

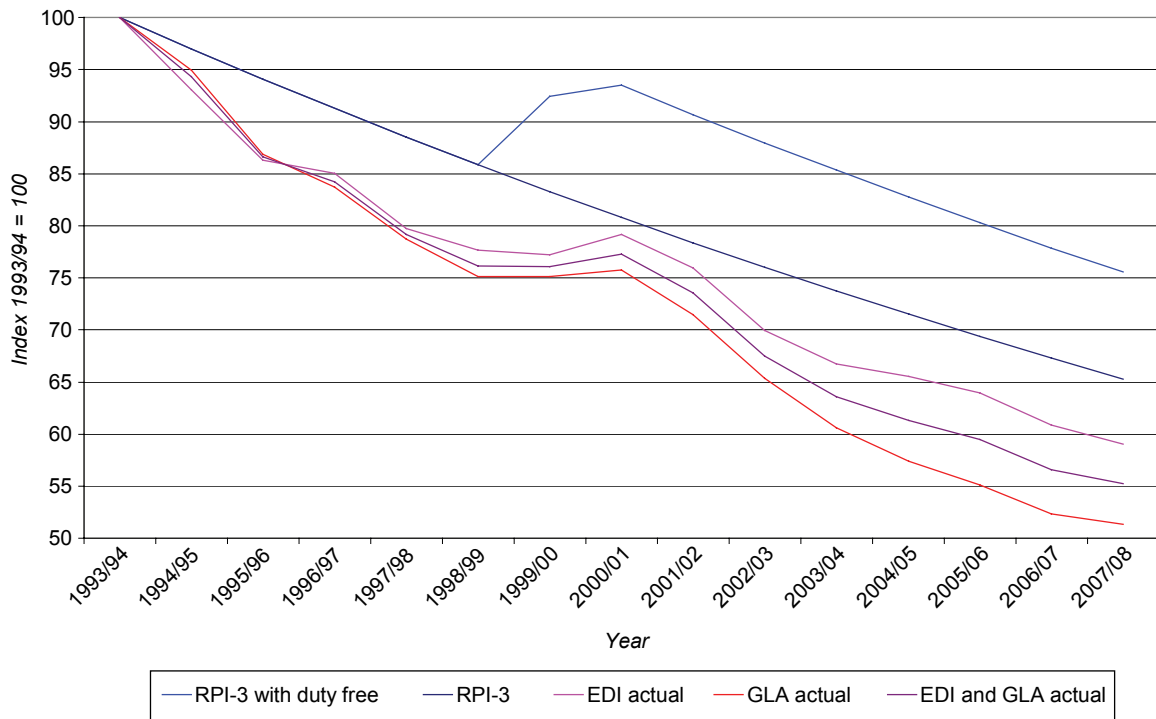
BAA's pricing policy at its Scottish airports

1. At its Scottish airports, BAA has since 1993 followed a policy of not increasing tariffs by more than RPI-3 at Edinburgh and Glasgow taken together, and RPI-1 at Aberdeen (its voluntary pricing commitment). We note that BAA's voluntary pricing policy was introduced in the early 1990s following political concern about the level of prices at BAA's Scottish airports.¹ However, we have not seen more recent evidence of regulatory interest, indeed for the past ten years the CAA's concern has been with de-designating airports rather than designating new ones.
2. In July 1999, duty-free sales to intra-EU passengers were no longer allowed and BAA told us that, following significant consultation with the airline community, it was agreed that BAA would recover 75 per cent of its lost duty-free income by a supplement to airport charges (this was £0.90 per passenger at Edinburgh and Glasgow and £0.29 at Aberdeen).
3. During 2007 BAA told us that this voluntary price commitment had been exceeded for the last six years and that, in addition to this, discounts were available for new services. Subsequently, in its response to our Emerging Thinking, BAA said that, while there had been a few occasions where BAA had exceeded its voluntary price commitment, this had been as a direct result of RPI being greater than 3 per cent and/or changes in the structure or level of sundry charges requiring BAA to stay within the spirit of its voluntary price commitment. As regards discounts, BAA acknowledged in its response to our Emerging Thinking that airlines setting up at regional airports tended to expect discounts and that failing to offer discounts could have a practical effect, but said that the majority of traffic did not receive discounts and that those discounts that were in place were for a prescribed period only, meaning traffic paid tariff when the deal came to an end.
4. The charts below compare trends in real airport charges per passenger with BAA's targets under its voluntary pricing commitments. They show that at Edinburgh and Glasgow, the reduction in real airport charges per passenger has consistently exceeded 3 per cent (even ignoring the duty-free compensation), while at Aberdeen the reduction in real airport charges has exceeded 1 per cent since around 2000.

¹BAA's policy was introduced following a recommendation by the Scottish Affairs Select Committee (which, however, was not adopted by the Government) that Edinburgh and Glasgow airports should be designated, and their aeronautical charges regulated by the CAA under section 40 of the Airports Act.

FIGURE 1

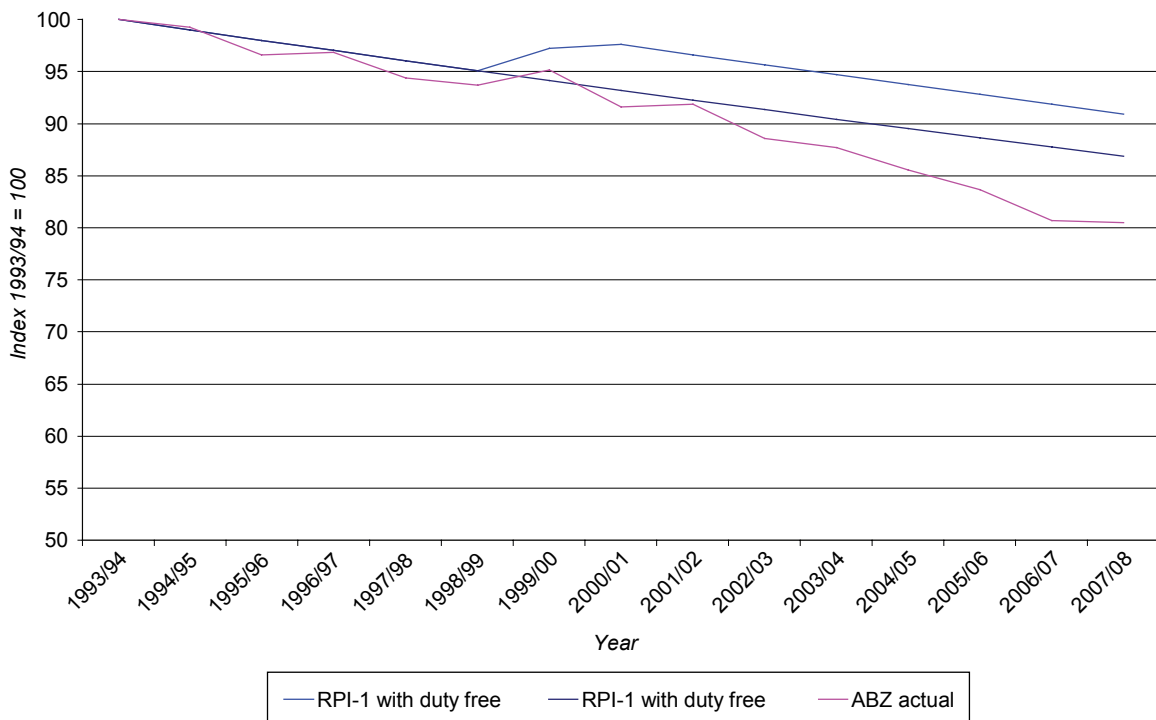
Edinburgh and Glasgow trends in real airport charges per passenger



Source: CC calculations based on data from BAA.

FIGURE 2

Aberdeen trends in real airport charges per passenger



Source: CC calculations based on data from BAA.

5. BAA told us that its voluntary pricing commitments related to the weighted average change in a basket of tariffs relative to the change in RPI for the previous September. There are three reasons why our calculation of trends in real airport charges per passenger might differ from trends in a basket of tariffs:
 - (a) the volume mix may change (relevant because the weighted average change, calculated using fixed volume weights, may then differ from the change in average airport charges per passenger);
 - (b) the average change in RPI used in our calculation may differ from that in the previous September; and
 - (c) discounts and rebates may change (relevant to the extent they are excluded from the tariff basket).
6. It seems unlikely that these factors could fully explain trends in BAA's prices at Edinburgh and Glasgow:
 - (a) The main relevant change in volume mix has been an increase in the proportion of international passengers; since BAA's charge per international departing passenger is higher than that for domestic passengers, this increases the average charge per passenger and goes in the wrong direction to account for reductions in airport charges per passenger exceeding tariff changes.
 - (b) Any difference in RPI measures is far too small to explain the difference and also in fact goes in the wrong direction (cumulative RPI, based on previous September figures, exceeds by about 0.6 per cent that used in our calculation²).
 - (c) If, as BAA implies, discounts are simply a normal aspect of business at regional airports, they would not be expected to change very much. In any case, changes in discounts and rebates are generally relevant to assessing price changes.
7. BAA did not provide us with contemporaneous documentary evidence showing how it had decided tariffs at each airport. It did, however, provide details of tariffs since 2002/03 (BAA said that earlier years were not available due to changes in spreadsheet technology and staff). This is shown in Annex A to Appendix 7.3 on the financial and investment performance of BAA's unregulated airports—in most years there was a small reduction in Edinburgh and Glasgow tariffs (except that in 2003/04 the Glasgow winter passenger charge was reduced by 19 per cent), and a tariff freeze at Aberdeen. The lower passenger charge at Glasgow was, and remains, the only material difference in tariffs between BAA's two lowland Scottish airports, though discounts at Glasgow are greater. In Table 1, we have used this information to compute the change in a basket of tariffs for 2003/04 to 2007/08 and compare it with the change in average charges per passenger as shown in the figures. This shows that over this period the annual reduction in the tariff basket after inflation for Edinburgh and Glasgow was more than 3 per cent; and that for Aberdeen more than 1 per cent.

²This reflects timing differences and that BAA uses the all items RPI while our calculation used the RPI excluding mortgage interest.

TABLE 1 **Comparison of change in basket of tariffs with change in average net charges per passenger (per cent per year after inflation)**

	2003/04	2004/05	2005/06	2006/07	2007/08
RPI (previous September)	1.7	2.8	3.1	2.7	3.6
Edinburgh					
<i>Tariff basket</i>					
Annual change	-3.2	-2.9	-3.8	-3.9	-3.5
Cumulative (% pa) since 2002/03	-3.2	-3.1	-3.3	-3.5	-3.5
<i>Average net charges per passenger</i>					
Annual change	-4.6	-1.8	-2.5	-4.7	-3.1
Cumulative (% pa) since 2002/03	-4.6	-3.2	-3.0	-3.4	-3.3
Glasgow					
<i>Tariff basket</i>					
Annual change	-4.7	-2.9	-3.8	-3.9	-3.5
Cumulative (% pa) since 2002/03	-4.7	-3.8	-3.8	-3.8	-3.8
<i>Average net charges per passenger</i>					
Annual change	-7.2	-5.4	-3.9	-5.1	-1.9
Cumulative (% pa) since 2002/03	-7.2	-6.3	-5.5	-5.4	-4.7
Edinburgh and Glasgow					
<i>Tariff basket</i>					
Annual change	-4.0	-2.9	-3.8	-3.9	-3.5
Cumulative (% pa) since 2002/03	-4.0	-3.5	-3.6	-3.7	-3.6
<i>Average net charges per passenger</i>					
Annual change	-5.9	-3.6	-3.1	-4.9	-2.4
Cumulative(% pa) since 2002/03	-5.9	-4.8	-4.2	-4.4	-4.0
Aberdeen					
<i>Tariff basket</i>					
Annual change	-1.8	-2.7	-3.1	-2.6	-3.5
Cumulative (% pa) since 2002/03	-1.8	-2.2	-2.5	-2.6	-2.7
<i>Average net charges per passenger</i>					
Annual change	-1.0	-2.5	-2.2	-3.5	-0.2
Cumulative(% pa) since 2002/03	-1.0	-1.7	-1.9	-2.3	-1.9

Source: CC calculations based on BAA data.

Note: Tariff basket is a weighted average of tariff changes using previous year's revenue before discounts as weights (2002/03 revenue breakdown is CC estimate). The source for the tariff basket is Annex A to Appendix 7.3 (financial and investment performance of BAA's non-designated airports).