

# Why Airlines Oppose Airport Peak Pricing

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# Punchlines

- **Airport peak pricing lowers airlines profits**
- **Especially in Europe**
- **Airlines sensible to oppose it**
- **And we rarely see it**

# Outline

- **The problem**
- **Cost pass through in airlines**
- **Airport peak pricing**
- **Why airlines oppose peak pricing**
- **Morals of the story**

# The Puzzle

- **Peak pricing at airports is potentially efficiency improving**
- **Airlines oppose it (strongly)**
- **Yet they practise it all the time themselves**
- **Are they dumb? Ill informed?  
Hypocritical? Devious?**
- **Not necessarily any of the above**

# Airport Types

- **No slots, delay rationing (US except for NY etc)**
- **Airports with no demand rationing problem (HAM, MEL)**
- **Slot controlled airports with excess demand at the peak (AMS)**
- **Slot controlled airports with excess demand all the time (FRA, LHR)**
- **Slots: supply is fixed, and allocated somehow**
- **Dominant form of rationing outside the US**



# To What Extent can Airlines Pass Cost increases through to Passengers?

- **Suppose an airline faces a €X per pax increase in input costs**
- **E.g fuel, carbon tax, airport charges**
- **Will they be able to increase air fares by the same amount?**
- **A live issue with the European ETS permit charge (and fuel costs)**
- **Answer depends on how air fares are set**

# How Air Fares are Set

- **Either:**
- **Competitive conditions- competition, oligopoly, monopoly (supply variable)**
- **Or:**
- **Willingness to pay for limited supply- slots limiting supply, capacity regulation (e.g. In international ASAs)**

# Unconstrained Markets- No Supply Restriction

- **Competition- full pass through in long run, not in short run**
- **Oligopoly with fixed number of firms- <100%**
- **Monopoly-<100%**
- **Oligopoly with number of firms variable- feasible to have 100% pass through**
- **Firms leave unprofitable markets enabling survivors to raise prices**
- **Pass through higher in the long run**
- **With no supply restrictions, pass through is extensive, though not necessarily 100%**
- **If airport charges rise, ultimately passengers pay most or all**

# Constrained Markets- Supply Limited by Slots

- **Excess demand for airport slots, and for airline seats into airport**
- **Fares set by demand and fixed supply**
- **Suppose air routes are profitable (will be dropped if not)**
- **Suppose an increase in airport charges- increases airlines' input costs**

# Pass Through at Slot Constrained Airports

- **Demand supply balance is unchanged by airport charges increase**
- **Air fares unchanged**
- **Airlines earn slot rents**
- **Slot rents reduced by the amount of the charges increase**
- **Airlines pay all of the higher charges-pax pay none**

# Airlines, IATA and Airport Charges

- **Can airlines pass on increases in charges to pax?**
- **In US, yes (no supply constraint- fares set by costs, competitive conditions)**
- **In Australia, (no supply constraint- fares set by costs, competitive conditions)**
- **In Europe, often no- many airports are effectively slot constrained**

# In Europe...

- **Predominance of slot controlled major airports**
- **Slots limit supply during peak or all day**
- **Air fares often cannot be adjusted when costs (including airport charges) are increased**
- **Thus airlines are right in being particularly concerned in Europe about airport charges**

# Collateral Questions

- **Who really pays the APD in the UK-airlines of the passengers?**
- **Do airlines or passengers gain when regulators impose single tills?**

# Peak Pricing

- **General presumption in favour on welfare grounds**
- **Makes for more efficient use of limited capacity**
- **But rare at airports- usually do not ration by price**
- **Use slots or delays**
- **With slots, prices are set below market clearing levels**

# Peak Pricing at Airports

- **Unconstrained, non busy airports- no point**
- **Airports with continual excess demand (FRA,LHR)- no point**
- **Higher peak, lower off peak prices have no effect**
- **Airports with excess demand at the peak but not the off peak (AMS) - peak pricing matters**

# The Unregulated Optimum

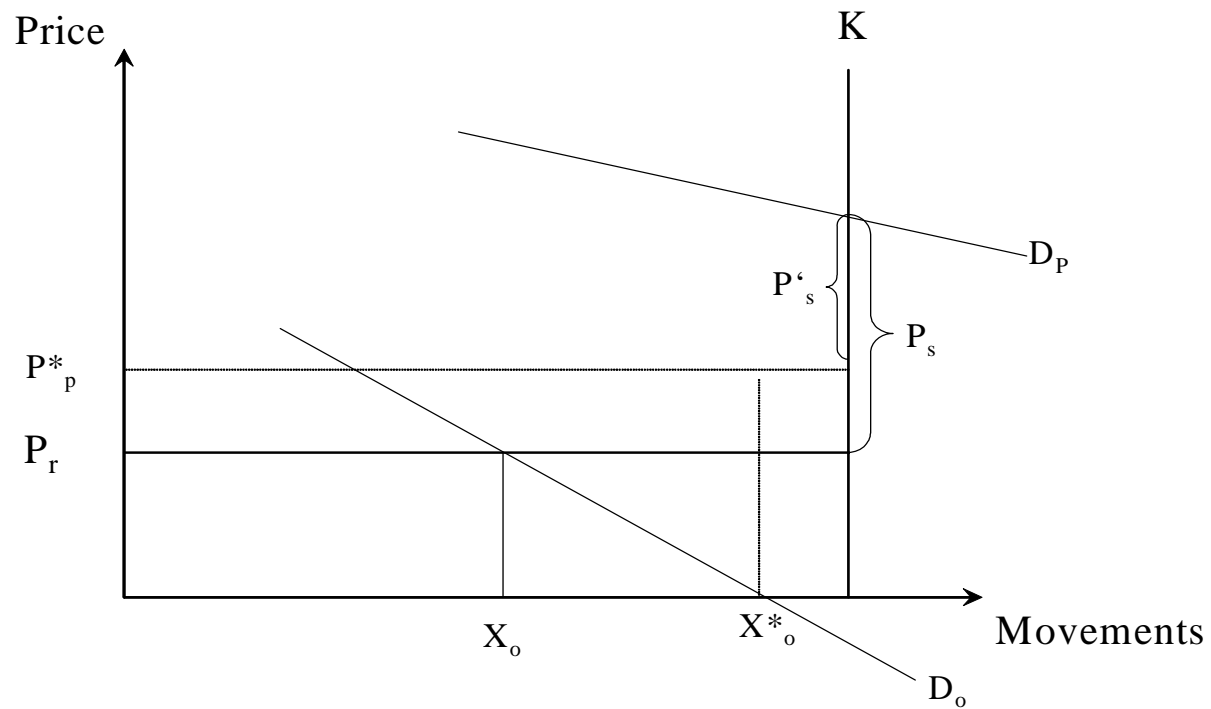
- **Set  $P=MC$  ( $=0?$ ) at the off peak**
- **Set  $P$  to limit demand to capacity at peak**
- **Peak price exactly limits demand- no need for slots**
- **If peak charge is high enough, no need for weight related charges to ensure cost recovery**



# Regulated Airports

- **Many airports are regulated**
- **Regulator seeks to ensure that average revenues just cover average costs**
- **Or public airports required to just cover costs**
- **Typically have a uniform peak and off peak price**
- **Regulation results in excess demand at peak, rationed by slots**
- **Off peak price excessively high- lessens output when capacity is ample**

# Figure 1



# Peak Pricing under Regulation

- **Possible to preserve exact cost recovery- peak price rises, off peak price falls**
- **Peak air fare constant- airlines unable to pass on higher airport charges, and slot rents fall**
- **Off peak charges fall for all airlines**
- **Airlines compete reduction in charges away**
- **Off peak air fares fall – no gain in airline profits at the off peak**
- **Airlines lose profits, and passengers gain from lower off peak fares**



# Peak Pricing in Perspective

- **Peak pricing only relevant when there is excess demand at the peak (allocated by slots) and available capacity at the off peak**
- **A common situation, especially in Europe**
- **Regulation which sets average prices at average costs common also**
- **Introduction of peak pricing results in lower profits for airlines**
- **Sensible for them to oppose it**

# Morals of the Story

- **Airlines sensible to be concerned about airport charges in Europe (more than they might be in US or Australia)**
- **Airlines bear the burden of higher airport charges in most major European airports, while passengers bear them in the US and Australia**
- **Peak pricing will improve efficiency where relevant (efficiency gain may not be large though)**
- **But airlines lose profits when regulated airports implement peak pricing**
- **Observation: in spite of decades of economists recommending peak pricing for airports, it is extremely rare**



**Vielen Dank!**

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