

Establishing Regional Airport Authorities in Korea

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As Korea enters the ranks of advanced industrial countries, it is facing the need to make strategic decisions in the economic sphere. The aggressive action of president Kim, Young Sam, in restructuring the financial system, and doing away with the old system of contract award which too often led to corruption, are examples of what distinguishes most developed countries from those that are still developing. Indeed, Korea -- with an GDP of over \$300 billion, and per capita income in 1993 of almost \$7,500 -- has clearly graduated from the ranks of 'less developed' into those of 'newly developed' countries.

Of course, reaching 'developed' status does not mean a country 'stops developing'. This 'developing' process continues regardless of a country's current level of economic development. Even highly advanced industrial countries are still developing -- but on the leading edges of technology. In fact, many times they are developing even more rapidly than less developed countries, but in different ways. Less developed countries (LDCS) undertake development through 'extensive' economic growth. Their growth is primarily through expanding into 'new' industrial sectors, and acquiring 'borrowed' technology from abroad. In most cases, this 'borrowed' technology is two or three generations behind 'state of the art' (defined as commercially marketable world-class technology).

As countries eventually graduate to the 'developed' status, they produce indigenous technology and, when bringing in foreign high technology, pay

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intellectual property royalties through license agreements with the foreign technology suppliers.

In addition to changes in methods of technology acquisition, new financial approaches and legal structures must be introduced to sustain an advanced technology society. In Korea, old methods of directing economic growth — through ‘five year plans’, and state subsidized credits to chaebol who pursue government directed development objectives, — are no longer applicable. Korean industry must allow the ‘invisible hand’ of free market competition to operate, with the result that the strong and efficient will grow and prosper, while weak and mismanaged companies are resigned to the dustbins of history. Already, in the increasingly overcrowded automobile manufacturing sector, the battle lines of darwinian competition are being drawn. It is not the role of government in advanced industrial society to referee the struggle of companies, so long as they compete fairly on a level playing field — government only ensures that the rules of fair play are enforced. Government support for weaker competitors will only lead to general weakening of the entire nation’s competitive position.

In the absence of ‘five year plans’ and ‘policy loans’, what is the appropriate role of government in supporting advanced industrial development? One such needed function of government is to plan and assist development of infrastructure for industry and commerce. New sea and air ports, new railroads and highways, telecommunication systems, and advanced technical education, all are needed to support an advanced industrial base. These massive projects cross into the political jurisdiction — where they will be built? What tax basis and compensation programs will be used to finance the projects? — that only government can adequately resolve.

In Korea, the government neglected upgrading infrastructure for almost 15 years, since the early 1980s. Today Korea is facing a tremendous ‘underinvestment’ situation, where shortages of infrastructure threaten the con-

tinued pace of economic expansion. A recent study by the Korean Transportation Institute estimated that transportation bottlenecks due to inadequate infrastructure results in transportation costs running 17% of the total production cost of merchandise (this compares with the U.S. where these costs are less than 10%). Yet the costs of building new infrastructure over the next 10 years are estimated by various sources at over \$140 billion. The government is faced with a dilemma: it can raise taxes to pay for these projects, (but this will be very unpopular with the voters); it can borrow abroad—foreign debt levels were paid down in the 1980s, and so Korea has access to sovereign borrowing at reasonable rates; or it can open the infrastructure market to ‘private capital’ direct equity investments by private companies, both Korean and foreign.

In fact, the government seems to have adopted a mixed policy, including some of all three forms of project finance. The Korea development bank has been authorized to borrow abroad for financing infrastructure projects that will be launched in 1995, while the private sector is preparing feasibility plans for proposed privately financed infrastructure projects under the ‘soc bill’ which passed the national assembly last summer. (these feasibility plans will be submitted to the government in the next half year on projects valued at almost \$10 billion).

Another method of financing infrastructure projects, —not yet under discussion here in Korea, —is ‘project bonds’. Such project bonds are typically sold directly to investors for a given infrastructure project. The bonds offer a fixed rate of return (based on the risk of the project, the length to maturity of the bond, guarantees offered by a government, and so forth).

The issuing body for project bonds is often a quasi—governmental organization, set up at the direction of the government, to fund the project, supervise construction and, in some cases, operate the completed project. Such quasi—governmental organizations are typically given their operating ‘cha-

arters' or 'franchises' from local municipal government (city, province or state).

One reason Korea has not utilized project bonds in the past is that local municipal authorities traditionally had limited control over decisions on projects and finances. This situation is expected to change this summer with the direct election of mayors and governors. Another reason project bonds have not been widely used is there is limited legal precedent here in Korea for a quasi-state organization issuing a financial obligation document.

The ability of the financial community to rate such project bonds is limited by the lack of transparency of financial prospectus, and questions regarding the security of tax basis for the government guarantee. Nevertheless, these problems can and must be overcome to establish a governmental financial structure whereby infrastructure projects can be successfully financed.

Today I will speak of a particular quasi-governmental organization typically found in the United States—the regional airport authority. The airport authority is just one type of 'chartered company' used to finance, construct and operate infrastructure projects in the U.S.—we also have subway authorities, highway authorities, and seaport authorities. In all these cases, a charter of franchise is granted by the municipal or state government to the 'authority' to build and operate an infrastructure project on behalf of the public good. The charter is subject to revocation if the 'authority' fails to uphold the terms, (mismanagement, cost overruns, etc). The charter allows the government to effectively turn over the project to a qualified private sector team, with the government maintaining a role as overseer. But let us turn to the case of regional airport authorities.

In the U.S., regional airports were developed alongside the paving of highways, the building of factories and offices. In the 1920s, most of the

U.S. was rural. There were large distances. Air transport was essential for delivery of time sensitive items like the mail. So almost every 'city' or 'town' of any size had its own airport. At the beginning, this was not much of an investment. Only a dirt runway, and maybe a hanger to store the plane. Later, the airport paved the runway, and put up a control tower. When an airport got busy, the city or county fathers set up a committee, called an airport authority, to run the airport.

In the 1960s, and later, most major U.S. cities built 'regional' airports, which were large enough to accommodate medium sized commercial jets, and at least several flights per day. These 'regional' airports also earned income by servicing a population of 'general aviation', including air delivery services, corporate planes, and private pleasure planes. They earned income from charging for landing rights, hanger fees, fuel service, parking fees for travelers, concession stand rental fees, and so forth.

Most of these 'regional' airports were formed by a city or county, and incorporated under the legal form of 'municipal airport authority'. This authority delegated the responsibility of providing airport services to the airport authority board, which was appointed by the mayor (sometimes the governor). Board members were selected from a range of citizens, particularly those with major business experience, but including lawyers, usually one public official, and so forth. The board was responsible to the city for efficiently running the airport. They hired a general manager (professional airport administrator), and reviewed all plans for construction, financial requests, the profit and loss sheets. In essence, they acted like the board of directors of any major corporation. They were responsible for insuring the airport made a profit, while at the same time offering the city and its citizens a needed transportation service.

Let's look at a specific example of a 'municipal airport authority' to get a better idea of how it is organized. The case we will use is the 'Dal-

las—fort worth regional airport’. Dallas—fort worth airport was formed by a contract and agreement between the Cities of Dallas, Texas and fort worth, Texas, on april 15, 1968. The contract set 1) The terms of board members 2) The election of officers 3) The establishment of the board, board qualifications, composition of board, compensation, powers and duties of board, and so forth. On november 12, 1968, the airport authority issued it’s first regional airport joint revenue bonds, valued at \$35 million, ‘for the purpose of defraying in part the cost of constructing, equipping, and otherwise improving the airport’. The security for the bonds (security they would be paid back) was ‘from the revenues derived from the operation of said airport’. The funds raised by the bond issue were restricted to the use only of the airport authority, and only for certain predefined uses. This gave the bond buyers assurance the money would be used effectively.

Bond buyers were also offered income tax exemption. But as I said earlier, The success of the offering was tied to the confidence the investors had in the viability of the project. Since there was no direct obligation by the city to pay the bond holder if the airport did not make money, the bond buyers insisted on high level of proof the airport board knew how to manage the airport. In a sense, the popularity of the bonds was a vote of confidence that the airport was being run properly.

In the case of Dallas—fort worth, this was certainly true. The total gross revenues of the airport grew from \$94 million in 1983 to \$218 million in 1992. Net operating and maintenance expenses were \$41.4 million in 1983, and \$93.3 million in 1992. This means the ‘profit’ available to pay back bond holders, and establish reserves for future expansion, grew from \$52.8 million in 1983 to \$125.1 million in 1992. This is not a bad growth in operating profits. In fact, the Dallas—fort worth airport is extremely successful, and it’s construction and operation is at almost no cost to the taxpayers. In fact, the total cost included under 10% taxpayer money, with

most being provided by the airport bond holders. This is capitalism at its best — providing a useful public service, with private capital financing, and paid for out of the quasi-public enterprise's profits.

In addition to the convenience to the citizens of having an airport nearby, so they can easily visit friends and relatives in other cities, the airport is an economic growth engine. It produces jobs at the airport, companies that locate in the region because they can cover the region due to the ease of transportation (for products and personnel), and so forth. Dallas—Forth worth estimates that one third or more of all jobs in the region have been created as a result of this regional airport.

Lets fact it, a company thinking about locating in two cities will choose the one — all else being equal — that has the best transportation system and airport.

The 'airport authority' model is not foolproof. If other factors do not contribute, flights to the airport will not occur, and its profitability will suffer. Tourism is an important component of air traffic. If Korea's tourism infrastructure, hotels, services, are inadequate, tourists will not use the airport, no matter how nice it is. In the early stages, there will be fierce competition among cities to attract investment, and airports will be built to give competitive advantage. Some cities will be more successful than others, and their airports will grow.

But from the view of this presentation, the important point to be made is that 'private/public partnership airport authorities' and 'private investor purchase of airport bonds' will improve operating efficiencies of Korean aviation, and more importantly reduce the strain on the central government to finance these infrastructure needs with tax revenues. As an additional benefit, the use of regional airports, once they have reached critical mass to be convenient for business and tourist travelers, will reduce the pressure on Korea's already overcrowded highways. Local government officials al-

ready recognize the potential for airports to encourage economic growth in their region. Finally, local airports contribute to the development of new industries, such as commuter airlines, and aircraft manufacturing.