
Contracts, Financing Arrangements, and Public Ownership – An Empirical Analysis of the US Airport Governance Model

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Outline of Talk

- **Research Question**
- **Transaction Cost Perspective**
- **Case Study Findings**
- **Concluding Remarks**

Why apply institutional analysis to airport governance?

Airport privatization reforms are currently underway in Europe, but in different “forms and sizes”

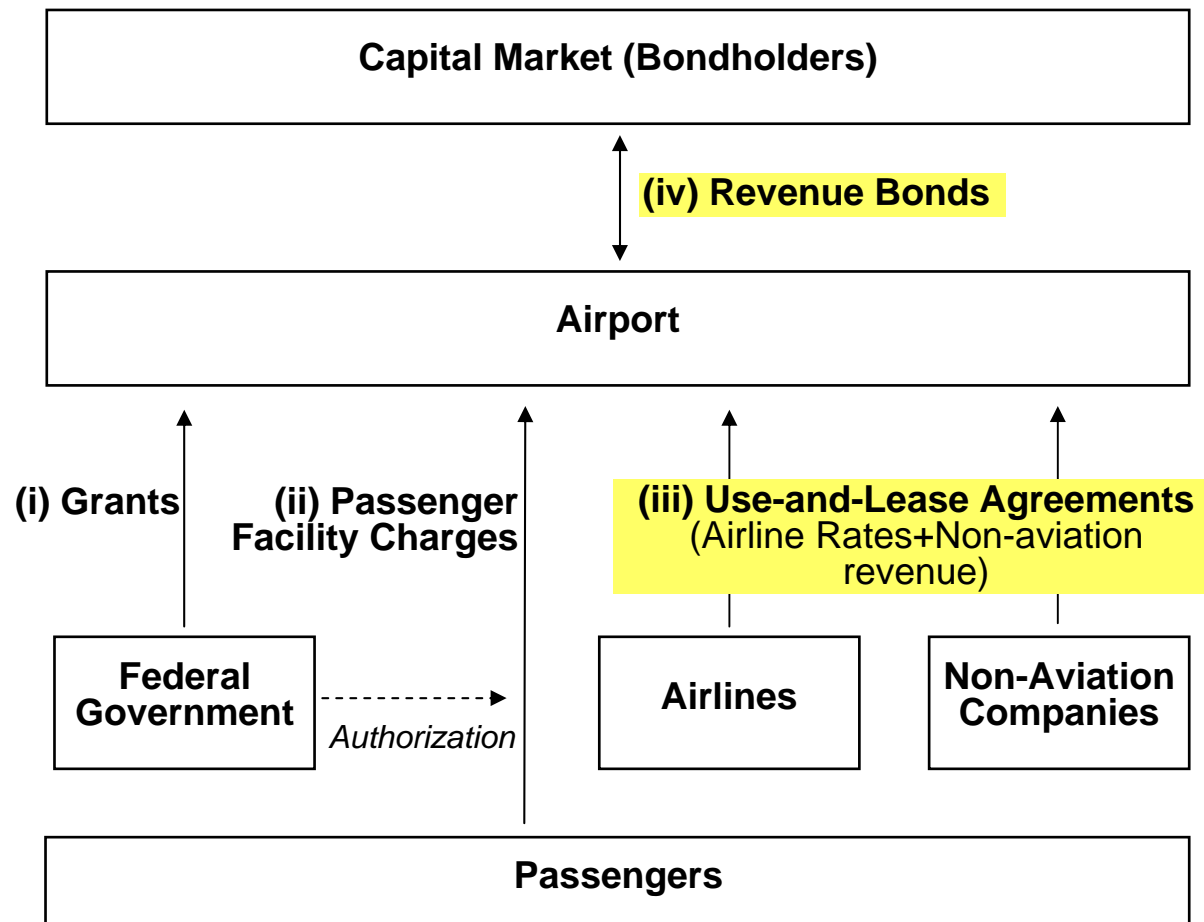
Empirical evidence on link between ownership structure and performance of airports is not conclusive (e.g. Parker 1999, Oum et al. 2006)

Research Objective: Explore the more ‘subtle’ efficiency drivers via an institutional analysis of airport governance models.

... in this context the US airport governance model is interesting:

- local government ownership,
- freedom to contract between airlines and airports, and
- involvement of capital market via revenue bonds

US Airport governance model: Revenue and financing source



Existing Literature: Airline agreements reduce competition

Airline Agreements are an 'airport barrier' to entry

(Abramowitz and Brown 1993, Dresner, et al. 2002, Hartmann 2006)

Anti-trust concerns by legal scholar

(Dempsey 2002, Hardaway and Dempsey 1992, Notes 1990)

Public ownership detrimental to economic efficiency

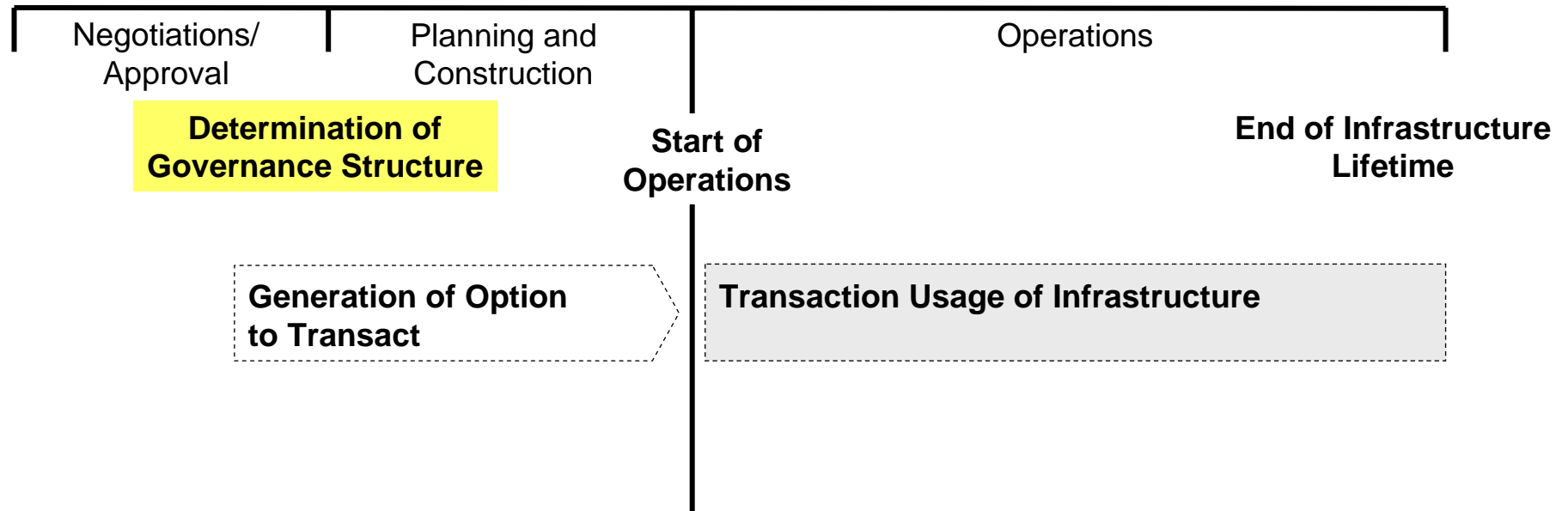
(Winston and Morrison 2000, Poole 1994, Gillen and Morrison 2004)

Our research proposition

Airline and Airport employ specialized contractual forms to achieve joint value maximization, while economizing on transaction costs
(Williamson, 1985, 1991, 1999)

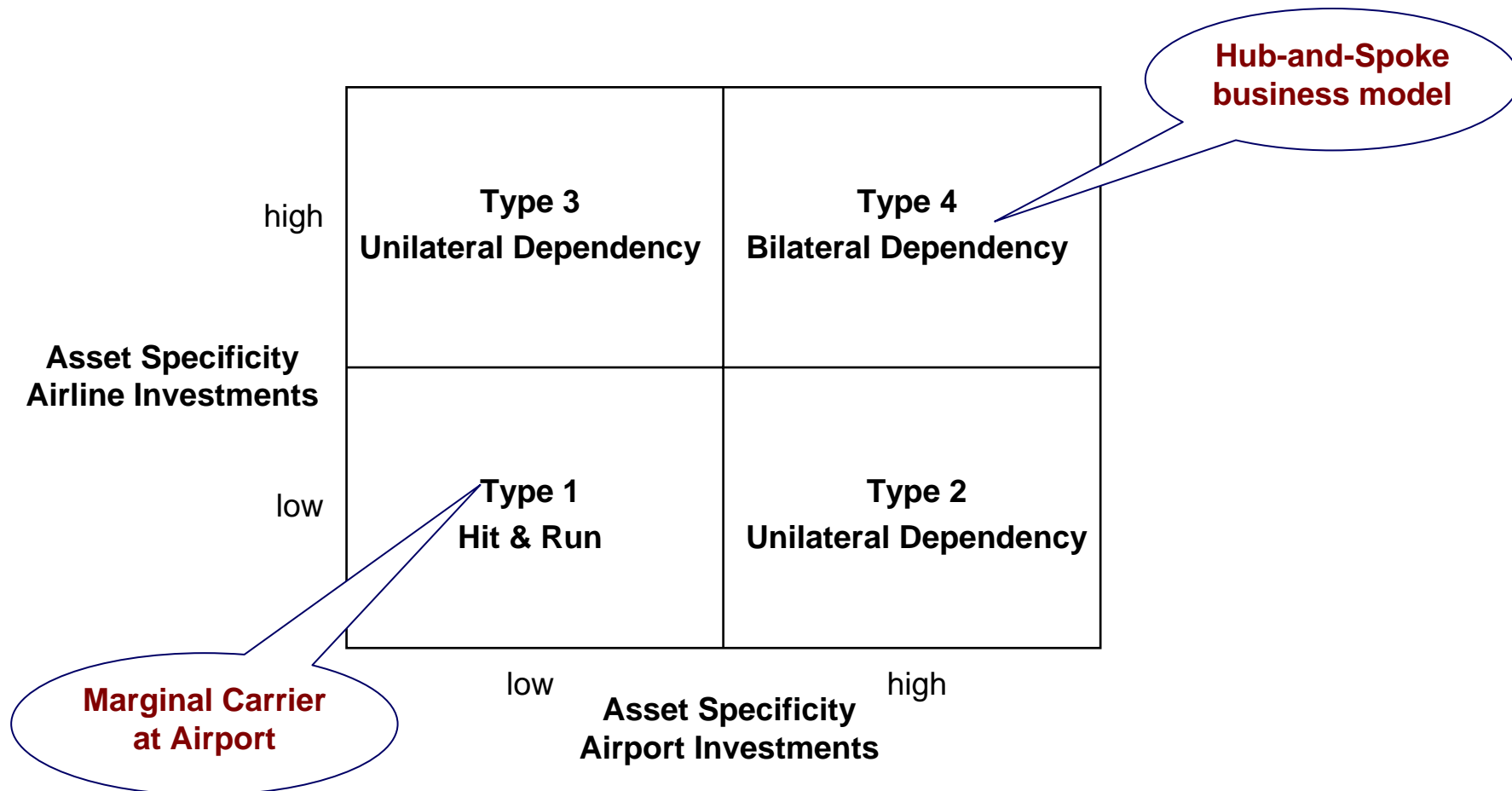
1. How do airlines and US airport vary the design of their contractual/financing arrangements to economize on transaction costs?
2. What are the competencies of public owners in these arrangements?

Airport Investment projects: transactions and governance choice



(Fuhr and Beckers, 2006)

Typology of airline-airport supply relationships



Empirical study: data and methodology

Case study research design: Primary focus on bilateral agreements on the use of gates and terminals at four US Airports: DTW, JFK, PDX, BOS.

Data Sources: Bond prospectuses, newspaper, and expert interviews

Research Constructs: Contractual and financing arrangements to

- (i) safeguard relationship-specific investments,
- (ii) facilitate coordination in the planning and construction phase
- (iii) allocate rights and obligations between public and private parties

...to safeguard relationship-specific investments

A. Contracts

Airlines seek long-term and exclusive contracts to gates to safeguard quasi-rents, residing in:

- proprietary investments in gate/terminal assets
- investments associated to large scale entry or network structure

Airports seek long-term commitment by particular airlines to safeguard quasi-rents in relationship-specific terminal capacity and functionality

...to safeguard relationship-specific investments

B. Choice of Financing

Project finance arrangements turn airlines into “quasi-owners”

- Long-term leases and exclusivity rights
- Credible commitment by the airlines (investment hostage)
- separate relationship-specific from general purpose assets

General Airport Revenue Bonds for general purpose investments

..to facilitate coordination in the planning and construction phase

Airport vs. Airline steered development

- **Specialized arrangements:** decision and control rights are transferred
- **Standard arrangements:** airport develops facility + consults with future users

Comparative (transaction cost) advantages are rooted in:

- reduced information asymmetries on the lifetime cost
- facilitated knowledge transfer between airline and third parties
- superior adaptive capabilities as changes unfold

...to allocate rights and obligations between public and private parties (1/2)

Allocation of rights between airlines and airports via contracts, financing arrangements and rules in the US institutional environment

Airports face substantial control from:

- Capital markets via revenue bond financing
- Airlines via airline agreements

Strong reliance on airlines and outside suppliers in airport operations

...to allocate rights and obligations between public and private parties (2/2)

Public agencies as airport proprietors will...

- operate the runway system and general airport assets
- set standards and rules to facilitate private arrangements
- arrange for debt financing
- act as „manager fo last ressort“ if private terminal investments fails
- safeguard competition (special monitoring and enforcement rights)

Concluding remarks (1/2)

Specialized Arrangments are welfare enhancing:

- Support relationship-specific terminal investments
- Investments have increased total gate capacity (at our case study airports)
- „Learning to contract“ by public authorities as well as recent legal changes mitigate threat of anti-competitive airline agreements

Inefficiencies linked to public ownership are mitigated:

- **Efficient investment incentives:** Bondholders/airlines not tax payers bear the risk of 'bad' investments.
- **Cost inefficiencies:** Limited. Public agencies rely heavily on the private sector

Concluding remarks (2/2)

Feasible alternative arrangements with superior performance?

- Public agencies provide the framework for private investments and contracts
- Transaction costs and investment distortions under regulation

Lessons for future empirical studies:

- More empirical work at the microanalytical case study level
- Simple distinction in quantitative studies (Public, Private, vs Public-Private) mask important cross-country differences in airport governance models