

CONFERENCE ON THE ECONOMICS OF AIRPORTS AND AIR NAVIGATION SERVICES

(Montreal, 19 - 28 June 2000)

Agenda item 3:	Funding issues
Agenda item 4:	Determinants of the economic regulation of airports and air navigation services
Agenda item 5:	ICAO policy
Agenda item 5.2:	Elements for consideration with regard to ICAO policy

PRE-FUNDING OF PROJECTS THROUGH CHARGES

(Presented by the Secretariat)

SUMMARY

This paper addresses the issue of the pre-funding of projects through charges and relates this practice to relevant ICAO policy. Suggested action by the Conference is at paragraph 6.1.

1. Introduction

1.1 The general issue of funding the provision of aviation infrastructure is of fundamental importance at the present time and various sources and developments are discussed in ANSCConf-WP/8. The present paper addresses the specific issue as to whether airport and air navigation services charges might be used to directly pre-fund infrastructure projects.

2. ICAO policy

2.1 A fundamental principle in international cost recovery policy for airports and air navigation services is that charges shall not be levied for any facilities or services until they have been implemented, that is become operational. This is explicitly expressed in the *Statements by the Council to Contracting States on Charges for Airports and Air Navigation Services* (Doc 9082/5)*, with regard to airports in paragraph 14 ii):

*Proposed by the Secretariat in ANSCConf-WP/4 to be retitled *ICAO Policies on Charges for Airports and Air Navigation Services*.

“In general aircraft operators and other airport users should not be charged for facilities and services they do not use, other than those provided for and implemented under the Regional Plan.”

and with regard to air navigation services in paragraph 34 ii):

“The costs to be taken into account should be those assessed in relation to the facilities and services, including satellite services, provided for and implemented under the ICAO Regional Air Navigation Plan(s), supplemented where necessary pursuant to recommendations made by the relevant ICAO Regional Air Navigation Meeting, as approved by the Council.”

The objective of this principle, which is of long standing, is to protect the users from being charged for facilities or services that do not exist or are not provided (currently or in the future).

2.2 Self-financing of airports and air navigation services requires reserves to be built up from an excess of revenues over expenses and could thus be assumed to contain an element of pre-funding. However, and particularly in the case of airports, such an excess usually does not originate from charges exceeding costs but from profits from non-aeronautical activities. ICAO policy on self-financing is contained in Doc 9082/5 in paragraph 14 (vii) (airports) and 34 (iv) (air navigation services) which essentially state:

Airports/air navigation services may produce sufficient revenues to exceed all direct and indirect operating costs (including general administration, etc.) and so provide for a reasonable return on assets (before tax and cost of capital) to contribute towards necessary capital improvements.

3. Recent developments

3.1 In recent years a few airports have introduced fees, usually charges on passengers, that are not applied against defraying the costs of facilities or services in operation but instead are to be used to pre-finance facilities that do not yet exist, such as new or expanded terminals. This practice has given rise to protests from users (air carriers and passengers alike) on the grounds that it contravenes the international policy referred to above.

3.2 As a rule only airports operated by autonomous bodies have engaged in this practice. The underlying reason has usually been that when the government transferred the operation of the airport(s) to a financially autonomous body it also stipulated that the body itself and not the government would be responsible for securing financing. This has encouraged some such bodies to seek pre-funding, at least in part, through user charges.

3.3 The general practice of commercial enterprises which operate in a competitive environment is to fund their investment needs through reserves normally composed in part of profits and depreciation, and where major investments are involved, principally through loans obtained on the financial market.

4. Discussion

4.1 A primary argument for pre-funding through user charges is increased assurance that funds will be forthcoming for infrastructure projects, particularly as the cash in hand can provide leverage for raising additional financing (for example through loans, bonds or equity offerings). Another argument for pre-funding is the reduction in administrative costs and financial charges made possible with an early increase in user

charges rather than having to negotiate loans to finance the investment and then recover the costs of servicing the loans through charges once the facility becomes operational.

4.2 There are, however, fundamental features of the provision of airports and air navigation services which call for special treatment. First, their provision is monopolistic in nature and there may be no incentive to keep the costs down - where competition prevails clients will simply not pay for a service in advance if a competitor can provide it now at a similar price. Second, in many instances aviation user fees are still not earmarked for the provision of aviation services but rather go into some general government reservoir - there is no guarantee that the pre-funded charges will actually be spent on aviation projects. Third, in a large number of States the airport and/air navigation service accounting systems employed are unable to identify the various costs, notably the value of assets and associated depreciation and cost of capital attributable to the provision of specific services (particularly important where, for example, some services such as air traffic services, communication services and meteorological services are provided by two or three different entities which to a varying extent carry out non-aviation functions) - there is no guarantee that pre-funded (or even other) user charges will be well-spent. Fourth, concerns have been expressed that users may be charged for twice, once through the pre-funding charge then, if the full cost of the new facility was subsequently depreciated, through the depreciation and cost of capital included in the cost basis for post-implementation charges.

4.3 In a large number of States where revenues from airports and air navigation services provision exceed expenses this may nevertheless not depict a truly profitable situation. This is because not all the costs have not been included. In particular depreciation and cost of capital are either unrealistically low or absent, because the proper value(s) of the infrastructure components(s) concerned has not been entered into the accounts and possibly never estimated. Pre-funding through charges would not be required to generate additional cash flow in such circumstances since additional revenues could be obtained by proper cost accounting providing all recoverable costs that should be included in the cost basis for the regular charges. Efforts should therefore be aimed at improving the accounting and cost identification procedures in the States concerned. Endorsing pre-funding through charges in such circumstances could reduce incentives to improve the accounting framework.

4.4 In certain, very specific circumstances, pre-funding could perhaps be justified for the provision of airport or air navigation services if strict safeguards against abuse were in place, including the prerequisites of: demonstrably effective and transparent economic regulation of user charges and the related provision of services, including performance auditing and “benchmarking” (comparison of productivity criteria against other similar enterprises); comprehensive and transparent accounting, with assurances that all aviation user charges are, and will remain, earmarked for aviation services or projects; and advance, transparent and substantive consultation with users regarding significant projects.

4.5 The principles espoused by ICAO in Doc 9082 have long promoted the evolution of such prerequisites and progress in this direction is evident, but in practice there are extremely few cases around the world at present where all the prerequisites could be said to be in place. Bearing in mind that general acceptance of pre-funding could undermine the fundamental principles of ICAO policy described in paragraphs 2.1 and 2.2 above, with potential consequences for the entire policy, the Secretariat feels it is premature for ICAO to endorse the concept of pre-funding.

5. **Enhancement of ICAO guidance**

5.1 While endorsement of pre-funding may be premature, there are some aspects of ICAO policy which both merit enhancement in their own right and could pave the way for general acceptance of pre-funding. With the rapid growth in financial and organizational autonomy in the provision of airports and air navigation

services and private involvement in or outright privatization of airports, protection of users from potential abuse by a monopoly provider has become more relevant. In particular, it emphasizes the need for adequate economic regulation, preferably with an independent body to oversee the operations of autonomous service providers and comprehensive, transparent (and preferably, to the extent possible, common standard) accounting (see ANSCConf-WP/9), along with prior consultation with users and mechanisms for the handling of complaints (see ANSCConf-WP/12). It is suggested that the issue of pre-funding through charges also be addressed in that context. In addition, it is suggested that ICAO should provide more extensive guidance on cost accounting and cost identification procedures.

6. Action by the Conference

6.1 The Conference is invited to note this paper and agree to recommend to the Council that:

- a) it reaffirm the principles quoted in paragraphs 2.1 and 2.2 above;
- b) ICAO provide more guidance in cost accounting and identification; and
- c) pre-funding through charges be considered in the context of economic regulation, accounting, prior consultation with users and handling of complaints.

— END —