The International Air Carrier Association

18 December 2014

UK CAA Economic regulation of new runway capacity – a draft policy

The International Air Carrier Association (IACA) represents 29 airlines (including Thomson Airways, Thomas Cook UK and Monarch Airlines) serving the leisure industry. IACA members operate over 800 state-of-the-art, environmentally efficient aircraft and directly employ more than 50,000 people. Each year IACA airlines transport over 100 million passengers to 650 holiday destinations worldwide.
Our Members undertake extensive operations to and from the UK and form a significant proportion of the UK airports 'customer base.

IACA wishes to contribute to the consultation on the draft policy document by providing the following general remarks:

In our view the whole approach followed by the CAA is based on the assumption that the role of the State should be limited to regulate where a market is not possible and where there is a substantial marker power. We could qualify this role as regulating by default.

IACA believes that there would be lot of merit in analysing first what is the economic nature of an airport and deriving from that analysis how to regulate it. We consider indeed that the market approach cannot be justified because an airport meets the characteristics of a **mixed public good** and is a **strong natural monopoly**.

The two features characterizing a mixed public good are being non rival and non excludable:

- There is indeed no rivalry between economic agents (airlines) until saturation (congestion) of an airport is reached.

- An airport is an essential facility that limits the possibility to exclude potential users.

Furthermore:

- An airport is an infrastructure that benefits from increasing returns to scale. It is a natural monopoly. This is a common feature to all important infrastructures for production that generate very high fixed costs. The average costs decrease as production increases because fixed costs are "divided" on a bigger amount of units sold. This pattern is identical for all the network industries (telecommunications, rail- road- air-transport, water supply, gas, electricity...)

- An airport is an infrastructure that produces positive externalities for the entire economy of a city or state. This occurs when the action of consumption or production of an agent has consequences for the welfare of at least one other agent without this interdependence being recognized by the price system, and therefore without resulting in a monetary compensation.

As a consequence:

- The decision to extend (increase) the capacity at an airport has to be taken by the public authority based on an independent assessment of the actual congestion (example: movement per hour) taking into account the characteristics of a mixed public good that is a strong natural monopoly.

- The public authority has therefore **also** to assume its role in the allocation of public resources for the funding of an airport (or extension) for the following reasons : an airport *is a mixed public good, it is an essential facility, there is a decreasing cost function and increasing returns to scale as in any natural monopoly, there are positive externalities to the entire community* and last but not least ***there are important risks up to the completion of works*** that cannot be put on the shoulders of the airlines as they are not in the position to manage those activities and risks. Pre-funding of new capacity by airlines is economically unjustified and therefore unfair. It is also, for all the reasons expressed above, totally inappropriate.

IACA considers the issue of airport capacity and the related funding to be of crucial importance for its members and would welcome further in depth discussions with the CAA.

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