

COMMENT

ACCC's Submission to the Productivity Commission's 2018 Review of Airports Regulation

The ACCC's submission to the Productivity Commission's 2018 review of airports regulation was recently [published](#).

As the long-term monitor of the four major Australian international airports (Sydney, Melbourne, Brisbane and Perth), the ACCC's submission might be expected to hold significant weight for the review. Given its monitoring role, the ACCC's submission can draw on a substantial body of evidence relating to its monitoring activities. However, the submission is also an opportunity for the ACCC to submit on the merits of the regulatory regime.

The ACCC's overall message is largely unchanged from 2011. In fact, even the media release headlines are all but identical! ("[Effective airport regulation needed](#)").

The ACCC's reasoning is that monitoring of airports has not proved to be an effective constraint on market power. Nor is Part IIIA an effective constraint on airports' behaviour, particularly given the recent amendment to criterion (a) that has raised the declaration threshold. As an alternative, the ACCC argues that a negotiate-arbitrate model for aeronautical services would deliver better outcomes – at least for the airlines.

Aside from its recommendations on the overall effectiveness of the regime, there are two parts of the submission which caught our attention; what the ACCC said about monitoring, and what form of regulation should apply to non-aeronautical services.

- On **monitoring**, the ACCC submission maintains its position that it cannot readily use monitoring data to assess profits and whether the airports have exercised their market power. In other words, the ACCC believes that airports have exercised market power (hence the call for effective regulation), but primarily supports this call with a structural analysis of market power rather than direct evidence of excessive profits. In part, this seems to be because it is directed to monitor the aeronautical activities of the airports and the reported returns on the value of airport *aeronautical* assets are not obviously high (for example, at Figure 3.5).
 - In the context of the Productivity Commission review, even though its monitoring data is limited, our view is that the ACCC could do more with the data it has to estimate the degree to which different airports have exercised market power. The ACCC (rightly) notes the limitations of using accounting data to estimate economic returns, associated with the exercise of market power. This is particularly so given past asset revaluations which have deflated observed returns. However, the ACCC holds detailed information on cash flows that covers up to 20 years for the monitored airports. These can be used to derive rates of return across the airport's operations – not just limited to aeronautical activities. To the extent that high airport returns are 'hidden' in non-aeronautical services, it might have been useful to have brought that out.
 - To take an example of how the data can be used: Melbourne Airport's assets were valued by purchasers at a little over \$1.25 billion at sale in 1998, and the current reported value of assets (2016-17) is a little over \$5 billion. Calculating the economic (internal) rate of return using cash

flows and those opening and closing values indicates a return to owners of over 14% (calculated on a pre-tax, nominal basis).

- The ACCC's monitoring data does not estimate what a reasonable rate of return on assets would be for the monitored airports. An analysis of profits must take into account a benchmark return reflecting the risk associated with investing in the business. Estimating a cost of capital is controversial, but it remains unclear why the ACCC's monitoring does not include benchmark returns.
- On **non-aeronautical activities**, the ACCC does not consider more regulation would be justified. This is notwithstanding that the ACCC also believes monitored airports have market power over these services, and have used it (see page 44). The ACCC supports monitoring and that advising consumers of different options might be a better approach. In our view, this sits somewhat uncomfortably with earlier suggestions that monitoring has not effectively constrained behaviour.

Frontier Economics has assisted with the preparation of submissions for the inquiry for [A4ANZ](#) and [AFIA](#) (on behalf of car rental operators).

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