

# IMPROVING THE GOVERNANCE OF AIRPORT AUTHORITIES

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*Although the privatization of Canada's airports to local airport authorities (LAAs) has generally worked well, some fine-tuning is in order. There is no formal means for ensuring that major decisions by LAA managements, with their purely local and regional accountabilities, do not have negative consequences for the national system of air transportation. There is currently no requirement that the costs of operation be allocated fairly across the principal groups of airport users. And there is pressing need for a close look at the airports' heavy reliance on airport improvement fees.*

*D'une façon générale, la privatisation des aéroports canadiens par cession à des administrations locales a donné jusqu'ici de bons résultats; mais certaines mises au point s'imposent. Comme ces administrations ne sont responsables qu'à des instances locales ou régionales, le gouvernement n'a aucun moyen de s'assurer que leurs décisions majeures n'entraînent pas de conséquences fâcheuses pour le système pancanadien de transport aérien. Actuellement, par exemple, rien n'exige que les coûts d'exploitation des aéroports soient équitablement répartis entre les principaux groupes d'utilisateurs. Et il devient urgent de scruter la trop grande dépendance des administrations locales face aux redevances destinées à l'amélioration des aéroports.*

This paper argues that Canada's approach to the commercialization of its major airports, while a great success in most respects, has important deficiencies from the standpoint of governance. It is evident that the Government, in its eagerness to create fully independent, commercially viable airport operators:

- left them unduly free to act as they saw fit, without offering substantial, documented justification for their decisions;
- gave users insufficient protection against potential abuses of market power; and
- gave itself insufficient powers to protect important national interests that might be undervalued by facility operators focused on their commercial self-interest, seen in a purely local and perhaps regional context.

These and other weaknesses may be remedied through the current effort by Transport Canada (TC) to determine an appropriate response to the deficiencies uncovered by a review, in 1998/99, of the first four major airport transfers—to new local airport authorities in Montreal, Calgary, Edmonton and Vancouver. If so, similar improvements may be made to the governance of Canada's other com-

mercialized transport infrastructure monopolies, including the ports and the air navigation system. More fundamental fixes may be needed in the terms of the transfer of the many medium-sized and smaller airports that have also been transferred to local control. The human and financial resources of those airports are likely not sufficient to maintain adequate levels of service in the long term.

The commercialization of Canada's airports and other transport infrastructure, which started in the early 1990s, was driven by several key circumstances, beliefs and observations. One primary factor, undoubtedly, was a need for major expenditure reductions, first accepted in the mid-eighties. When reducing the deficit became a top national priority, the government could no longer finance the major capital expenditures needed to replace, modernize and expand the existing transport infrastructure, or afford the many direct and indirect operating subsidies for transport infrastructure services already provided or being sought.

Secondly, there was a belief that many of TC's existing operations were inefficient, either because the plant was too large (often having been built, at least to some degree,

for political rather than operational reasons) and/or because reducing the facilities and staff to the extent required for greater efficiency was too often very difficult politically.

Thirdly, there was a belief that generating the necessary additional revenues through higher TC user charges would be politically impossible, and that independent operators would typically be much better than TC in stimulating additional commercial revenues.

Finally, there was a recognition that TC was inherently less responsive to user demands at a particular facility than independent, locally-based operators would be. TC's national mandate required it to treat everyone in the same way—and thus not to say “yes” to anyone unless it were prepared to say “yes” to everyone with the same request.

The last three considerations did not add up to a broad condemnation of the competence of TC's management. Instead, informed observers recognized that the weaknesses of the Department's operations were inherent in fundamental political imperatives, among which greater efficiency and higher revenues did not normally come first. Independent operators, not facing those constraints, did not have to be miracle workers to produce lower costs, higher revenues and greater responsiveness to users and particular communities.

Because of the breadth of the drive to devolve and commercialize TC's operations, in the wide variety of circumstances involved, the components of the initiative did not fit into a neat, consistent pattern. In fact, the approach evolved considerably as lessons were learned from earlier initiatives. Still, despite these evolutionary changes, all of the initiatives had important similarities. They stemmed, fundamentally, from three premises:

- TC should remain responsible, in all cases, for the regulation of safety and security;
- Direct and indirect subsidies should be eliminated or reduced wherever and whenever politically feasible; and
- There would be no need for economic regulation of commercialized infrastructure operators (e.g., controls on their prices and pricing policies), as long as they were constituted as not-for-profit entities; had an appropriate governance structure providing substantial accountability to largely local constituents; were required to justify their fees and user charges (but only as they saw fit); and were obliged to institute periodic audits and reviews.

Regarding the third of these premises, it was only in the case of Nav Canada and the new Port Authorities that users were given a chance to appeal the user charges imposed on them, and even then only on the basis that those charges were inconsistent with certain general charging principles contained in Nav Canada's enabling legislation (the *Civil Air Services Commercialization Act, 1996*) or were unjustly discriminatory (in the case of the Port Authorities). In reality, however, some of the principles governing Nav Canada were worded so vaguely as to offer virtually no guidance at all, and no practical grounds for appeal, while the restraints on the pricing freedom of the Port Authorities are also less than robust.

When the first four local airport authorities (LAAs) were established in 1992, in Montreal, Calgary, Edmonton and Vancouver, the Government directed that these airport transfers be reviewed in five years. Accordingly, a major study was done in 1998 covering 12 work components, ten of them completed by independent consultants and two (relating to safety and security) by TC itself. While the individual reports have not been released to the public, the Department did issue a summary entitled *LAA Lease Review Consultation Report* (April 1999).

So far, there has been no comparable review of the performance of the Canadian Airport Authorities (CAAs), which operate the many other large commercialized airports in Canada under a governance regime that is somewhat more directive than that of the LAAs. Nevertheless, many of the changes in LAA governance that require consideration as a result of the LAA review might need to be applied to the CAAs, as well.

TC's report on the LAA lease review was sent out to major stakeholders for comment, following which the Department planned to determine how best to respond to the policy issues that had emerged—a process that has not yet been completed. Many of the findings were highly encouraging. It was reported, for example, that airport stakeholders recognized that the transfers had led to significantly better levels of service; that the LAAs were generally providing capacity to a higher standard, faster and in a more timely fashion than Transport Canada could have done; that the airport authorities had responded quickly to operational issues; and that safety and security standards had been respected in every way.

Despite these generally very encouraging conclusions, the TC Consultation Report identi-

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**If only there could be competition on the ground, too.**

fied ten “key policy issues” for consideration. Eight of these were explicitly linked to the “governance” of the LAAs but all ten had important governance dimensions. The most important policy issues had to do with the absence of a statement of federal government role and responsibilities; the lack of an LAA code of conduct (expectations); inadequate LAA accountability to users and the traveling public; and inadequate disclosure by the LAAs of information, particularly relating to airport costs.

Remarkably, the “changes considered” in the LAA review included a large number of purely voluntary remedies. This approach reflected the firm belief in some quarters, not least among the LAAs themselves, that minimally diluted self-regulation remains the best approach to the operation of major airports. In this view, major new external constraints would have drawbacks that would far outweigh the benefits expected. Those perceived disadvantages would include, especially, the potential reductions in the LAAs’ ability to ensure their own financial viability and to optimize efficiency and effectiveness.

On the other hand, the references in the TC consultation report to the inconsistency between the governance regimes of the LAAs (and CAAs) and the somewhat more restrictive regimes governing Nav Canada, the Canadian Port Authorities and the St. Lawrence Seaway Management Corporation indicate a modest change in government policy which the LAAs may find it difficult to resist.

Those more recently adopted regimes are somewhat more “restrictive” because they give users direct representation on the respective Boards of Directors, include specific require-

ments for public consultation, and allow users to appeal to the Canadian Transportation Agency against the user charges imposed on them, though only in certain narrowly stipulated circumstances.

As merely a summary of the reports of the consultants who did the LAA review, the TC consultation report was limited in its utility by the contents of its supporting documents. Those documents are not available for public inspection, but it appears from the TC report that the critiques presented were, in some cases, very timid. What is more, TC reports that those consultants who found deficiencies in LAA performance often failed to recommend any remedies. All of which may be understandable but is regrettable nonetheless.

**T**hree important issues should have been examined more closely during the LAA review. They are:

- the lack of any formal means of ensuring that major decisions by airport managements, with their purely local and regional accountabilities, do not have negative consequences for the national system of air transportation;
- the absence of any requirement to allocate the total costs of operation among the principal groups of airport users, as a basis for demonstrating that none is required to pay for more than its fair share of those costs; and
- the need for a much closer look at the heavy reliance on airport improvement fees, which have become a valid and growing source of concern among the traveling public and which raise important issues of national transport policy.

The rest of this article looks briefly at each of these issues, and proposes a general solution to each.

**A**lthough the objectives of the LAAs were not formally stated at the time of transfer, they have been defined by the LAAs themselves in purely local terms—e.g., to provide “their communities” with the best in airport services. The mandates of all other Canadian airport authorities (CAAs) were spelled out a little more specifically and broadly at the time of transfer—to carry out certain defined functions “for the general benefit of the public in [their] region.”

As was noted in the TC consultation report, the directors of all airport authorities have a fiduciary duty to promote the welfare of those

organizations. While directors are certainly—and quite reasonably—expected to express the views and interests of those who nominated them, in cases of irreconcilable conflict it is their primary obligation to advance the welfare of “their” airport.

In these circumstances, directors nominated by the Minister of Transport cannot be expected to do more than articulate any concerns that the Minister might have regarding the authority’s policies or intentions. If in the view of the Board as a whole such concerns are incompatible with the authority’s best interests, the Minister has no formal way of requiring an accommodation.

Only in Canada is such a situation seen as acceptable (and only by defenders of the new airports status quo). Everywhere else in the world, even in countries, like the United States, with a much longer history of favouring local airport autonomy, national governments have retained powerful levers to ensure that important national transportation interests are not subordinated to local preferences. Such safeguards have been necessary, for example:

- to ensure that the allocation of airport landing and take-off slots at major hub airports is done in a way that takes account of the implications throughout the national and regional network of services, and gives adequate weight to the needs of smaller operators serving smaller communities. Such powers are available to the US Department of Transportation, for example, which plays a major role in the allocation of runway slots at congested airports like Chicago O’Hare and New York LaGuardia, and prevented Boston Logan from introducing a landing-fee structure that was seen as unfair to local and regional airlines;

- to ensure that national interests are given adequate weight in decisions to expand (or not expand) the airport’s facilities. In contrast, it would have been unthinkable for the respective national governments to have had no say in, for example, the expansion of London Heathrow, Amsterdam Schiphol, Paris Charles de Gaulle, or Kingsford Smith in Sydney, Australia;

- to prevent airports from diverting airport revenues to non-airport purposes, in the service of other community needs, as in the case of the notorious plan of the Los Angeles International Airport Authority to allocate airport funds to urban transit, prevented by the US Department of Transportation; and

- to protect the interests of the traveling public, particularly outside the airport commu-

nity, who may be detrimentally affected by airport decisions yet have no effective ways of making themselves heard. A good case in point would be the inability of travelers living elsewhere in Canada to resist the widening and constantly increasing reliance on airport improvement fees (about which more later).

These gaps in the governance structure for airports could conceivably be remedied by requiring the airports to obtain the Minister’s approval before implementing a number of specified types of decisions. But many people would rightly see that remedy as undesirable, because the resulting discretionary power in the hands of the Minister would be excessive. Instead, it would be better if the Minister were to issue a general policy, or general policy principles, with which the airport authorities would be expected to conform and which would carry substantial penalties for non-compliance. The development of such a policy, as a preventative measure, would give rise to an altogether desirable public debate.

**I**n the private sector, where suppliers normally have to compete for business, how they allocate their costs is their own business. Market forces are expected to prevent serious misallocations.

In the case of airports, which have great market power *vis-à-vis* a large percentage of their clients (who cannot practically take their business elsewhere, or could only do so at unacceptable cost to themselves), more vigilance is justified. In such cases it is more reasonable to expect the supplier to demonstrate that he is not exercising his market power to extract revenues from one group of users that are unjustifiably out of line with the costs that can fairly be allocated to that group.

It is precisely to stop that from happening that ICAO (the International Civil Aviation Organization) has issued detailed recommended charging practices. Although Canada has always been a leading member of ICAO, and has strongly supported adherence to its recommendations, the Government has not seen fit to require such adherence from its new airport authorities, or indeed, from Nav Canada.

If such a requirement had been imposed, the commercialized operators would have been obliged to develop far more detailed cost allocations than the primitive ones uncovered during the LAA review. There is no reason to believe that doing so would have reduced their revenues

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in any way. It might, however, have produced fee structures that were demonstrably equitable and consistent with the letter *and spirit* of ICAO’s recommendations—a demonstration that none of the airport authorities has ever provided. Moreover, development of the necessary accounting system would have had the major benefit of providing LAA managements with a more solid data base for their investment and other decisions than reportedly has been available to them thus far.

If necessary, new legislation could require the airport authorities to provide users with a better justification for the charges imposed on them, and to respect specific charging principles, akin to those imposed on Nav Canada. At the same time, those principles should be expanded by adding a requirement that no major group of users may be required to pay for more than its fair share of the corporation’s costs, taking due account of differences in the value to users of the services provided. This amendment, which the writer has also proposed for Nav Canada in an article in the fall 1999 issue of *Canadian Public Administration*, would have the following advantages:

- It would add an explicit requirement for equity in the treatment of users, stated in terms designed to command widespread support;
- It would require the airport authorities to justify their allocation of costs among principal user groups, as well as their chosen emphasis on cost-of-service and value-of-service in the development of their user charges—though without dictating the approach to be used.
- It would bring Canada’s approach to charging for air navigation services into greater harmony with the spirit of the approach recommended by ICAO.

There would naturally be objections to this recommended requirement from the airport authorities, on two grounds: that their fee-setting process and associated consultations would become more complicated, and that the likelihood of appeals would also rise, implying delays and uncertainties that could be financially troublesome. These objections would be realistic but not deserving of great sympathy. The anticipated inconveniences seem a reasonable cost of doing business for any monopoly enterprise.

The authorities and others may also be expected to object to the lack of specificity in the proposed requirement that no user group be required to pay for more than its “fair share” of their costs, most likely on the grounds that this

stipulation is much too vague and subjective and would open the door to endless debate. This objection is understandable but the implied ban on the use of concepts like fairness and equity has no merit. In the case of the user charges imposed by airports and air navigation service providers, the guidance provided by ICAO sets reasonable parameters for a disciplined discussion of the subject, to arrive at charges that reflect both cost of service and value of service in a way that promotes efficiency of use while recognizing users’ differing abilities to pay and the service provider’s need to cover all costs. (For more on this complex trade-off, see the article mentioned above.)

When Parliament considers control issues like this, it naturally uses concepts like fairness, equity and reasonableness, realizing full well that anything else is not practical and being quite content that those subject to the legislation should be required to justify their interpretation of the mandate received. Debate about the applied meaning of such notions is central to democratic politics. It is precisely because they cannot be defined satisfactorily to cover all eventualities that we attempt to find processes that are more likely than others to come up with satisfactory answers. That is also why the governance of airport authorities and other privately operated monopolies is a legitimate matter of public concern.

From the earliest days of their existence, all of the LAAs (and subsequently many of the CAAs) have drawn a substantial part of their revenues from new airport improvement fees (AIFs), collected directly from passengers. Before then, all aeronautical revenues had come from user charges collected from the airlines and other aircraft operators, while all so-called commercial revenues had come from fees and rentals collected from a large variety of independent airport concessionaires and service providers. The airports’ end-users—that is, passengers, meeters-and-greeters, and cargo shippers and consignees—ultimately provided all of these revenues, but they did not do so directly. This was important for two reasons: because end-users were protected, up to a point, by their common interest with organized interests intent on maximizing the efficiency of airport operations and reducing the costs; and because indirect payment meant much less inconvenience than direct, turnstile-type levies. They were more efficient as well, requiring fewer airport resources

and less space. Direct levies on passengers had also been discouraged by the International Civil Aviation Organization (ICAO), because of their detrimental effects on “facilitation” (a general term for the facility with which travelers can move to, from and through airport terminal buildings).

There were three basic reasons why the airport authorities nevertheless went ahead with the imposition of AIFs: First, if set at a level of say \$10 per passenger, which is not unusual, the new charges would quickly generate very large revenues. Second, the resulting funds were needed to pay for essential capital improvements. And, third, the fees could be imposed without the extensive, potentially difficult consultations with the airlines that would have attended traditional proposals for higher user charges and without unmanageable opposition from the traveling public. Apart from these reasons, there were many precedents for AIFs in the direct charges imposed by many airports abroad.

To date, the AIFs introduced in Canada have only been payable by passengers starting their (return) trip at the airport concerned, including those who had stopped *en route* for more than 24 hours. Connecting and arriving passengers have not been charged, even though they make virtually equivalent use of the facilities. This pattern is about to be changed by the Toronto Airport Authority, through the imposition of AIFs on connecting passengers. All AIFs at Vancouver, Montreal and a number of CAAs are collected directly from passengers, through a turnstile procedure. At Calgary and Edmonton and a number of CAAs that have followed their example, the authorities have made an agreement with the airlines under which the latter collect the fee on behalf of the authority at the time of ticket purchase, in return for certain important agreed conditions limiting both the purposes for which the revenues may be used and the size of the fee and period during which it may be collected.

Although the airports’ fondness for the AIF is easy to understand, and in some airports its direct collection by the airlines removes an important objection and adds an important element of discipline, as a pricing policy (a key aspect of governance) this approach to revenue generation is open to major objections. They include the following:

- It is unreasonable and unbusiness-like to expect travelers to pay for facilities and services not yet available for use—as they are typi-



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### And an airport tax, too

cally required to do in the early years of all AIFs;

- It is unfair and unbusiness-like to expect today’s travelers to pay “up front” for long-lived capital assets, instead of spreading the costs involved over all users during the expected life of the assets;

- It is inequitable to impose such up-front capital costs on one set of airport users (air travelers) but not on others (terminal building concessionaires);

- The cumulative total of AIFs could easily become an unreasonably heavy burden on the traveling public, particularly if AIFs also come to be imposed on connecting passengers;

- It is far simpler and more efficient to recover all of the costs of capital improvements over the life of the new assets from the airlines and concessionaires, as an addition to existing user charges and rental fees (which cover operating costs as well);

- AIFs are not essential, because operators of comparable facilities without similar direct access to end-users (like Nav Canada or the Canadian Port Authorities) have no difficulty financing capital improvements using other mechanisms; and

- As a matter of pricing policy, it is fundamentally inappropriate for the airport authorities to generate revenues directly from travelers, who are not in a good position to avoid or challenge the charges involved. Only in the case of parking and other “discretionary” services does this general pricing principle not apply. As organizations that possess great market power and have corresponding responsibilities to the public, the authorities should adopt a self-denying ordinance requiring them not to charge travelers directly, except for discretionary services. Any

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argument that such direct charges are essential to the authorities' financial viability (rather than merely convenient) would be difficult to sustain.

When considering these objections, it should be noted that the United States has also accepted the imposition of AIFs (or "passenger facilitation charges" as they are known there), but with very tight restrictions. Under the US practice, AIFs cannot be imposed without the approval of the Department of Transportation. They can only be collected for approved purposes. They must not be imposed directly on the passenger at the airport but collected by the airlines at the time of ticket purchase. They are limited to \$4.50 per enplaned passenger. And they can be collected no more than four times from any one passenger during any one return trip. This is a far cry from the free-for-all in Canada, yet is found in a country that can hardly be accused of hostility to autonomous airport authorities. It does, however, have a much more robust process for consumer protection.

At this late stage, it would be unrealistic to expect Canada to restrict the use of AIFs as much as the US does. But perhaps that is unnecessary. It might well suffice if all airport authorities agreed to adopt the indirect collection method pioneered by Calgary, and to set a maximum on

the total AIFs payable by any one passenger per round-trip ticket. Failing a successful voluntary initiative along those lines, appropriate legislation would be well justified.

As indicated at the start of this paper, there are many reasons for enthusiasm about the results of Canada's airports transfer policy. It is also clear, however, that the policy has a number of significant weaknesses, including its provisions on governance.

The reasons for these deficiencies would make an interesting subject for students of public policy development and administration. For present purposes, however, what matters is the evidence that Canada, in its eagerness to achieve a rapid transfer of TC's operational responsibilities, gave the new operators excessive freedom to do as they pleased. No other country has gone as far, for good reasons. Monopolists and quasi-monopolists should not have that much freedom and should be subject to stronger checks and balances.

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**Life without property rights** To get an idea of just how difficult the migrant [to the city's] life was, my research team and I opened a small garment workshop on the outskirts of Lima, Peru. Our goal was to create a new and perfectly legal business. The team then began filling out the forms, standing in the lines, and making the bus trips into central Lima to get all the certifications required to operate, according to the letter of the law, a small business in Peru. They spent six hours a day at it and finally registered the business—289 days later. Although the garment workshop was geared to operating with only one worker, the cost of legal registration was \$1,231—thirty-one times the monthly minimum wage. To obtain legal authorization to build a house on state-owned land took six years and eleven months, requiring 207 administrative steps in fifty-two government offices. To obtain a legal title for that piece of land took 728 steps. We also found that a private bus, jitney, or taxi driver who wanted to obtain official recognition of his route faced twenty-six months of red tape.

My research team ... has repeated similar experiments in other countries. The obstacles were no less formidable than in Peru ... In every country we investigated, we found that it is very nearly as difficult to stay legal as it is to become legal. Inevitably, migrants do not so much break the law as the law breaks them—and they opt out of the system. In 1976, two-thirds of those who worked in Venezuela were employed in legally established enterprises; today the proportion is less than half ... Their only alternative is to live and work outside the official law, using their own informally binding arrangements to protect and mobilize their assets. These arrangements result from a combination of rules selectively borrowed from the official legal system, ad hoc improvisations, and customs brought from their places of origin or locally devised ... These extralegal social contracts have created a vibrant but undercapitalized sector, the center of the world of the poor.

Hernando DE SOTO, in *The Mystery of Capital*.