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COMMISSION AUTHORIZED

Fees for Off-Airport Rental Car Companies

Comments of the Bureau of Economics[1] to the U.S. Department of Transportation regarding the study requested in the Senate Appropriations Committee Report on H.R. 4794.

I. Introduction

Congress has asked the Department of Transportation (DOT) to consult with the Federal Trade Commission (FTC) in its preparation of a study that analyzes the competitive aspects of gross-receipts fees imposed by airports on off-airport car-rental companies.[2] The staff of the Bureau of Economics of the FTC appreciates the opportunity to submit these comments to DOT.

In January 1989, DOT provided the FTC with a preliminary draft of its study.[3] That draft provides a thorough description of the car-rental market, the major companies involved in both on-airport and off-airport operation, the airports that currently assess off-airport gross-receipts fees, and the present sources of airport revenues. The draft also analyzes recent changes in the car-rental industry subsequent to airline deregulation.

The draft study does not address the larger (and difficult) question of the most desirable level and structure of fees assessed on airlines, car-rental companies, and other firms dependent on the airport. The most desirable fee

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[1] These comments represent the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner. Questions should be addressed to James D. Reitzes, Bureau of Economics, Federal Trade Commission, Washington, DC 20580, (202)326-3349.

[2] The Senate Appropriations Committee requested the study in the report on H.R. 4794, the DOT and Related Agencies Appropriations Bill.

[3] A Review of the Imposition of Gross Receipts Fees on Off-Airport Car Rental Companies, Report to the Senate Committee on Appropriations; the Senate Committee on Commerce, Science and Transportation; the House Committee on Appropriations; and the House Committee on Public Works and Transportation, January 1989.

structure would assess charges that allow the airport to meet its revenue needs while achieving the greatest level of overall consumer welfare. To determine that structure, one would need first to consider all of the benefits provided by the airport (such as the reduced travel time for commercial and private air passengers and the improved profitability of businesses that depend on the airport) as well as the costs imposed by the airport (such as the noise imposed on households located near the airport, and the congestion costs experienced both by neighboring households and by users of the airport.) After analyzing the benefits and costs, one could determine the schedule of fees (and possibly subsidies) that would raise the revenues required by the airport in the most efficient manner.[4] The efficient fee schedule may require payments from all that benefit from the airport.[5]

Like DOT, we acknowledge the complexity of determining the efficient fee schedule, and we do not further address that issue in these comments. Rather, for the remainder of this comment, we accept that airports charge revenue-based fees on their on-airport car rental companies, and then we examine the effects of imposing revenue-based fees on off-airport car rental companies.

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[4] For a discussion of efficient solutions involving different fees for different users of a common facility, see Kahn, The Economics of Regulation, (John Wiley and Sons, 1970) pages 70-86 and 134-35. See also Baumol, "Optimal Departures from Marginal Cost Pricing," 60 American Economic Review 265 (1970).

[5] Whether the fees currently assessed car rental companies are those that maximize overall consumer welfare is beyond the scope of these comments. One cannot rule out the possibility that airports maximize collections from landside sources (such as car rental companies) in order to subsidize airside users of the airport (i.e., the airline companies and general aviation.) If such subsidization were occurring, airports could alter their fee structures and raise the same amount of revenue while increasing overall consumer welfare.

II. Summary

Airports currently assess gross-receipts fees on their on-airport car rental companies. The DOT draft contains only a limited analysis of the rationale for extending gross-receipts fees to off-airport car rental companies, and the likely effect of these fees on competition between on-airport and off-airport car-rental companies. We develop this analysis a bit more thoroughly highlighting the factors likely to affect the magnitude of the impact on the prices, profitability and locational decisions of both off-airport and on-airport car rental companies. In addition, we discuss the possible effects on competition in the car rental industry.

Airport authorities may find it sensible to charge on-airport car rental companies a higher fee than off-airport car rental companies. On-airport companies may receive advantages such as on-site concession booths and the potential for quicker delivery of rental cars that are not available to off-airport companies. When these advantages exist, we expect that consumers (and hence on-airport companies) would be willing to pay a premium for them. On-airport companies may also impose higher costs (such as traffic congestion costs) on the airports' patrons than do off-airport companies. Therefore, airports may have an incentive to charge on-airport companies higher fees either to appropriate some of the value derived by these companies because of their preferred location or to force them to take account of the costs they impose.

The imposition of fees on off-airport car-rental companies would likely cause price increases in the short run. Off-airport companies would desire to charge higher prices to help recoup the cost of the gross-receipt fee. Any price increase in off-airport car rental services would increase the demand for services offered by on-airport companies. In turn, on-airport companies would have an incentive to increase the quantity of car rental services provided and might increase their prices.

In addition to the new revenues from off-airport car rental companies, the revenues collected by the airport from the on-airport car rental companies would increase. Moreover, the imposition of fees on off-airport car-rental companies may indirectly increase the airport's revenues by increasing the bids by car rental companies to supply on-airport car rental services. The rise in the demand for on-airport services might also increase the number of bidders for an on-airport location.

In addition, the imposition of fees on off-airport car-rental companies would decrease the total supply of services provided by these companies for a given level of demand for car rental services. This may be associated with a decrease in the profits of off-airport companies, and a decrease in the number of off-airport car rental companies at a particular airport.

Although our analysis implies that the imposition of off-airport access fees would affect the profitability, and ultimately the supply, of off-airport and on-airport car rental services, we expect that in many markets the number of companies would be sufficient to maintain price competition in the car rental industry. That result would be more likely in markets where entry is relatively easy.[6]

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[6] We have not examined entry conditions at individual airports. Such an analysis would be necessary to determine conclusively that the imposition of off-airport fees would not diminish competition in the car rental industry at a particular airport.

III. A Brief Review of Gross-Receipts Fees on On-Airport and Off-Airport Car-Rental Companies

For many years, airport authorities have charged concession fees to on-airport car-rental companies. Concession fees typically consist of a percentage of revenue, which usually includes the daily rental paid by customers and any additional charges for mileage. Also, the contract between the on-airport car-rental company and the airport authority often specifies a minimum payment.[7] The contract terms typically arise from a bidding process where the airport sets the gross-receipts fee (commonly around 10 percent), and the winning bidders are those who guarantee the highest minimum payment. In addition, rental companies often pay access fees for their vans. Finally, the on-airport companies pay rent for the space they occupy, and they are often required to construct their own operating facilities.

Revenue-based fees on off-airport car-rental companies are a relatively recent phenomenon. As of November 1988, sixteen airports nationwide had begun collecting gross-receipts fees from off-airport car-rental companies. Memphis, the largest airport collecting fees, charges 8 percent to both on-airport and off-airport car-rental companies. Kansas City charges 10 percent to on-airport car-rental companies and 7 percent to off-airport companies.[8] Atlanta, which currently imposes a 9-percent on-airport car-rental fee, will begin imposing a 7-percent off-airport fee in April 1989. We understand that other major airports are presently considering the issue.

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[7] In many cases, the minimum payment is not binding. That is, car rental companies pay more (based on the 10 percent fee) than they bid.

[8] On-airport firms in Kansas City are allowed telephones but no concession booths. Memphis has the same system, and the four on-airport firms are located on the boundary of airport property.

IV. Rationale for a Fee Differential between On-Airport and Off-Airport Companies

For a given level of demand, the revenues generated for the airport by a ten percent fee charged on-airport car rental companies will be largest when no off-airport companies are offering services because the services offered by the two types of companies are, to some extent, substitutes. Any increase in the supply of off-airport car rental services would reduce the quantity of car rental services supplied by on-airport companies, and this reduction, in turn, would reduce the revenues generated for the airport. The resulting reduction in airport revenues will be more pronounced the greater the extent to which consumers shift from on-airport to off-airport services and the easier that new off-airport entrants can appear. Thus, if off-airport companies are not charged a gross receipts fee, airports will lose revenues as the total quantity of car rental services is increasingly supplied by off-airport companies.[9]

If consumers considered the services of off-airport and on-airport car rental companies to be perfectly interchangeable, then the benefits provided by the airport would be the same for both types of companies and an equal percentage fee assessed on both on-airport and off-airport companies may be

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[9] The proportion of airport generated car rental revenues captured by off-airport car rental companies has increased from approximately 15% in 1982 to 30% in 1987. (DOT draft study, page 4.)

Even if the airport authority imposed fees on off-airport companies, it might not completely capture the revenues from car rental companies serving airport patrons. If price increases by off-airport car rental companies are likely to cause consumers to switch to in-town car rental companies or other means of transportation (such as taxicabs or mass transit), then airports should attempt to account for those shifts when predicting the revenue likely to be generated by the imposition of gross-receipts fees on off-airport car rental companies. In-town car rental companies would then be one of the many businesses that would be considered in setting optimal fees for all airport dependent businesses.

appropriate.[10] However, we doubt that the services of off-airport car rental companies are considered perfect substitutes for the services of on-airport car rental companies.

Consumers (and thus on-airport car-rental companies) derive two principal advantages from on-site locations relative to off-airport companies. First, on-airport companies typically offer a concession booth inside the airport while off-airport companies cannot.[11] Although the value of this advantage has declined in recent years due to the reduction in "walk-up" business, such accessibility still must be considered a convenience to consumers.[12] Second, on-airport companies may have more conveniently located facilities than off-airport companies.[13] This advantage shortens the time required by a customer to reach the rental car.

If either or both of these advantages exist, consumers would be willing to pay more for on-airport services than off-airport services. As a result, on-airport car rental companies may be willing to pay a higher percentage gross-receipts fee than would off-airport companies. Therefore, airports

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[10] Equal percentage fees would not be appropriate if off-airport companies did not derive all of their income from airport patrons. In addition equal fees might not be appropriate if on-airport companies imposed higher costs on the users of the airport, as discussed below.

[11] As indicated in note 8, supra, some airport do not permit on-site companies to operate concession booths.

[12] According to one on-airport company, "walk-up" business has declined to approximately 10% of revenues. (DOT draft study, page 32.)

[13] This may not always be the case. In many airports, customers of both on-airport and off-airport car-rental companies are required to use pick-up vehicles to gain access to their automobiles. Of 27 major airports, 21 require the use of pick-up vehicles for all car-rental customers. (DOT draft study, Table 4.1)

could charge on-airport companies higher fees to reflect the greater value consumers place on the services provided by on-airport companies.[14]

In addition, on-airport companies may impose greater congestion costs on users of the airport than off-airport companies. If on-airport companies do impose higher costs on airport patrons, a higher fee on on-airport companies would help to reduce the costs. Therefore, airports may choose to reduce congestion by charging on-airport companies higher access fees than off-airport companies.

V. Competitive Effects Within the Car-Rental Industry of Imposing an Off-Airport Fee in the Presence of an On-Airport Fee

The DOT draft study contains the following assessment of the effects of the imposition of fees on off-airport car-rental companies:

> "...[T]he extension of airport access fees to off-airport firms will change the competitive relationship between the latter and the on-airport firms that are already paying the fee. In such a highly competitive, narrow-margin business, increasing one competitor's costs by seven to ten percent must affect the relationship between on- and off-airport car-rental companies. For the off-airport operator, it will mean some combination of higher prices, lower profits, or less market share. For the on-airport operator, it will mean an opportunity to either increase prices (and hence profits) or market share, or both."[15]

We generally agree with DOT's assessment, and in this section extend the analysis in two ways. First, we examine the factors that affect the magnitudes of the short run price, profit, and market share effects cited by DOT. Second, we discuss the likely consequences of the off-airport fees on

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[14] If on-airport and off-airport companies had differing marginal costs of providing car rental services, the airport authority may want to take those differing costs into account when setting fees for the two types of companies. The airport authority may also want to take into account any rent subsidies it provides on-airport companies.

[15] DOT draft study, p. 3.

car companies' longer run decisions to locate on the airport, locate off the airport, or exit the industry altogether.

Consider as a starting point the situation that currently exists at many airports: on-airport car rental companies are charged a revenue-based fee while off-airport companies are not. Then, let us suppose that a revenue-based fee is imposed on off-airport car-rental companies. When the off-airport gross-receipts fee is imposed, the off-airport companies may consider passing this fee on to the customer by raising prices. The likely price increase becomes smaller as the services provided by off-airport and on-airport car-rental companies become better substitutes. If these two types of services are good substitutes, then a rise in the price of off-airport car-rental services would likely cause a significant number of customers to switch to on-airport car-rental services, holding the on-airport price constant.[16] In addition, price increases by off-airport car rental companies would be restrained if they face competition from other off-airport car rental companies, such as those located in a nearby city, that are not subject to a gross-receipts fee.

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[16] The willingness of consumers to substitute between on-airport and off-airport car-rental services is probably the most important factor in assessing the effects of imposing an off-airport gross-receipts fee, or more generally, in changing the relative fee structure affecting on-airport and off-airport companies. Under certain market conditions, car-rental companies may be able to create differences in the quality of their product and orient their product toward different customer groups. When on-site location conveys a substantial convenience advantage relative to off-site location, then on-airport car-rental companies may direct their services toward convenience-oriented customers, such as business customers. Off-airport car-rental companies may orient their marketing toward leisure customers. In markets where the quality and orientation of car-rental services differs between on-airport and off-airport companies, the substitutability between the services offered by these two types of companies is relatively less than in other markets. Thus, the imposition of an off-airport fee may create a relatively larger short run price effect on a particular segment of the car-rental market.

If prices increase for off-airport car-rental services, the demand for on-airport car-rental services would rise. Thus, on-airport companies would be likely to try to raise their prices. The likely price increase would be greater the more costly it is for on-airport companies to provide additional car rental services when demand increases.[17] Assuming that on-airport companies price competitively, the higher prices would reflect higher costs, and the imposition of fees on off-airport companies would not reduce the number of potential bidders to provide all or part of the on-airport car rental services.

It is important to recognize that on-airport companies may be a source of suggestions to impose revenue based fees on off-airport companies. On-airport companies may have incentives to lobby airport authorities to assess fees on their off-airport competitors. By raising the costs of operating off-airport locations and thereby increasing the demand for on-airport services, on-airport companies may earn higher profits.[18] Such a profit-increasing strategy is known as nonprice predation.[19]

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[17] In economic terms, the likely price increase will be greater the steeper the short run marginal cost curve. Later in this section, we discuss longer run adjustments, such as alterations in the size or location of rental car operations.

[18] See, Salop and Scheffman, "Raising Rivals' Costs," 73 American Economic Review 267 (1983). To raise price successfully, impediments to enter on-airport locations must exist. According to the DOT draft report (pp. 6, 31), some airports do place constraints on bidder qualifications.

For the on-airport companies to benefit, the airport authority must share the potential revenues. It is uncertain whether the airport authority has the information necessary to extract the full gains and may, therefore, share the potential revenues with the on-airport companies. See Salop and Krattenmaker, "Anticompetitive Exclusion: Raising Rivals' Cost to Achieve Power over Price," 96 Yale Law Journal 209 (1986).

[19] The FTC has previously examined the issue of nonprice predation in this industry. In 1976, the Commission issued a Consent Order against three of the major on-airport companies (Hertz, Avis, and National) prohibiting

We currently have inadequate information to determine whether the imposition of fees on off-airport companies is a revenue collection device of airport authorities, the result of a profit-raising strategy of on-airport companies, or both.[20] We note, however, that if off-airport fees are the result of a profit-raising strategy of on-airport companies, antitrust laws may not be able to address the issue. As explained in the DOT report (pp. 54-5), airport authorities may have immunity from antitrust prosecution by the state action doctrine.[21] Further, efforts by car rental companies to lobby airport authorities may or may not be exempt from the antitrust laws under the Noerr-Pennington doctrine.[22]

In the long run, the imposition of gross-receipts fees on off-airport car rental companies may reduce their profitability sufficiently to induce some of them to exit the industry.[23] Our own preliminary investigation of the

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them from engaging in certain practices allegedly designed to increase profits by creating entry impediments for on-airport companies. See Hertz Corporation, et al. 88 FTC 715 (1976). The Complaint alleged that the companies attempted to persuade airport authorities to establish bidder qualifications for airport car rental concessions.

[20] To make a determination, it may be necessary to address the question of the most desirable level and structure of fees assessed on all firms dependent upon the airport. As we stated above, this is a difficult problem to solve.

[21] See, Parker v. Brown, 317 U.S. 341 (1943).

[22] See, Eastern Railroad Presidents Conference v. Noerr Motor Freight Co., Inc. 365 U.S. 127 (1961) and United Mine Workers v. Pennington, 381 U.S. 657 (1965). Even if this immunity holds, car rental companies would, of course, still be liable for antitrust violations not covered by the immunity.

[23] DOT interviewed firms at ten airports that have assessed off-airport gross-receipts fees. Since the imposition of these fees, there has been a net reduction of one off-airport firm in these ten markets. In Sarasota, two off-airport firms have left the market, but eleven off-airport firms remain. Gulfport-Biloxi has shown a net loss of one off-airport firm,

effects of off-airport fees suggests that the number of off-airport car-rental companies may be lower at airports that impose gross-receipts fees on off-airport car rental companies.[24] In most major markets, we would not expect that any potential fall in the number of off-airport companies would significantly increase the risk of anticompetitive behavior because entry into the off-airport car rental market, at many locations, appears relatively easy.[25]

The imposition of off-airport fees would likely raise the value of operating on the airport premises relative to operating off the premises. As the fees charged off-airport companies rise toward those charged on-airport companies, off-airport companies may be more inclined to move onto the airport because relatively more services would be supplied by on-airport providers.[26] Some of the increased value of an on-airport location could most likely be recaptured by the airport authority through increased revenue collections. The increased value should also be reflected in an increase in

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with only two remaining off-airport firms. (DOT draft report p. 19 and p. 29)

[24] Appendix A provides a preliminary analysis which suggests the number of off-airport car rental companies may be lower at airports that assess gross-receipts fees on off-airport car rental companies. For reasons discussed in the Appendix, we caution that our analysis should be considered preliminary.

[25] While we have not examined this issue in detail, the recent growth in the number of off-airport companies and the market share commanded by them suggest that entry barriers, at least in some markets, are minimal. Entry conditions differ across airports, however, and the conditions at a particular airport would need to be examined before concluding that potential entry at that airport was relatively easy.

We also note that the imposition of off-airport gross-receipts fees may make entry more difficult than before. These fees would raise the cost of doing business for any prospective entrants.

[26] However, if the airport places constraints on bidder qualifications, off-airport companies might not be able to bid.

the bid offered to secure an on-airport concession. Accordingly, when the existing contracts between the airport and its on-airport car rental companies expire, the bids to supply on-airport car rental services should rise from their previous levels.[27] In addition, the on-airport car-rental companies may alter their facilities to allow them to handle the increased demand for on-airport car rental services more efficiently. In sum, a car rental company's decision to locate on or off the airport premises, and its decision regarding the size of its operation, may be strongly affected by changes in the fee structure.

[27] Our analysis suggests that on-airport car rental companies may be willing to pay a higher percentage fee than off-airport car rental companies. Even if both types of companies pay the same percentage fee, car rental companies would be willing to bid for the right to locate on the airport when an on-airport location provides consumers (and, hence, car rental companies) with benefits relative to an off-airport location. A competitive bidding process for the rights to on-airport concessions would reveal the differential value of an on-airport location, and permit the airport to collect some of the value of the differential benefits. For a discussion of various auction mechanisms and their properties, see Harris & Raviv, "A Theory of Monopoly Pricing Schemes with Demand Uncertainty," 71 American Economic Review 347 (1981); McAfee & McMillan, "Auctions and Bidding," XXV Journal of Economic Literature 699 (1987).

VI. Conclusion

Airport authorities currently charge on-airport car rental companies fees based on gross receipts. To the extent that an on-site location conveys certain advantages over an off-airport location, it may be sensible to place a higher fee on on-site companies than on off-site companies. As on-airport and off-airport car-rental services become better substitutes over time, a given fee differential would be more likely to affect the locational decisions of these companies. Finally, although the decisions of car rental companies and their profits will be affected by any change in revenue-based fees, we expect that in many markets potential entry would be sufficient to maintain price competition in the car rental industry.

Appendix A

Other things equal, one would expect the proportion of total car rental services supplied by off-airport car rental companies to be smaller at airports that assess off-airport access fees. We do not have data on the proportions of total car rental services provided by on-airport and off-airport companies at various airports. Still, the DOT draft study reports data on the number of each type of company at various airports. We examined whether airports that assessed off-airport fees have fewer off-airport car-rental companies than airports without these fees by regressing the number of off-airport car-rental companies on five variables: 1) a constant, 2) the number of originating passengers at the airport (in millions), 3) a dummy variable indicating whether the airport is located in a tourist market, 4) the proportion of residents in the city served by the airport who use public transit to commute to work; and 5) a dummy variable indicating whether off-airport gross-receipts fees are imposed. We would expect the first three variables to be positively related to the number of off-airport car rental companies and the last two variables to be negatively related.

Our sample includes forty-three airports cited at some point in the DOT draft study, sixteen of which had imposed gross-receipts fees on off-airport car rental companies by 1988. The coefficients (and t-statistics) generated by the regression are as follows:

	Coefficient	t-statistic
constant	4.516	3.912
number of originating passengers (in millions)	0.327	3.583
tourist dummy	6.461	5.338
percentage of residents who use public transportation	-0.111	-1.556
off-airport fee dummy	-2.640	-2.198

These results indicate that, at a 5-percent level of significance, the number of off-airport car-rental companies is positively affected by the size of the airport and whether the airport serves a tourist market. Further, the coefficients on the off-airport fee variable and the percentage of commuter variable are negative and the coefficient on the fee dummy is significantly different from zero at the 5-percent level of significance. Thus, this evidence provides limited support for the conclusion that airports that assess gross receipts fees on off-airport car rental companies have fewer off-airport companies. (When the dependent variable is the total number of on-airport and off-airport car rental companies, the regression results are qualitatively unchanged.)

We emphasize that these results are preliminary. Due to the recent imposition of some of these fees, the number of off-airport companies currently in operation may not represent the full impact of these fees on competitive conditions. We have also assumed that the off-airport companies cited in the DOT draft report are independent businesses. If some of the off-airport businesses are jointly owned, the dependent variable for that market would overstate the number of independent off-airport companies. In addition, the airports in this sample that assess fees on off-airport car rental companies tend to be markedly smaller than those in the sample that do not collect such fees. It is unclear whether those differences are adequately controlled for by the originating passenger variable. Further, the results may be sensitive to the relatively small number of observations and to alternative specifications of the determinants of supply and demand in the car-rental industry (e.g., the number of automobiles per thousand people in the metropolitan area served by the airport may be superior to the proportion of residents who use public transportation to commute). DOT may wish to consider whether a more extensive analysis of these data would be useful. (Data sources: DOT draft (January, 1989) Tables 3.3, 3.4, 3.6, and 4.3; Airport Operators Council International; and State and Metropolitan Area Data Book, Department of Commerce (1986)).