

## Book Review:

# David Starkie (2008) *Aviation Markets: Studies in Competition and Regulatory Reform*

**Guillaume Burghouwt<sup>1</sup>**

SEO Economic Research/Airneth, the Netherlands

Little more than 25 years ago, the airline industry was highly regulated. The industry is now placed within the market economy due to liberalization and privatization initiatives. Still, large parts of worldwide aviation remain subject to negligible competition. "Too often the instinct of the politician and administrator is to intervene, try to manage [...] the market and to generally distrust its working". In his book, David Starkie provides a critical analysis of such policy initiatives by addressing the interplay of economic policy and aviation markets.

The book consists of a collection of 17 papers from his writings over the last 25 years, partly adapted and combined with new material. The book is divided in five parts. Each part starts with an overview that outlines the various chapters. The overview is useful as it helps the reader to place the different chapters, which cover a wide range of topics and time periods, in their historical context as well as in the current academic and policy debates on competition and regulation.

In the first part on airline competition, the author assesses the contestability of the regional airline market in South Australia. The absence of fare differences between single and multi-airline routes in this market suggests that sunk costs are very low or non-existent and that contestability theory is robust. In chapter 2 and 3 he discusses possible interventions in the aviation market by the European Commission and US DoT by means of respectively residual price controls on EU air services and enforcement policy on predatory pricing in US domestic aviation. In both cases, Starkie is highly critical about such intervening approaches. With respect to predatory pricing, pinning down predation is a difficult task for policy makers and therefore, questionable. The author suggests an alternative approach by *locking-in* the incumbent's response to new entry. This means that if a new entrant does withdraw from a route, the incumbent is required to continue to service the route for a specific period with pre-exit capacity levels. This simple approach puts a penalty on predatory behaviour without inducing significant costs to the aviation industry.

Part two deals with airport privatization in the UK. One of Starkie's central arguments is that the public debate on airport privatization lacks a discussion about restructuring ownership of airports in close proximity to each other, in order to achieve a more competitive environment. In chapter 4 on the salient features of the British Airport Authority (BAA) as it was prior to privatization, the author reveals scepticism that privatization of BAA's London airports *en-bloc* (all airports in common ownership) would improve efficiency. Instead, he argues that more

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<sup>1</sup> Roetersstraat 29, 1018WB Amsterdam, the Netherlands, T: +31205251642, E: [g.burghouwt@seo.nl](mailto:g.burghouwt@seo.nl)

competition between the airports and between services at the airport is an essential element in the case for privatization. "A more promising option is to privatise in a manner which promotes competition [...]. Separate ownership of London's airports would introduce more competition into the large market associated with travel to and from London". This chapter, originally written in 1985, has regained its relevance given the recent decision by the UK competition authorities to break-up the BAA monopoly.

The author discusses the regulatory system for the UK airports in the third part. One of the particular issues that Starkie critically considers is the so-called systems approach in relation to the expansion of Stansted. The systems approach means that price caps on airport charges at BAA's three London airports are interdependent. If any of the airports is unable to earn its cost of capital, prices are adjusted at the other airports so that the group as a whole earns its cost of capital.

BAA's Stansted Airport had been expanded in the late 1980s, early 1990s, but the expansion "was most likely a mistake and [...] has not proven to be a viable expansion by normal commercial standards". The project emerged from a non-market driven planning process, and has only partially been rescued by the low-cost carrier revolution. The author shows that the system approach allowed BAA to cross-subsidize loss-making Stansted and leverage its market power at Heathrow to produce a satisfactory return overall. Moreover, the low charges at Stansted and excess capacity in the market were to the detriment of other competing airports, such as (non-BAA) London Luton.

Airport competition is the subject of the fifth part. Amongst other things, Starkie sheds light on the extent to which airports compete in the supply of airport services and to what extent they are able to exercise market power. The author concludes that the market power of an airport with respect to setting aeronautical charges varies between different segments of the air transport market. Airports are likely to have most market power with respect to home based hub carriers and least market power in the low-cost carrier segment. The latter seeks out airports that minimise operating and station costs and has proven to be relatively footloose in terms of the airports it serves. Starkie stresses, however, that profit-maximizing airport companies have incentives not to exploit their market power due to the particular characteristics of the airport business: airport companies have an incentive to increase airside throughput in order to maximize non-aeronautical revenues, which nowadays form a substantial part of their revenues.

Finally, Starkie shifts his attention to the access of airport infrastructure. Starkie starts with an overview on the US system of infrastructure access and the experience with secondary slot trading at the High Density airports. Some readers might have appreciated a chapter on the European regime of slot allocation here. One of the most intriguing chapters in this part, however, is Starkie's defence of slot concentration at network hubs. The author puts forward the argument that concentration of slots in the hands of a few carriers at large hubs is not necessarily inefficient from an economic perspective. On the one hand, slot concentration is of concern to regulators as it could lead to reduced competition at the route level, high air fares and hence, a reduction of consumer welfare. On the other hand, high fares at slot concentrated airports may also reflect a more costly quality of service at the hub, consisting of a large international network, high frequencies and on-line connections.

This book represents firstly, a strong proof of Starkie's role as one of today's leading aviation economists. Apart from the fact that the material is highly accessible with substantial practical relevance, it is striking for the reader to note that in his earlier papers, Starkie seems to be years ahead of policy makers on various competition issues. For example, Starkie notes in chapter 4 (originally written in 1985), long before the UK Guernsey case (1999), which resulted in a grey market of airport slots in the UK, and the formal authorization of secondary slot trading by the EC (2008): "Existing capacity at Heathrow and Gatwick is limited relative to peak demands.

Because of this, airside access to Heathrow and Gatwick is valuable and should be allocated by price to those who value access most. This can be done by allowing airlines to trade [...] their existing rights [...].

Secondly, for researchers, industry professionals and policy makers in the field of competition and regulation in the aviation industry, this is an essential reading. It provides valuable insights in the way market mechanisms, and in particular competition, can operate successfully to resolve policy issues. As an introductory textbook for students novel to aviation economics, this book may be less suited. This type of reader may not have the background to fully understand and the wide range of papers and place them in the right academic context. It is to hope that David Starkie, with his exceptional skills in careful reasoning and accessible writing, will one day embark on a definitive student textbook on competition and regulation in the aviation industry.