SUBMISSION TO THE COMMISSION FOR AVIATION REGULATION
by

THE IRISH HOTELS FEDERATION

on

DUBLIN AIRPORT PRICE CAP DETERMINATION 2010-2014: DRAFT DETERMINATION

Need to improve the cost competitiveness of the Irish economy

There is general recognition that a significant improvement of Ireland's cost competitiveness is essential if there is to be a lasting economic recovery. This view has been argued in the past months by the National Competitiveness Council, the International Monetary Fund, The OECD, the ESRI, the Central Bank and the Government. The private sector is engaged in a widespread process of cost and price reduction. Public sector determined prices and costs must also be reduced to facilitate international cost competitiveness. In many respects it could be argued that public sector prices and costs, as an arm of public policy, should take the lead in driving down costs. Hitherto the public sector has been very slow to respond to the new economic reality. In this context the Irish Hotels Federation (IHF) is disappointed that the basic proposal from the aviation regulator is that the Dublin Airport cap should be raised from its existing level of €7.39 (in 2009) to €8.35 in 2010, an increase of 13%. This is at a time, for example, when hotel accommodation prices have declined by 13.7% in the 12 months to June 2009 and when the consumer price index is expected to decline by 5% in 2009 and 2% in 2010.

The IHF recognises that a detailed and defined methodology is followed by the Commission for Aviation Regulation in determining the price cap and that this approach includes, in the current draft determination, an expectation of savings in the operating expenses of Dublin Airport. Nonetheless, the IHF considers it to be completely unsatisfactory when the economy is in such dire straits and experiencing price deflation that any public sector charge should increase by 13% as is proposed by the regulator.

The IHF proposes that the Commission for Aviation Regulation should do all in its power to avoid this increase and instead, at least, hold the 2010 and 2011 price cap at the 2009 level.

Determining the price cap

The price cap is determined by identifying what the regulator considers to be the "efficient" cost of operating the airport in 2010 (€184M) and identifying a required level of capital expenditure (€116M). This gives a total 2010 outlay of €300M. The airport is expected to generate €127.4M in commercial revenues leaving a gap of €173.3M to be raised from airport passenger charges. The draft determination assumes that passenger level in 2010 will be 20.7M persons giving the regulator's recommended €8.35 price cap.

The regulator has been assisted in the determination by two studies on the appropriate operating expenses for the airport and the required capital expenditure. It estimates what would be likely commercial revenues and passenger numbers.

Paradoxically, this system can result in higher prices precisely when the economy is at its weakest and needs competitiveness. Other things being equal a weaker economy in 2010 would reduce commercial revenues and passenger numbers. In the absence of corresponding operating cost and capital cost reductions the gap to be financed by passenger charges would increase and this would be borne by a smaller number of passengers resulting in a larger charge per passenger.

It is difficult to identify substantial extra sources of revenue in the current and likely 2010 economic environment. It is also unlikely that large numbers of extra passengers will materialise. Indeed, it is highly possible that the regulator's passenger expectations may not be achieved. If so, the only determinants which are available to reduce the passenger charge are the operating costs and capital expenditures.

Role of passenger charges

The IHF is acutely aware that airport passenger charges are not the major determinant of inward tourism. However, they are one element of the currently overpriced economy and tourism product. The aim has to be to reduce cost wherever possible and by whatever amounts are possible. Maintenance of passenger charges at 2009 levels would be one small contribution, but a necessary one, to the restoration of cost competitiveness.

Requirements to prevent price cap increase

The proposed increase is 96 cent per passenger on the assumption of 20.7M passengers. Consequently €19.9M must be found from operating expenses and/or capital to keep the price cap at the 2009 level.

Operating expenses and capital expenditure

The assessment of 2008 airport operating costs undertaken for the regulator as part of the determination identified scope for a 12% savings in operating costs. The draft determination is based on an expectation that these will be achieved over a three year period 2010-2012. The regulators expenses study (Indecon /Jacobs) assumes that 2009 costs will be between 9% and 11% lower than the DAA estimates. The determination assumes that there will be no increase in real wages at the airport over the period of the determination. It is notable that Indecon/Jacobs states (page 130) that

"It is not clear that Dublin has performed as well as might be expected over the period in terms of operating cost efficiency. Per passenger costs have fallen slightly over the period. However, a larger fall would have been expected given the relatively low level of capacity addition at the airport. In any event the fall in per passenger costs appears to have been at the corporate level rather than at the Dublin Airport level"

Staff costs represent 63% of total costs. Between 2001 and 2004 full time equivalents were held approximately constant but between 2004 and 2008 there was a staff increase of 28% or 444 full time equivalents from 1581 to 2025. According to Indecon/Jacobs the DAA expected 2009 costs to be higher than 2008 despite 10% less passengers. The study identifies two possible 2009 expenses budgets, €190.2M with conservative cost reductions and €185.9M with ambitious cost reductions as opposed to the. The determination uses a mid point between the conservative and ambitious cost reductions identified by the consultants and expects them to be realised over three years. It also expects actual 2009 costs to be about 10% lower than the DAA initial estimate.
The IHF proposes that the regulator should take a more active and ambitious approach to cost levels in Dublin Airport including substantial efficiencies and lower labour costs per person which is in line with what the rest of the economy is experiencing. In addition the cost reductions should be introduced in 2010 instead of phasing over a three year period.

The current determination of €184M operating expenses should be reduced by a further €14M for 2010 to €170M. Dublin Airport should be expected to adjust to operate within this budget limit for 2010. This would provide 70% of the expenditure reduction necessary to freeze charges at 2009 levels. The remaining almost €6M should be reduced from the allowed capital budget through the following approaches - adjustment in the formula used by the regulator to calculate allowed capital expenditure, more effective price negotiation or reduction in the currently allowed set of smaller capital projects or DAA financing from own resources.

This would represent a more active approach by the regulator in driving efficiencies and reducing costs. It would be an approach which meets the needs of the economy and supports its statutory objectives to facilitate efficient and economic development of the airport to meet the requirement of users, to protect *reasonable* interests of users and to enable DAA to operate and develop the airport in a sustainable and financially viable manner. The approach would put more emphasis on cost reduction rather than price increases. This is an approach that the entire economy must adopt.

Recommendation
The IHF recommends that, at minimum, the 2009 passenger charge should be frozen in 2010. The proposed increase should not be proceeded with. The required finance to facilitate this should be obtained from a more determined reduction in operating expenses than is currently envisaged by the regulator. The reduction should be larger and phased in more quickly. This will provide €14M or 70% of the required finance. The remaining €6M should be sourced from a small reduction in the intended €116M capital expenditure. The increased focus on cost reduction is also desirable because the passenger and commercial revenue forecasts which underpin the determination may well be optimistic. If they should prove to be so it would put additional pressure on passenger charges. In our current economic position the approach must be to reduce costs to a sustainable level rather than increase prices.