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Airport privatization with public finances under stress: An analysis of government and investor's motivations

Carlos Oliveira Cruz [a,*], Joaquim Miranda Sarmento [b]

[a] CERIS/ICIST, Instituto Superior Técnico, Universidade de Lisboa, Portugal
[b] ADVANCE/CSG, ISEG-(Lisbon School of Economics and Management), Universidade de Lisboa, Portugal

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ABSTRACT

The management model of airports has long stood as a central research area in the transport sector. There are a wide range of studies that focus on the potential benefits and pitfalls of private airport management. The results of these efficiency studies have not provided irrefutable evidence for the superiority of private management over public management, but the momentum towards privatizing airports is growing. The reason for privatization has been more related with privatization revenues for governments, rather than more efficient management. The search for maximizing the sale value can have negative impacts from a welfare perspective, for example, through excessive increases in tariffs for passengers. This research reflects on the motivations for governments to privatize, and is illustrated by a case study – Portugal – in which the privatization occurred as a result of three main large drivers: 1) a bailout programme by the IMF, the EU, and the ECB; 2) a revision of the regulatory model, and; 3) the need to increase the capacity of Lisbon's airport system in the medium term.

1. Introduction

Over the last few decades there has been a steady increase of private sector involvement in the development and management of airport systems through long term contracts, or partial/full privatization processes (Oum et al., 2006). This trend has also impacted in other infrastructure sectors (e.g. energy with the total or partial privatization of production and distribution system, transportation particularly in ports, airports and motorways, although in the former case the model was public-private partnerships and not pure privatizations, or the environment, in waste collection, water supply or waste water systems) (Van de Walle, 1989; Neto et al., 2016; Singh et al., 2016). Several countries, such as Italy, Australia, New Zealand, Denmark, Mexico, Portugal, UK, and India have privatized some or all of their airports, either entirely or partially (Hooper, 2002; Galeana, 2008). The case of BAA is a textbook example, not just because it was one the first examples of airport privatization, but also because of the concerns regarding antitrust and market power (Bush and Starkie, 2014). In this case, BAA was forced to sell three airports – Gatwick, Stansted and Edinburgh - the British anti-trust authority. Concerns about excessive market power and lack of competition between the airports, forced this "post-privatization unbundling". Years earlier, Starkie and Thompson (1985) proposed that the ownership f BAA's airports should be divided and the London Airports should have separate ownership to introduce more competition. The same authors used the example of Stansted and Gatwick as potential competitors for similar markets. The reality confirmed the concerns of the authors, as regulating a private monopoly is extremely complex, and the likelihood for success is low.

There have been different models for privatizing airports (Cruz and Marques, 2011). The authors use the term "privatization" to refer to private sector management of airport infrastructure and operations, and not strictly the concept of *ad aeternum* material privatization. In many cases, there was a full privatization, while in others, a concession was awarded to the private sector. Two main forces have been driving private sector participation in airports operations: first, an increase necessity for investments in this area as at the same time there are strong fiscal constraints exist in most of the countries [during the first decade of the 21st Century the world's airports would require an investment of $250 billion (Spillers, 2000)]; secondly, and related with those fiscal constraints, the need of governments to obtain "lump-sum" revenues by selling or by granting concessions for infrastructures. Furthermore, private

* Corresponding author.
E-mail addresses: oliveira.cruz@tecnico.ulisboa.pt (C.O. Cruz), jsarmento@iseg.ulisboa.pt (J.M. Sarmento).

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sector involvement in infrastructures has been motivated "ideologically" by the tendency to look for private sector management skills as a means of addressing public sector inefficiencies (Oum et al., 2008).

However, the discussion on privatization has often been supported by political or ideological arguments, rather than by any theoretical analysis or empirical evidence (Vasich and Haririan, 1996; Oum et al., 2008). Among others, we highlight several benefits from airport privatizations, such as: stimulate competition; improve project delivery; improve efficiency (thus reducing costs to end users), and; reduce political/administrative interference with the commercial management of airports (Carney and Mew, 2003; Costas-Centivany, 1999; Poole, 1997; Cruz and Marques, 2011). With regards to the issue of efficiency, several authors found evidence of the higher efficiency of fully-privatized airports (Boardman and Vining, 1989; Hooper, 2002; Oum et al., 2008; Gillen, 2011), and also that partially-privatized airports are less efficient than public ones (Oum et al., 2008). Public ownership is susceptible to political interference and is highly bureaucratic (Benitez et al., 2012) thus creating more difficulties for improving operational performance.

However one of the primary motivations for privatizing airports (if not the first, and sometimes the only one) has been the "cash-in" of capital (Truitt and Esler, 1996; Hooper, 2002). Airports are among the most valuable systems in the air transport value chain (Button et al., 2007), and are thus susceptible to the financial clawback strategy of governments, particularly those requiring capital liquidity (as most governments were in 2007–2011 in the midst of the global and financial crisis; and still face strong fiscal constraints in the aftermath of the financial crisis). The commonly-referred to example of the UK London-based airports privatization in 1987 in the Thatcher era, was a first move towards quick cash-in in a profitable market that was relatively well protected, ensuring a stable, close to risk-free, return on investment. Although the superiority of airport private management is yet to be proved (Oum et al., 2006), several countries have followed, and are still following this trend (e.g. New Zealand, Italy, Austria, just to name a few examples) (Abbott, 2015). The question is how far is a government willing to go to maximize its cash generation when privatizing an airport, or an airport system.

The discussion about airport privatization generally involves a discussion on regulation and anti-trust mechanisms, given the characteristics of monopolies for many airports, particularly those smaller and medium airport systems (Humphreys et al., 2007; Beesley and Littlechild, 1989). Starkie (2008) argues that most airports are local monopolies, but not natural. Airports can evolve into competitive structures, such as industries competing in spatial markets, meaning that for a significant share of the market, airlines can choose alternative airports. This competition can be even higher under the model of hub-and-spoke used by most airlines. In the hub-and-spoke model, airlines can choose the most competitive airport to serve as the hub. This paper addresses the privatization of the Portuguese airport system which occurred in 2012. We aim to discuss and clarify the following issues: 1) what motivated the Portuguese government to undertake this privatization?; 2) As the winning bid paid a substantial premium price, what was the bid price a potential monopoly price for the private sector?, and; 3) What other motivations could have led Vinci to pay for such a premium? This paper is organized as follow: Section 2 briefly describes the Portuguese airport system and the privatization process. Section 3 provides a discussion and some evidences of the motivations that guided the government's decision to sell the airport company, thus answering our first research question. Section 4 analyses the potential monopoly premium (Research Question 2) and Section 5 elaborates on other potential benefits to Vinci that could explain the price of the operation (Research Question 3). Section 6 concludes.

2. Setting the context

2.1. Economic and financial background

Understanding the process of privatization of the Portuguese airports requires an overview of the overall economic and political framework. In 2011, Portugal required official financial aid (a "bail-out" programme) from the International Monetary Fund (IMF), given its impossibility to comply with its financial responsibilities. The IMF, the European Commission (EC), and the European Central Bank (ECB) all established an agreement with the Portuguese Government - the Memorandum of Understanding (MoU), setting up the requisites, in terms of reforms, to sustain the financial aid. Among several public reforms that were agreed was the privatization of state-owned companies, opening up to private initiative those infrastructures that still remained within the Government's responsibility, one of them being the airport sector.

Up until 2012, Portugal was one of the few countries in Europe where the government was still the only owner, or the major stakeholder of the air transport sector: both the national flag carrier (TAP), and the airport owner and manager (ANA). The MoU clearly established as a priority, the opening of traditionally government-owned companies to private initiative, particularly in the transport sector. The Troika Memorandum established, among several fiscal, financial, and budgetary objectives, that the Government would be able to raise up to 5.500 million Euros with the privatization of several companies, including ANA and TAP. The privatization of ANA in 2012 end up representing more than half of this value.

Taking into account the political decision of privatizing these air transport-related companies – the airport manager and the airline – both being companies with highly correlated activities, what is the best way to ensure that both processes are articulated in order to maximize social welfare?

TAP is the largest client of ANA, and its operational basis located at Lisbon Airport, working as a hub linking Europe to Brazil, and Europe to African Portuguese-speaking countries (e.g. Angola, Mozambique, Cape Verde, and São Tome). ANA handled around 38.9 million passengers in 2015, and TAP handled around 12 million. A significant volume of TAP's passengers does not have as an origin/destination any of ANA's airports (Lisbon, Porto, or Faro) but are transit passengers passing through Lisbon's hub. Therefore, the future of TAP, and particularly its strategic decisions regarding the Lisbon hub, are determinant to setting ANA's economic value, given its impact on ANA's expected traffic. Much of the potential of the airport relies in the existence of a Hub, local traffic being dependent on tourism and economic growth.

The most economically-rational approach would have been to first privatize TAP, and then to privatize ANA, given that the first would influence the second. Although this would have been the logical decision, the sale price of TAP is incomparably lower than ANA. As discussed by Button et al. (2007), most legacy airlines have low profit margins and since 1997 they have operated in Europe in a highly competitive market. In fact, many airlines are struggling to breakeven and during large periods of time, airlines experiment negative cycles, e.g., in the period 2001 to 2007. On the other hand, airports have bigger profit margins and less competition. TAP was partially privatized in 2015, for 10 million Euros, with significant