

**57th CONFERENCE OF
DIRECTORS GENERAL OF CIVIL AVIATION
ASIA AND PACIFIC REGIONS**

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**AGENDA ITEM 6: ECONOMIC DEVELOPMENT OF
AIR TRANSPORT**

**CRAFTING AIRPORT CHARGES POLICIES THAT EXTEND
BENEFITS TO CONSUMERS – AIRPORTS NEED A
RESPONSIVE AND FLEXIBLE REGULATORY FRAMEWORK**

Presented by Airports Council International (ACI) Asia-Pacific

SUMMARY

The last thorough examination of the relevance and responsiveness of ICAO's policies on charges in Doc 9082 was done in 2008 at the Conference on the Economics of Airports and Air Navigation Services (CEANS–2008). The competitive and economic landscape of the airport industry and the aviation ecosystem has changed dramatically. Airport competition has become the new normal. Looking ahead, airports need responsive and flexible charging approaches to recover sustainably from COVID-19 and to respond adequately to their capital expenditure needs. Additionally, policies and regulations on airport charges should ensure the efficient and sustainable use of infrastructure for the benefit of the travelling public (consumers). Economic oversight should consider the important role commercial agreements play in delivering risk sharing mechanisms and for price determination.

Action: Actions by the Conference are found in paragraph 4.

CRAFTING AIRPORT CHARGES POLICIES THAT EXTEND BENEFITS TO CONSUMERS – AIRPORTS NEED A RESPONSIVE AND FLEXIBLE REGULATORY FRAMEWORK

1. INTRODUCTION

1.1 The aviation ecosystem needs economic oversight frameworks responsive to its needs and capable of ensuring the short-term recovery of aviation and the long-term sustainable development of airports and air transport. Accordingly, ICAO regularly convenes worldwide conferences to examine the relevance, responsiveness and appropriateness of its policies.

1.2 The last examination of the relevance and responsiveness of ICAO's policies on charges in Doc 9082 and ICAO's positions on the economic oversight of airports was done at the Conference on the Economics of Airports and Air Navigation Services (CEANS–2008), which ICAO convened in Montréal from 15 to 20 September 2008.

1.3 The main purpose of CEANS–2008 was to learn from the experiences of the commercialization and privatization process, and further develop and refine policies on cooperation between providers and users of infrastructure by strengthening policies on consultation with users.

1.4 In the past 14 years since the last Conference, the competitive and economic landscape of the airport industry and the aviation ecosystem has changed dramatically. Policies and regulations on airport charges should be developed in support of consumer interests. The balancing of airport and airline should instead be played out in commercial negotiations without regulatory interference.

2. PRE-COVID-19 PANDEMIC: AIRPORT COMPETITION IS THE NEW NORMAL

2.1 In the past, airports used to be regarded as monopolistic infrastructure providers, even though airport competition has long been a reality, for instance between airports located in the same catchment area.

2.2 The competitive dynamic of the airport industry had been rapidly growing even before CEANS–2008. Airports have faced a strong multi-faceted competition as they compete for airline services and capacity, for passengers, for cargo, and for commercial activities.

2.3 Airlines make full and extensive use of the freedom they have flying between airports and switching away from them when they deem that economic conditions are not right. Since CEANS–2008, these dynamics have been evident at the individual route level or base level—where airlines put airports in competition against each other when considering adding new services and/or increasing capacity. With airlines being able to move capacity between airports, airports compete to attract, retain and develop air service from both full service and low-cost airline. Three trends have also been clearly observed: first, super-connector airports driving away traffic from long-established hubs; second, the development of multi-hub strategies by the largest airlines and airline groups; and third, the increasing number of direct routes resulting in hub bypass, enabled by new generation aircraft.

2.4 Competition for passengers has also dramatically intensified since CEANS–2008, as the ability of passengers to use alternative airports or other modes of transport exposes individual airports to greater competitive pressures. Both point-to-point and transfer passengers can switch between airports. Point-to-point passengers can switch in a variety of ways. For instance, they can switch to other airports in their departing region and/or in the destination region; passengers may consider substituting one destination for a different destination. Transfer passengers have all these switching possibilities but, in addition, are also able to choose between connections at different hub airports. Passengers have, in several instances, the additional option to opt for different modes of transportation. The option not to travel is also a choice available. Passengers, to a large extent, base their decision on price grounds. Price elasticity of demand, though different for various markets and distance, is reflective of such viewpoint.

2.5 The continuous digitalization of the economy for two decades now is also changing consumer behavior and reshaping the competitive landscape for airports' activities. Digital multi-modal travel search engines provide consumers with information about access to alternative airports or alternative travel modes, increasing cross-mode substitution for air travel. In terms of commercial or non-aeronautical activities, airport retail segments are in direct competition with online retailers whereby consumers can directly compare prices from stores and buy goods online and get these directly delivered home—without considering airport security restrictions—if prices are more attractive online. Similarly, more advertising platforms are now competing with airports' traditional advertising space. Sharing economy models, especially in ground transportation and real estate—such as ride hailing and hospitality brokerage services (Uber and Airbnb, for instance)—are also major disruptors for the traditional airport commercial revenue streams, such as car parking, car rentals and airport-site hotels.

2.6 Such intense competitive trends are shaping the dynamics of the airport industry in the interest of consumers, in a context where airline consolidation and airlines' countervailing power has continuously increased in many markets since CEANS–2008. The rise and prevalence of the low-cost carrier business model, presence of dominant carriers, formation of oligopolistic airline alliances, and holding of large portfolios of grandfathered airport slots are giving airlines significant countervailing power vis-à-vis airport operators.

2.7 As such, competition is a key driver of the airport business. Airports compete on all aspects of their business—from aeronautical business to on-site and off-site commercial activities. The result is a competitive and dynamic airport market, which did not get addressed at CEANS–2008. Competition, rather than price regulation, should be sought to deliver outcomes in the interests of the travelling public (consumers).

3. SUSTAINABLY RECOVERING FROM COVID-19: AIRPORTS NEED RESPONSIVE AND FLEXIBLE POLICIES

3.1 The air transport industry felt a triple shock from the COVID-19 global pandemic: administrative travel restrictions have been superimposed on a steep global economic downturn and exacerbated by significant behavioral shifts.

3.2 The COVID-19 global pandemic has not only intensely shaken the demand for airport facilities and services but it has also perturbed the supply side of the equation.

3.3 Like many asset-intensive businesses, the airport cost structure is characterized by predominantly high fixed costs in the operation and maintenance of major infrastructure components, such as runways and terminal buildings. However, the COVID-19 pandemic and resultant travel bans have placed the airport business in a precarious state. With supply side restrictions on travel and the collapse in air transport demand, airport operators have neither sufficient traffic to drive down costs and achieve economies of scale nor to generate significant aeronautical or commercial revenues to cover costs and to service debt levels.

3.4 With revenues shoring up quicker than what cost containment can achieve and with a large cost component remaining fixed, the industry is witnessing a major shift in liquidity and solvency measures. The debt-to-EBITDA ratio is a direct illustration of airports' impaired liquidity position and jeopardized financial health. On average, based on comprehensive data from ACI Airport Economics Report and KPIs, global debt-to-EBITDA levels were reported at 4.4:1 in 2019. Debt levels have consistently oscillated in the realm of 5:1 for many years, though a declining trend has been observed in recent years. As a result of the current pandemic, even based on assumed debt levels that have remained constant into the 2020 pandemic, the projected revenue shortfall would mean that debt-to-EBITDA ratios would reach 10:1—a financially unsustainable figure for any industry or economic agent.

3.5 To add a complication, not every aspect pertaining to the airport business will recover at the same pace and to the same extent. Current economic regulation frameworks usually provide that the return on capital that airport operators must charge to passengers and airlines correspond to its weighted

average cost of capital (WACC). The unprecedented crisis that is affecting the solvency and debt obligations of airports specifically is likely to increase the WACC required by airports' owners and investors.

3.6 ICAO's policies and economic regulatory frameworks as assessed and examined at CEANS-2008 are not fully reflective of a changed industry and the competitive landscape. They are also not able to resolve pricing in extreme circumstances. The regulatory frameworks inherently act as a double-edged sword. In a context of robust traffic growth and efficient cost management, such economic regulatory frameworks may lead to decreases in airport charges. Conversely, when airport traffic declines, regulated regimes of airport charges may also result in increases in airport charges. However, these frameworks demonstrate the clear weaknesses in a context of a major shock and radical drops in traffic volumes. If airports had price flexibility based on the competitive landscape many of them face, charges that are levied on airlines and passengers, and negotiated through commercial agreements, would adjust to certain realities and market conditions. Such agreements permit effective risk sharing mechanisms.

3.7 Regulatory frameworks that formalize strictly cost-based airport charges should be reassessed, as they are insufficiently responsive to market realities. They often do not ensure that infrastructure is used more efficiently for the benefit of the travelling public. The cost-based approach considers only one side of the market. It ignores the demand side of the market and the need for airport pricing policies that provide the right incentives and signals based on competitive factors and market dynamics — efficient capacity utilization, community responsibility regarding noise and environmental impact, traffic growth to support aviation dependent economic sectors and social connectivity, and non-aeronautical revenue development.

3.8 An important case study for consideration is Australia. Historically, the regulatory framework had a cost-based price cap regulation, even before airport privatization, when it started to commercialize its federal airports. However, after some years of experience following privatization, the government replaced heavy-handed regulation with a light-handed price monitoring approach, which has now been successfully used for 20 years. Successive reviews by the Australian Government Productivity Commission in 2006, 2011 and 2019 have shown that the system delivers effective infrastructure development with good market outcomes and benefits accruing to all stakeholders in the aviation ecosystem and especially the travelling public.

4. SUPPORTING THE WORK OF THE ICAO AIRPORT ECONOMICS PANEL (AEP-ANSEP)

4.1 Following the recommendations of the eighth joint meeting of the ICAO Airport Economics Panel and Air Navigation Services Panel (AEP-ANSEP/8), a new Working Group was established *“with the task of conducting a general review of ICAO's policies on charges contained in Doc 9082, comprising the assessment of its ongoing relevance and responsiveness, including with regard to the effect of the long-term impact of the COVID-19 pandemic and an examination of which airports and ANSPs were most significantly affected.”*

4.2 In the Report from AEP-ANSEP/8, members of the panel recognized *“the changes to the airport sector over the past decade, including the impact of the COVID-19 pandemic, which has significantly affected the condition of financing, investment and competition, etc., some members were of the view that it is important and justified to conduct an in-depth analysis of these changes with the objective to identify potential improvements and/or supplement to the existing policies in order to ensure the viability of airports in the long-term.”*

4.3 The current composition of the AEP-ANSEP/8 Working Group is made up of ICAO Member States – Canada (Rapporteur), Brazil, China, Denmark, France, Germany, Ireland, Morocco, Nigeria, Russian Federation, Spain, Trinidad and Tobago, United Kingdom, United States – and Official Observers: ACI, CANSO, European Commission, EUROCONTROL, IATA. Updating the guidance material and policies on airport charges to account for industry changes and adverse shocks will represent important contributions for both industry and States.

4.4 The ongoing deliverables of the AEP-ANSEP/8 Working Group are perfectly aligned with the Priorities outlined in ICAO’s Draft Business Plan for 2023-2024-2025 (C-WP/15412), presented to Council at its 226th Session. Under passage 9.2.2 of the working paper, *ICAO will prioritize its work as follows: a) Develop and update air transport policy and guidance related to economic regulatory frameworks;*

5. ACTION BY THE CONFERENCE

5.1 The Conference is invited to:

- a) Acknowledge the changed competitive landscape of the airport industry over the past decades and the long-term airport infrastructure needs to meet international targets; and
- b) Note the activities and tasks of ICAO’s Airport Economics and Air Navigation Services Panel (AEP-ANSEP) to conduct a general review of the ICAO policies on charges contained in Doc 9082, including the assessment of its ongoing relevance and responsiveness to industry changes and encourage adequate representation and active participation of Asia-Pacific States in the Panel.

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