Ramsey Pricing

An application to German Airports

Varvara Simakova
Cristian Steffan
Markus Dinse

Supervised by:
Prof. Dr Jürgen Müller (FHW Berlin)
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1.1 Charges’ structure

Charges

- Runway operations
- Terminal operations

Airside
- Landing charges

Groundside
1.2 Pricing schemes

1. Weight- & passenger-based charging (recommended by ICAO and applied)

2. Pricing schemes
   1. Marginal cost pricing
   2. Peak pricing
   3. Ramsey pricing
   4. Two part tariff
2.1 What is Ramsey pricing?

- A calculation scheme to achieve cost coverage for natural monopolists
- Usually natural monopolists maximise their profits by charging the price according to marginal costs.
- But what happens if average costs are higher than marginal costs?

Source: Martin-Cejas, R. R., Airport pricing systems in Europe and an application of Ramsey pricing to Spanish airports
2.1 What is Ramsey pricing?

- As depicted, pricing to marginal cost will result in a loss in this case as average costs are higher than marginal costs.
- If capacity is not exceeded, airport’s cost for additional demand is close to zero. Thus marginal cost pricing will lead to a loss.
- Therefore an alternative pricing scheme (second best pricing) is necessary, where price + subsidies (if there are any) are high enough to cover the average costs.

Source: Martin-Cejas R. R., Airport pricing systems in Europe and an application of Ramsey pricing to spanish airports
Source: Church and Ware, in Powerpointpresentation of Prof. Dr. Niemeier, H-M,
2.1 What is Ramsey pricing

- Ramsey prices are computed by charging inversely to elasticity of demand. Those with a high willingness to pay have to pay higher prices as those not willing to pay more.

- Thus it allows an adequate allocation of capacity and lowers the deadweight loss (which occurs if monopolists charge according to marginal costs.).
2.2 Definition of our calculation

- We used an approach due to R. R. Martin-Cejas‘ research in „Airport pricing systems in Europe and an application of Ramsey pricing to spanish airports“

- The Ramsey formula is denoted:

\[ p_i = \frac{\partial(TC) / \partial Q_i + (K / \eta_i)TC_i}{1 - K / \eta_i} \]

- \( i \)- denotes an aircraft type
- \( \eta \)- price elasticity of demand for passenger trips (demand for landings)
- \( Tci \)- Total cost of a flight: Depending on aircraft size & flight distance
- \( \delta(TC)/\delta Q_i \)- marginal cost; they result from differentiation of total operating costs, which are functions of distance
- \( K \)- \( \lambda / 1+\lambda \), where \( \lambda \) – extent to which the revenue constraint is binding.
3.1 Example: Parameters

- Year: 2003
- Airport: DUS
- Aircraft: Airbus 320-200
- Flight distance
  - 1.000 Km
  - 3.000 Km
- Block hour operating costs: 4.790€/h
  Source: Eurocontrol
- Cruising speed: 840 Km/h
  Source: Airbus
- Runway length DUS: 5.400 metres
  Source: Airport DUS
- Average taxiing time: 0,22325
- MC of an air carrier landing at a German airport: 72 €
  Source: Eurocontrol
- Elasticity of demand $\eta$: 
  - 1.000 Km: 2,156
  - 3.000 Km: 1,120
  Source: InterVISTAS Consulting Inc
- K: 0,0559
- Number of block hours per flight: 
  - 1.000 Km: 1,413726
  - 3.000 Km: 3,794679
  Source: own calculation
3.2 Example: Calculation

- 1. Example – Flight distance: 1.000 Km

\[
\begin{align*}
72\text{€} + \frac{0.559}{2.156} \times 4.790\text{€} &= 434.414\text{€}
\end{align*}
\]

- 2. Example – Flight distance: 3.000 Km
  - Ramsey price = 1.985,50 €
3.3 Example: Comparison

• To make Ramsey prices comparable we calculated the landing fee for the same aircraft, charged in reality.

• In 2003 the landing fee for an Airbus A 320 – 200 was:
  \[221,00\text{€} + 73,5 \text{ t} \times 4,15\text{€} = 528,10\text{€}\]

Sources: Airbus, Charges manual NFL I – 207/02
3.3 Example: Comparison

- Result:
  At a flight distance of 1,000 Km weight-based charging leads to 21,57% more revenue as Ramsey pricing.
3.3 Example: Comparison

• But if flight distance increases to 3.000 Km, the airport will benefit massively from Ramsey pricing due to the lower elasticity of demand and gain about 376% more revenue than by using weight-based charging.
3.4 Consequences

• If a Ramsey pricing system is adopted long-distance flights will become more expensive, especially for small aircrafts.

• Contrary to this, short-distance flights will become cheaper, especially for large aircrafts.

• But in reality small air carriers don‘t do long-distance flights, neither do large aircrafts short distance flights.
4. Problems

• Hard to implement in reality.
  – Have airports the marketpower to implement such a pricing scheme?
  – It is difficult to get the necessary data.

• Even if airports have the market power to do so, there are legal barriers which prohibit charging different prices for the same service such as:
  – Art. 82 EGV Satz 2 a, c
  – § 19 (4) Nr. 3 GWB
  – § 20 (1) GWB

Source: Requate, Till, Preisdiskriminierung
5. Reflection on Martin-Cejas’ work

- In our opinion, some figures which Martin-Cejas used could be improved:
  - The elasticity should reflect airline‘s demand for capacity, not passenger‘s.
  - In Germany airports do not charge according to flight distance, so this term should be replaced in the block hour price-calculation as well.
  - Generally it is doubtfull to use block hour costs for handling an air carrier in this equatation
6. Next steps

- Apply same calculations for small, regional airports
- Calculate an airline-elasticity
- What are the effects of a pricing scheme based on flight distance?
  Who will get better/worse off by applying this approach?
Thank you very much, for your attention