

Vertical Relations Between Airports and Airlines: Is There a Trade-off Between Welfare and Competitiveness?

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Airports and airlines often engage in vertical contracts in order to protect themselves against risk. These practices seem to have been enhanced by pro-competitive legislation (de-regulation). Though there is a wide variety of vertical contracts between airports and airlines, it is possible to include them in three main types: negotiation of all fares (European case), operation of part of the airport facilities (Australian case) and cost-level fares with sharing of investment expenses (United States case).

Using a model that covers the downstream and the upstream markets and so allows for a two stage game, I analyse the effects of these three types of vertical contracts in what regards (i) welfare and consumer surplus, and (ii) pro-competitiveness, or the effects on other airlines that remain as outsiders. Results differ according the type of contract. Namely: (i) the European case presents the trade-off between welfare and competitiveness, increasing welfare but leading to market foreclosure; (ii) the Australian case is anti-competitive but may increase welfare, depending on airlines' efficiency in terminal operations; and (iii) The United States case is pro-competitive and welfare-enhancing, but will only be interesting for airports under certain conditions.

The paper contributes to literature as effects of vertical contracts in air transport are not clear up to now, and have not been analysed. The paper also contributes to industry and politics as these vertical contracts lead to hidden price discrimination by the airport towards airlines and so may be subject to competition laws, as it has already happened.

Keywords: vertical contracts; welfare; competitiveness; airlines; airports