

Irish Air Traffic Control: Primed for Privatisation

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Privatisation is a topical issue at the moment, with many semi-state bodies being suggested. Paul Geaney examines the case of Ireland's Air Traffic Control (ATC), where the sole provider is expected to regulate itself. He rejects suggestions that privatisation will lead to monopoly rents, highlighting competition for the market. He also sees no danger of a reduction in safety standards. Thus, he concludes that privatisation is necessary to hope for any Irish-run ATC in the future.

Introduction

One can't help but smile wryly at recent events in Britain. The proposal by the British government to create a Public Private Partnership for their National Air Traffic Service (NATS) has caused the now customary furore among their left wing press. A cursory glance at the facts shows that the very elements of privatisation most feared by people such as falling safety standards, failing service and profiteering, are in fact least likely when an industry is opened to the rigours of competition. Below, I have hopefully taken something more than just a cursory glance at the major issues surrounding privatisation of the industry, specifically looking at the future of Irish Air Traffic Control (ATC) provision. My analysis starts with a critique of the system presently in operation, which has uncomfortably married regulation and service provision, with both jobs designated to the same organisation. With the separation of these, which I believe should be undertaken without delay, comes the dilemma of what form the resulting entities should take. Having examined that, I present my case for the privatisation of ATC service provision in Ireland. The conclusion I come to is an uncompromising one: prompt privatisation will provide a myriad of opportunities now and in the future, failure to privatise will consign Irish run ATC to history.

The concept of an organisation being both the sole producer and the regulator of a market has long since been dismissed for its lack of transparency and the potential for conflicts of interest that arise from such a concentration of power. Subsequently, and to the benefit of all, lawmakers and consumers alike rarely countenance such scenarios. However the Air Traffic Control (ATC) business is a sorry exception. For example, the Irish Aviation Authority (IAA) is the monopoly provider of en-route air traffic services in Ireland, and in the Atlantic airspace over

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which Ireland has jurisdiction¹. For safety reasons all domestic en-route ATC providers are monopolists. This I will show, contrary to conventional wisdom, does not preclude competition, and will be efficient if privatised. The problem lies with another role delegated by the government to the IAA, as outlined in the Irish Aviation Authority Act of 1993².

The Act made the Authority the regulator of the ATC industry, effectively making the service provision wing of the company answerable to the regulatory wing, both of whom are answerable to the same board of directors and Chief Executive, a post held since by Mr. Brian McDonnell. It is important to make clear just how unsatisfactory a situation this is. The role of the regulator of any industry is to ensure that the companies in the industry over which it has jurisdiction act in accordance with the regulations as set out by it. So if a company was to act in a manner which contravened those rules, the regulator must take action against the firm, most likely against its management. So if a regulatory body is headed by the same person as the only service provider (company) in the industry, and thus the person they are likely to be criticising, the potential for conflicts of interest are great and no matter how objective this amalgamated organisation is in operation, the independence of the regulatory wing will always be brought into question. Though the IAA has always retained the confidence of its customers (the airlines) and the government, the existence of perceived or potential conflicts and lack of regulatory autonomy is damaging to the Authority. Therefore the regulatory and service provision wings of the Authority must be separated. This is a policy which has been followed by aviation authorities elsewhere, for example in Canada and the Netherlands, it has been called for in the UK since the late 1980s and is a stated objective of the EU Commission. It is also in line with a broader domestic government policy that has seen the decoupling of regulation from service provision in the utilities sector.

If we separate the two bodies, what structure should the newly independent entities have? I believe that question answers itself when we examine the culture of

¹ The Irish air traffic service and its British counterpart (NATS) have joint jurisdiction over the airspace between 15 and 30 degrees latitude, with the remainder of the Atlantic airspace to the west controlled by NavCanada.

² The IAA Act incorporated the IAA as a government sponsored commercial body, reporting to the Minister of the Environment, Transport and the Regions but having broad operational independence from her Department.

a regulatory body and that of a provider of services to customers. The cultures of these two types of organisation, as pointed out by Mr. Philip Hughes of the IAA³, should be at opposite ends of the spectrum. It is accepted that regulators should never be profit orientated and that no incentive should be given for them to be so. The regulator should be concerned solely with the performance of companies in its industry with regard to the rules of that industry and of taking action when those rules are breached. This is also the opinion of the Chief Executive of the IAA, Mr. Brian McDonnell⁴. He believes that the state has a role to play in the regulation of the ATS industry, but this is best delegated to a semi-State body rather than dealt with in the appropriate government department. Such a structure would allow for independent regulation, without financial constraints or concerns. Mr. McDonnell is also of the opinion that, as the signatory of all international civil aviation agreements, it is the government that must be responsible for their implementation.

Both men also agree that the essence of a service provider should be to focus on the provision of the best possible service by the most efficient means. The government has proven itself incapable of this for all commercial services it has provided. This is due to the absence of competition and a lack of performance-based incentives. It is however, far more efficient for services to be provided by the private sector. Optimal efficiency levels can only be achieved with privatisation of ATC and the subsequent goals of achieving commercial returns while being competitive.

Some people argue however that the ATC sector does not lend itself to competition because the nature of the industry dictates that only one provider of the service can operate in each country's airspace. Therefore the chosen operator must be a monopolist. It is true that there can only be one operator in a region, for safety reasons. The notion of competing ATC providers struggling for competitive advantage and vying with each other for the quickest routes through the shared airspace could lead to safety problems, something that is not countenanced in the industry. So if the business is privatised, only one firm can operate in it. While the government fills the role of sole provider, some argue that charges are kept to a minimum as the IAA only looks to recover costs. The argument goes that private monopolies will want to increase charges so as to boost profits and with no competition will go unpunished for doing so. This is conventional wisdom and has

³ In an interview conducted by myself with Philip Hughes, one of the project managers for the IAA on the 'Airline Bid' conglomerate, presently vying for the licence to run NATS.

⁴ From a recent interview conducted by the author.

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led to economic regulation of the industry wherever it has been privatised (for example the proposals for privatising NATS). Even Mr. McDonnell would support such a step. He argues that an economic regulator should be allowed to measure the firms unit costs against a European benchmark, and if they are too high, should be given the powers to force the company back into line⁵. However I don't believe this is necessary. In an industry where there cannot be competition in the market, there can be competition for the market. This will ensure that the licensed provider has an incentive to price fairly and provide the best service possible.

Economic doctrine tells us that in an industry where one firm can provide a service more efficiently than two or more firms, then just one firm will survive. If this firm is subsequently left unregulated it will set price and output at monopoly levels in order to maximise its profits. So in practical terms, the privatised monopolistic ATC provider would charge airlines significantly more than it would cost to provide them with the service. Therefore a government sponsored economic regulator is needed to ensure that airlines are not overcharged and that prices are kept at reasonable levels.

However in his article, "Why Regulate Utilities?", Harold Demsetz argues that this is based on a flawed interpretation of the concept of competition. It was he who first argued in a modern context, that where you cannot have competition in a market, you can have competition for the market. Although Demsetz was writing about the privatisation of utilities, such as electricity supply, I believe the underlying principle is just as apt for ATC provision. If we assume for now that there are a number of bidders, bidding for the sole licence to provide ATC services in Irish airspace, and that that licence is renewable every five years, competition for the licence will push down the per unit cost that will be charged by the victor. This is because the bidder that fulfils the government's pre-requisites and has the lowest bid price for the provision of the service will win the licence. In other words, there is no incentive to set your charges higher than they should be, as you will use the "beauty contest" being held for the allocation of the licence. Nor is there any incentive for the successful bidder to renege on the price he proposed to charge while bidding; if he increases his prices, he will lose out to a more competitive bidder when the licence comes up for renewal. Equally if he fails to pass on cost reductions to customers, another bidder will next time around. Such a transparent system removes any incentive for the service provider to increase charges to "unreasonable" or monopolistic levels and will ensure that market driven efficiency prevails, which is

⁵ From a recent interview conducted by the author.

more dynamic and healthy than “efficiency” imposed from above.

Returning briefly to the assumption that there will be many bidders, which is necessary for the theory to hold (because without a number of bidders, there is no competition). There is little doubt that such a number of bidders would compete for the ATC licence. Irish ATC is a low risk, high growth and profitable business, making it attractive to bidders. Also, the cost of bidding is low and the ATC infrastructure is in place, so there are no barriers to entering the bidding contest. This has been verified by the fact that nine bids were originally considered by the British government in its sell-off of NATS, with three bidders now in the final round.

So, given that there would be a pool of bidders, each of whom would act independently to gain the licence to provide all en-route ATC services for a pre-determined period of time, I see no need for economic regulation of the industry. The price charged would be set through a competitive bidding process and maintained by the promise of similar bidding processes in the future, ensuring that charges would not deviate significantly from the per-unit cost incurred by the firm.

It is noteworthy that the bidders must not necessarily be for-profit organisations. The Canadian model is illustrative in that its ATC provider NavCanada is a non-share-capital corporation (or trust). Its board comprises of representatives of the airlines, unions, government and 'independents'. The composition of the board is not particularly significant, what is important is that:

'it does not distribute profits; any excess earnings are re-invested in the company, kept as operating reserve, or used to reduce debt or user charges' (UK Dept. of the Environment, 2000).

So the company is not driven by profits, but the results are the same as for profit orientated companies- costs are minimised and efficiency is paramount. The composition of the board in the NavCanada model is not significant because a similar model is being used by the 'Airline' conglomerate in the bidding process for the NATS operations in Britain. That group consists of some of the largest airlines in Europe and the IAA, but the other groups on the NavCanada board are not represented. Clearly the model is a viable one, even when firms could opt for creating for-profit companies. Of course the reason such a model is beneficial to the airline group is that any commercial returns can be fed into reducing charges, which will filter through to the same airlines as lower costs. The benefit to the IAA is

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largely strategic, as it would position the company well for the consolidation that is on the horizon for the industry. The IAA will also benefit commercially from contracting its expertise to the ATC centres in Britain. Therefore, whether the private monopolist is aiming to maximise profits or to minimise charges to customers, the result is a more efficient service for everyone. Greater efficiency is one of the great advantages of privatisation, as is greater access to capital and improved safety. It is to the issue of safety that I now turn my attention.

One of the fears often voiced in certain sections of the media when the government privatises industries formerly under its control is that in the rush for profits, corners are cut and safety is compromised. This has been the catch-cry of the left wing press in Britain since the government there announced plans for the privatisation of NATS in mid 1998. However it is a claim strenuously denied by Mr. McDonnell. In this industry, he argues "*safety is not taken for granted, rather it is a given*"⁶.

This statement underlines how fundamental safety is to the industry. Safety is the bedrock upon which companies build efficient, profitable businesses. Without the highest safety standards, demand for air travel would dry up, leaving the private ATC provider either bankrupt or out of a contract. The reason such issues don't arise is simply because the importance of safety is never overlooked. This is as true, if not more so, for private companies as it is for those run by the government. Where breaches of best safety practice are unearthed, the safety regulator should step in and enforce the safety guidelines that are in place. We can say with the greatest degree of certainty that such a safety regulator would be established by the government in the event of privatisation so there is no fear of falling safety standards due to privatisation.

In fact another characteristic of commercial companies would suggest that safety would be enhanced if privatisation were to be undertaken. Private companies have a much greater incentive than government bodies to perform efficiently and to a consistently high standard. To this end, a culture of accountability exists in private firms, where it is absent from the civil service. There is no clear delineation of responsibility when a quasi-independent semi-State agency (such as the IAA) has to report to a government minister and his or her department. Private companies, on the other hand, have clear hierarchies with a more structured delegation of duties, allowing errors to be rectified and the cause (be it human or machinated) identified.

⁶ From a recent interview conducted by the author

The technological leaps that have been a defining feature of the industry in recent times are set to speed up. When put in the context of continued growth in air traffic, estimated by the Air Transport Association at 5.3% per year in Western Europe between 1999 and 2003 (CSFB & the UK Dept. of the Environment, Transport and the Regions, 2000), it is clear that large amounts of investment will be needed in the coming years:

“Capacity must increase both within the upper and lower airspace, and at airports in order to keep up with demand. This will require significant investment if existing safety levels are to be maintained” (Ibid).

In such a business environment it is important that the board of the ATC provider should have funds for capital investment readily available to it, so as to advance the safety, service level and strategic position of the firm as and when needed. Presently, the IAA is constrained in its ability to act in such circumstances. Any proposal by the board that involves capital expenditure of more than £3.5m requires the approval of the Minister of the Environment, Transport and the Regions and the Minister of Finance. Mr. McDonnell estimates that this triples the length of time it takes to get approval for such expenditure in comparison to the time needed by private companies. It also means that the ministers, who can boast a far inferior knowledge of the industry than the board of the IAA, can in theory refuse to allow such spending, despite the fact that the IAA is self-funding. This is clearly ludicrous. Our ATC provider should have access to adequate private capital without government constraints to ensure the safety of air travellers and prosperity for the company. This will only be achieved through breaking the ties to the government and privatising the company.

Improving efficiency would not just help maintain safety in the skies, or the company's margins, it would also improve the service provided to customers. ATC caused delays have a huge impact on the costs of airlines, and hence on the traveller. This is caused by the reduction in the efficient utilisation of aircraft, higher fuel costs and increased labour costs associated with such delays. The problem was identified in the late 1980's:

“In total, 150,000 hours of flying time was lost through delays in 1988...and some 70% of these delays were caused by shortcomings in air traffic control. The total cost penalty

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is put at £4.19bn." (Egan, 1989)

The problem has been exasperated in the 1990's by the proliferation of flights due to the deregulation of the airline industry. The problem has also been worsened by the inability of government run ATC providers to treat airlines as customers, not surprising due to the lack of commercial incentives for them. However private companies, by tailoring their service to the needs of their customers, can help minimise delays and provide an efficient service.

The next decade promises to be an exciting time for European ATC providers. The EU has developed a "single sky" policy to integrate European ATC services so as to boost safety and efficiency. As the market consolidates, only the most efficient providers will survive, and subsequently thrive. Despite its small size, Ireland's ATC provider is strategically placed at the gateway between Europe and the US. It is also highly respected. However this is not enough. In order to capitalise on this competitive advantage, the company needs to split, allowing ATC services to be run by the most efficient private company that bids. This will boost efficiency, streamline decision making and open channels of capital investment presently closed to the IAA. The emphasis on safety should not and will not wane. If allowed to privatise, the company could find itself as one of the standard bearers of 21st Century ATC provision, if not, it will be drowned in a wave of consolidation and will become a relic of the past.

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In addition to my written research, I was very fortunate to have had the opportunity to interview at length Mr. Brian McDonnell and Mr. Philip Hughes of the Irish Aviation Authority and I am very grateful for their time. Despite repeated attempts to contact appropriate officials in the Department, I was unable to arrange an interview with any Department official.