



"Raymond Yeung"

To: <airportcomments@edlb.gov.hk>
cc: wilsonfung
Subject: Comments on Airport Privatization
 Urgent Return Receipt

25/05/2005 14:51

Mr Wilson Fung JP
Deputy Secretary
for Economic Development and Labour
The Government of the HKSAR
By email

25 May 2005

Dear Mr Fung,

Pleased to meet you in the American Chamber of Commerce luncheon a few weeks ago.

Attached please find my responses to the captioned consultation. Please consider my views in evaluating the need of the airport privatisation exercise.

Please note that this is my personal submission and my view does not represent any unit of the University of Hong Kong or Aviation Policy Research Centre of Chinese University of Hong Kong.

Yours,

Dr Raymond Yeung
Honorary Assistant Professor
and Programme Director
The University of Hong Kong



Response to Consultation Airport Privatization.doc

**Response to Consultation Document on
Partial Privatization of the Airport Authority**

**Dr Raymond Yeung¹
The University of Hong Kong**

25 May 2005

This paper highlights my analysis and conclusion of the issues related to partial privatization of the Airport Authority.

(xi) Do you consider it essential to preserve taxpayer's \$30.7 billion investment in AA in the privatization exercise; and if so, do you consider it reasonable and acceptable to increase airport charges over a period of three to five years in order to achieve this?

This question itself needs to be reworded. It is not essential to preserve the \$31 billion sunk investment but the overall economic return derived from the asset, from a societal perspective. I agree that airport charge should be adjustable, functioning like prices in other service or commodity market.

In considering the fact that HKIA is a monopoly – there is no other airport in this geographical jurisdiction, airport charge is simply a nominal charge affecting the profit margin of users. The charge will only have minimal impact on airlines' choice of destination. Increase in the charge would result in cutting down of usage frequency.

However, in evaluating the level of airport charge, the appropriate positioning of the Government should be to evaluate the cost-benefit from the societal perspective instead of centering from the AA perspective (not to say from the angle of IPO). The ultimate consumers (business or leisure travelers as well as cargo users) will be the group to bear the incremental costs. This imposes external costs to the society at large. A recent example in the transportation economics is the case of Eastern Harbour Tunnel.

¹ The author is the MBA Programme Director at School of Professional and Continuing Education and Honorary Assistant Professor, the University of Hong Kong. The author is a Founding Member, Aviation Policy Research Centre, Chinese University of Hong Kong and is the author of *Open Skies: Analysing the 5th Freedom*. This is my independent submission, and the views do not reflect that of the Centre nor the University of Hong Kong..

Unless there is ways to internalize the social cost-benefit into the valuation, should there be conflict of commercial interest, the community interest should always be the dominant factor of consideration. If fact, the Government should not undermine the potential benefit from reducing airport charge in order to capture the external economic benefit from boosting up the mobility of travelers and cargo.

xii) Do you attach more importance to minimizing any increase in the airport charges in the next few years; and if so, do you consider it acceptable if taxpayers' investment in AA as measured by its valuation at IPO is diminished?

As described above, the taxpayers' interest is not necessarily a one-to-one relationship with the level of airport charge.

Note that the main value of HKIA is the strategic location – Hong Kong. The demand for landing on and departing from HKIA is NOT driven by the quality services of HKIA BUT the needs to transit Hong Kong. **In the context of aeronautical segment, to financialize the public investment in the aviation infrastructure, the Government can consider internalize such needs in the valuation exercise. Users of HKIA are in fact utilizing the right to land and depart the jurisdiction of Hong Kong's sky. A transfer of ownership of airport traffic rights to AA can be an incentive-compatible way to align the societal interest (tie to traffic volume) as well as to monetarize the full economic value of using HKIA. Otherwise, it does not seem to have a need to simply improve the service efficiency of HKIA by means of privatization.**

xiii) It is proposed that the regulatory framework should also subscribe to the user pays principle; allow the new Company a reasonable return on its investment; and provide incentives for enhancing efficiency and increasing capacity to cater for demand.

User pays principle is acceptable for public service. The level of charges is cost-based. However, I do not think AA should necessarily operate in commercial principle. In the case of monopoly, privatizing cannot increase allocative efficiency – there is no independent airport. **For operating efficiency, outsourcing of selected services (replaceable) is the most direct method.** In conclusion, a non-profit, publicly run organization can still be an operatively efficient organization. There is no need to allow a reasonable return on AA or the new Company.

xiv) It is proposed that only airport charges paid by airlines should be regulated.

Due to the monopolistic position of HKIA, airport charge is simply a nominal charge and cannot perform the full function of price as in other market.

xv) The level of the new Company's target return for aeronautical activities should commensurate with the risk of the aeronautical business, which may not necessarily be the same as the average cost of capital of the new Company a whole.

HKIA should be operating on cost-recovery basis if the business of the new Company cannot capture or internalize the overall economic benefit, based on the above consideration.

xvi) The new Company should be allowed to negotiate on a commercial basis with airlines on the level of airport charges every three years or as a need arises, within a set of broad parameters set out in the Ordinance.

If the Government is willing to operate HKIA in a non-profit fashion, AA can work on a piece of mind solution – changing airport charge only if it runs into deficit. It is in fact the most administratively efficient solution in the aviation economy.

xvii) It is for consideration whether the Government or a Government appointed independent panel should be empowered to adjudicate on the reasonable level of airport charges.

The Government simply needs an auditor to work out the cost of aeronautical services involved in HKIA, if AA is operating in a non-profit fashion.

xviii) It is proposed that the new Company should be required to draw up a set of service standards, and on the basis of which a financial reward and penalty system should be devised to link the actual service standards to the level of airport charges.

In a non-profit organization, this proposal is a must in the 21st century. But the penalty system should be devised to link to the remuneration of AA's staff.

End of Responses