



Privatization Task Force

Applying Global Best Practices to the Privatization of Narita Airport



The American Chamber of Commerce in Japan
May 2005

The American Chamber of Commerce in Japan
Privatization Task Force
Second Printing, May 2005

Cover photograph by Charlie Furusho

Applying Global Best Practices to the Privatization of Narita Airport

Table of Contents

Executive Summary	2
Introduction	3
Current Privatization Plan Remains Inadequate	4
A. Background	
B. Mid-Term Management Plan	
C. Corporatization of the NAA	
D. No Mention of Haneda Airport	
Best Practices and Basic Principles for Airport Privatization	6
A. The Need to Regulate a Privatized Airport	
B. Regulating Airport Economics: Two Methods	
C. The "Single Till" Approach: Covering Aeronautical Costs by Combining Aeronautical and Commercial Revenues	
Recommendations	8
A. Create an Independent Regulatory Body	
B. Impose Incentive Pricing Regulation	
C. Adopt a "Single Till" Approach	
D. Increase Financial Transparency	
E. Engage Outside Experts	
F. Set Goals to Measure Success	
Conclusion	10
Appendix A. Narita Airport's History as a Public Entity	12
Appendix B. Case Study: The United Kingdom Experience with Airport Privatization	16
Endnotes	17

Executive Summary

Since its completion in 1978, Narita Airport has been plagued with problems stemming from its strained relations with the local community, limited infrastructure, inefficient operations and business practices, and excessively high charges. Crucial runway expansion is impeded by the refusal of certain residents to vacate land necessary for the expansion; and full use of existing runways is prevented by, among other things, agreements concerning noise pollution made with airport area residents long ago in the era of noisier jets. Additional infrastructure handicaps include limited warehouse and service space.

Landing fees that have been the highest or second highest in the world for at least the last fifteen years accompanied by low non-aeronautical revenue have rendered Narita Airport uncompetitive compared to other major hubs in the region. Narita Airport has had a history of limited bidding processes, consistently high profits for a public entity, and a lack of transparency that raised fundamental obstacles to improving the airport's efficiency and competitiveness.

Many of the foregoing problems might be resolved if the Narita Airport operating company achieves the general goals and specific numerical targets proposed in the 2003 legislation that began the privatization process, and in the operating company's own 2004 mid-term management plan.

While the American Chamber of Commerce in Japan (ACCJ) takes no position as to whether or not Narita Airport should be privatized, the ACCJ regards privatization as an opportunity to remedy many of the problems that have plagued Narita Airport if internationally-recognized best practices and examples from successful airport privatizations are used.

Although there have been some noticeable improvements in retail activities, passenger services, and terminal expansion in the past several years, the ACCJ believes that for privatization to be beneficial to all airport stakeholders, fundamental changes in the Narita Airport operational model are necessary. Key changes include:

- The establishment of a strong, independent regulator composed of representatives of all stakeholders.
- Implementing an "incentive regulation" regime such as the RPI-X approach to financial oversight.
- Adopting the "single till" approach to financial management whereby an airport applies commercial revenues to offset some of the costs of providing its aeronautical activities.
- Conforming to private-sector financial reporting and auditing standards and taking additional steps to improve financial transparency for all stakeholders.
- Engaging outside experts at an early stage to advise on privatization planning and implementation.
- Setting specific goals to measure success, including the overcoming of essentially political obstacles to correct infrastructure concerns such as additional runway capacity and faster rail service between Tokyo and Narita.

The ACCJ recognizes that Narita Airport faces a number of tough challenges as it moves forward with privatization; but we believe this is a valuable opportunity to introduce global best practices that will improve airport management, lower costs, and promote the interests of all stakeholders. Finally, if done correctly, the privatization of Narita Airport can help the Japanese government achieve Prime Minister Koizumi's goal of doubling foreign direct investment (FDI) and doubling tourist arrivals from abroad by 2008.

Introduction

This paper is the third in a series of ACCJ reports published in 2004–05 on privatization in Japan. The first, entitled “Applying Global Best Practices to Privatization in Japan,” discussed in detail the global best practices of privatization and highlighted a number of privatization case studies in Japan and abroad. The second analyzed the privatization of Japan Post, the country’s postal entity.

This third paper focuses on how Narita Airport can be privatized according to global best practices. After explaining the status of Narita’s current privatization program, we give specific recommendations for a successful privatization that would greatly reduce current problems and provide maximum benefits to all stakeholders. We have also appended a description of many of the problems Narita Airport has faced during its life as a public entity, and a case study on the UK’s experience with airport privatization.

Since its completion in 1978, Narita Airport has provided inadequate service and value relative to its importance both to Japan and the international community of travelers. Narita, about 80 Km from the center of Tokyo, is difficult to get to, crowded, and offers few of the amenities provided at other airports. It is expensive, has limited capacity, and has, in the past, been managed inflexibly. Notwithstanding the economic benefits brought by the airport, the noise created by airplanes landing and taking off is of significant concern to local residents. International travelers are inconvenienced by the limited number of domestic connecting flights and the distance from Tokyo.

Over the past twenty years, Japan has privatized a number of prominent government enterprises such as Nippon Telegraph and Telephone (NTT) in 1985, Japan National Railways in 1987, and Japan Tobacco and Salt Monopoly in 1985. The privatizations of Japan Highway Public Corporation and Japan Post are in progress. It is now Narita’s turn, and on April 1, 2004, when the Narita Airport Authority was converted from a public corporation (*kodan*) to a government-owned, private corporation (*kabushiki kaisha*), the Japanese government took a major step in the privatization of Narita.

The ACCJ believes that privatization of Narita Airport provides an opportunity to address many of the airport’s problems; but a favorable outcome for all stakeholders will only be achieved if high priority is placed on increasing the efficient management and use of this national asset. Looking at past privatization experience in Japan, it is clear that there is a danger that privatization can become an end in itself and that no fundamental changes will be made in the airport’s operating model and practices.

Airport privatizations globally in recent years have shown that privatization will deliver the expected benefits—lower costs, greater convenience, better facilities, economic development, and a reasonable return to investors—only if it includes: (i) strong regulation that prevents the management and new airport owners from extracting monopoly rents from airport users, and (ii) significant improvements in the way the airport is managed and operated. The privatization of Narita should increase efficiency to the benefit of all stakeholders—such as passengers, airlines, shippers, concessionaires, employees, residents, and stockholders.

Current Privatization Plan Remains Inadequate

A. Background

Government deliberations to privatize Narita began in 2000, primarily to reduce the government's budget deficit, improve aviation infrastructure policy, enhance airport management, and offload the burdensome Kansai Airport by pairing it with Narita as a package privatization. The last objective was seen as an attempt to subsidize one airport with revenue from another, which directly contradicts economic principles established by the UN's International Civil Aviation Organization (ICAO).

That original plan was widely criticized before being dropped in favor of a standalone Narita "privatization" in 2002. (BAA plc, the company that operates London's Heathrow airport and several other airports nearby, has not been allowed to mix revenues from those airports.)

In 2003, the Diet passed a bill to "corporatize" Narita on April 1, 2004. The government will hold all shares in the joint stock company until it is listed on the Tokyo Stock Exchange sometime after April 1, 2007. (The name of the company is Narita International Airport Corporation, but the company continues to refer to itself as "NAA"—which before corporatization was an acronym for "Narita Airport Authority") Even after shares are being publicly traded, several years may pass before the government divests all or a majority of its shares, if ever.

B. Mid-Term Management Plan

In October 2003, the public airport operator, then called the Narita Airport Authority, published a "mid-term management plan" to establish guidelines and provide post-privatization performance targets¹. The plan set out six "basic management guidelines."

1. Business expansion through secure, customer-focused management: Objectives include improving international competitiveness, reducing landing charges, extending runway "B," reshuffling the terminals airlines use to match their "alliance" groupings, getting the agreement

of the local community to increasing the number of takeoffs and landings allowed each year to 220,000, and increasing non-aeronautical revenue.

2. Commitment to environment management: The NAA says it is committed to "sustained environmental and community integration activities in the area around the airport."
3. Management efficiency: The NAA promises "extensive changes in cost awareness...and improvements to management supervisions system," as well as improved labor productivity.
4. Creation of a solid financial footing: The NAA hopes to create a "solid financial structure to sustain a stable source of funds for the management and development" of the airport.
5. Expansion of international activities: The NAA wants to "step up international activities and contribute to the growth of the global civil aviation network."
6. Consolidation of Group strength: The NAA wants to create "an influential corporate group for...revenue expansion."

In addition, three key management targets were later established:

- Turnover: Minimum ¥170 billion in fiscal year 2006.
- New business turnover: ¥10 billion in fiscal year 2006.
- Cost reductions: At least 10 percent total reduction in three years.

While these management guidelines contain many laudable objectives, other than promising the introduction of a "private-enterprise procurement system," they contain few specifics on how the NAA intends to become more efficient and what operating costs it expects to be able to reduce. The mid-term management plan furthermore does not enunciate any scheme or formula by which cost reductions achieved by the NAA will be used to lower the charges airlines and passengers

pay to use Narita Airport. That the NAA considers a total cost reduction of 10 percent in three years as adequate only reinforces the image of the NAA as still being dominated by conventional bureaucratic inertia and thinking: In private business, a 10 percent cost reduction would be a one-year goal.

In the period since the NAA began privatization, there have been noticeable changes geared toward increasing commercial revenue. The "NAA Retailing" subsidiary has opened 20 new retail shops in Terminal 1, and there are plans to expand the retail floor space in Terminal 2 as well. These changes have brought improved services, and growth in commercial revenue which are essential to successful development and privatization. However, revenue growth is not a goal in itself, and without strong outside independent regulation, the NAA could make only token reductions in user charges and few changes to its business practices, while exploiting its monopoly position to increase profits.

C. Corporatization of the NAA

As explained earlier, the Narita Airport Authority was corporatized (that is, made into a *kabushiki kaisha*) on April 1, 2004. However, the government still owns 100 percent of the stock, and therefore, by any global standard definition, NAA is not yet a privatized entity.

At the same time, a new chairman was appointed from the private sector and senior staff members were shuffled. New departments were formed to address new business and procurement opportunities. NAA initially, in April 2004, stated it had no employee retrenchment plans, but more recent statements mention headcount reductions of 200 employees, from a base of 900, through attrition.

As a direct result of having been corporatized however, NAA is now subject to all the standard requirements under Japan's Commercial Code for large private companies: Namely, appointment of statutory auditors and outside accountants, disclosure of annual financial results and standard corporate fiduciary obligations.

D. No Mention of Haneda Airport

Haneda Airport, located about thirty minutes by train or car from the center of Tokyo, served as the greater Tokyo area's primary civil airport for both domestic and international commercial flights from the end of WWII until the opening of Narita Airport. When Narita opened in 1978, except for special cases, all international flights were shifted to Narita.

However, in the summer of 2002, in conjunction with the football World Cup which was jointly held in Japan and Korea, the government allowed charter flights between South Korea and Haneda Airport for a limited period. Following the World Cup, a system allowing ten daily international charter slots was started, but the flights could only operate between 23:00 and 06:00 each day. Most recently, since the fall of 2004, the government has allowed four daily flights between Haneda Airport and Seoul's Gimpo Airport during daylight hours. The four major airlines from the two countries each operate one flight per day between these two close-to-downtown airports. (The government has announced that the four-flights-per-day limit will be increased to eight. This new limit is expected to become effective August 1, 2005.)

A fourth runway at Haneda Airport is under construction and is due to open in 2009. The Ministry of Land, Infrastructure and Transport (MLIT) has said publicly that international flights will be expanded at Haneda Airport in 2009; unfortunately few details have been released. One thing is clear: Any international flights that operate from Haneda Airport will have an impact on Narita Airport's finances and the finances of the airlines that use Narita.

The ACCJ is concerned that the issue of Haneda Airport's internationalization has not been discussed in the context of NAA's privatization process.

Best Practices and Basic Principles for Airport Privatization

As stated in the introduction, privatizing Narita provides an opportunity to address many of the airport's problems; but a favorable outcome for all stakeholders will only be achieved if high priority is placed on increasing the efficient use of this national asset. There is a danger that privatization can become an end in itself and no fundamental changes are made in the airport's policies and business practices. This result can said to have already been seen in the cases of Japan Tobacco and NTT, where continued government majority ownership and regulation have overlapped, causing market confusion and delaying market development to the detriment of Japan's consumers.

It is necessary, therefore, that Japan closely adhere to internationally recognized principles of effective airport privatization and that NAA be subjected to internationally accepted principles of regulation. Close reference should be made to the practices of the most successfully privatized airports around the world such as London's Heathrow and other airports operated by BAA plc, and Copenhagen Airport.

A. The Need to Regulate a Privatized Airport

With rare exceptions, commercial airports are natural monopolies. When an airport is privatized, its finances and services must be regulated to prevent abuse of that monopolistic power and to ensure that airport users receive satisfactory service and value. (Aeronautical regulation, which is necessary at all airports, is normally provided by the government aviation authority and will not be addressed in this paper.)

The fundamental objective of regulating an airport's financial operations is to ensure that all stakeholders benefit from privatization. This objective is accomplished in two ways: first, by preventing the airport operator from earning unreasonably high profits, and second, by enforcing some of the economic discipline that the operator would face in a competitive market. ICAO, the UN body responsible for promoting and regulating international aviation, has identified seven principles for effective airport regulation:

1. Ensure nondiscrimination in the application of charges.
2. Ensure that there is no overcharging, other anticompetitive practices, or abuse of dominant position.
3. Ensure transparency, including the availability and presentation of all financial data required to determine the basis for charges.
4. Assess and encourage efficiency and efficacy in the operation of service providers.
5. Establish and review standards, quality, and level of services provided.
6. Monitor and encourage investments to meet future demand.
7. Ensure that user views are adequately taken into account.

B. Regulating Airport Economics: Two Methods

The two long-standing approaches to financial oversight of natural monopolies such as utilities and airports are rate-of-return regulation and incentive regulation.

Rate-of-return regulation, also called cost-of service regulation, has long been used in the United States as a tool for overseeing utilities. It may be expressed by the following equation:

$$\text{Revenue} = (\text{Asset Value} * \text{Rate of Return}) + \text{Operating Costs} + \text{Depreciation}$$

Rate-of-return allows companies to pass through any costs the supervising regulatory body deems necessary to ensuring that end users receive an adequate level of service, while providing investors a maximum or fixed rate of return based upon the cost structure. However, this type of regulation does not necessarily provide incentives to the regulated entity to reduce costs.

Incentive regulation was developed to avoid the shortcomings of rate-of-return regulation and to encourage regulated monopolies to function to the greatest degree possible as market-driven entities. This type of regulation has gained particular favor in the UK, where it is being used to regulate a number of privatized utilities and airports. It may be expressed as the following equation:

Revenue = Approved Charge * Inflation (RPI) – Annual Productivity Enhancement (X)

Incentive regulation allows the regulated entity to realize all gains from efficiencies achieved beyond established targets for a given period. This form of regulation can also be described as performance-based regulation, and it is often referred to as RPI-X. In the RPI-X formula used to set the efficiency target, “RPI” stands for retail price index, a measure of inflation, with “X” representing a productivity factor.

Under RPI-X regulation, the regulated entity is typically subject to a regulatory cycle of three to five years. For each period, the regulator uses the RPI-X formula to set the maximum price the entity can charge in the period. If the regulator expects the regulated entity to improve its efficiency, then the productivity factor, X, will be positive. Conceptually, that means the entity’s charges to end-users are expected to increase less than the inflation rate. If the entity can produce greater efficiency gains in the period than assumed by the X value, it will be able to keep any incremental profit that exceeds the efficiency target. When the regulatory cycle is completed, the regulator conducts a new review and sets new targets for future productivity gains. The regulator is then able to pass on some of the benefits of the realized efficiency gains to end-users.

Compared to rate-of-return regulation, RPI-X regulation is less bureaucratic and provides a strong incentive for increasing efficiency. However, there are no magic solutions to the problem of regulating privatized airports. No matter which form of regulation is eventually adopted, the natural monopoly characteristics of airports make the regulatory body’s mission critically important. The regulator must actively police and monitor the airport operator and set incentives that encourage efficiency rather than simply condoning a continuation of the government entity’s past practices.

C. The “Single Till” Approach: Covering Aeronautical Costs by Combining Aeronautical and Commercial Revenues

Airports bring together two very different activities: aeronautical—i.e., those activities directly related to the primary business of an airport, such as getting passengers and cargo on and off airplanes—and ancillary commercial activities, such as duty-free shops, banking services, concessions, and restaurants, which make an airport more appealing to passengers and increase revenue for the airport operator. Airport operators often try to separate the finances of commercial activities from the finances of aeronautical and related activities. However, an airport’s commercial activities can only be financially successful if the airport engages in aeronautical activities.

It is therefore appropriate to consider both aeronautical and commercial activities when evaluating an airport’s financial position for the purpose of economic regulation. This “single till” approach is advocated by the International Air Transport Association (IATA), the leading trade group of the worldwide airline industry, and helps to ensure that a steady (and expanded) flow of income is available to conduct aeronautical activities safely and efficiently. IATA has had consultations with Airports Council International and the UN’s ICAO on the subject of the single till. ICAO falls short of a full endorsement of a pure single till system, but the organization does agree that an airport’s revenue streams should be mingled when determining the appropriate aeronautical fees to charge. ICAO’s most recent Airport Economics Manual says: “It has been a longstanding policy of ICAO to encourage the intermingling of aeronautical and non-aeronautical revenues and costs for establishing the cost basis from which charges should be calculated.”

Recommendations

A. Create an Independent Regulatory Body

Since Narita Airport operates as a natural monopoly, it is vital that the airport be subject to independent economic regulation. The regulatory body should be composed of representatives of each of the airport's major stakeholder groups: the airlines, passengers, freight forwarders, tenants, government agencies such as Customs and Immigration, and of course, NAA itself. No single stakeholder should have controlling power.

The administrative office (often referred to as the "secretariat") should not be staffed by retired government officials, and great care should be used in deciding to what part of the government it is attached so that entrenched interests cannot exert undue influence. The Cabinet Office might be an appropriate spot.

This regulatory body must have the dual objectives of (i) ensuring that Narita continues to improve service standards in all operational areas, and (ii) providing financial incentives to NAA to continually increase the efficiency of its operations. As efficiency increases, the regulator must ensure that some of the efficiency gains flow through to airport users in the form of reduced user charges and then to passengers and shippers.

NAA has expressed concern that this type of independent regulator might adversely affect NAA's share price or bond rating. This concern, while understandable, demonstrates the natural conflict between NAA's interests as a profit-seeking company, and the interests of passengers, airlines, and other customers of the airport. However, the experience of BAA, plc and American utility companies, as well as Japanese utility companies, indicates that these concerns are unfounded.

B. Impose Incentive Pricing Regulation

As pointed out in the previous section, incentive regulation has been recognized as a key tool for ensuring that a portion of the economic gains of a monopoly enterprise achieved through

privatization will in fact flow to users. Subjecting NAA to incentive regulation would encourage it to operate more efficiently. The RPI-X form of incentive regulation has been successfully applied to other privatized airports such as those operated by the United Kingdom's private operator BAA plc. The ACCJ urges that this UK model be applied to Narita Airport as well.

Incentive regulation challenges a privatized entity to operate with increased efficiency, and it is likely that incentive regulation of Narita Airport may be opposed by vested interests that have benefited from the airport's past management practices. As discussed in the ACCJ's general report on privatization, strong commitment at the highest levels of government and frequent, early communication are necessary components of the process in shifting to incentive regulation in order to give all stakeholders time to adjust². When establishing the regulatory body, the government must ensure that a fundamental part of the regulatory body's charter is to require NAA to operate more efficiently at lower cost, and to pass those benefits on to all stakeholders, not just shareholders.

C. Adopt a "Single Till" Approach

The single till approach to financial management, wherein an airport integrates the finances of its aeronautical and commercial activities, as explained in the "Best Practices" section of this paper, will be a critical consideration in NAA's future. Both IATA and ICAO encourage airports to use some portion of commercial revenue to offset aeronautical costs. The ACCJ believes this approach is the only fair way of setting fees for the aeronautical activities that make commercial activities possible in the first place.

D. Increase Financial Transparency

To protect the interests of all stakeholders and to allow objective and accurate analyses of NAA's performance, increased financial transparency is necessary. Now that it has been corporatized, NAA will be required to comply with exactly

the same accounting and financial disclosure standards required of regular, private-sector companies. NAA reports that the Japan branch of the international accounting firm Ernst & Young has been appointed as its public auditor. The ACCJ has great expectations that NAA's financial disclosures will exceed the minimum standards required by Japanese law for privately held, publicly traded companies, and will enable all stakeholders to clearly and completely understand NAA's finances. Looking forward to its initial public offering in or after 2007, NAA should prepare itself now for that step by early full disclosure of its financial statements and corporate governance policies through active investor relations.

Since it is now corporatized, the financial statements NAA issues for its first full fiscal year of operations ended March 31, 2005 will be in accordance with generally accepted accounting principles applied to private-sector corporations in Japan. These first full financial statements as a private corporation and accompanying outside audit will establish a baseline from which improvement can be measured as its privatization proceeds in the coming years.

E. Engage Outside Experts

Outside experts such as investment bankers, accountants, lawyers, and management consultants, have been critical in other countries to craft a best-in-class private airport and to ensure successful privatization.

F. Set Goals to Measure Success

In its mid-term plan, NAA set out some specific numerical targets for itself. Along those lines, the ACCJ encourages NAA to additionally adopt the following specific targets.

1. Overcome political obstacles to correct infrastructure concerns and:
 - a. Win the IATA Eagle award by 2010.
 - b. Bring baggage security up to world-class standards by implementing 100 percent "in-line" screening for all baggage.
 - c. Completely eliminate bussing of passengers to airplanes and have 100 percent gate contact for all scheduled flights.
 - d. Establish a high-speed rail line linking Narita and Tokyo.
 - e. Complete a second taxiway for the B runway.
2. Reduce landing fees by 10 percent per year over a period of five years, in conjunction with increased commercial revenue and reduced costs.
3. Have the independent regulator bring all charges down to the level of similar airports in other countries.
4. Raise commercial revenue to 50 percent of total NAA revenue by 2008.

Conclusion

Narita Airport privatization offers both opportunities and risks. Experience elsewhere shows that to succeed, a privatized Narita Airport must operate under a strong, independent regulator that protects and promotes the interests of all stakeholders. This objective necessarily will include reasonable fees and charges, increased infrastructure investments to enhance services and revenue, as well as expanded use of terminal buildings, concession areas, runways, and taxiways.

Statements by NAA officials made to the ACCJ in June and November 2004 and February 2005 offer hope for improved management but also give some cause for concern that the process may fall short of realizing its potential for providing first-class services and facilities for international travelers and shippers. On the other hand, NAA has publicly stated that if landing charges are not decreased Narita's privatization should be considered a failure.

Narita Airport is the first experience most visitors to Japan have. It plays a vital role in fulfilling two of Prime Minister Koizumi's objectives: doubling both foreign direct investment and tourist arrivals from abroad. Because Narita Airport is the dominant gateway linking Japan with the world, the experience it provides needs to be more positive for Japan; and to achieve that goal consistently for the future, its privatization success or failure will have a lasting and disproportionate impact on Japan.

To ensure success, the process should be fully transparent and employ the best practices that have been learned and recognized globally in major airport privatizations around the world. The global best practices outlined and recommended in this paper have been employed in other major infrastructure privatizations that were studied in depth by the OECD, the World Bank, and other highly respected independent multilateral agencies, governments, and private parties. ACCJ members, among the heaviest users of Narita, look forward to contributing to NAA's privatization process and seeing NAA's potential realized.

Appendix A. Narita Airport's History as a Public Entity

In the early years of the development of Narita Airport, the Japanese government stumbled from one difficulty to another in the planning and implementation of the airport, in large part because little incentive existed to consider and coordinate the interests of all stakeholders, which is essential to maximizing revenue, facilitating flights, serving passengers, expeditiously settling disputes with neighbors, building the best-possible infrastructure, and operating efficiently. Instead, the Narita Airport project seems to have been an example of some of the worst tendencies of Japanese bureaucracy. The following intractable problems have plagued the airport.

A. Strained Local Community Relations

In 1962, Haneda Airport was deemed unable to handle anticipated demand for both domestic and international services. In 1966, therefore, the government decided to construct an international airport with three runways 80 kilometers from central Tokyo rather than expand Haneda. Protests by the local community forced the government to abandon its first choice, Tomisato, and the second site in the Sanrizuka area of Narita also quickly became mired in controversies that have hobbled airport operations ever since.

Many residents initially refused to sell their land needed for the planned airport, long-delaying construction. Even today—almost 40 years later—a few residents next to the airport still refuse to vacate land needed for airport development. The government has been reluctant from the beginning of this project to exercise eminent domain to obtain the land with fair compensation to its owners, and still refuses to resolve this continuing problem through its eminent domain rights. In order to reduce community objections to the project, airport authorities agreed early on in negotiations with neighboring residents to reduce the noise caused by new flights by severely limiting the approach and departure paths used by Narita flights. Despite occasional amendments, these old agreements still apply and have significantly limited the capacity of the

second runway opened in 2002. The 23:00 nighttime curfew also limits the number of airlines that can use Narita and landing slots available to those that do. The curfew adds costs to airlines and passengers during periods of bad weather and flight irregularities. There is a long waiting list of airlines trying to gain access to Narita due to the accumulated effect of all these constraints, namely space, facilities, runway use limits, airspace control and operation. Extended hours of operation recognizing reduced noise levels of modern airplanes would permit more flights and open the door to new airline companies.

B. Severely Limited Infrastructure

The Narita "footprint" is 1,084 hectares. With a collective Kanto area population of 39 million, Narita ranks as the smallest international airport serving a major international city when measured in hectares per million residents, at 28 hectares per million. By contrast, the average for a group of 25 major Asian, North American, and European metropolitan areas, many of which have more than one international airport, is 517 hectares per million residents³.

In addition to its small footprint, Narita has had many infrastructure inadequacies that affect the airport's customers, passengers, airlines, and shippers to varying degrees.

- A second runway that took 16 years to construct and is still considered "interim" because, at only 2,180 meters, it is not long enough to handle large airplanes or departures of long-haul flights.
- The lack of a second taxiway for the interim runway results in taxi times of up to 40 minutes. This is inconvenient for passengers and expensive for airlines—to say nothing of the negative environmental impact of the additional tons of jet fuel that are consumed.
- De-icing facilities have been constructed without lighting and in an area affected by departing airplanes.

- Insufficient warehouse space for airlines and freight forwarders.
- Congested passenger terminals, particularly Terminal 1 in the afternoon and Terminal 2 in the morning.
- Insufficient space to install adequate self-service check-in devices that would reduce congestion.
- Insufficient space in baggage-handling areas to install the latest in-line security equipment, causing longer check-in queues at x-ray machines that are located in already-crowded areas.
- A limited variety of concessions in a cramped space, particularly outside immigration.
- Baggage carousels that cannot be lengthened to handle new large airplanes.
- An inadequate number of gates that connect directly to a plane, so-called contact gates, at both terminals limits capacity. For example, in February and March 2005, approximately 18 percent of flights could not be accommodated at contact gates. Using buses to transport passengers to remotely parked airplanes is inconvenient, expensive, and enormously unpopular with passengers. (In recently past years, an even greater number of flights were not able to use contact gates. And it is largely because airlines—at significant cost to themselves—have towed their airplanes back and forth between temporary parking positions away from gates and the gates themselves that the 18 percent figure has been achieved.)

The ACCJ recognizes that NAA is in the midst of a large scale construction project at Terminal 1 that will alleviate some of the problems described above.

C. Inefficient Operations

Narita's inefficient operations have directly harmed Japan's and Tokyo's competitive position as an Asia-Pacific center for international business.

Noise footprint commitments made in the 1970s require the use of a single airspace entry and exit point for both runways, dramatically reducing the added capacity of the new second runway. Elsewhere, at major airports around the world,

parallel runways operate with separate arrival and departure flight paths, thereby doubling airport capacity. The airspace over Tokyo is heavily congested and allocated to different entities, including Haneda Airport, the Hyakuri Air Self Defense Base, and the U.S. Air Force base at Yokota. Noise limitations, combined with Tokyo airspace limitations, cause frequent in-air flight delays.

The nighttime curfew restricts both cargo services and low-cost nighttime "utilization" flights to leisure destinations. Both affect airlines and passengers by reducing flying opportunities and increasing Narita's common costs. Consumers also lose opportunities and encounter other problems. As a result of the curfew, for example, Honolulu immigration queues are overly congested because all Tokyo flights arrive almost simultaneously.

Although the number of daily slots increased from 180 in 1978 to 546 in 2002, slot volumes are still restricted due to agreements with the local community. The longer A runway handles 32 takeoffs and landings per hour, while the "interim" B runway handles just 12 per hour. These figures are significantly below international standards; each runway should be able to process more than 30 takeoffs and landings per hour. Low runway utilization also precludes the Japanese government from reaching international agreements on flights between Tokyo and other countries and dramatically increases costs to both passengers and airlines for the flights that do operate.

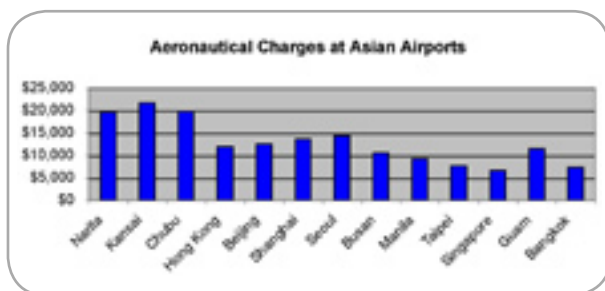
D. Excessively High Charges

Landing charges

The landing charges at Narita are currently the second most expensive in the world, just slightly below those at Kansai International Airport in Osaka. Based on the ¥2,400 per ton rate applicable at the time of publishing this paper, it costs ¥948,000 (\$9,028) to land a B747-400 with a maximum gross take-off weight (MTOW) of 395 tons at Narita. This is approximately two times the average of thirteen Asian airports surveyed in February 2005, and as published in "IATA Airport

and Enroute Charges Manual,” (Throughout this paper we convert Japanese Yen to U.S. Dollars at an exchange rate of 105.)

Airport cost comparisons are difficult to calculate because each airport charges in different ways—some include charges for many services in the landing fee, and others charge separately. Fees for air navigation are also collected by means that differ from country to country. Still, no matter how the charges are measured, Narita is among the most expensive airports in the world. The chart below, which indicates overall airport charges paid by the airlines, is based on data from the “IATA Airport and Enroute Charges Manual,” and it shows that Narita is joined by Kansai and Chubu in levying aeronautical charges that are far in excess of their peers.



Fees Paid by Passengers

Narita’s airline users are not the only group paying fees that are higher than in other countries. The passenger service facility charge at Narita is ¥2,040 (\$19.43) per passenger. This is lower than Kansai, which charges ¥2,650 (\$25.24), and Chubu, which levies a ¥2,500 (\$23.81) fee. In this fee category too, the Japanese airports lead their peers with a passenger levy that is more expensive than any other airport in Asia we sampled. Narita’s passenger charge is 43 percent higher than the average for the 13 airports in the chart below.

One might rightfully ask if the charges at Narita Airport are really unreasonable if they are very similar to what is being charged at the other two international airports in Japan. The ACCJ believes the airport fees at Narita are too high, even in the Japan market, for two reasons. First, Narita has consistently posted operating profits (that is,

its charges and other revenues have exceeded its very high expenses), as detailed below. Secondly, the airport has greater efficiencies of scale than Kansai and Chubu by virtue of its greater flight activity and passenger throughput. NAA also has the opportunity to collect more revenue from concession sales due to the higher proportion of transit passengers. In short, an efficient NAA should be capable of handling passengers at a lower cost than its other domestic competitors.



Non-aeronautical revenues

Amsterdam, Copenhagen, Dubai, Hong Kong, Seoul-Incheon, and Singapore airports all derive 40 percent or more of their total revenue from non-aeronautical sources, such as retail sales from shops and dining. Narita’s non-aeronautical revenue, however, is currently just 30 percent of total revenue. This lack of non-aeronautical revenue shifts the economic burden of covering airport costs and realizing a reasonable margin to the airlines and passengers. Until corporatization in April 2004, the MLIT restricted commercial activities at Narita. The NAA, which controls Narita’s operations, could not operate commercial ventures, such as retail stores at the airport, or participate in complementary business activities. These restrictions on earning revenue from ancillary sources at the airport have, for many years, forced the airport operator to impose excessive charges to airlines and departing passengers.

Excessive profitability

In the fiscal year ending March 31, 2004, the NAA reported accumulated capital stock of ¥305 billion, notwithstanding considerable spending on capital infrastructure and a reduction in passenger traffic in 2003 attributed to the SARS outbreak and the war in Iraq. Narita has been run very inefficiently as a public entity, yet research

presented by IATA suggests that lowering the airport's landing fees from ¥2,400 to ¥2,000 would still provide NAA with a ¥10 billion annual profit based on its previous operating model. An MLIT forecast for years 2002-2005 suggested Narita's annual profits would increase 10-20 percent per year.⁴ Furthermore, IATA estimates that ¥82 billion in excessive land costs has been assessed to the landing fees cost center in the period 1978-2002. The high land cost enabled the NAA to shift reported profits from its "Landing and Parking" cost center to its "Others" cost center.⁵ This rate of forecasted profit growth coupled with historical profits from land, lead the ACCJ to believe that the NAA's profits have been excessive for a government-owned airport presumably operated for the benefit of users. Indeed, a December 2004 survey by Airline Business magazine of the world's one hundred largest airport operators in terms of revenue showed that average operating margin for 2003 for the one hundred operators was 19.3 percent, and Narita's 31.2 percent margin for the year made it the sixth most profitable airport operator in the world.

E. Inefficient Business Practices

Limited bidding process

Until it was corporatized in April 2004, the NAA was required by law to abide by the government's mandated and very strict tendering process. The process did not encourage regular, healthy, or competitive bids. When procuring goods or services, for example, the NAA had to accept one of the tenders submitted without further negotiation. Bid requests were written in such a way that very few companies met the bidding criteria. Major contracts, such as for airport security, have repeatedly been awarded to the same company ever since the airport opened. The NAA has cited contract bidding as one of the means by which it expects to lower costs after it becomes a fully privatized entity⁶.

NAA has told the ACCJ that NAA's greatest successes in lowering costs from competitive bids have come from construction projects. Previously, only contracts in excess of ¥500 million could be put up for bid. With the change in corporate structure, NAA now puts all contracts in excess of ¥100 million up for bid. In addition, NAA now

uses less stringent qualifications for bidding companies, in an attempt to increase the number of bids. Last, and most significantly, NAA reports that it works to get winning bidders to resubmit lower bids in a follow-on round of negotiation. NAA claims to have saved 10 percent or more on recent construction contracts compared to what they used to pay as a state-owned enterprise.

While NAA has made strides to lower costs with regard to construction, the ACCJ believes that even greater improvements can be made. The security contract in particular has not yet been competitively bid. Instead, the same security contractor is providing service on a year-to-year contract basis, with a tacit understanding that its contract will be renewed for a number of years. While airport security is a critically important service, and the quality of the firm's work force must be ensured, the ACCJ believes that the best way to meet the dual aims of high quality and low cost for security is to allow open competition for this contract. A contract term of 5 years, for example, would reasonably alleviate uncertainty for the contractor and allow for a higher quality work force.

Lack of transparency and accounting standards

Historically, the lack of transparency in all areas of Narita's finance and accounting practices have been of deep concern to airlines and other airport users and has represented a fundamental obstacle to improving its efficiency. Specific areas of concern include:

- Excessive land valuations
- Large pension provisions
- Lack of cash flow disclosure
- Lack of disclosure of true operating costs

Appendix B. Case Study: The United Kingdom Experience with Airport Privatization

London's three largest airports—Heathrow, Gatwick, and Stansted—were privatized in 1987. Their joint operator, BAA, plc (known as the British Airports Authority before privatization), is the most mature example of a privatized airport operator in the world. Two other smaller airports in London—Luton and City—are also operated by private entities. These airports all face significant competition to win customers. Each airport has carved out a niche in terms of the types of passengers and airlines it serves: European business (City); ultra-low-cost (Luton); freight and low-cost passenger airlines (Stansted); and international gateway (Heathrow). Gatwick airport serves as an alternative to congested Heathrow, handling charter flights, low-cost airlines, and international services that cannot gain access to Heathrow. Because of its proximity to the city center and rail link, Heathrow is generally preferred over Luton, Gatwick and Stansted. There is some spillover between these airports, but each tends to serve a specific market.

The competition among these airports brought on by privatization has resulted in several desirable outcomes, such as low airport charges and terminal facilities that are tailored to the airport's niche. For example, Luton Airport has no jet bridges, all gates and ticket counters are shared, and the airport focuses on very fast turnaround times for its efficient, low-cost airlines. BAA derives 60 percent of its revenue from non-aeronautical charges, which allows BAA to offer very competitive rates to airline operators, thereby encouraging airline operators to bring more traffic through BAA airports.

In discussing the privatization of Narita, it is important to note that no such competition has existed between airports in Tokyo. Also, Haneda and Narita face severe capacity constraints and their supply of landing slots remains far short of demand. There is little or no competitive pressure to address those problems. The situation in Tokyo therefore requires regulatory safeguards equivalent to or exceeding those implemented in the UK.

The regulatory regime put in place in the UK is a combination of the rate-of-return and incentive methods. The primary elements are as follows.

- a. BAA's revenues are set by the regulator and are tied to a per-passenger price cap.
- b. Capital expenditures for the airport are jointly agreed upon by regulators, the airport operator, and the airlines.
- c. The regulator, the Civil Aviation Authority (CAA), sets a risk-adjusted allowable rate of return.
- d. The CAA estimates commercial revenues.
- e. The single till method is employed, with the revenue requirement from airlines subtracted from the commercial revenue.
- f. The regulator requires annual efficiency enhancements.

In public statements and in its annual reports, BAA, plc highlights the interdependence of the airlines and the operator and its own drive to lower airline charges.

For example, in its 1999 annual report BAA says, "The income from commercial activity enables the business to keep down charges to airlines—which inevitably are passed on to passengers in the fares they pay—and invest in airport infrastructure. It is no accident the UK is the only country in the world where major airport infrastructure is provided at no cost to the taxpayer."⁷

And BAA management, in its Annual Report 2000, describes the company's operating principle as follows: "By offering customers what they want, we can maximize commercial returns, making it possible to keep airline charges low and invest in airport infrastructure."⁸

Endnotes

- 1 NAA Green Port Report, October 2003.
- 2 ACCJ Privatization Task Force: "Applying Global Best Practices to Privatization in Japan," August 2004
- 3 IATA Airport Development Reference Manual 9th Edition - January 2004.
- 4 IATA User Charges Seminar, Tokyo April 9, 2003
- 5 IATA letter to the NAA, December 20, 2002
- 6 NAA Green Port Report, March/April 2004.
- 7 BAA Annual Report 1999, page 20.
- 8 BAA Annual Report 2000, page 26.