

Airport Privatization: False Panacea?

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Abstract

This paper describes the recent history of airport privatization, presents the arguments for and against airport privatization, and assesses the prospects for airport privatization in the United States. The traditional role of government in aviation was challenged during the 1970s with passage of the Airline Deregulation Act, which terminated 40 years of federal economic regulation of commercial airlines. Many economists and policy analysts have argued that airline deregulation did not go far enough, and that the federal government should have also introduced competition into the airport industry. Calls for greater reliance on the private sector in aviation infrastructure development gained momentum in the 1980s that has continued into the 1990s. The authors conclude that, given the complex goals that public administrators must balance, coupled with the risks involved in total privatization, the prudent course of action is to seek less extreme solutions for the problems facing airports today. In this regard, privatization models that have combined elements of the market approach with a public administration approach would seem to represent the models worth replicating.

Introduction

The concept of privatization is as old as capitalism itself, with intellectual roots in the free market theories of Adam Smith. Historically, government has played a limited role in America, an effect of its liberal, capitalist traditions. However, exceptions have been made to this general rule for activities considered too important to be subjected to market controls or for activities that markets could not, or would not, undertake. The ownership and operation of airports is one such activity. The role of aviation has been considered to be so vital to society, in general, and to commerce, in particular, that it has always been characterized by high levels of government involvement. Moreover, the substantial capital costs associated with land acquisition and construction of airport facilities, coupled with the long payback period, have resulted in government ownership of virtually all of the nation's largest airports as well as many small and medium-size airports. This paper examines the recent history of airport privatization, presents the arguments for and against privatization, and assesses the prospects for privatization of airports in the United States from the public administration perspective.

The traditional role of government in aviation was challenged during the 1970s with passage of the Airline Deregulation Act, which terminated 40 years of federal economic regulation of commercial airlines. Many free market economists have argued that airline deregulation did not go far enough and that the government should have introduced competition into the airport industry as well. During the 1980s, and into the 1990s, calls for greater reliance on the private sector in the development and operation

aviation infrastructure gained momentum. The support of the Reagan and Bush administrations provided impetus to the movement toward airport privatization (Gesell, 1994). The most radical advocates of the privatization movement call for the outright sale of publicly owned airports to private enterprises. Other supporters of airport privatization propose less extreme measures such as long term leases and/or contracting out to private firms for the provision of particular airport services or functions.

The sale of publicly owned enterprises has occurred frequently in Western Europe, the former planned economies of Eastern Europe and the former Soviet Union, and in the developing world. The most notable sale of state-owned airports occurred in 1987 when the British Airports Authority (BAA), which consisted of seven United Kingdom airports, was sold to the public (Gomez-Ibanez and Meyer, 1993). Airport privatization on this scale has not yet been attempted in the United States. However, many proposals to sell publicly owned airports have surfaced in recent years. For example, local officials have proposed to sell or lease Los Angeles International Airport, Albany County Airport, and Peoria County Airport (Poole and Snyder, 1992). The FAA, citing federal grant agreements that prohibit the diversion of airport revenues, has vetoed these plans so far on the ground that the transfer of airport revenues to off-airport uses is illegal.

The Privatization Debate

The main argument for privatization is efficiency. It is widely believed that the private sector is inherently more efficient than the public sector because private enterprises are better equipped and more motivated than their public sector counterparts to be cost conscious and customer oriented (Gomez-Ibanez and Meyer, 1993). Privatization advocates argue that efficiency translates into lower costs to the public because private firms have a more flexible procurement process. Advocates of privatization also suggest that private firms would not be as constrained as public organizations with respect to the myriad of government requirements that often delay planning and construction schedules, mandate detailed contracting procedures, and increase paperwork. Purchasing managers in a privatized airport would not be bound by the bureaucratic procurement system that exists in the United States. However, it is important to note that the public procurement system was designed to encourage equity and to prevent corruption and favoritism, with little concern for efficiency.

According to privatization proponents, efficiency would also be enhanced because private operators have more flexibility in personnel management than public administrators. Private managers can hire and fire more easily and are not constrained by civil service pay scales or other administrative rules and procedures (AAAE/ARDF, 1992). Advocates also argue for privatization on the ground that the private sector can build facilities cheaper and faster than government. Indeed, the Alliance Airport in Ft. Worth, which was planned and completed in less than two years, provides strong evidence to support this claim.

The 1987 BAA privatization experiment, which resulted in the creation of the newly privatized BAA, is perhaps the major success in airport

privatization. BAA has demonstrated the ability to earn profits, which grew 49% to 285 million pounds in 1993 (Coleman, 1994). An examination of its revenue streams reveals that a significant proportion of its operating income comes from innovative retailing and leisure activities rather than traditional airport activities such as landing fees. Privatization appears to have transformed the BAA from an inefficient monopoly into a lean, efficient, and customer-oriented private company that is earning substantial profits. A few smaller scale airport privatization experiments have met with success in other areas of the world. For example, Mexico City's new international terminal and Toronto's Terminal 3 at Pearson International Airport were both constructed and are owned and operated by private consortiums. The BAA and these other smaller cases provide evidence to support the efficiency case.

However, critics of airport privatization question the degree to which privatization enhances efficiency. They claim that privatizing airports does little to increase economic efficiency since most economic activities undertaken at public airports have always been provided by commercial airlines and other private vendors. Furthermore, some of the efficiency gains claimed for privatization of the BAA, such as the expansion of on-airport retailing activities, may be largely due to transfers from off-airport businesses. A strong case can be made that many airport gains in such activities as airport restaurants, hotels, and retailing may come at the expense of off-airport enterprises, rather than representing any net gain to society (Gomez-Ibanez & Meyer, 1993).

Moreover, any efficiency advantages that privatized airports might have over public airports are often thwarted by political realities. For example, political constraints have limited the privatized BAA from implementing pricing and other incentives to promote the more efficient use of existing airfield and terminal investments. Prior to privatization, the BAA stated that aviation charges would be set to cover long-run marginal costs; that is, the incremental costs of landing an additional aircraft or processing an additional passenger. However, in setting landing fees to achieve economic efficiency, the BAA would have had to impose large increases on airlines. Imposing such increases has proven to be politically untenable. Thus, while there is evidence that privatization offers the potential for increased efficiency, the experience of the BAA indicates that much of what is advertised as gains in efficiency is actually a result of transfers from off-airport businesses to private enterprises located on the airport (Gomez-Ibanez & Meyer, 1993).

A second argument posited by advocates of privatization is that it taps an alternative new source of funds necessary to finance airport infrastructure for governments in fiscal distress. Some experts suggest that there is a pool of equity investors with a willingness to accept higher risks than the typical municipal bond investor and that this pool of equity investors can be a ready source of capital for airport infrastructure projects (AAAE/ARDF, 1992).

This argument is open to debate. Public entities in the United States are able to secure investment capital by issuing tax-exempt securities in the municipal bond market. In the case of airports, the standard practice

is to issue revenue bonds that are secured by the stream of revenues that flow from the enterprise. An airport's size, as measured by passenger enplanements, volume of cargo, or general aviation activity has historically been an important determinant of its financial performance. In the case of publicly owned airports in the United States, only large and medium sized airports that are generally in good to excellent financial condition are attractive candidates for privatization. For example, in 1993 Atlanta Hartsfield International Airport generated \$39.7 million in net income (Atlanta, 1993). Most large and medium size commercial airports in the United States are able to obtain financing at a lower cost of capital because of their tax exempt status. On the other hand, the income of the majority of small commercial service airports and for small general aviation airports is inadequate to support the issuance of revenue-backed airport bonds. Indeed, many of these airports fail to cover even their operating costs. Therefore, the argument that privatization leads to increased investment in airport infrastructure is limited.

Private investors are not the only interests that support privatization. Many cash-strapped local units of government in the United States that own and operate airports support privatization because of the desire to receive the windfall of cash that would be generated by a sale. The sale of BAA raised \$2.5 billion for the British treasury. Robert Poole of the Reason Foundation estimates that the net present value of the sale or long-term lease of Los Angeles International (LAX) would earn the city of Los Angeles approximately \$1 billion (Poole and Snyder, 1992). That privatization provides a source of much needed cash infusions to local units of government is a point that has validity. The desire to capture the proceeds from the sale of an existing public airport has been a strong factor for motivating many privatization proposals. Local units of government that own and operate airports view these facilities as one of their largest capital investments from which they are not earning any direct return. According to Clifton Moore, Director of Airports for the City of Los Angeles, "the city of Los Angeles never has received five cents return on the work and investment that it has made" (Reason, 1990). Moore's reference is to the legal obligation on the part of the recipients of federal airport grants that all airport revenues be used for airport purposes. These assurances are based on the fear that if municipal governments are allowed to take the proceeds from airports to finance other programs, then airport needs might be neglected. Municipal officials might delay expansion of needed airport capacity because of other pressing needs. These conditions attached to federal airport grants present a legal obstacle that has prevented outright privatization from occurring in the United States to date.

The Public Administration Perspective

There are other weighty arguments for taking a cautious approach to airport privatization. Unlike private managers, who have the profit motive as their primary objective, public administrators are charged with serving the public interest. Although defining the public interest is problematic, it encompasses a range of values and objectives broader than just the pursuit of profit. History is replete with examples of robber barons stripping viable enterprises of their assets through complex financial maneuvers and

the use of debt instruments. The experience of the 1980s with leveraged buy-outs demonstrates the dangers of leverage. The possibility of unscrupulous operators controlling one or more of our nation's airports is disturbing. The prospect of a major hub airport filing for bankruptcy protection is cause for alarm. If private firms serve the purpose of pursuing their own private economic gain through vigorous competitive behavior in the marketplace, the government's role is to protect the public interest from damage that the private sector might inflict on society at large (Hart, 1984).

From its early years, aviation has been rightfully considered a "public good." Public goods are characterized by two properties: it is neither feasible nor desirable to ration their use (i.e., to exclude any individual). Because of the monopolistic nature of airports and the positive and negative externalities associated with air transportation, market approaches to airports have often been viewed as inappropriate. Most commercial service airports have long been considered to be natural monopolies. A natural monopoly is an industry in which the most efficient form of organization is a single entity. However, to prevent abuses associated with monopolies, public ownership or government regulation is required. While the risks of monopoly with respect to airports have been challenged in recent years (Snyder and Poole, 1992; Gomez-Ibanez and Meyer, 1992), it remains a concern among many policy analysts and public administrators involved in aviation issues.

Arguments in favor of privatization can also be misleading. While often presented as a panacea, the fact is that relatively few airports in the United States are attractive candidates for privatization. The United States presently has approximately 17,500 landing sites, of which over 12,000 are privately-owned general aviation facilities, leaving only 5,400 publicly-owned facilities. (AOPA, 1993). Together, these two groups of airfields and other landing sites form a nationwide network for conducting commerce and other vital services that can be best supplied by air. At the core of this network are the 3,285 airports subject to federal planning criteria as outlined in the National Plan of Integrated Airport System. Only 486 of these airports operate control towers, which makes service by commercial airlines more likely. Of the commercial service airports, the vast majority of passengers are processed by the top 50 airports, which accounted for well over 80% of the passengers in 1992. Only airports that have a sufficient number of passengers, cargo, or general aviation traffic warrant the interest of private investors. In effect, then, privatization represents a plan to sell off the "crown jewels" of the airport system. Since airports in the United States truly constitute a system, the viability of the system would be threatened if the centerpieces were removed.

Conclusion

The purpose of this paper has been to introduce the concept of airport privatization and to present a balanced view of the arguments for and against privatization. Airports in the United States represent the full range of the airport ownership continuum, from complete government ownership and operation to full private ownership and operation, with a range of mixed arrangements in between. The custom of publicly owned

airports entering into leases with private management firms to operate an airport, or contracting out for selected services is well established in the United States. However, total privatization, defined as the outright sale of a publicly-owned airport to a private enterprise, continues to generate considerable opposition. This opposition is well founded in that the arguments for privatization are sometimes overstated. More fundamentally, there are formidable arguments against privatization that arise from the understanding that institutions that serve the public should be organized in a fundamentally different way than private organizations.

The goals of private sector enterprises are easy to identify: profitability, growth, and market share. Public organizations, on the other hand, have more complex missions in their obligation to protect the public interest. Thus, managers of public organizations, unlike CEOs of private firms, are constantly balancing efficiency and productivity goals with goals of equity and equal opportunity. Given the complex goals that public enterprises must balance and the dangers involved in total privatization, the prudent course of action is to seek less radical solutions for the problems facing airports today. In this regard, the systems that have attempted to combine elements of the market approach with a public administration approach would seem to represent the models worth replicating.

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