

**CONFERENCE ON THE ECONOMICS OF AIRPORTS AND
AIR NAVIGATION SERVICES**

(Montreal, 19 - 28 June 2000)

DRAFT REPORT ON AGENDA ITEM 5.2 (part)

Agenda Item 5.2: Elements for consideration with regard to ICAO policy

COST BASIS FOR CHARGES AND COST ALLOCATION

5.2.1 Documentation

Switzerland (WP/44) sought to encourage States to apply internationally accepted accounting standards for airports as a means of ensuring effective exploitation of international capital markets for privatized or semi-privatized entities, together with a transparent and uniform platform for the setting of charges. Switzerland suggested that ICAO develop appropriate guidance along these lines.

United States (WP/42) invited the Conference to call upon States to re-examine their cost allocation methodologies as they pertain to ICAO guidance on the allocation of common and fixed costs across service environments or facilities. Service providers should adopt allocations that accurately reflect the actual cost of service provided. The paper also recommended that ICAO conduct a detailed study on how States and other air navigation services providers comply with existing ICAO guidance in identifying and allocating costs. United States (WP/98) also suggested that the guidance in the Council Statements in Doc 9082 be strengthened to discourage discrimination and cross-subsidization among users in general.

European Commission (WP/76) described the regulatory framework for the European Single Market, particularly as it relates to ground handling and the principles of airport charging. The Commission had adopted a directive for compulsory application in the European Union of the principles of non-discrimination, cost-relatedness and transparency contained in the Council Statements in Doc 9082.

EUROCONTROL (WP/45) raised the same issue for air navigation services concerning internationally accepted accounting standards as Switzerland did for airports in WP/44. EUROCONTROL (WP/72) also recommended that ICAO guidance on cost allocation between en route, approach and aerodrome control in the *Manual on Air Navigation Services Economics* (Doc 9161/3) be expanded to reflect recent and possible future developments in air navigation services organization and charging practices.

World Meteorological Organization (WMO) (WP/97) expressed its opposition to IATA's suggestion in WP/78 (see below) to amend the current ICAO guidance on determining aeronautical meteorological costs, noting that it was based on safety considerations and had recently been developed through an ICAO panel in which IATA had participated but had not at that time raised reservations as to the guidance.

International Air Transport Association (IATA) (WP/78) was concerned that the costs of aeronautical meteorological services had increased significantly and that aviation was

burdened with an unduly high share of meteorological services costs. IATA suggested the ICAO guidance material in the Council Statements in Doc 9082 be amended so as to limit the costs of meteorological services that would be allocated to aviation users to those facilities and services that are exclusively intended to serve aeronautical requirements. IATA suggested that competition in the provision of these services might reduce costs and should be actively promoted.

5.2.2 Discussion

5.2.2.1 There was broad support for extending ICAO guidelines to promote and facilitate the application of internationally accepted accounting standards for both airports and air navigation services (WPs 44 and 45). Some concern was voiced with regard to promoting only “international” accounting standards since national accounting standards would also need to be observed. Consequently States themselves would decide what accounting standards to use and apply international standards where appropriate. With this qualification, the Conference agreed to accept the proposals in the papers.

5.2.2.2 The Conference readily endorsed the proposals in WP/42. There was also substantial strong support for the principles expressed in WP/98 for non-discrimination and cost-relatedness, but the majority view was that the text proposed to reflect this in the Council Statements in Doc 9082 went beyond the intention of Article 15 of the Chicago Convention. Concerns were expressed also with regard to capacity and environmental issues as well as practical aspects with cost allocation. The Conference accordingly was unable to endorse that proposal.

5.2.2.3 The Conference agreed to endorse the proposal in WP/72 to expand the guidance in the *Manual on Air Navigation Services Economics* (Doc 9161/3) in view of the changes and developments that have taken place in air traffic management.

5.2.2.4 Regarding cost recovery of aeronautical meteorological services the Conference agreed to principally retain the existing guidance on cost determination in Appendix 2 of the Council Statements in Doc 9082. However, the concept in WP/78, essentially calling for the separate identification of meteorological costs in the cost basis for route air navigation services charges, would be taken into consideration by the Council when reviewing the Statements. The view was expressed that the provision of aeronautical meteorological services on a commercial basis should be encouraged.

5.2.2.5 To give effect to its discussion, the Conference agreed to the following recommendations:

RECOMMENDATION 5.2/1

THE CONFERENCE

RECOMMENDS

- a) that States consider the application where appropriate of internationally accepted accounting standards for airports and providers of air navigation services, which maintain separate accounts; and

- b) that ICAO accordingly expand the guidance contained in the Council Statements in Doc 9082 and the *Airport Economics Manual* (Doc 9562) and the *Manual on Air Navigation Services Economics* (Doc 9161/3).

RECOMMENDATION 5.2/2

THE CONFERENCE

RECOMMENDS that States re-examine the cost allocation methodologies they apply for their airports and air navigation services providers as they pertain to ICAO guidance related to the allocation of common and fixed costs, for example, between different stages of utilization of services such as terminal or en route.

RECOMMENDATION 5.2/3

THE CONFERENCE

RECOMMENDS that ICAO study how States and other providers of air navigation services comply with existing ICAO guidance in identifying and allocating costs.

RECOMMENDATION 5.2/4

THE CONFERENCE

RECOMMENDS that ICAO, in the planned review of the *Manual on Air Navigation Services Economics* (Doc 9161/3), the guidance on cost allocation between en route, approach control and aerodrome control to reflect recent developments in air navigation services organization and charging practices.

APPLICATION OF ECONOMIC PRINCIPLES

5.2.3 Documentation

Secretariat (WP/14) referred to the fundamental economic principle in the Council Statements in Doc 9082 that costs should be determined on the basis of sound accounting principles. To allow for more flexibility in the setting of airport and air navigation services charges, notably in cases where capacity problems exist, the paper proposed the insertion of new text in the Council Statements, advising that costs may reflect as required other economic principles provided that these were in conformity with Article 15 of the Chicago Convention and other principles in the Council Statements.

United States (WP/43) questioned whether the application of economic principles including marginal pricing in setting airport and air navigation services charges was consistent with the

existing Council Statements. The United States proposed that ICAO guidance on the use of economic pricing for capacity management be expanded in order to avoid possible over-recovery of costs. It also urged consultation with users and a high level of transparency where economic pricing principles were applied in cost allocation. Finally, the United States proposed that the Council examine whether the traditional approach to measuring discrimination and cross-subsidization needed to be revised.

European Commission (WP/74) noted that while fair and efficient charging systems must be based on the principles of non-discrimination, cost-relatedness and transparency, the transformation of management of airports requires an in-depth debate on how to further develop the regulatory framework. In this context it was noted that the concept of social marginal cost pricing (for example, to reflect environmental considerations) can make an important contribution.

Airports Council International (ACI) (WP/54) advocated freedom for airport operators to adopt pricing policies which took into account unique local circumstances. However, when marginal pricing was implemented it should be accompanied by careful cost analysis.

International Air Transport Association (IATA) (WP/80) opposed the use of marginal pricing in the setting of user charges. In WP/81, IATA also expressed its opposition to the concept of peak pricing, indicating that ICAO should reaffirm the basic charging principles of non-discrimination and cost-relatedness.

5.2.4 Discussion

5.2.4.1 The Conference noted that States should not be obliged to resort to a single theory or principle in setting their airport and air navigation services charges but should choose the approach best suited to their own local circumstances provided it met basic internationally accepted principles. It was also felt that due consideration should be given to demand factors. In addition, it was observed that other economic principles not listed in WP/14 could be envisaged, some of which could have a discriminatory effect if not applied in conformity with Article 15 of the Chicago Convention. Concerns were expressed over the possible abuse of market power that could result from the application of these principles, and over their “open-ended” character.

5.2.4.2 There was wide support for the proposal in WP/14 to insert new text in the Council Statements in Doc 9082, with one modification to the text and its location.

5.2.4.3 With regard to WP/43, there was wide support to endorse the action suggested, also with modifications, including the notion that charges were not only destined to provide a reasonable return on investment, but also to cover costs of providing additional capacity.

5.2.4.4 The action proposed in WP/54 was adopted with some amendments to the text, for insertion in the *Airport Economics Manual* (Doc 9562), the Conference noting the same text which was already contained in the *Manual on Air Navigation Services Economics* (Doc 9161/3) would be amended accordingly.

5.2.4.5 To give effect to its conclusions, the Conference agreed to the following recommendations:

RECOMMENDATION 5.2/5

THE CONFERENCE

RECOMMENDS that the Council insert the following text in the Council Statements in Doc 9082 (in relation to both airport charging systems and air navigation services charging systems):

“Charges should be determined on the basis of sound economic principles and may reflect as required other economic principles provided that these are in conformity with Article 15 of the *Convention on International Civil Aviation* and other principles in the present document”.

RECOMMENDATION 5.2/6

THE CONFERENCE

RECOMMENDS

- a) that States urge their service providers that adopt economic pricing principles to report details on both the level and allocation of fixed and variable costs, and to consult with users on how marginal costs are estimated and used in setting charges; and
- b) that ICAO:
 - 1) supplement guidance in the *Manual on Air Navigation Services Economics* (Doc 9161/3) and the *Airport Economics Manual* (Doc 9562) aimed at ensuring that the use of economic pricing for capacity management does not result in over-recovery of costs while at the same time providing for a reasonable return on investment; and
 - 2) examine whether the traditional approach to measuring discrimination and cross-subsidization needs to be revised given the increased interest in applying economic principles in setting charges.

RECOMMENDATION 5.2/7

THE CONFERENCE

RECOMMENDS that ICAO modify the present paragraph 5.6 of the *Airport Economics Manual* (Doc 9562) to read as follows, and align paragraph 5.7 of the *Manual on Air Navigation Services Economics* (Doc 9161/3) correspondingly:

“The application of economic principles to setting charges which are consistent with the Council Statements in Doc 9082 should emphasize the need to recover costs in an efficient and

equitable manner from the users of airport services. Within an economic context, charges should be set both to recover costs and to provide additional capacity when justified.”

PRE-FUNDING

5.2.5 Documentation

Secretariat (WP/15) addressed the issue of pre-funding projects through charges, a practice that some airports had introduced in recent years. While recalling the fundamental principles of cost recovery, according to which charges should not be levied for any facilities or services until they had been implemented, and that reserves being built from an excess of revenues over expenses could contain an element of pre-funding, the Secretariat considered that in very specific circumstances pre-funding through charges could perhaps be justified if strict safeguards against abuse were in place.

ECAC States (WP/69) outlined the principles of best commercial practice that airports should follow. In so doing one consideration airports should have ? was that pre-funding, in the form of increased charges or any appropriate agreed method, may be necessary to deliver long-term large scale investment.

ACI (WPs 52 and 55) was of the view that controlled pre-financing may form part of an efficient airport management plan, and may be used, where appropriate, subject to the provision of safeguards for users.

IATA (WP/31) was of the opinion that the cost of large projects should be financed through external financing, which should only be included in the cost base for charging purposes once the facilities in question were operational.

IBAC (WP/38) explained that individual business aviation users of airports and air navigation services were, by and large, not “regular” users of these facilities and services and that it would be appropriate to make some distinction between regular and other users in the context of pre-funding.

5.2.6 Discussion

5.2.6.1 The Conference agreed that in the Council Statements in Doc 9082 the principles of cost relatedness for airport charges, and of the protection of users from being charged for facilities they do not used, should be retained. Nevertheless in light of the costs of infrastructure development and the rapidly growing organizational and financial autonomy of service providers the Conference felt that the concept of pre-funding in very limited circumstances in the case of large-scale projects merited consideration.

5.2.6.2 A number of comments were made on the application and process of such pre-funding. Some delegates, for example, expressed reservations with regard to the principle of pre-funding projects through charges, noting that the element of pre-funding already recognized in the Council Statements in Doc 9082/5. Consequently, should the concept of pre-funding through charges be accepted, it should be an exception to the normal rule. Also, any pre-funding should be considered in the context of all the revenues that an airport receives, notably including non-aeronautical revenues, which should form the primary basis from which capital for investment purposes should be derived in the first place. It was also felt that it was not appropriate to apply pre-funding as the sole source for financing the totality of a project, but that a combination of different sources should be used.

5.2.6.3 In conclusion, there was widespread support for the concept of considering pre-funding in the context of economic regulation, that is subject to a degree of control, and accompanied by safeguards including those described in WPs 15 and 69. The Conference agreed that the elements proposed in both papers should be combined, noting that emphasis should be placed on consultation with users and transparency, as also expressed in WPs 52 and 55.

5.2.6.4 In light of its deliberations, the Conference adopted the following recommendation:

RECOMMENDATION 5.2/8

THE CONFERENCE

RECOMMENDS that the Council in its review of ICAO guidance on the issue of pre-funding of projects through charges should:

- a) retain the principles of cost-relatedness for charges and of the protection of users from being charged for facilities that do not exist or are not provided (currently or in the future);
- b) to indicate that pre-funding of projects, particularly from non-aeronautical charges, may be accepted in specific circumstances where this is the most appropriate means of financing long-term, large-scale investment, providing that strict safeguards are in place, including the following:
 - 1) demonstrably effective and transparent economic regulation of user charges and the related provision of services, including performance auditing and “bench marking” (comparison of productivity criteria against other similar enterprises);
 - 2) comprehensive and transparent accounting, with assurances that all aviation user charges are, and will remain, earmarked for aviation services or projects;
 - 3) advance, transparent and substantive consultation and, to the greatest extent possible, agreement with users regarding significant projects; and

- 4) application for a limited period of time with users benefiting from lower charges and from smoother transition in changes to charges than would otherwise have been the case once new facilities or infrastructure are in place.

SEARCH AND RESCUE (SAR)

5.2.7 Documentation

Secretariat (WP/16) referred to Appendix 2 of the Council Statements in Doc 9082 where recovery of the costs to States of providing search and rescue (SAR) services is addressed under “Other ancillary aviation services”, and the 1996 recommendation by the Air Navigation Services Economics Panel that this policy guidance be amended to allow for costs of SAR services performed by establishments other than permanent civil establishments, such as the military, to be included in the cost basis for air navigation services charges. The Council had not approved the Panel’s recommendation pending a Secretariat study of the implications concerned.

This study had been based on responses to a questionnaire circulated to States seeking background information on search and rescue cost recovery policy and practices. A limited number of States (33) had replied to the questionnaire, the majority (21) of which had stated that they were not in favour of applying the Panel’s recommendation. In this context, the Conference was invited to advise the Council whether or not there were sufficient grounds for the existing text in the segment “Other ancillary aviation services” in Appendix 2 of the Council Statements, to be amended.

AFCAC States (WP/100), concerned at inadequacies in search and rescue, proposed a regional approach, with funding through user charges or a proposed international aeronautical fund presently under study by the Council.

IAOPA (WP/63) suggested that language in the Council Statements in Doc 9082 should be strengthened to reflect that certain essential services provided to a State's citizens, including SAR services, also should be provided to international civil aviation.

IATA (WP/84) suggested that more appropriate guidance should be developed by ICAO for the allocation of SAR costs to aeronautical users, notably not based “on ability to pay”.

IBAC (WP/38) submitted that costs of SAR should be borne by the society as a whole and that, in particular, civil aviation should not be allocated costs for facilities and services provided by the military.

5.2.8 Discussion

5.2.8.1 Some delegates pointed out that it was very difficult to arrive at any conclusion for global application based on the limited number of States that had replied to the survey as to whether States were in favour of costs of SAR services provided by establishments other than permanent civil establishments being included in the cost basis for charges. The Conference agreed that there was a need for follow-up of the Secretariat study and information from many States that had not responded to the survey in the first instance.

5.2.8.2 The Secretariat drew attention to the wider perspective of SAR activities as part of humanitarian undertakings by States as part of their emergency response requirement for which there is no charge. It was noted that in the *International Convention on Maritime Search and Rescue* there is an obligation to render assistance to anybody in distress and that there was no cost recovery mechanism established for maritime SAR.

5.2.8.3 While some delegates took the view that SAR services are an obligation of States to provide free of charge, others expressed concern about the difficulties by many less developed countries to funding investments in SAR facilities and services. The establishment of mechanisms at the regional or sub-regional level could contribute to reduce the existing shortcomings in this field and would enhance safety. In this context it was suggested that existing aviation training institutions should be taken into account. The Conference accordingly endorsed the proposals in WP/100 in general terms, but without reference to an “international aeronautical fund” as this issue is currently under consideration by the Council in a specific context.

5.2.8.4 To give effect to its discussion, the Conference agreed to the following recommendations:

RECOMMENDATION 5.2/9

THE CONFERENCE

RECOMMENDS that ICAO undertake further study as to the position of States and the implications of amending ICAO policy with regard to recovery of costs for search and rescue services provided by other than permanent civil establishments.

RECOMMENDATION 5.2/10

THE CONFERENCE

RECOMMENDS that ICAO

- a) develop guidance on the establishment of organizations at the regional level for search and rescue activities; and
- b) conduct a study on the establishment of regional or sub-regional search and rescue mechanisms and how they might be funded as regards civil aviation.

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