The Role of Regulation in Facilitating Efficient Investment

Civil Aviation Authority

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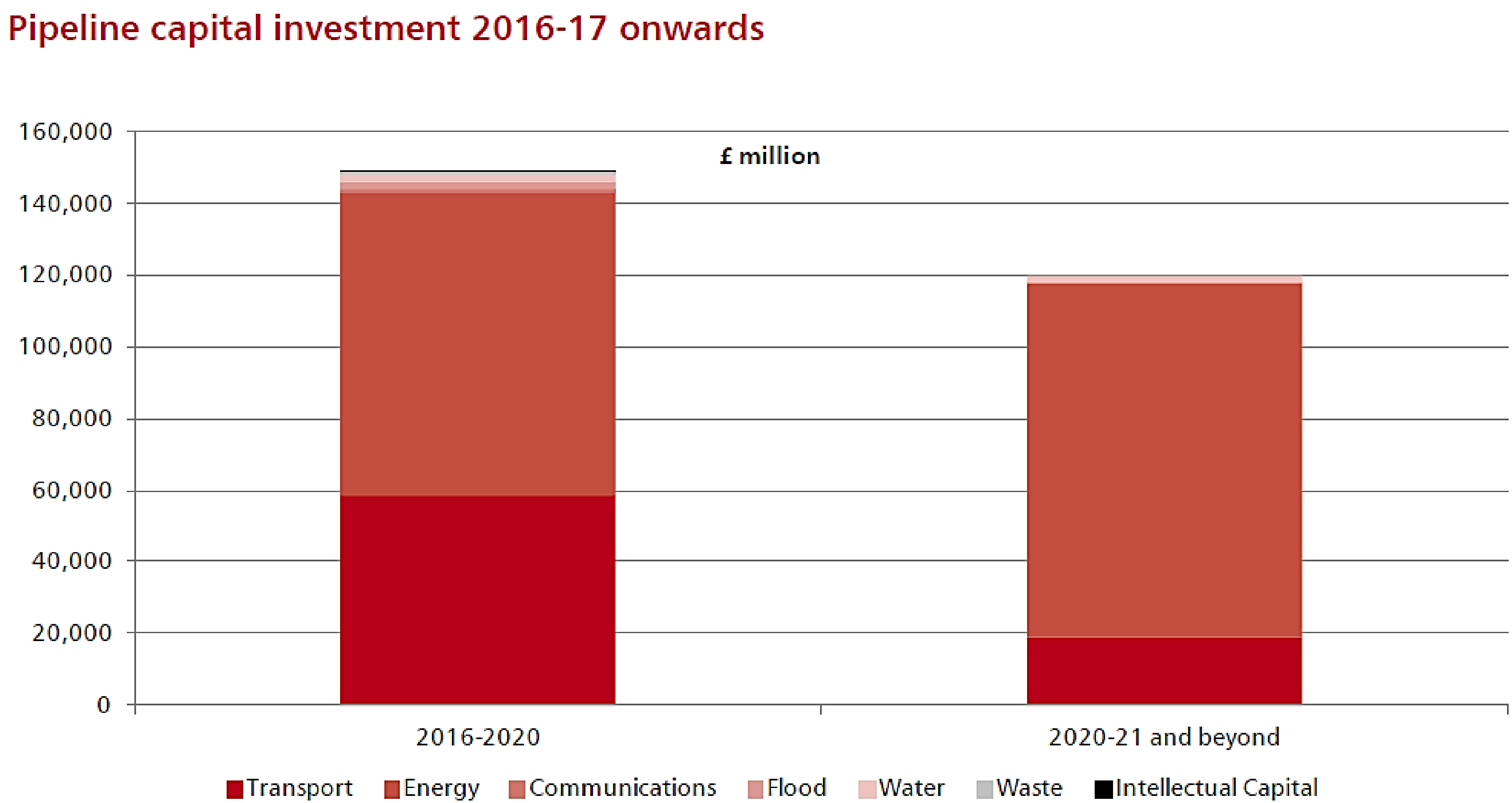
RPI Conference, 23 April 2015

Outline

1. Regulation and investment
2. Airports as an example
3. Regulation in context

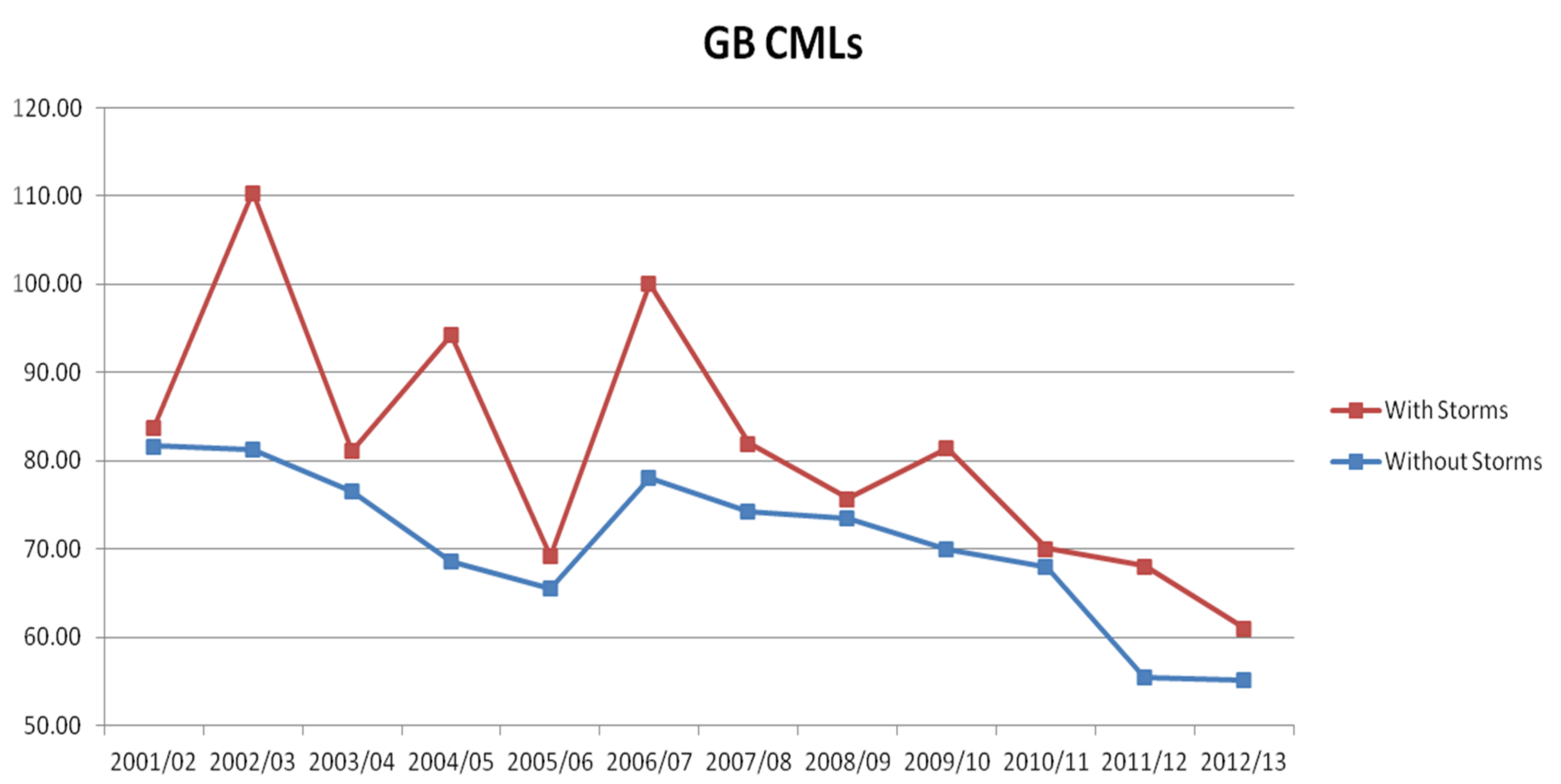
Size of the pipeline



Source: HM Treasury, Major Infrastructure Tracking Unit

Energy

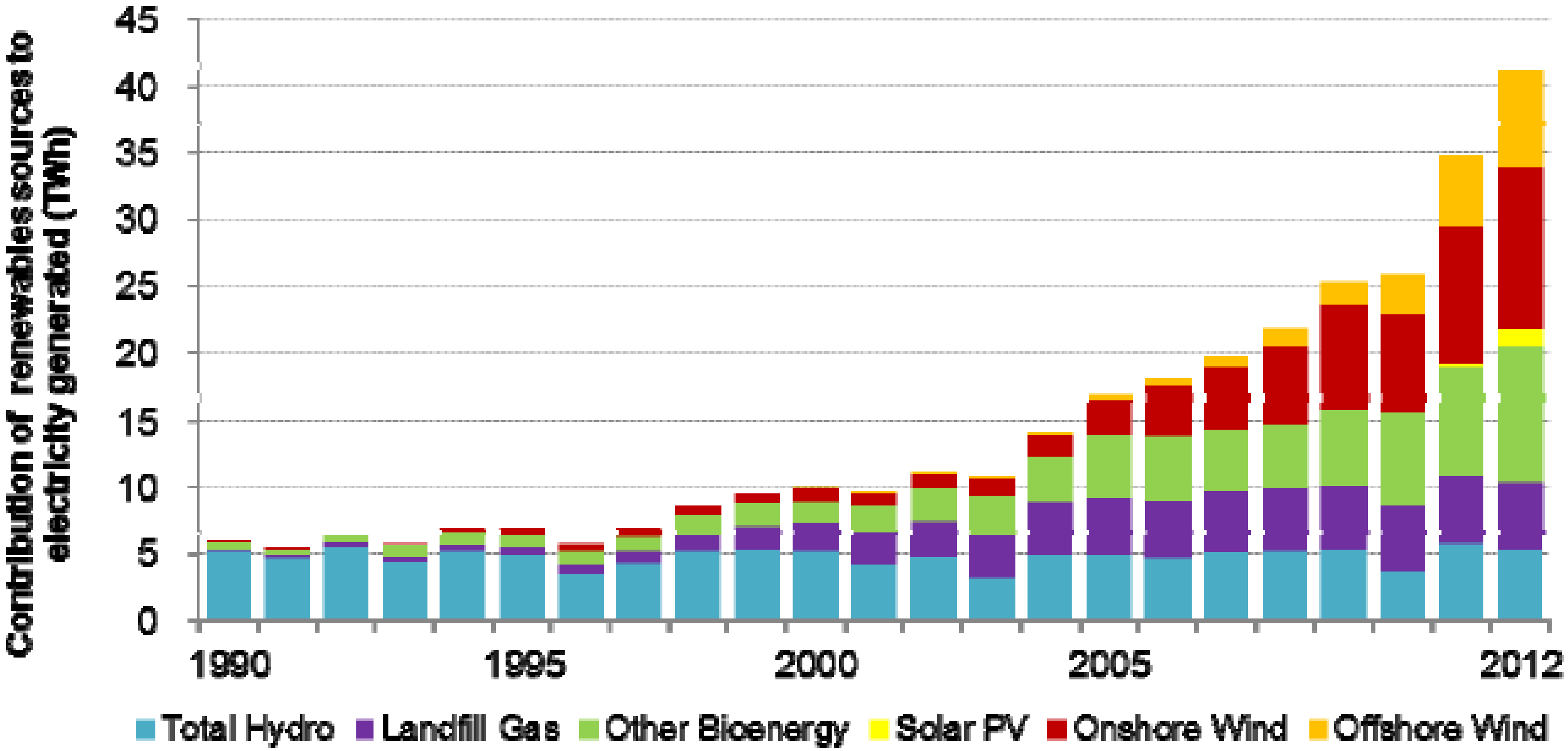
£80bn of investment in the networks since privatisation



Source: Ofgem

Energy

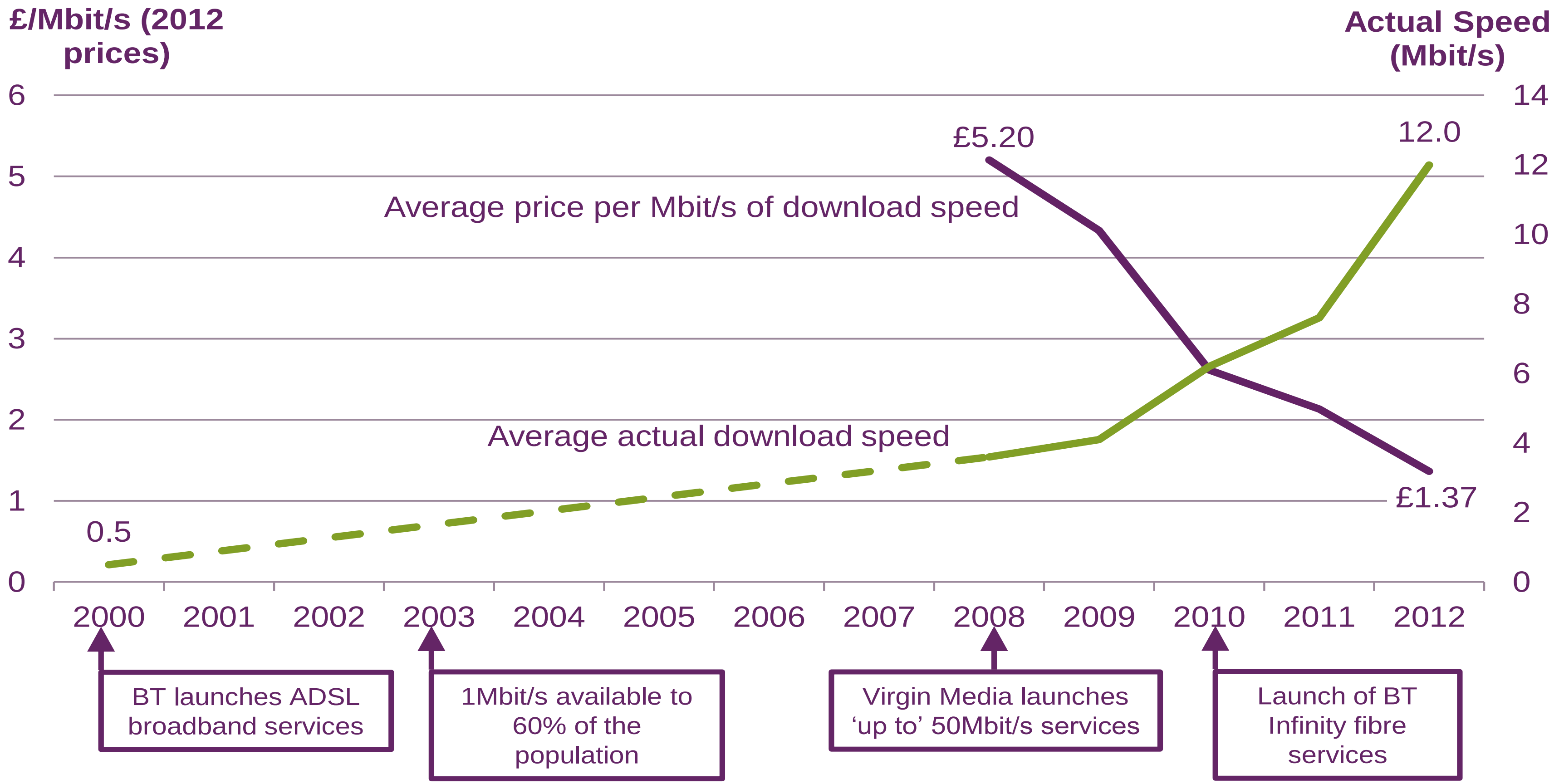
Chart 6.1.2: Electricity generated from renewable sources, 1990 to 2012



Note: Hydro bar includes shoreline wave/tidal (0.004TWh in 2012)

Broadband

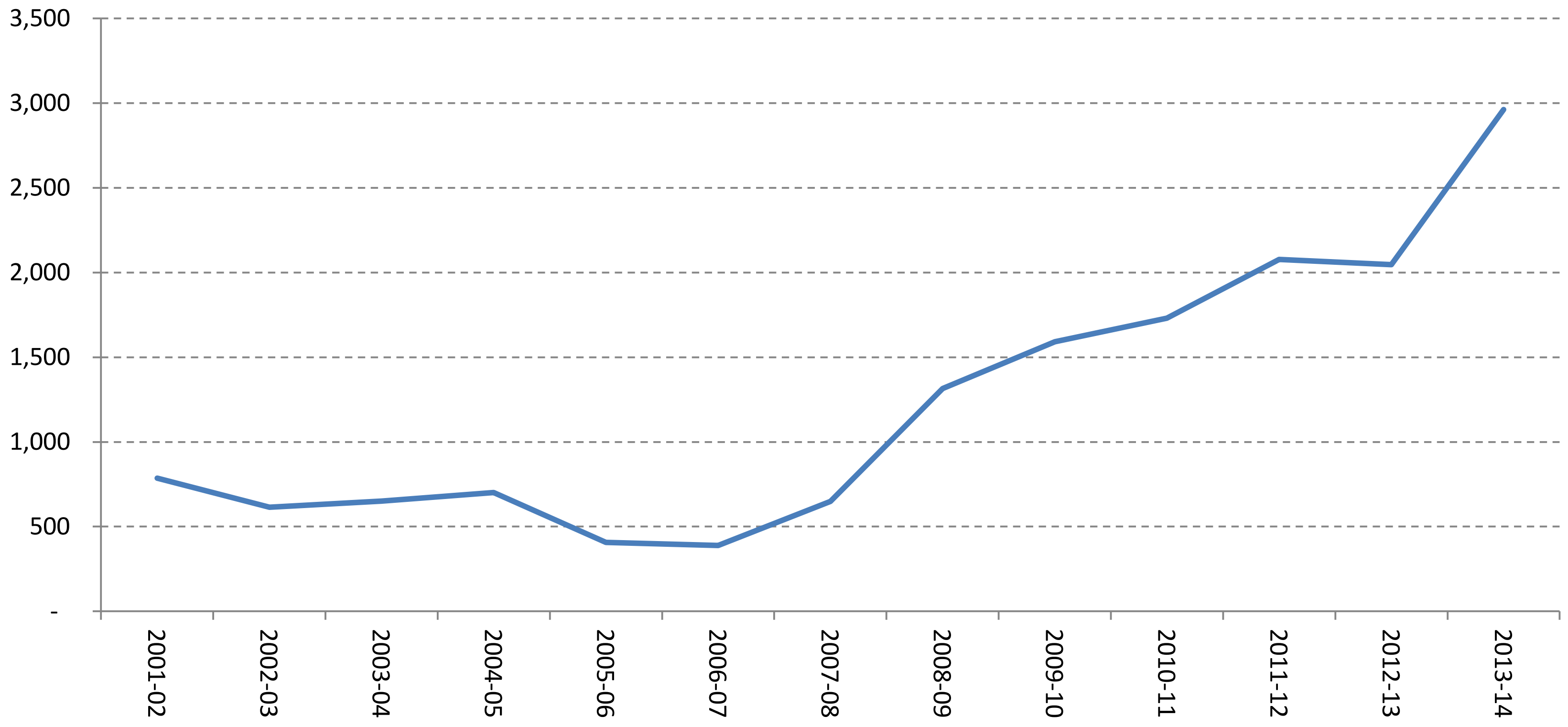
Average residential download speeds up to 14.7Mbit/s by mid 2013



Source: Ofcom

Rail

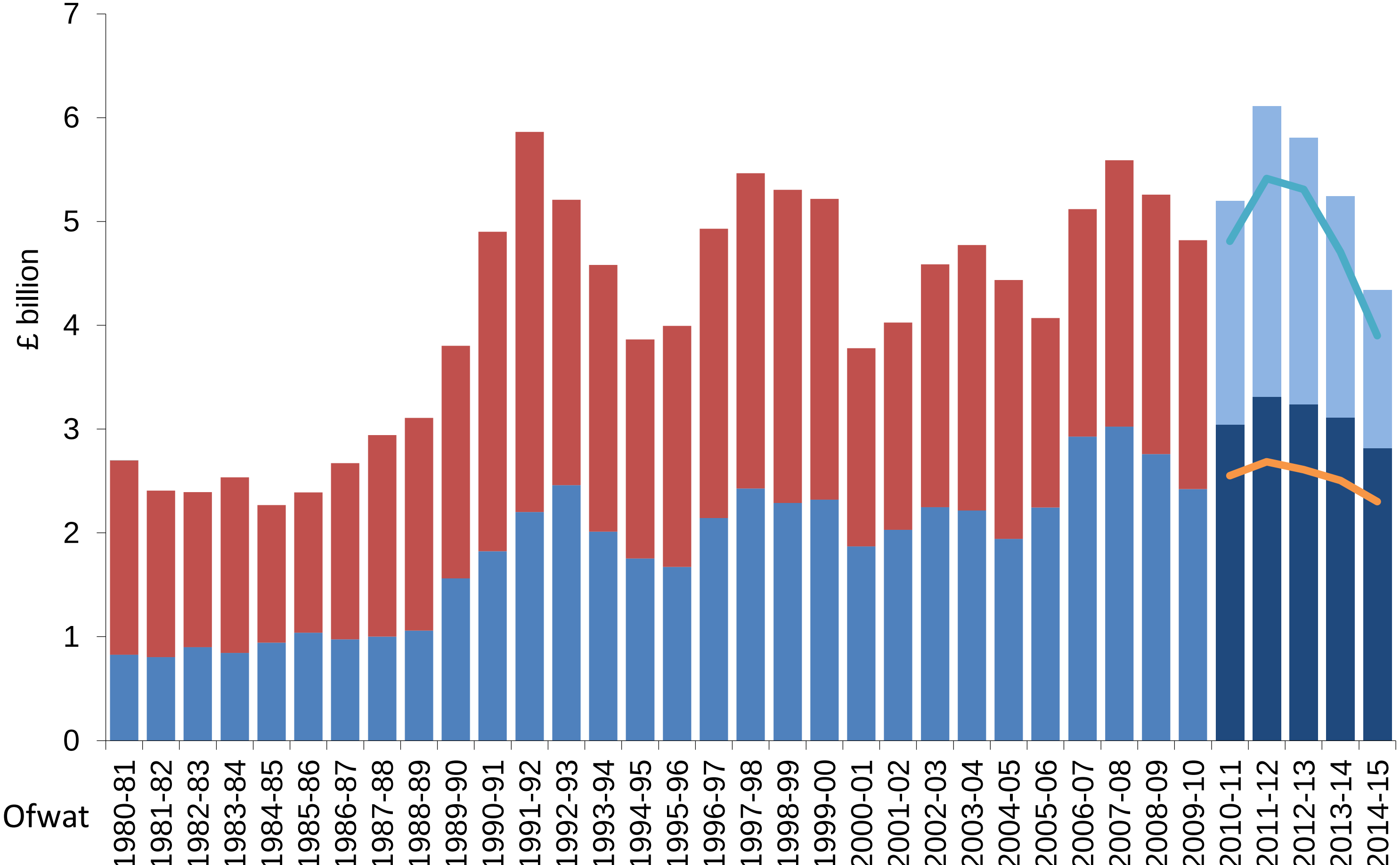
Network Rail spend on enhancements since 2001-02 (£m nominal)



Source: ORR

Water

Annual capex doubled after privatisation, doubling RCV over 25 years



Source: Ofwat

Some key lessons

- Track record of favouring investment both in competition and monopoly conditions
- Value of RAB/RCV approach, although also downsides
- Cumulative small gains add up to transformation

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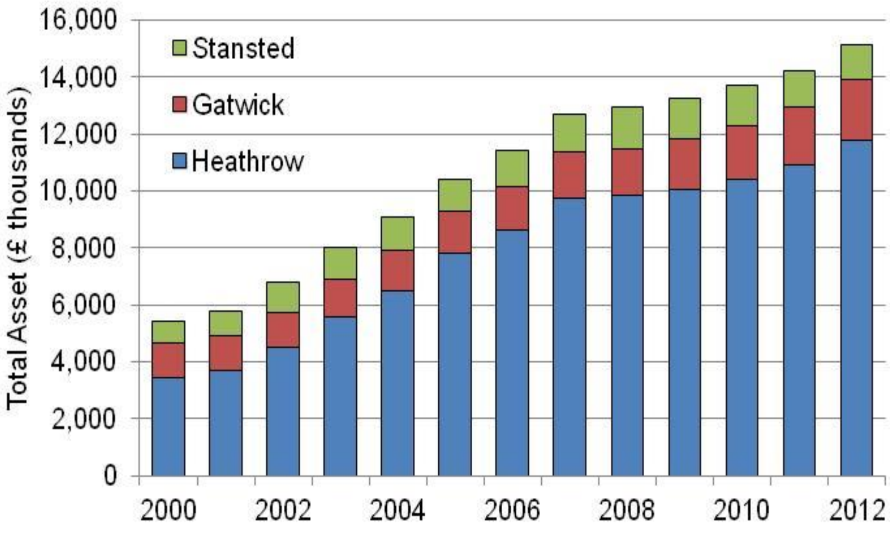
2. Aviation

- Saved passengers £2.1bn in airport charges from 1988/89 to 2013/14
- Encouraged investment of £10bn in regulated airports between 2000 and 2012
- Contributed to higher commercial revenues at regulated airports, which helped lower airport charges
- Contributed to lower operating expenditure at regulated airports
- Improved service quality and raised passenger satisfaction at airports
- Reduced average flight delay from 130 seconds in 2003 to one second in 2013
- Lowered lower the cost per flight-hour for en-route services from €634 in 2002 to €399 in 2011.
- Going forward, CAA will further the interests of users by:
  - only imposing economic regulation where it is warranted
  - ensuring prices are appropriate
  - ensuring continuity of service
  - ensuring reasonable levels of service by regulated airports and NATS

Strong investment story

- Heathrow, Gatwick and Stansted have undertaken significant investment in airport infrastructure. Notable investments include:
  - Heathrow Terminal 5, built at a cost of £4 billion to house the majority of BA's flights and opening in 2008.
  - Heathrow Terminal 2, built at a cost of £2.5 billion to consolidate the 23 airlines of the Star Alliance and opening in 2014.
  - Gatwick's various improvement to the South and North terminals, which has included improvements to the forecourts, landside concourse, security processes, baggage system and departure lounge.
- Increased investments has resulted in improvements in passenger service quality and airline operational efficiency.
- Total assets at Heathrow, Gatwick and Stansted have increased by around 280% between 2000 and 2012, rising from £5.4 billion to £15.1 billion in nominal terms.



Regulating new runway expansion: the challenges

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- High gearing and/or the investment is a large proportion of existing RAB (x2 - x3)
- Not possible to forward-sell capacity. Airline balance sheets not up to it; and legal issues.
- Payback over a period that is a significant proportion of the lifetime of aviation so far – not easy to predict the future!
- Costs for this kind of project often escalate

Principles for regulating runway expansion

- Risks should be allocated to the bodies best placed to manage each specific risk
  - Maintain incentives for efficient delivery
  - Allocation to passengers is a last resort
- Commercial negotiations between the airport and its airlines should be encouraged
  - Pricing of risk less likely to be distorted by regulatory gaming or information asymmetries
  - But need to remain alert to effects of market power
- Runway capacity can be paid for both before and/or after it is operational
  - Smooth the price shock and reduce risk

Pre-requisites for successful regulation of runway expansion

- Clarity of purpose. This is already in place in the Civil Aviation Act 2012
- Institutional credibility. This is down to us!
- Ministerial commitment.

3. Regulation in context

- Regulation is part of a policy and industrial project.
- Do consumers and society accept the importance of investment and of profit?
- Who is trusted?
- Who has permission to lead?