

CONFERENCE ON THE ECONOMICS OF AIRPORTS AND AIR NAVIGATION SERVICES

(Montreal, 19 - 28 June 2000)

Agenda Item 2: Organizational issues

Agenda Item 4: Determinants of the economic regulation of airports and air navigation services

AIRPORT AND AIR NAVIGATION SERVICES COMMERCIALIZATION

(Presented by International Air Transport Association)

SUMMARY

The airline industry generally favours commercialising airport and air navigation entities. It is concerned, however, that the process often leads to increases in the cost base for charging purposes and thus higher user charges. The Conference is asked to endorse the need for proper consultation and transparency during the commercialisation process, independent economic oversight of commercialised entities, and a neutral dispute settlement mechanism.

1. Introduction

1.1 An increasing number of governments are “commercialising”^{*} their airports and air navigation systems (ANS). This trend, in conjunction with airline privatisation, is changing the relationship between the airline operators and the providers of ANS and airport infrastructure.

1.2 Up to the 1970s, airports, ANS entities and the national airline(s) usually belonged to the State and were financed by the national budget. Cost recovery by air navigation and airport charges was often minimal but this has since changed. During the past two decades, full cost recovery has become normal practice.

^{*}In this paper, the term “commercialisation” refers to the general process of moving away from being a governmental organisation to a quasi- or fully independent entity operated like a business. Although the number of airports that are eventually totally privatised is likely to be considerable, few air traffic services are expected to be fully privately-owned. An IATA paper on “User Charges Aspects of the Commercialisation of Airports and Air Traffic Services (ATS) Entities” is attached as Appendix A.

1.3 In the latest phase, airport/ANS infrastructure in some States is being commercialised. Airports are either being run on an autonomous, quasi-commercial basis, or sold, or airport installations such as terminals are being turned over to the private sector through operating concessions or long-term leases. ANS entities are being “corporatised” as autonomous operating organisations or not-for-profit corporations.

2. **Current Situation**

2.1 IATA and the airlines support the trend towards autonomy for airports and ANS and having their management operate as efficiently as possible. In the case of airports, the airline industry is strongly in favour of them developing the commercial nature of their business.

2.2 However, airport/ANS commercialisation may have a negative side, in particular when the principal objective is to maximise profits. No matter what organisational form an airport or ANS entity assumes through the process of commercialisation, it remains by its nature a monopoly on which the users are completely dependent. There are a growing number of cases of abuse of this monopolistic situation by newly created commercial organisations, often with the complicity of the governments concerned.

2.3 IATA’s experience is that, in many cases, commercialisation has resulted in significant increases in the airport and ANS cost base that are used to determine charges. In addition, the promised increases in efficiency and productivity have not always materialised.

2.4 Airport and ANS users should be involved in the commercialisation process to ensure proper consultation. The cost base and charging structure resulting from commercialisation should be agreed in consultation with airlines. Airport and ANS charges should be:

- determined on the basis of transparent, fair and reasonable costs;
- in conformity with international agreements and obligations of the individual State;
- in line with ICAO’s principles on user charges; and
- subject to economic oversight, preferably through an independent, neutral body.

3. **Action by the Conference**

3.1 The Conference is invited to:

- a) endorse the need for proper consultation and transparency and for independent economic oversight for commercialised airports and ANS entities; and
- b) urge States to follow ICAO principles on user charges.

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APPENDIX A

POLICY ON

"USER CHARGES ASPECTS OF THE COMMERCIALISATION OF AIRPORTS AND AIR TRAFFIC SERVICES (ATS) ENTITIES"

PART I - GENERAL

1. It is the responsibility of individual states, under Article 28 of the Chicago Convention, to provide in its territory appropriate airport and air navigation facilities and services to facilitate international air transportation. In providing such facilities and services, certain costs are incurred.
2. In the early days of civil aviation, airports, the ATS provider and the national airline generally belonged to the State and were financed through the national budget. Although some costs have always been recovered from users via charges (e.g. landing fees), for the last two decades, States have intensified efforts to obtain full cost recovery for providing airport and ATS facilities and services.
3. Many States have discharged this commitment directly through a dedicated organisation within the civil services (Civil Aviation Authority or similar). In recent years, this situation has changed further with the creation of autonomous airport and ATS entities which are licensed to provide the relevant services. In most cases, these autonomous entities are publicly owned and generally self-sustaining, with access to private debt capital.
4. Some airports have been fully or partially privatised. Others are currently being considered for privatisation either through divestment to private ownership or through partial privatisation of certain facilities or services at the airport by way of concessions or long-term leases.
5. There are many aspects to the commercialisation of airports and ATS entities apart from user charges, such as safety regulation, capacity and operational matters, etc., but this paper only addresses the user charges issues.

APPENDIX A**PART II - DEFINITION**

6. Throughout this paper the term “commercialisation” refers to the general process of moving away from a state (governmental) organisation and structuring this organisation in such a way that would allow it to operate more like a business. This does not imply that most organisations will complete the process and end up as privately owned companies. Indeed, only a relatively few are likely to do so.

7. A brief outline of the range of organisations and the factors involved in the “commercialisation” process of airports and ATS entities are illustrated below. Either the terms “privatisation”, or “corporatisation”, or “autonomisation” could also have been substituted for “commercialisation”:

Some Airport/ANS Organisations**Degree of Commercialisation**

State Authority (CAA)	0%
Autonomous State Entity	
State-owned Corporation (Crown corporation)	
Concession/Lease (all or part of the facilities)	
Partial Privatisation (e.g. non-aeronautical)	
Not-for-profit (stakeholder owned) Corporation	
Fully Privatised Company (publicly traded shares)	100%

Degree of Commercialisation**Commercialisation factors:**

0% ————— 100%

Ownership:	100% State	100% Public Shares
Accounting Methodology:	Cash accounts	Commercial practices
Capital Financing Options:	State budget	All options
Employee Status:	Civil servants	Corporate
Legal Status:	Government	Private
Entrepreneurialism:	Little	Considerable
Management Reports to:	Political	Board of Directors
Taxation:	Low	As private companies
Management Focus:	Government policies	Profits/Share Value

No matter what organisational form the airport or the ATS entity takes through this process of commercialisation, it remains a natural monopoly. The necessary checks and balances must therefore exist or be strengthened to prevent any possible abuse of this monopoly status. This monopoly power can be abused through unfair pricing practices and through the failure or unwillingness to improve efficiency and reduce costs. Users must therefore be assured that whatever organisational form the airport or the ATS takes, prices and costs are reasonable and equitable.

8. While a number of the issues relating to commercialisation of airports are the same as those relating to the commercialisation of ATS entities, there are some essential differences. It is therefore considered that separate statements on airports and ATS entities commercialisation would make the industry's position clearer, and reduce confusion on what is already a misunderstood subject.

PART III - DISCUSSION

9. The issue of airport and ATS entity commercialisation is currently very much debated. Generally, commercialisation is not a clear step from one organisational form to another, but rather an evolutionary process from a government entity to an autonomous (or corporatised) authority, and in some cases on to a not-for-profit corporation or a private company. There is inconsistency, and sometimes confusion, in the terminology used - autonomisation, commercialisation, and corporatisation are sometimes referred to as privatisation.

10. The initiative to commercialise an airport or an ATS entity normally comes from the owner, the State or local government, in order to resolve chronic problems and deficiencies often related to the difficulties in obtaining the funds necessary to finance airport and ATS infrastructure. Unfortunately, it is sometimes seen as a method for diverting aeronautical revenues to reduce government deficits.

11. It could be expected that commercialisation can bring more efficiencies to the organisation than traditional civil service bodies, and facilitate improvements to be passed on to users. From the users' standpoint, the objective of commercialisation of airports and ATS entities should not be to maximise profits, but rather to achieve optimum capacity at a reasonable price. In other words, users would expect to get value for money through an efficient, business-like management of the facilities and delivery of infrastructure demanded.

12. However, IATA's experience is that in many cases the commercialisation process has resulted in significant increases in airport and ATS entity cost bases. The reasons for such increases include:

- policies towards maximising profits;
- shareholders (or stakeholders) demanding unreasonable rates of return;
- governments diverting profits instead of re-investing them in infrastructure;
- non-observance of internationally recognised (ICAO) principles and practices for setting charges, often due to a poor regulatory regime;
- increases in capital-related and staff-related costs (including transfer of pension liabilities);
- transferred assets being remunerated at current costs or market values rather than at historical, depreciated costs;
- in recognition of the need and associated difficulties in raising the necessary financing, alternative vehicles are becoming prevalent, e.g. build-operate and build-lease schemes in various forms (BT, BOT, BOOT, BLT, etc.), with investors expecting a quick and profitable return on their investments.

This translates into higher user charges and the promised efficiency gains which should offset some of the new costs have not always materialised.

13. In some cases, commercialisation has resulted in users being negated rights (self-handling, accommodation, etc.) granted in bilateral agreements or other diplomatic treaties.

PART IV - COMMERCIALISATION OF AIRPORTS

14. IATA supports:

- the trend towards airports autonomy;
- that management is given the possibility to operate airports as efficiently as possible; and
- that such entities develop the commercial potential of their business.

15. IATA believes that commercialisation of airports is not always beneficial, in particular where the objective is to maximise profits. However, as the trend towards airport commercialisation continues, it is not a question of whether one agrees with commercialisation or not, but rather under what conditions commercialisation should be accepted. IATA considers that this is a complicated and delicate issue, and urges States considering the commercialisation of airports to be extremely cautious in setting the necessary laws, regulations, policies and contracts for the commercialised entities.

16. Therefore, it should be ensured that the following prerequisites are fulfilled:

16.1 Full involvement of users from the beginning to the end of the commercialisation evaluation process is vital to ensure appropriate and adequate consultation. The airport's starting cost-base and the charging scheme should be agreed to in consultation with users. Airport charges should be:

- determined on the basis of transparent, fair and reasonable costs;
- in conformity with international agreements and obligations of the particular State;
- in line with ICAO's policies and principles on user charges; and
- subject to a regulatory process (ideally through an independent regulatory body).

16.2 Charges should be fairly allocated between different categories of users, without discrimination. If a charging authority decides not to impose charges, or to apply preferential charges to certain categories of users, the corresponding under-recovery should not be borne by the other users.

16.3 The principle of gradualism should be observed by the charging authority in the approach towards full cost recovery or in any significant change in the charging scheme (e.g. cost allocation, or charging formula).

16.4 If facilities are to be sold, the selling price should not exceed the depreciated historical cost of assets. Proceeds from the sale should be used to eliminate any existing debt for the airport.

16.5 The costs incurred in the transition from one status to the other should not be passed on to the users.

16.6 Consultation with users should be mandatory. Full transparency of revenues and costs must always be preserved, including the provision of traffic figures, profit/loss statements, balance sheet and capital expenditure programme information, etc. The commercialised airport should regularly prepare, adopt and publish a medium term (i.e. 3-5 years) ongoing development plan, including planned investments and the impact these will have on the cost-base and charges levels.

16.7 The "single-till" principle should be applied. All aeronautical and non-aeronautical revenues accruing from the operations of the airport should benefit the airport and its users. Revenue diversion from airports and cross-subsidisation with other airports is to be avoided; airport charges should be site-specific and the revenues generated from operations should be ploughed back into the airport. Airport charges should not to be burdened with central government overheads.

16.8 Airports should not seek to raise all capital required for future expansion through current charges. Future capital infrastructure should be funded without forward financing. Airports should seek external financing on a competitive basis for projects. Depreciation over the full life of the assets, and capital costs, may be recovered through charges, once facilities are operational.

16.9 Land is an asset which does not have a limited life. Therefore, the land used by an airport should not be taken into account in calculating return on capital or depreciation. Land should be treated as an investment by the airport owner which does not yield a return, but may be disposed of (if the airport closes) at a significant capital gain. Any such capital gain should be applied toward the capital cost of the replacement facility.

16.10 An airport's rate of return should be capped through economic regulation based on the fact that airport entities are relatively low-risk, monopolistic providers of essential facilities and services, with a reasonable assurance of a continuing demand for their services. The rate of return of commercialised airports should take into consideration the cost of capital and the rates of return earned by comparable, low financial risk businesses or industries which operate in a monopolistic environment. As a guide, a return on investment similar to the prevailing government bond rate - calculated on return on capital employed (ROCE) - would be reasonable.

16.11 In the event of a dispute regarding user charges, the users should have the right to appeal to the regulatory authority and/or recourse to an arbitration process.

PART V - COMMERCIALISATION OF ATS ENTITIES

17. IATA's UCP supports:

- the trend towards ATS entities' autonomy; and
- that management is given the possibility to operate ATS entities as efficiently as possible.

18. IATA believes that commercialisation of ATS entities is not always beneficial, in particular where the objective is to maximise profits. However, as the trend towards ATS commercialisation will continue, it is not a question of whether one agrees with commercialisation or not, but rather under what conditions should commercialisation be accepted. IATA considers that this is a complicated and delicate issue, and urges states considering the commercialisation of ATS entities to be extremely cautious in setting the necessary laws, regulations, policies and contracts for the commercialised entities.

19. Therefore, it should be ensured that the following prerequisites are fulfilled:

19.1 Full involvement of users from the beginning to the end of the commercialisation evaluation process is vital to ensure appropriate and adequate consultation. The ATS's entity starting cost-base and the charging scheme should be agreed to in consultation with users. Charges for air navigation facilities and services should be:

- determined on the basis of transparent, fair and reasonable costs;
- in line with international obligations of the particular State;
- compatible with ICAO's principles on user charges; and
- subject to a regulatory process (ideally through an independent regulatory body).

19.2 Charges should be fairly allocated between different categories of users, without discrimination. If a charging authority decides not to impose charges, or to apply preferential charges to certain categories of users, the corresponding under-recovery should not be borne by the other users.

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19.3 The principle of gradualism should be observed by the charging authority in the approach towards full cost recovery or in any significant change in the charging scheme (e.g. cost allocation, or charging formula).

19.4 If facilities are to be sold, the selling price should not exceed the depreciated historical cost of assets. Proceeds from the sale should be used to eliminate any existing debt for the ATS entity.

19.5 The costs incurred in the transition from one status to the other should not be passed on to the users.

19.6 A consultation process with the users is mandatory. Full transparency of revenues and costs must always be preserved, including provision of traffic data, profit/loss statements, balance sheet and capital expenditure programme information, etc. The commercialised ATS entity should regularly prepare, adopt and publish a medium term (i.e. 3-5 years) ongoing development plan, including planned investments and the impact these will have on the cost-base and charges levels.

19.7 All revenues accruing from the operations of the ATS entity should benefit the entity and its users. There should be no revenue diversion. Air navigation charges should not to be burdened with central government overheads.

19.8 ATS entities should not seek to raise all capital required for future expansion through current charges. Future capital infrastructure should be funded without forward financing. ATS entities should seek external financing on a competitive basis for projects. Depreciation over the full life of the assets, and capital costs, may be recovered through charges, once facilities are operational.

19.9 In almost all cases, ATS entities are only involved in direct air navigation activities (en route/overflight, terminal navigation, and aerodrome control services) and concentrate on operational matters. Commercialised ATS entities should therefore have a non-profit status. Only full, economic costs (including cost of capital) should be recovered. However, if a return on investment is charged, this should remain limited and should take into account the low-risk, monopolistic nature of ATS's activity. This could be ensured through the adoption of an appropriate regulated monopoly status.

19.10 In the event of a dispute regarding user charges, the users should have the right to appeal to the regulatory authority and/or recourse to an arbitration process.