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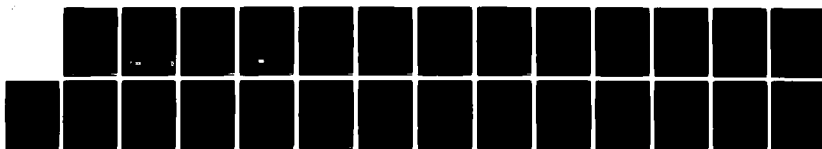
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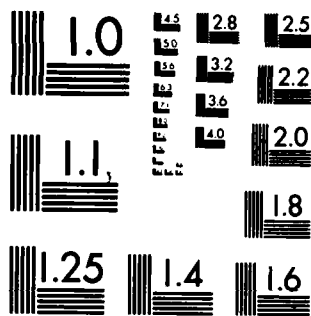
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PRIVATIZING AIRPORTS IN WASHINGTON, D.C.

Paul Feldman

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PRIVATIZING AIRPORTS IN WASHINGTON, D.C.

Paul Feldman

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"It is one of the finest problems of legislation--what the state ought to take upon itself to direct by the public wisdom, and what it ought to leave, with as little interference as possible, to individual discretion."

Edmund Burke
Thoughts on Scarcity, 1795

Anyone observing the growth of government in the United States since 1795 might be tempted to judge that, over the years, Americans have resolved Burke's "finest problem" by opting for greater direction of private actions by the public wisdom and leaving less for individual discretion. Times change, however, and so does public opinion. Judging from the recent outpouring of complaints about the size of government and the extent of its interference in private decisions, it appears that Burke's problem has, once again, become a live issue.

There is at least one good reason why the role of government in society should be reexamined: when government substitutes the public wisdom for individual discretion, it, of necessity, also substitutes political criteria for economic criteria. That is, it relies on head counts and special group interests in determining how to conduct business, rather than on efficiency. The results are often neither politically nor economically satisfactory. A good example of an unsatisfactory outcome is in the provision of airport services in the Washington, D.C. area, where the FAA actually operates two of the three commercial airports.

In this paper, I assert that the country as a whole, and the D.C. area in particular, would be better off if the federal government were to sell its airports and leave their operation to individual discretion, with no interference whatsoever. I'm going to support that assertion in two ways: first, I'll go over the conditions under which it would be appropriate for the federal government to administer airports and show that those conditions do not exist in the District of Columbia. Then, I'll compare the existing arrangement with what would happen if the airports were privately operated.

The general conditions that call for government intervention in the provision of any services are familiar; legislators tend to state them as:

- o Lack of competition, so that a monopolist can restrict supply and maintain an artificially high price
- o Lack of information about a service so that consumers are unable to make rational choices among available alternatives
- o The existence of benefits that cannot be captured by a private entrepreneur (so he underinvests) or costs not borne by the entrepreneur (so he overproduces).

In the case of airports, particularly in the Washington, D.C. area, only the last of these holds.

Consider the possibility of monopoly. There are three major commercial airports serving the market: Washington National (WNA) and Dulles International (DIA), both run by the FAA, and Baltimore Washington International (BWI), run by the state of Maryland. They are not equal competitors; WNA has relatively short runways but is only 10 to 15 minutes from downtown Washington; DIA and BWI, with longer runways, are more like an hour away. Travelers prefer WNA to both of the others if for no other reason than its convenience--it is time saving. But ground travel is also less expensive; taxi fare to the downtown is only about \$5, while from DIA a taxi is \$35 and even the limousine, with all its delays and stops, costs more than \$7. But none of the three airports is able to unilaterally restrict air access to the city and thereby raise the price. In fact, there is excess airport capacity, and airlines could maintain access to the city even if one of the three were to close completely.

There is certainly no limit on information about the available service; airlines maintain a national network of bookings, and both they and consumers have instant access to all that anyone could ever want to know about available services.

It is true that there are uncharged costs of airport operations, for example, noise, air pollution, and the danger of aircraft falling in neighboring communities, but these are local, community costs. Federal

administration of the airports or even its intervention in their administration is not required for them to be handled properly.

The federal government takes care of problems that concern all of society: national security, protection of civil liberties, maintenance of free commerce and a stable value of the currency, and, one could argue persuasively, maintenance of some minimal level of personal (income) security. None of these problems resides in or is solved by provision of a particular amenity--airport facilities--to a particular community--Washington, D.C.

If the arguments are so clear, you may ask, why does the federal government run two of the three airports in the area? Both custom and history have a lot to do with it. When I say "custom," I'm referring to the fact that there isn't a major commercial airport in the U.S. that is privately owned and operated. I'm sure that the custom derives in part from the fact that airports are generally not profitable enough to attract sophisticated investors. By itself that isn't an overwhelming argument that airports ought to be government operated; if people in a community have a strong feeling that they should have an airport available to them, they might do well to build one and turn it over to a private operator to manage. But governments seem to work under the principle that once any government, anywhere, has done something, that constitutes proof that it is proper for other governments to do the

same. Moreover, once any government starts to do something, it takes the equivalent of an earthquake to make it stop.

In the case of Washington, there is also history. The federal government used to be the District's local government; it acted like a county or municipal administrator, and following custom, it provided the same kind of services. As I said before, Washington has three airports: National, Dulles, and Baltimore-Washington International. National was built by the federal government during the Great Depression; it was a time when spending on public works was probably more of an objective than the provision of airport services. The current WNA replaced an earlier airport--Washington-Hoover--which in turn had replaced two competing (side-by-side) airports, Washington National and Hoover, which had begun operations in 1926 where the Pentagon is now.

BWI, which opened as Friendship Airport in 1950, was built by Baltimore City to replace another airport, Harbor Field, which had also been built by the City nine years earlier (the timing suggests that the county's foresight had been slightly defective). The state of Maryland "bought" the airport from the county in 1972. It was a typical government bail-out of a losing operation, although in this case, the state was bailing out the city instead of a private entrepreneur.

The bail-out was made necessary by the overoptimistic planning of the FAA which, foreseeing massive growth in airline operations, had concluded that four airports were needed in the area; they said that BWI, "even if developed to its ultimate capacity...would be incapable of handling its share of the traffic after 1965." To handle the expected crush of passengers, they built Dulles airport in the early 1960s. The complex comprises modern airstrips, a beautiful and cleverly designed terminal with mobile lounges to take passengers to the planes, and a wholly dedicated 17 mile, four-lane, divided highway from the airport to the Beltway around the metropolitan area.

As things have turned out, the FAA's foresight about both future traffic and the ultimate capacity of BWI was wrong; not only was a fourth airport not needed, but the demand for both DIA and BWI failed to grow as anticipated, and BWI currently has enough capacity to handle nearly twice the number of passengers that now flow through both BWI and DIA combined. DIA is a white elephant, a continuing embarrassment to the FAA, and a thorn in the side of the Secretary of Transportation.

So here we are; custom and history have conspired to give us three airports in the area where two would do. Is that any reason to complain? The answer is an unqualified yes. I'm going to point out several unfortunate results that almost naturally flow from government operation. For the sake of simplicity, I'll restrict the discussion to DIA and WNA.

The first thing to note is that when government runs something, it tries not to make a profit or loss along the way. That's not as innocuous as it sounds. When you try to make your revenues exactly cover costs, you have to charge the average cost; fees in a busy place will be low while, where demand is low, the price will be high. But customers for any service respond to prices; high prices choke off sales and low prices encourage them. Average cost pricing has caused that kind of problem for the FAA.

Remember that WNA is preferred by customers because it is relatively close to downtown by taxi and, for the last few years, by subway. The airlines have responded to customer preferences by scheduling as many flights as they can to that popular terminal. But the heavier use reduces the average cost so that the interests of airlines reinforce those of passengers in choosing WNA, and since 1966 when jets were first allowed to use the facility, the airlines have tried to schedule more flights there than the facility can handle. For a long time, the FAA has limited operations--takeoffs and landings--to 60 per hour and urged airlines to shift flights from WNA to DIA while at the same time landing fees and mobile lounge charges at DIA were higher than the fees at WNA.

In 1980, the FAA temporarily eliminated landing fees and charges for the mobile lounges at DIA and now treat the two terminals as a

single costing unit. That removes the airlines' financial advantage in using WNA, but it also means that passengers who use WNA are subsidizing those who use DIA. Cross-subsidization among passengers is a familiar story in public transportation, and the amount of cross-subsidy is not large by government standards--a \$10 million drop in revenues at DIA, which works out to about \$4 per passenger.

But cross-subsidization is not all that's involved. Far worse is that some way has to be found to choose who will get to use the airport among all those who want to. The fact that some potential users must be excluded is also a familiar problem in government; it signals that something valuable to the public is underpriced. When that happens, the typical response is to ration the valuable resource in the name of "fairness," using some such rule as "First-come, First-served." The FAA has tried several variants of that: initially they limited access to the airport to airliners flying nonstop no more than 600 miles. The idea was that travelers from nearby would arrive first. Unfortunately, that rule barely excluded Atlanta and Chicago, so the limit was soon raised to 650 miles, which included those cities, and in 1982, it was raised to 1000 miles. Distance rationing has been far from successful because it has no real basis in either consumer preferences or in the economics of air transportation. The proof is in the absurd spectacle of planes taking off from WNA, landing at Dulles, and taking off again for destinations more than 1000 miles away, just to beat the system.

Rationing among airlines doesn't solve all of the problems, however. Operators of Piper Cubs and corporate jets claim that, in "fairness," they deserve access to National as much as do commercial airliners. The way things work in a political system, claims made by any organized group are treated as legitimate, and the FAA has responded by reserving about 23 of the 60 landing and take-off slots for such operators. If it is absurd for an airliner to hop to DIA in order to operate more than 1000 miles nonstop out of WNA, how else can one characterize the spectacle of an airliner with 150 passengers having to land at DIA in order to make way for a Piper Cub to land at WNA?

There are other irrationalities that spring from obsession with "fairness." For example, when the FAA announced a new "Washington Airports Policy" last November, its stated objectives included encouraging greater use of DIA, "which has been underutilized," and achieving "a more equitable balance of service between the two Federally owned and operated airports serving the greater Washington area"* (emphasis added). Now when the FAA says that Dulles is "underutilized," it means that some thoughtless travelers are not using the facility as much as the FAA had hoped and planned for. But in seeking an "equitable balance," the FAA is trying to make airlines and passengers conform to its hopes and plans. Our government wants travelers to be fair to the airports, that is, to the FAA.

*The quotes are from a DOT news release dated November 23, 1981. Note that DOT seemed interested in the equity of the balance between its own airports but was strangely silent about BWI.

Fairness comes up in other ways. When the airlines, under the pressure of restrictions associated with the air traffic controllers' strike, took to selling landing slots among themselves as a way of rearranging their routes, the FAA formally forbade such sales; the airlines were only allowed to trade them so that the relative wealth of airlines wouldn't determine the allocation of slots. When Braniff's suspension of flights left some slots unused, the FAA allocated them by lottery! After all, a lottery is "fair," that is, no one could accuse the FAA of favoritism in allocating routes and landing rights.

No private airport operator in the same position would act that way. Rather than charging average cost and imposing rules to ration customers at his facility, he would charge a high price--"all that the traffic would bear." He wouldn't waste a single moment worrying about the "fairness" of his price or an "equitable balance" of use of airports, or whether some otherwise "worthy" users, like air taxis or corporate planes, were being excluded. He would maximize his profits and, in doing so, he would unintentionally ration his airport in the most efficient fashion: only those travelers to whom the quick access was valuable would use it while those who cared more for the dollars than for time would use the more distant one. He would treat WNA as a business, not as a political football.

And he would make a fortune at it too. WNA is so much more valuable an airport than the others that most passengers would be willing to pay a premium to use it. A round number estimate is that at \$15 extra per passenger,* few passengers would choose an outlying airport instead of WNA. But as things stand now, more than 15 million passengers use it per year. That works out to a cool \$225 million in profit (remember that WNA is now covering costs, including the costs of operating DIA, so anything in addition is gravy). And that says nothing about the 23 available slots per hour now being used by the Piper Cubs at a charge of \$4 per landing. So if we assume that they would become available for commercial airliners, the profit could be up to 50 percent higher.

Another way of looking at those numbers is to imagine that by failing to collect the rent, taxpayers (all of us) who "own" the airport are giving \$225 million per year to commercial air travelers who now use WNA (including some of us) and an additional multimillion dollar bonanza to the nonairline users. I call that a gift just as the IRS would call it a gift if a corporation were to allow a special group--say high government officials--to use a hunting lodge rent free or to provide free transportation to go there.

* David Graham, Daniel Kaplan, and Kathy Sharp, "A proposal to Adopt Noise And Congestion Fees at Washington National Airport," CAB Office of Economic Analysis, January 26, 1981. They calculate that it would be worth \$24 to the average "business" traveler and \$9 to the average "vacation" traveler to use National rather than DIA. They then calculate that \$16.50 would be a successful rationing price.

Rent may be a four-letter word, but it serves several valuable functions in resource allocation: first, it forces people to consider competing uses for a scarce resource. WNA sits on 680 acres of valuable waterfront land. Comparable land in the area sells for about \$40 per square foot so the total package would be worth about \$1.2 billion. That valuable a property should be getting a return of over \$200 million per year (assuming interest at 18 percent); if a private airport operator couldn't pay that much in rent, the land should be sold and the money invested in something else. The calculation shown earlier suggests that using the land for an airport may well be the most efficient thing to do, but if it is, it is certainly not because anyone planned it that way. Governments don't impute rent for public property, and typically, they never consider alternative uses.

The second value of charging rent is that it provides a standard for determining if capital improvements are warranted, and if they are, it provides funds to pay for it. WNA is short on parking, access roads, and terminal facilities. The CAB suggests that it could also expand its air traffic handling capacity to accommodate more than 60 planes per hour by installing more modern equipment.* Whether or not it should invest in expansion should be determined by the relation of the costs

* Graham, et. al, Op cit. The article points out that the FAA's limit of 60 operations per hour was imposed in 1968 because of limits on apron space for commercial airliners. Despite expansion of ground facilities and airfield capacity, the limit has remained in effect.

and revenues the expansion would generate. But because WNA is a government facility, whatever revenues it generates go to the Treasury and are not available to finance expansion. The FAA must go through a political appropriations process to make the necessary improvements, competing with other pork-barrel projects for federal dollars. Important criteria are the party affiliation of the local Congressman, regional "equity" in fund distribution, the level of unemployment in the area, the size of the budget deficit, etc. It goes without saying that none of those issues should affect a business decision.

Perhaps the most important advantage of private operation, however, is that it would remove a major source of irritation for a lot of people. For example, if the FAA were to sell DIA, the new owner might well close it down as an airport. That would make the operators of BWI happy. From the very beginning, they felt that DIA was stealing their passengers and making life harder. The idea of closing DIA may sound extreme, but as I said earlier, the place is a white elephant; no private entrepreneur would maintain the amount of excess capacity we see in the three airports in the area and it isn't clear why the government should do any different. The entire passenger load could be shifted to BWI without causing more than a ripple there.

In addition, the wholly dedicated access road, that four-lane, divided empty highway could be opened up to local traffic, easing congestion in the surrounding area. The road is arranged so that cars

getting on it on the way toward the airport cannot get off before the airport, although they can get off if they are heading into town. But cars can only get on to the road at the airport if they are heading toward town. The road traffic problem is so aggravating that some people in the area get onto the road in the suburbs, drive all the way to DIA, turn around, and drive back to Washington in order to avoid the less good roads. It's as absurd as those planes taking off from WNA and stopping at DIA before flying nonstop more than 1000 miles. Of course, if the road were sold to the new airport owner, it could be opened as a toll road (probably the only source of profit in the whole establishment) with all the good results that I have claimed for privatization of airports.

The Secretary of Transportation would probably be happy too. Recently, when asked what he found to be the most difficult problems he faced, he picked out the airport problem in the D.C. area as the greatest single consumer of his time. He is the focus of all the conflicting interests in the facilities: local residents complain about the noise and the wasted road; airlines complain about the allocation of space, and time, and about the fees charged; Congressmen complain about the administration--personnel policies, behavior of the guards, etc--and almost everyone complains about the reservation of parking spaces for high ranking government officials.

Most of the complaints people now make about the airports would simply evaporate if they were privately operated. The noise complainers, so long as they didn't have to fight with the federal government, would actually have a chance to get their case heard in court. They might even stop complaining altogether if the community were to collect some taxes on the land and use the revenues to reduce the real estate taxes of those who now suffer from the noise. The airlines would almost certainly stop fighting about the allocation of landing rights, fees, and ground facilities. They would recognize immediately that politics no longer had anything to do with those issues, and they would treat them as business decisions. Congressmen might still complain, but even that is questionable. They are often cast as villains for fussing with the bureaucracy when, in fact, they are merely responding to constituent requests. If WNA were not a federal establishment, they might find themselves happily relieved of an unwanted burden. What is almost certain is that no private operator would ignore them. While the reserved parking would probably remain, it would no longer be the kind of public affront that it is now, where every consideration Congress gets from the bureaucracy is seen as evidence of the abuse of power.

I set out to show the bad side of government operation of airports in the D.C. area. It's a lucky thing I'm not a debater because I understand that debaters have to be prepared to take either side of any

issue, and I can't think of a single argument on the other side. It is an open and shut case.

And yet, for 16 years, since WNA was first rationed because of overcrowding, there have been essentially no changes in policy.

I quote from a letter I received last year from OMB when I suggested that more rational landing fees would both improve resource allocation and raise revenue:

"As you are aware, determination of landing fees is closely related to the issue of allocation of landing slots. Alternative methods of allocating slots have been the subject of much study at the Department of Transportation, culminating in the publication of a Notice of Proposed Rulemaking (NPRM) in the latter part of 1980. One of the alternatives set forth on the NPRM, using an auction-type process to allocate slots, is consistent with your suggestion that landing fees reflect the value of services provided.

The appropriate mechanism of allocating slots and establishing landing fees is of interest to this Administration. Your thoughts will be helpful as the issue is given further consideration. Thank you for taking the time to convey them to us."

I have received similar responses from OMB and the FAA on the many occasions since 1966 when, as an OMB staff economist, I first got involved with the issue. It is the standard "don't bother me with your 'impractical' ideas" letter you get when you send crank letters to important government officials. They don't want to think about correcting errors, even gross errors in policy just to make their operations more efficient.

This last little tale is not intended as a complaint about my having been mistreated. The moral, and the moral of this paper as a whole, is that government is inherently handicapped when it comes to running a business. Even if it adopted some of the practices of profit-oriented business, it would still be bound by bureaucratic rules and political incentives, and we could count on it to find new ways to be inefficient.

Trying to get the government to seek efficiency by imitating a private operation would be like putting artificial legs on a legless man and then asking him to run the 100-meter dash in the Olympics. It would be better than asking him to run the race with no legs at all, but you shouldn't expect him to come in anything but last. If you want an operation to be run efficiently, as a private operator would run it, get a private operator to do the job. That's what "privatization" is all about.

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