand is that there seems to be some tradeoffs in the design of LHR. On the one hand frameworks designed to be truly “light” in the sense of minimizing compliance and administrative costs and minimizing the intrusion into industry decision making have not provided sufficient information to assess whether airports are economically efficient, and in particular whether they are using their market power. The new regulatory framework in New Zealand is designed to provide information which is rigorous, comparable between airports and facilitates a broader assessment of airport performance. This approach to the design of LHR is more likely to provide information on whether airport performance is economically efficient and on the use of airport market power. However, the New Zealand approach involves a relatively high degree of intrusion into airport decision making and compliance and administrative costs are more significant.

The existence of a credible threat of stronger regulation to address airport performance if it is unsatisfactory was an issue for the initial LHR in New Zealand and has been an issue under price and quality of service monitoring in Australia. It seems that the existence of a credible threat of stronger regulatory measures is an important feature of the design of LHR. The lack of a credible threat of stronger regulation in the initial New Zealand framework was an important influence on the adoption of the stronger regulatory approach introduced in 2008. In Australia, two Productivity Commission inquiries recommended measures to strengthen the threat of stronger regulation. The industry and the Australian Government saw deficiencies associated with the specific Productivity Commission recommendations to strengthen the credibility of the threat of stronger regulation through adopting a ‘show cause’ provision. However, submissions from Australian Government departments have supported improvements to the design of the national access framework to allow it to become a more effective regulatory mechanism for infrastructure industries, including airports. Increasing the effectiveness of negotiate arbitrate arrangements under the national access regime is an alternative way of strengthening the credibility of stronger regulation while still encouraging negotiated outcomes.

Australian experience has shown that in order to enable assessment of economic performance over time and to provide stability to the regulatory framework the method of determining airport asset values needs to be established at the outset. Asset valuations are an issue which has been given a lot of attention in the development of the new approach in New Zealand. Establishing airport asset values has proven to be a complex task under traditional regulation and which has not been overcome by taking a light-handed approach.

Through examining the design of price and quality monitoring in Australia and information disclosure regulation in New Zealand the potential for LHR to achieve the stated objectives sought can be more clearly understood. From an examination of Australian and New Zealand experience with LHR of airports it can be seen that the design of regulation is critical to its effectiveness in achieving the objectives sought from it.

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