

Airports Price Control Inquiry  
Regulatory and Competition Policy Branch  
Ministry of Economic Development  
PO Box 1473  
WELLINGTON

Attention: [mark.simpson@med.govt.nz](mailto:mark.simpson@med.govt.nz)

**Comment on Final Report: Part IV Inquiry into Airfield Activities at Auckland, Wellington, and Christchurch International Airports**

This comment on the Commerce Commission's final report on airport activities at Auckland, Wellington and Christchurch International Airports is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand businesses. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

The NZBR has made many submissions on Commerce Act-related issues over the years. Our consistent theme has been that the Act should have the single objective of enhancing economic efficiency. In some circumstances, regulatory constraints on the market power of a firm may improve economic efficiency. If constraints are demonstrably required, we believe there should be a presumption in favour of light-handed regulation. Heavy-handed approaches, such as rate-of-return or price regulation lead to cost-plus behaviour, interventions that distort entry barriers and competition, bureaucratic capture, and regulatory creep. They can result in unstable swings in prices and investment – reflecting changing political pressures on the regulators.

We make this comment because the Commerce Commission's final report recommended on a split decision that the airfield activities supplied by Auckland International Airport Limited be controlled. We assume that the Ministry will make its own recommendations to the Minister on whether she should accept this recommendation and, if so, how that control should be exercised.

We note that a variety of regulatory options are available to the Minister, with price or rate-of-return control representing an extreme, heavy-handed option. In our view, the potential for monopoly problems at Auckland airport does not justify a heavy-handed response on the analysis presented.

Airports are constrained in their ability to abuse market power. In Australia, the Productivity Commission found that "[t]he scope for airports with market power to use (or abuse) that power is constrained by commercial pressures and opportunities,

particularly the 'non-aeronautical' income to be had from promoting airline passenger traffic".<sup>1</sup> Competition legislation, political pressures, and the countervailing power of the major airlines constrain them further. Furthermore, the demand for landing facilities at Auckland International Airport may well be price inelastic. This also suggests that the cost to allocative efficiency of monopoly pricing would be small. In this case the imposition of price control for the use of those facilities would not provide substantial allocative efficiency gains. It would, however, produce substantial risks of dynamic efficiency – the effect on the incentive to further invest in such facilities in future.

The Commission's own figures support the proposition that any abuse of market power is likely to be small. It estimates that the annual net benefits to acquirers (foreign and domestic airlines) from the control of activities supplied by Auckland would be around \$2 million. It mentions that this is only 4 percent of total landing charges. It is also only 1 percent of AIAL's revenue in the year to June 2002 and 3 percent of its net profit. The \$2 million figure is tentative and trivial in relation to the market risks to profits and revenues of airlines and airport companies.

We are concerned that the recommendations for control appear to be driven in large part by income distribution issues rather than by economic efficiency considerations. The problems result from both the legislation and the Commerce Commission's analysis.

Section 53 of the Commerce Act required the Commerce Commission to consider whether control was in the interests of acquirers. The Commission interpreted the interest of acquirers as including income distribution as well as efficiency effects. Thus, the potential transfer of income from the airports to acquirers was considered a benefit of control. We believe that this is a serious flaw in the Part IV provisions.

The Commerce Commission's focus on *ex post* rates of return appears to reflect these distributional priorities. A concern with efficient prices would not imply a focus on average returns on historic costs. We have not closely studied the choice of asset valuation methodology that split the Commissioners and do not have a firm position on the issue. Our general position is that the focus of competition policy should be on achieving efficient prices. These would track forward-looking costs. Policy would allow (non-predatory) pricing structures that investors were relying upon to recoup long-run marginal costs at the time those costs were incurred. This may be the only way investors can hope to recoup sunk costs. Governments should protect investors from unprincipled changes to the legal rules or from ill-founded interpretations that have a retrospective effect. Regulated prices based on backward-looking costs that fail to allow (non-predatory) investor expectations to be achieved deter future investment. We believe that the Ministry should take care to ensure that the government is aware that its decisions on control are likely to unsettle investor expectations unless they are clearly based on sound principles that give predictability to future investor decisions.

In our view, the Commission's approach to the measurement of excess profits could further reduce the incentive to invest in infrastructure in New Zealand. Investors

---

<sup>1</sup> Productivity Commission, *Price Regulation of Airport Services*, Inquiry Report No 19, 23 January 2002, p xvi.

will be deterred if they perceive that the regulatory environment will remove their upside returns while leaving them fully exposed to downside risks. A focus on evaluating *ex post* returns against the cost of capital creates exactly this risk. It indicates that excess *ex post* profits may be taken as evidence of monopoly pricing. The Commission is aware of this difficulty, but its comment that superior returns should reflect superior performance implies that factors such as good luck should not be reflected in superior returns – even though bad luck will lead to inferior returns. There are many other reasons why *ex post* accounting returns provide at best a very weak indication of *ex ante* monopoly profits. For these reasons, we suggest the Ministry should take a more permissive approach towards apparently excess *ex post* profits.

Another legislative constraint on the Commerce Commission's analysis was the low threshold for determining whether there is a material competition problem ("competition is limited or likely to be lessened"). The threshold is arguably lower than the section 36 threshold ("substantial degree of power in a market") or even the "substantial lessening of competition" threshold for acquisitions and restrictive trade practices. It is particularly low because concentration ratios tend to be high in the small New Zealand market.

In our view these legislative shortcomings can be expected to inhibit private investment in critical infrastructure in New Zealand. The inhibition will be greater the more the government is seen to use distributionally oriented legislation to expropriate rents from investors. We urge the Ministry to give due weight to this aspect of the problem in considering its advice.

We note that the Australian Productivity Commission study referred to above favoured reliance on light-handed regulation, not price controls, in respect of the four airports that it found had market power. It proposed monitoring those airports for a 'probationary' five-year period.

In respect of its immediate response to the Inquiry report, we suggest that the Ministry should not lightly endorse the Commerce Commission's recommendation to control selected goods and services for Auckland International Airport. In the event that the Minister does wish to control them, we urge the Ministry to recommend against heavy-handed regulation such as price control unless it has much better evidence in its favour than that presented in the Inquiry report. If necessary, enhancement of the current light-handed regulatory regime, through additional disclosure and monitoring, may be an option that would address possible concerns while minimising the efficiency costs that are inevitable with increased intervention.

At the same time, we strongly urge the Ministry to take up the legislative problems that we have identified with the government with a view to restoring an efficiency focus for all aspects of the Commerce Act. It is hard to see any valid reason why legislation should be on the books that leads to a presumed benefit to society from regulation that has the effect of transferring wealth from airport investors to airline investors.

We would appreciate the opportunity to discuss our views with the Ministry.

Yours sincerely

R L Kerr  
**EXECUTIVE DIRECTOR**