THE REQUIREMENT FOR AIRPORT COMPETITION IN DUBLIN

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The aviation industry has been revolutionised by the development of low cost carriers. Yet competition among airlines is not mirrored by competition among airports. Here, Marcus O'Carroll determines and evaluates the potential monopoly power of Dublin Airport Authority and the negative impact that this has on Irish air travellers. He highlights the inefficiency and waste inherent in the system as well as the impotence of the aviation regulator in sanctioning anti-competitive activities. The potential for competition in this market is examined, as well as potential pitfalls to such proposals.

Introduction

In almost every market a monopoly is undesirable for the consumer. In the past, most airports operated as 'natural monopolies', on the basis that their industry was believed to be unable to support competition. However, contemporary analysis calls this assumption into question, particularly in the face of a revolutionised airline industry driven by low-cost carriers.

In this essay, the operation of Dublin Airport will be examined with a view to showing that passengers would benefit greatly from airport competition in Dublin. In doing so, the role of airport competition in the modern aviation industry will be discussed. The practices of Dublin Airport and the aviation regulator will then be assessed, showing that monopoly power is being abused. Finally possible policy solutions to this predicament will be analysed.

Dublin Airport as a monopoly

The first issue that must be addressed is whether Dublin Airport is indeed a monopoly. There are other international airports on the island of Ireland but it is argued that Dublin Airport operates as an effective monopoly due to the distance between Dublin city and other potential alternate airports. Given that the majority of flights taken to and from Dublin Airport are short-haul and low-cost, passengers are unlikely to be willing to incur the additional travel time and cost involved in using one of these alternate airports. For example, the Dublin-London route, which is the second busiest air-corridor in the world, is only 460km (varying depending on which London airport is the destination) and may be flown in just over one hour. Thus it may be concluded that Dublin Airport Authority (henceforth DAA) operates an effective monopoly because alternate airports are simply too remote to compete.

Airport competition and low-cost carriers

The emergence of low-cost airlines (henceforth LCCs) and the resulting decrease in airfares has transformed the structure of the costs faced by airlines. As Barrett (2000:13) described it: 'The world of non-competing airlines was mirrored in non-competing airports'. However, the portion of the average airfare which consists of airport charges has now increased greatly. For example, Ryanair's average fare in 2008 was €44 and DAA's 2008 passenger-charge price-cap was €7.28 – thus airport charges represent 16.54% of the fare (Ryanair, 2008a; CAR, 2008a). This provides a far greater incentive for airlines to seek lower charges.

Previously, airlines had no scope to bargain with airports, as Doganis stated:

> 'While the airlines as a whole, acting through the IATA, may try to hold increases in landing fees or en-route charges down in a particular country, an individual airline has no scope for negotiating better rates for itself' (Doganis, 2002:110-111).[1]

Modern LCCs do have considerable scope to bargain with airports in order to reduce fares. This is witnessed by the newfound prominence of secondary airports. LCCs now have the option of rejecting high charges at hub airports in favour of low-service, low-charge secondary airports, such as Charleroi or Lübeck. Forsyth (2003) argues that, assuming secondary airports are more cost-efficient, they will offer choice to LCCs and introduce some heterogeneity to the market.

As well as securing lower charges, LCCs can also demand customised services from airports which face competitors. Barrett (2004) states that the main requirements of LCCs are low charges and simple, quick facilities. This is severely at odds

[1] It is worth noting that this is an extract from the first edition, published in 1985 before the LCC revolution.

with the services provided by the existing DAA monopoly, which boasts both high charges and complex, unnecessary facilities, which are more suitable for long-haul legacy flights.

Dublin Airport Authority and monopoly power

Having established firstly that Dublin Airport is a monopoly and secondly that airport monopolies are antithetical to the development of successful aviation markets, the actions and regulation of DAA will now be discussed with a view to determining whether this monopoly power is indeed being abused.

As Adam Smith (1776:I.7.26: 78) stated:

> 'The monopolists, by keeping the market constantly under-stocked, by never fully supplying the effectual demand, sell their commodities much above the natural price, and raise their emoluments, whether they consist in wages or profit, greatly above their natural rate'.

The above quote has been reproduced countless times, but has yet to lose its relevance in any argument regarding competition. In this context, the implication is that an airport which operates a monopoly can and will abuse its power by undersupplying and overcharging the airlines. According to Baumol's theory of contestable markets, it is the duty of potential competitors to 'exercise discipline over the incumbent' (Baumol, 1982:14). However, the start-up time and costs for an airport are sufficiently large to ensure that Dublin Airport is not vulnerable to what Baumol refers to as 'hit-and-run' entrants. As stated in the introduction, the contemporary airline industry has changed the role of the airport; while it was once viewed as a public utility, it is now a business (Barrett, 2004). Thus with Smith's words in mind, any airport not exposed to competition must be observed with great suspicion.

Dublin Airport Authority and supernormal profits

A simple way to identify a monopolist which is abusing its market power is to observe profit levels. While in most competitive markets large profits may be a sign of virtue, they are a sign of cynical practice in a monopoly. DAA's Dublin Airport accounts for 2007 (the most recent year for which audited accounts are available) yield the information contained in Table 1. Dublin Airport recorded very substantial pre-tax profits of over €84m in 2007. This represents 23.7% of total revenue in 2007. In any competitive market these profit levels would have attracted the potential entrants discussed by Baumol (1982). This would push prices down to marginal cost and increase quantity. The LCCs, who themselves compete fiercely, would then pass the savings on to passengers.

Year	Revenue (€ 000)	Airport Charges Revenue (€ 000)	Passenger Numbers (000)	Pre-Tax Profit (€ 000)	% Profit
2006	308,123	128,409	21,196	71,489	23.20%
2007	355,972	158,976	23,287	84,383	23.70%
% Change	15.53%	23.80%	9.87%	18.04%	

Table 1: Revenue and Profits of DAA at Dublin Airport
Source: CAR Regulated Entity Accounts for Dublin Airport plc 2007 (CAR, 2008b).

Of particular interest is the dramatic increase in revenue accrued from airport charges in Table 1. Though passenger numbers increased by 9.87%, revenue from airport charges increased by an enormous 23.8%. The (albeit reluctant) willingness of airlines to endure this tremendous price increase indicates that passenger numbers would have grown even further had the prices been lower. Thus it may be concluded that DAA increased prices above their natural level and effectively undersupplied the demand of airlines. This, when considered alongside the enormous profits made by DAA, is *exactly* what Smith (1776) warned us of.

Regulation of DAA at Dublin Airport

In order to ensure that that DAA does not abuse its monopoly power, the Irish Government instructed the Commission for Aviation Regulation (henceforth CAR) to monitor the charges and policies of DAA under the Aviation Regulation Act, 2001 (CAR, 2008c). If CAR performs its duties effectively, outcomes in Dublin Airport should resemble as closely as possible outcomes that would occur under competition.

For 2007, CAR set a price cap (airport charge per passenger) of €6.39 for Dublin Airport (CAR, 2006). Table 2 documents the relevant figures for Dublin Airport in 2007. DAA exceeded the price-cap by €0.44 in 2007, resulting in an estimated €10m in illegitimate revenue. This represents overcharging of passengers by 6.89%.

	Passenger Charge	Airport Charge Revenue[2]
CAR Price-Cap	€6.39	€148,734,500
Actual Passenger Charge	€6.83	€158,976,000
Difference	€0.44	€10,241,500
% Difference	6.89%	

Table 2: Dublin Airport Price Cap and Actual Charge in 2007
Source: CAR, 2008a.

In response to this overcharging, CAR claims to have built a discount into the 2009 price cap, which will return the €0.44 plus interest to passengers (CAR, 2008a). This proposition is incredible – the 2009 passengers and 2007 passengers are different groups, one of which now apparently benefits from the overcharging of the other. CAR failed to penalise DAA in any way for the overcharging of customers. Thus, CAR has allowed moral hazard to develop by signalling that there is no significant downside to overcharging. In reality, it is DAA who decide charges, as they have 'regulatory capture' over CAR. The resulting dissatisfaction of Ryanair with CAR is very much evident in the following extract from a press release:

> 'The main purpose of the Aviation Regulator is to replicate the effects of competition. Competition reduces charges and improves services. This Regulator has totally failed to do either... How can we reasonably expect this inefficient civil service quango to effectively regulate another inefficient semi-state service airport monopoly?' (Ryanair, 2004a).

Investment in Dublin Airport

A major criticism of DAA has been that they are using profits extracted from passengers to undertake grandiose, inefficient, 'gold-plated' investments (Aviation Appeals Panel, 2009). Table 3 documents several past, current and potential investments undertaken or planned by DAA at Dublin Airport.

[2] Passenger numbers are assumed to be price-inelastic only for the purpose of determining the proportion of 'ill-gotten' revenue.

	Pier C	Pier D	Terminal 1 Extension	Terminal 2	Second Runway
Projected Cost	€40m	€120m	€55m	€270m	€200m
Actual Cost	€150m	€120m	€80m*	€582m*	NA
Overrun	€110m	€0	€25m	€312m	NA

***Currently in Process**
Table 3: Investments by DAA (/Aer Rianta)
Sources: Whitaker 2008; Joint Committee on Regulatory Affairs 2008; DAA 2007 & 2008; CAR 2008d; Hancock 2008; Aviation Appeals Panel 2009.

Pier C, which was originally completed in 1999 at a cost equivalent to €150m, has already been demolished in order to make way for Terminal 2. As a result, Pier D (including 'Skybridge') was built to replace the lost capacity at a cost of €120m. However, poor planning led to Pier D passengers' isolation from vital retail units. Retail is far more important to Dublin Airport than most European airports, supplying €114m in revenue to DAA in 2007 (Graham, 2008; CAR, 2008a). Thus the Terminal 1 'retail' extension was built for €55m and is currently awaiting an upgrade at a further cost of €25m.

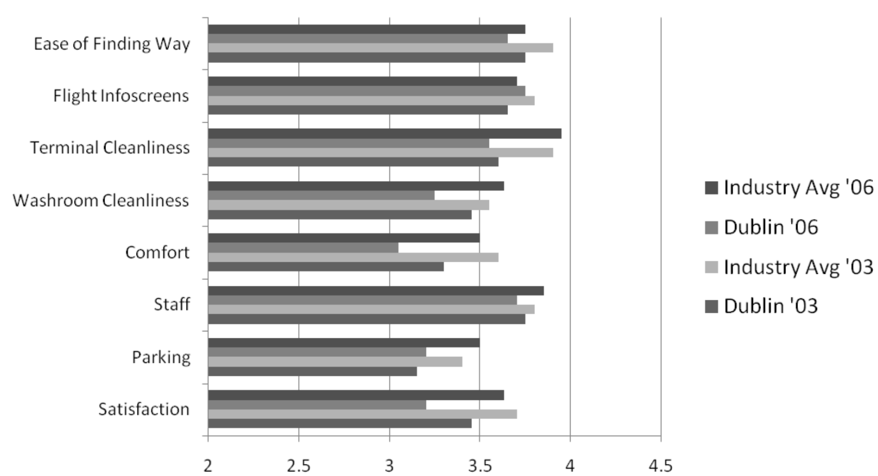
The current projected cost of Terminal 2 is €582m, which is already €312m over budget. When completed (likely mid-2010), this terminal will expand Dublin Airport's terminal capacity from 23mppa (million passengers per annum) to 35mppa. However, the main runway is currently operating near capacity, so any passenger increase is contingent on completion of the second runway (CAR, 2008d). The second runway is optimistically scheduled to open in 2012. However, recently passenger number fluctuations have prompted DAA to defer runway construction, essentially rendering Terminal 2 impotent (Hancock, 2008).

Although these investments have proven to be extremely flawed, costs of ill-planned and ill-fated projects will be passed on to passengers through the Regulatory Asset Base (RAB) allowance in the CAR price-cap.

Quality of service at Dublin Airport

As well as quantity and price, it is informative to discuss the quality of service at Dublin Airport with a view to determining whether increasing charges and high profit margins are justified by an increase in service quality. Airline Council International regularly surveys passengers in thirty-two airports to determine quality of service. The results of the 2003 and 2006 surveys are displayed in Figure 1. Six out of eight indicators show a decline in service quality in Dublin Airport between and 2003 and 2006. Furthermore, Dublin Airport's results are worse than the industry average for all but one indicator. Thus it must be concluded that service quality certainly does not justify the high charges and profits of DAA. It appears more likely that these service quality results confirm that Dublin Airport can comfortably operate a substandard service due to the lack of competition from viable alternate airports.

Figure 1. Results of 2003 and 2006 ACI Global Surveys



Source: ACI 2007, cited in CAR 2008d.

Prospects for Airport Competition in Dublin

Occasionally, the establishment of a second commercial airport for Dublin receives attention in the press and in government. A frequent candidate is the Air Corps base at Baldonnel in South Dublin. South Dublin County Council has recently expressed a desire to develop the existing base for joint civilian and military use (Kelly, 2009). This would strongly resemble the experience of countless NATO and Warsaw Pact airfields across Europe, which have since become civilian airports. Barrett (2000) points out that the availability of these ready-made airports was crucial to the growth of the LCC industry. Other candidates include a retired (and dilapidated) military airfield in Gormanston and a green site in Monasterevin, Kildare.

The most accessible and cost-effective site is Baldonnel, which is still an active airfield and is located near motorways and a tramline. However, any plans to develop this site into a commercial airfield would likely meet with considerable opposition from local residents and could become something of a 'third rail' issue. Furthermore, the large investments already undertaken by DAA at Dublin Airport may motivate the government to prevent the development of a competing airport.

Terminal competition

Another way of introducing competition to Dublin Airport would be to separate Terminal 2 from Terminal 1 upon its completion. A contract to operate Terminal 2 could be put to tender, inviting private firms to compete with DAA. The two terminals could then compete on the basis of price and service levels. McLay and Reynolds-Feighan (2006:182) argue that terminal competition may well be the ideal solution to the DAA's monopoly power:

> 'The notion of competition between individual terminals at Dublin Airport is introduced as a measure that has the potential to overcome the locational barriers to competition and provide an alternative to ''heavy regulation '.

There are very few examples of terminal competition within airports. An oft-cited case is the 'Trillium' Terminal 3 at Toronto Pearson Airport. It operated in competition with the two publicly owned terminals for five years, making large profits until the Canadian government purchased it in 1996 as part of a redevelopment plan (McLay and Reynolds-Feighan, 2006). The experiment was perhaps too short-lived to provide any long-term insights, though its short-term success is encouraging.

Ryanair have frequently stated their desire to see terminal competition in Dublin Airport, in the past going so far as to offer to build a new terminal themselves (Ryanair, 2004b). However, the Minister for Transport recently announced that there would be no terminal competition at Dublin Airport, citing a €1.3m report by Goodbody Corporate Finance (Downes, 2009; Hancock, 2009).

Conclusions and Policy Implications

In examining the practices and regulation of Dublin Airport, it has been shown that DAA is operating an extremely inefficient monopoly. Returning to Smith’s (1776) condemnation of the monopolist, the effects of the DAA monopoly will now be outlined:

1. **Quantity** is restricted by the slow and inefficient planning of Dublin Airport and its Terminal(s).
2. **Price** is artificially high, as is witnessed by the almost conspiratorial nature of CAR’s price-setting practices, which allow DAA’s losses to be passed on to passengers. Thus prices are following costs, rather than the other way around. Furthermore, the DAA has been allowed to ignore what little regulation there has been.
3. DAA has accrued vast **profits,** through its €1.2bn RAB, rarely heard of in even the most efficient companies (Aviations Appeals Panel, 2009). As DAA is a semi-state company, these supernormal profits cannot be passed on to private investors.
4. **Quality** of service is in constant decline at Dublin Airport according to key indicators, in spite of the large-scale investments undertaken by DAA.

The DAA bears all of the hallmarks of an abusive monopoly. There is one reason why this happens: DAA is not exposed to any competition. Returning to Baumol’s (1982) theory of contestable markets, producers will act efficiently for fear of losing their business, *not* because of a sense of civic duty.

Ideally, a second airport should be established in the greater Dublin area. This would offer an alternative to airlines and passengers while simultaneously motivating DAA to be more efficient. However, several vested interests are likely to block any such development. A more realistic alternative may be to award a contract to operate Terminal 2 to a private entity, as already discussed. Although this practice is relatively unproven, the current excess capacity of the Dublin Airport terminals relative to the runway capacity should minimise the possibility of so-called ‘wasteful competition’. Put simply, the better terminal will win.

Failing the former two suggestions, a new, aggressive regulator must be appointed to actively engage in lowering charges, increasing quantity and increasing quality. The recent success and acclaim of the UK Competition Commission, which is currently breaking up the BAA monopoly, suggests that there is indeed scope for efficient regulation of airports as long as regulatory capture is avoided (Ryanair, 2008b, 2008c; Robertson, 2009).

Since the late 1990s, European aviation markets were revolutionised by the emergence of LCCs, who depended upon competing secondary airports to enable them to provide efficient services. In Dublin, passengers have benefitted from competing airlines, but have yet to benefit from competing airports. Particularly as an island economy, it is vital that this deficit in the aviation market is somehow rectified.

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