Airport Privatization: Navigate Carefully

Modules 30 and 31

Prof. Paul S Dempsey, McGill University

Istanbul Technical University
Air Transportation Management, M.Sc. Programme
Air Law, Regulation and Compliance Management
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Professor Dr. Paul Stephen Dempsey
Director, Institute of Air & Space Law
McGill University


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Privatization

Privatization is a megatrend that has swept through:

- Airlines
- Airports
- Air Navigation Service Providers

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Margaret Thatcher: Queen of Privatization

Steel mills
Telephone services
Power plants
Automobile manufacturing
Coal Mines
Railroads

British Airways 1987
British Airports Authority 1987

Many countries have followed suit, including:

- Argentina
- Australia
- Austria
- Germany
- Hungary
- Italy
- Mexico
- The Netherlands
- The Philippines
- South Africa

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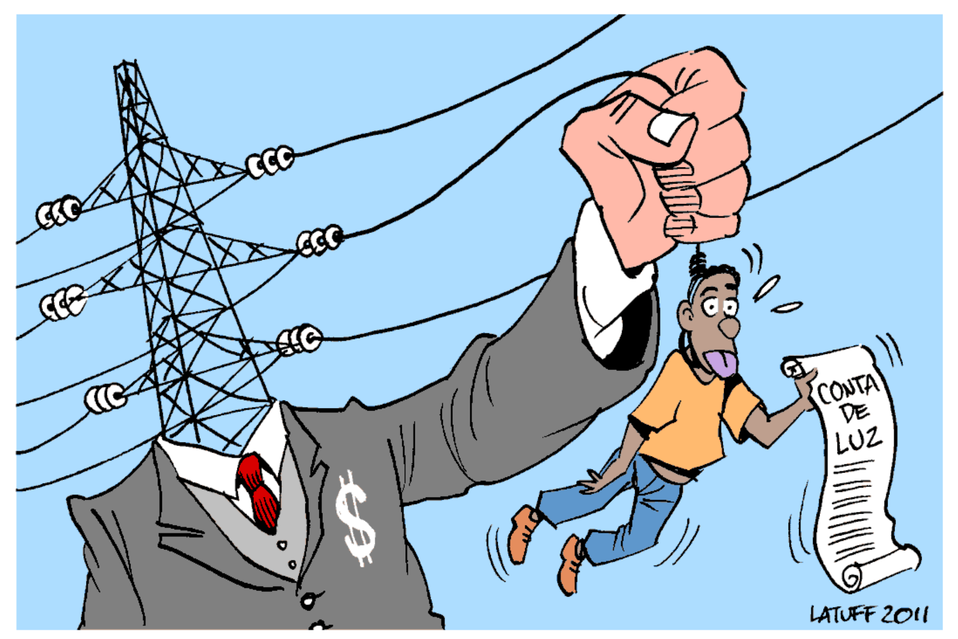
Privatization has swept through many industries:

- Malaysia sold its National Lottery,
- Buenos Aires sold its zoo,
- Czechoslovakia sold the guest house of the Communist Party, and
- Austria and Nigeria sold their telecommunications companies
- Some jurisdictions in the US have privatized prisons



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Welcome to
"NAME FOR SALE"
Stadium

What is Privatization?

- The sale or lease of a controlling interest in a governmentally-owned enterprise.
- The government can also sell a minority share, while retaining control.
- Sometimes, it is corporatization rather than privatization, whereby the State holds the shares but the enterprise behaves like a private firm.

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Organizational Structures

Organizations *Degree of Commercialization*

0%

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

100%

Corporatized Organizations can be

- For-Profit, or
- Non For-Profit

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Motivations:

Reduce Inefficiency
Eliminate civil service regulations
Eliminate government procurement policies
Enhance access to capital markets
Stimulate innovation and responsiveness to market needs
Liquidate public investment to pay for the social welfare needs of an aging population

Problems of Traditional Governmental Institutions

- Governmental institutions have had difficulty in keeping pace with the capital needs to accommodate rapidly growing traffic demands and maintain high levels of safety in aviation;
- Governmental institutions usually are restricted in their ability to borrow money in capital markets to finance infrastructure improvements.
- Governmental institutions are subject to governmental procurement and decisional policies and practices, imposing bureaucratic efficiency impediments; and
- Governmental institutions are subject to civil service labor costs and staffing levels undisciplined by market forces.

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Advantages of Privatization

- It stops loss-making public sector enterprises from adding to government debts;
- It depoliticizes public sector enterprises, removes governmental pressures for over-manning and the sub-optimal use of resources;
- It gives new owners a strong incentive to turn around failing public sector enterprises into successful businesses;
- It gives new businesses access to investment capital that government cannot provide;
- It raises more money for government through taxing former public sector enterprises;
- Government can raise funds to pay off other debts fast because of relieve from financial burden of the public sector enterprises being privatized;
- Profit incentive may deliver better outcomes, by for example, staff down-sizing to increase efficiency, enhanced staff motivation, and cheaper prices to be competitive.
- If floated on the stock exchange at a good price, investors can earn attractive returns on investment through increased business revenue, efficiency and profitability.
- It removes government's monopolistic status and inability to be responsive to citizens' needs, resulting in inefficient, one-size-fits-all services.
- Costs may be reduced at the long run.
- Public sector workers are not necessarily harmed by privatization. Displaced workers can be hired by contractors or transferred to other government positions.

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Source: Titiloye Oyebanji
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THE PROS AND CONS OF
PRIVATIZATION

Disadvantages of Privatization

- Government no longer receives profits (if it was previously profitable), therefore, the revenue accruing to the government from public sector enterprises is reduced.
- Privatization may decrease safety or service due to greater profit incentives.
- Downsizing could result in increased unemployment.
- Prices may rise if the service was previously subsidized by the government.
- Privatization alone may not lead to better quality or cost reduction in public service delivery.
- The standard economic measures used to make privatization decisions fail to accurately assess the real costs and benefits of care.
- A major concern to the organized labour is the impact of privatization on job security and employment. Workers layoffs, erosion of wages and benefits, and decreased levels of union membership could result.
- The privatized company will no longer operate in the public interest. While a state-owned company primarily serves the citizens of the state, the primary goal of a privately operated company is to make profit. It may make these profits at the expense of its customers without serving them properly. For example, it may choose the market which is most profitable to operate in and leave less wealthy customers without a service.

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>> PRIVATIZED WATER TREATMENT PLANT SAVES $1 MILLION ANNUALLY
>> AIRPORT TAXI MONOPOLY TAKES PASSENGERS FOR A RIDE
>> "LIVING WAGE" LAWS KILL PRIVATIZATION
>> TURNING AWAY FROM PRIVATIZATION
>> SHOULD STATE HISTORY MAGAZINE BECOME A THING OF THE PAST?

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Many State-owned airlines have been fully privatized.

- Korean Airlines – 1960s
- Air Canada – 1986
- British Airways – 1986
- Japan Airlines - 1993
- Qantas - 1995
- Lufthansa - 1997
- KLM – sold to Air France
- Austrian – sold to Lufthansa
- Iberia – sold to British Airways

And partial privatization of:
Singapore Airlines, Malaysian Airlines, Philippine Airlines

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Air Navigation Service Providers

There are three forms of classical ANS providers:

- Individual State
- Joint States (e.g. EUROCONTROL)
- Non-Governmental Entity on behalf of a State/States

Examples of (fully or partially) corporatized ANSPs

- Skyguide (Switzerland)
- NAVCANADA
- Deutsche Flugsicherung GmbH (DFS)
- Airservices Australia
- Airways Corporation of New Zealand
- Luchtverkeersleiding Nederland
- Irish Aviation Authority

Lufthansa poster from the 1930s.

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Privatized ANSP: United Kingdom

- UK National Air Traffic Services, Ltd. (NATS) is a public/private partnership
- - 49% State-owned (Govt retains a Golden Share)

  - 51% private-owned (42% by the Airline Group, 4% by BAA

  and 5% by UK NATS employees).

Airport Privatization

- The United Kingdom became the first major entrant into the land of airport privatization, with its sale of British Airports Authority [BAA] which controlled seven major airports: London's Heathrow, Gatwick, Stansted, and Southhampton and three airports in Scotland in 1987, in a $2.5 billion public share offering.
- The government continued to provide oversight of airline access, airport charges, safety, security and environmental protection, and veto power over airport investment or divestiture.

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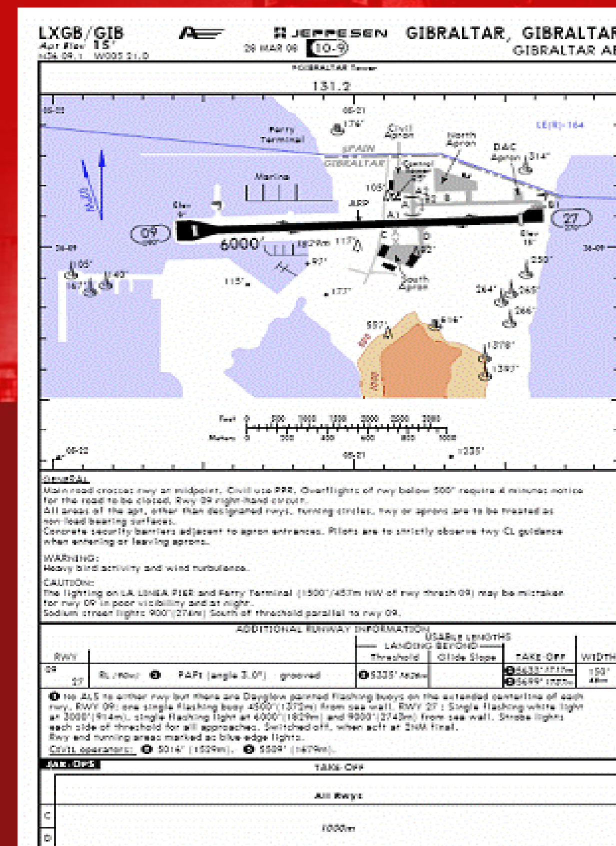
Privatized/Corporatized Airports

- Malaysian Airports Berhad
- Most former federal airports in Australia
- Vienna Airport
- New Zealand Wellington and Auckland
- Major Canadian Airports, under the Canada Airports Policy of 1994, with high rents charged for land retained by Crown land.



Advantages of NGOs

- •Typically, they are financially self-sufficient, weaned from government subsidies; not a burden on the federal treasury;
- •They are better able to raise capital in the market, and thereby meet growing capacity needs;
- •They may be more efficient, and more capable of reducing costs for users, and subsidy requirements from governments;
- •They can have governance structures allowing users greater access and input on decisionmaking;and
- •They sometimes move to a more equitable user-charge approach to cost allocation.

IATA's Concerns About Corporatization

Commercialization may have a negative side, in particular when the principal objective is to maximize profits. No matter what organizational form an airport or ANSP assumes through the process of commercialization, 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 organizations, often with the complicity of the governments concerned.

IATA's experience is that, in many cases, commercialization 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 materialized.

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ICAO Recommendations

ICAO recommended several of the following requirements for the ANSP:

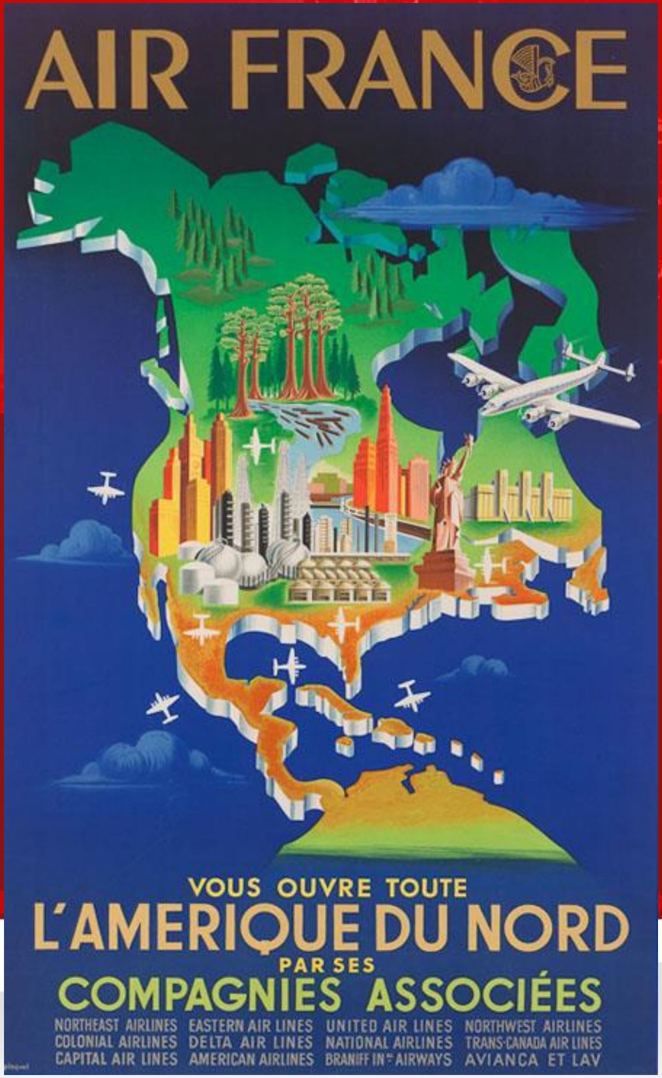
(1) the organization should be subject to the State obligations under the Chicago Convention;

(2) its Charter should provide for appointment of a Board of Directors;

(3) the organization should be self-financing, obtain funds from commercial markets, and attempt to achieve a financial return on investment;

(4) it should apply commercial accounting standards and practices; and

(5) it should be subject to normal business taxes.



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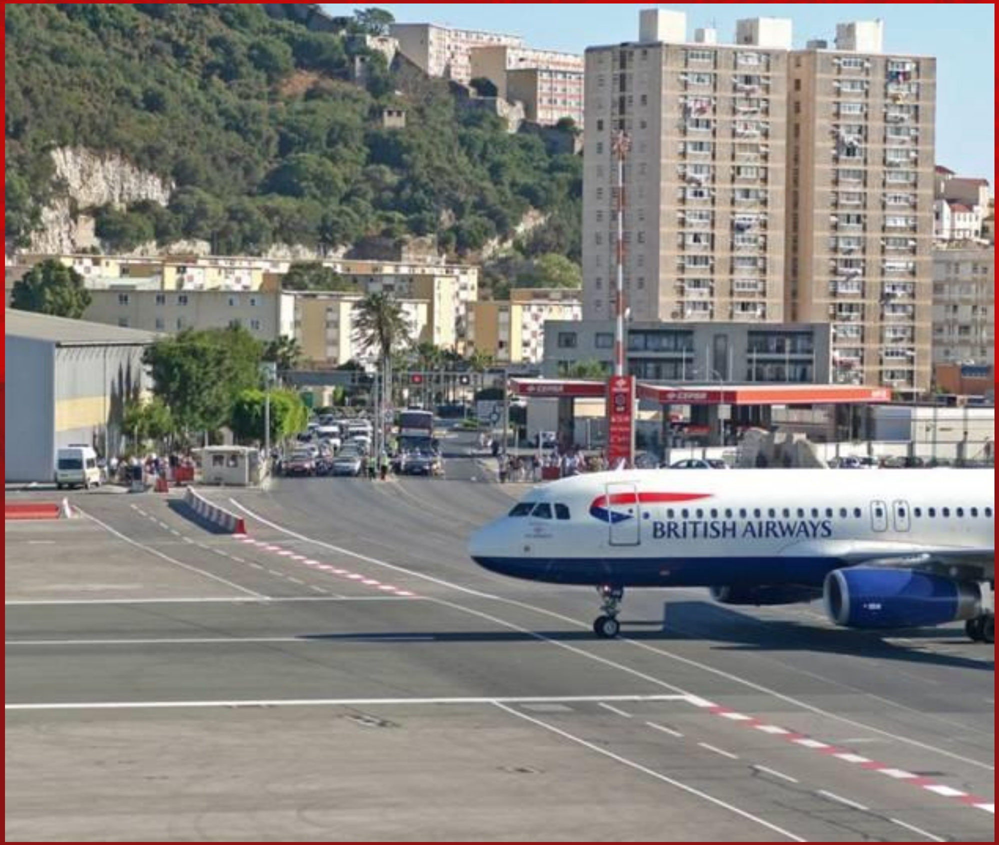
ICAO Position on Airport Privatization



- States cannot delegate their obligations "to ensure safety, security, efficiency and economics of airport services to a private entity."
- ICAO neither supports nor opposes airport privatization.
- ICAO recommends the establishment of autonomous authorities for the management and operation of airports, with operational and financial independence.
- ICAO recommends the institutional strengthening of the aeronautical authority prior to privatization.

ICAO Recommendations

- ICAO has expressed a general principle in favor of assessing fees in a manner in which "users shall ultimately bear their full and fair share of the cost of providing the airport."
- Cost should include the full economic cost, including depreciation and interest, but allowing for all revenue, aeronautical and non-aeronautical. In setting the fees, airlines are not to be charged for facilities and services they do not use, or otherwise not properly allocable to them.
- Landing charges should be based on aircraft maximum permissible take-off weight. ICAO has also approved a cost-based formula based on separate en-route/in-flight and terminal/approach charges, adjusted for aircraft weight and distance flown. Others have suggested additional factors should be considered, such as the time of day, level of airport congestion, and airspace utilized.
- Two types of charges -- security charges and noise-related charges -- should be designed to recover no more than the relevant costs of providing security and noise-abatement equipment and services. In contrast, other charges may produce sufficient revenue to exceed direct and indirect costs by a reasonable margin.
- Of course, airport and air navigation fees and charges may not discriminate between domestic and foreign carriers.

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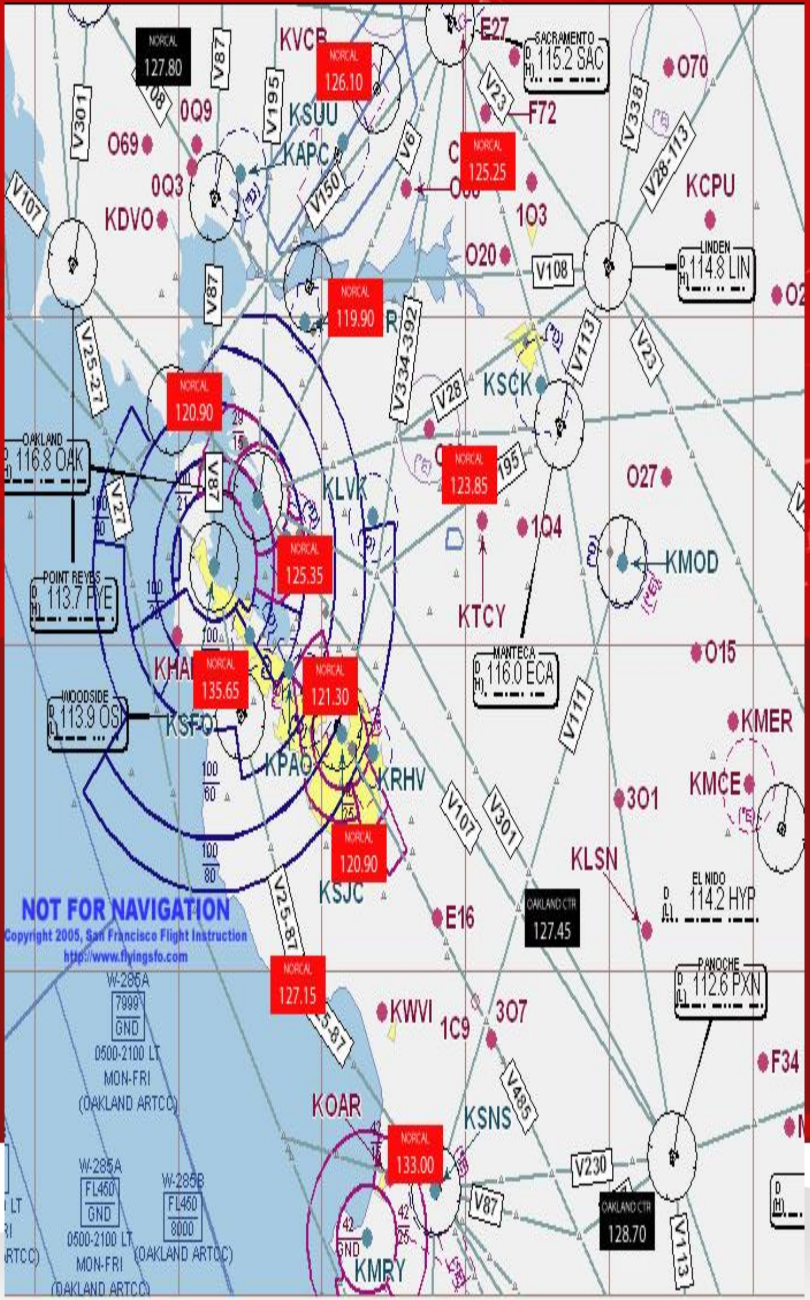
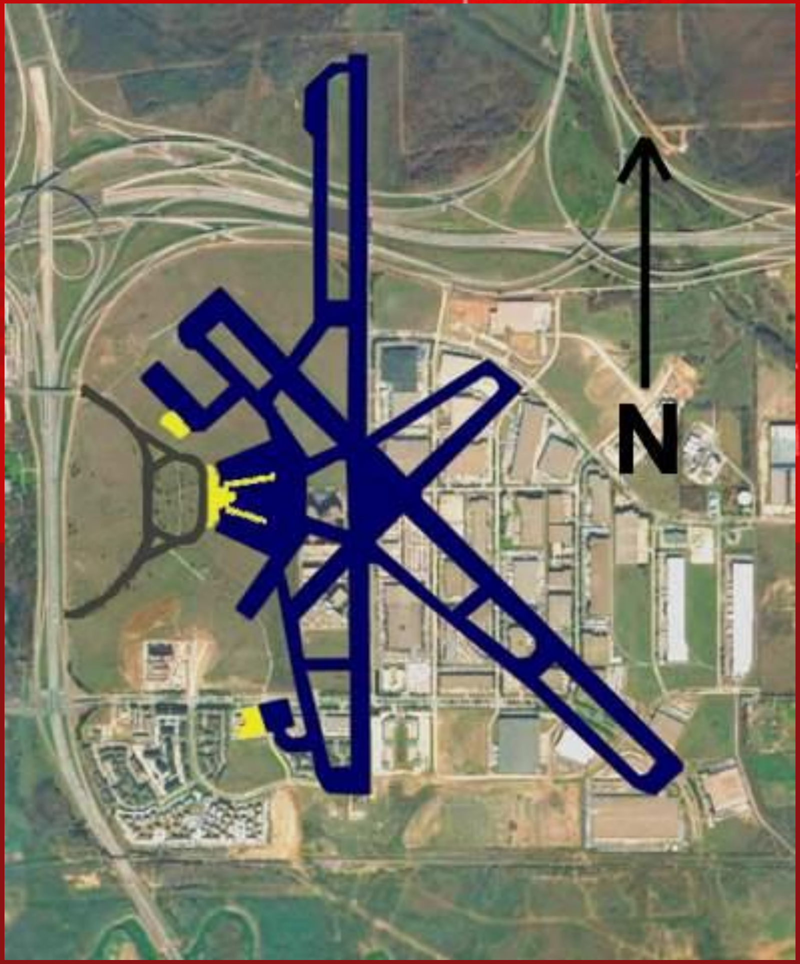
Full Privatization Is Not Desirable for Activities That:

1. Are essential for the community's welfare; and
2. Have the potential to result in monopolistic exploitation of the public.

Airports and air navigation services have these characteristics.



Access to private debt or equity requires profitability; private investors will not invest without a profit. This cost must be passed through to users.



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Regulation

- Governments which have privatized airports have adopted one of four regulatory approaches

1. Rate of return regulation (e.g., Spain, France, Greece and the Netherlands);
2. Rate of return price caps (e.g., the United Kingdom);
3. Aeronautical price caps (e.g., Australia, Austria, Denmark and Mexico); and
4. Limited governmental oversight (e.g., Canada, New Zealand, and the United States).

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Duties of the Regulator

- prevent overcharging and other monopolistic practices;
- ensure transparency as well as the availability and presentation of all financial data required to determine the basis for charges;
- assess efficiency and efficacy in the operations of providers;
- review standards and quality of services providers; and
- monitor investments planned in relations to traffic forecast.

STRENGTHS AND WEAKNESSES OF AIRPORT REGULATORY APPROACHES

	Rate of Return	Rate of Return Price Cap	Aeronautical Price Cap	Government Oversight
Predictable Aeronautical Prices	Moderate	Moderate	Strong	Weak
Predictable Airport Profits	Strong	Moderate	Weak	Weak
Improving Airport Operating Efficiency	Weak	Moderate	Strong	Weak
Ability to Attract Investment Capital	Strong	Moderate	Moderate	Strong

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Build-Operate-Transfer (BOT) Airports

Another private sector funding mechanism is the Build-Operate-Transfer [BOT] approach, whereby the contractor commits to financing, construction, operations and maintenance for a specified number of years (known as the "free use period"), after which it transfers the facility over to the government. Examples:

- Athens Spata International Airport (25-year concession)
- Berlin-Brandenburg Airport

Upon privatization as a for-profit corporation, BAA had a regulatory cap on charges the airport could impose on airlines tied to the UK consumer price index.


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