

Price cap regulation and competition: BAA London airports

Price cap regulation is the conventional utility regulation model applied in the UK to companies considered to be dominant. BAA owns the three main London airports: Heathrow, Gatwick and Stansted. Since privatization these three airports have been subject to price cap regulation. Until the new price cap came into effect on 1 April 2003 the price caps were basically set on what is known as a “system” approach. This approach, inter alia, enabled BAA to use revenue from charging Heathrow users to ensure that development at Stansted airport was remunerated at the allowed rate of return. In its 2003 decision on the price cap for the BAA London airports, the CAA moved away from the “system” approach to a “stand alone” approach. Under the “stand alone” approach price caps are airport-specific and based on the costs faced by the particular airport. The “stand alone” approach is expected to improve economic efficiency through a better allocation of scarce resources and through providing better signals for efficient investment compared with the “system” approach. However, there is a superior policy package available. This would be to rely more on competition and less on regulation. This would involve encouraging separate airport ownership together with the removal of Stansted and Gatwick from the Airports Act. The latter would therefore involve de-regulating Stansted and Gatwick and thus ending the price cap regime for these airports. Information disclosure and consultation requirements could be maintained for the de-regulated airports consistent with recent CAA proposals on more effective airline-airport interaction. Such de-regulation would greatly clarify property and decision rights which should encourage greater contracting between the individual airports and its customers particularly in respect of new investments.