AN OVERVIEW BY THE LEGISLATIVE AUDITOR OF THE STUDY OF AIRPORT SYSTEM FINANCING DEPARTMENT OF TRANSPORTATION

INTRODUCTION

Hawaii's statewide system of airports is financed through a special fund where revenues generated by the airport system are expected to cover all airport system costs. A key element in this financing arrangement is the lease agreement which exists between the airport system and the overseas and interisland air carriers who constitute the major users of the airport system. This lease agreement establishes the use charges which the airport system can impose upon the user air carriers. Although the basic lease agreement is quite long-term, one of its most significant portions is subject to periodic renegotiation. This is the portion which sets the level of charges to be imposed and specifies many of the financial details of the lease. The next such renegotiation is supposed to be completed by the end of June 1977.

In the conference committee report accompanying the general appropriations act for the 1975–1977 biennium (Conference Committee Report No. 18, Act 195, SLH 1975), the legislature expressed interest in the forthcoming renegotiation of the airport-airline lease agreement and indicated a need to obtain detailed information on this subject. The office of the legislative auditor was requested to assist the appropriate legislative committees in reviewing the existing system of financing Hawaii's airports and in examining the airport-airline lease agreement to determine legislative policies which should be taken into consideration during the 1977 renegotiation of the agreement. The special study report on airport system financing represents our response to this legislative request.

Due to the complexity of the subject matter and taking into consideration the importance of the airport-airline lease agreement, we decided to focus our study upon those matters which had a direct bearing upon the lease agreement and the forthcoming renegotiation of vital elements of this agreement. One result of this decision, however, is that we have had to exclude from our immediate attention some aspects of airport system financing which are important, but which require separate and thorough analysis.

For example, in this study we did not examine the real property leases and agreements which exist between the airport system and the air carriers and other users of airport property. A separate and fairly detailed economic analysis would have to be made to determine whether or not the rates, terms, and conditions of these leases and rental agreements are reasonable and equitable. Similarly, we did not look into the special situation affecting general aviation activities at the State's airports. At present, general aviation users receive favorable treatment in terms of use charges and rentals. However, up to now, general aviation activities have had only a marginal impact upon total airport system costs and revenues. Since general aviation encompasses commercial activities as well as non-commercial and recreational activities, separate and distinct considerations may have to be given to each type of activity. In short, this subject is sufficiently complex and important in its own right as to warrant its own separate study.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

The study report identifies two major issue areas which appear to warrant legislative consideration during the period when the airport-airline agreement is being renegotiated. One of these concerns implicit external subsidies which the airport system now seems to be enjoying and which do not appear to be consistent with the self-sufficient concept of the airport special fund. The other is the internal subsidizations which now seem to be occurring within the airport system, which are largely hidden from view, and which pose serious risks and disadvantages to the airport system. In effect, the study focuses upon and tries to answer two basic questions: (1) how real is the airport system's self-sufficiency; is the airport system really paying its own way or is it being subsidized to some degree from external sources? and (2) are the carrier-users of the airport system paying their fair share of the costs of the system?

Implicit external subsidies. Implicit external subsidies arise when operations which are supposedly self-sufficient actually receive services from other state agencies without fully reimbursing the other agencies for such services and without the costs of these unreimbursed services being reflected in the books of the agency receiving the services. The examination undertaken as part of this study reveals that Hawaii's airport system may be considered as receiving implicit external subsidies in at least two areas: (1) interest-free construction loans made by the state general fund to the airport system and (2) administrative overhead costs paid by the airport system to the state general fund.

1. Interest-free construction loans. With respect to interest-free construction loans, the state general fund from time to time advances money to various special funds, including the airport special fund, to finance the construction of capital improvement projects pending the issuance of bonds to cover such construction. Upon issuance of the bonds, the general fund is reimbursed for these advances, but under section 39–67, HRS, the special funds cannot be charged any interest for the money so advanced. These interest-free advances constitute general fund subsidies to the affected special funds. In the case of the reef runway project at the Honolulu International Airport alone, the interest-free construction loan subsidy by the general fund to the airport system may have been $720,000 or more.

2. Administrative overhead costs. With respect to administrative overhead costs paid by the airport system to the general fund, the airport special fund, pursuant to sections 36–27 and 36–28.5, HRS, is among the numerous special funds which are subject to a surcharge payable to the general fund amounting to 5 percent of the operating revenues of each affected special fund. Although the purpose of this surcharge is not entirely clear, there are indications it is intended to defray the costs of state central services rendered to the special funds.

Assuming the purpose of the 5 percent surcharge is to cover the full costs of state central services rendered to the affected special funds, such surcharge appears to be inadequate with respect to the airport special fund for the following two reasons:

- Most central overhead costs relate to the processing of expenditures, but in the case of the airport system very large segments of expenditures are excluded from the application of the surcharge—namely, expenditures financed out of proceeds from bond sales and federal grants. Thus, with bond proceeds totaling more than $270 million between May 1, 1969 and June 30, 1976, a 5 percent surcharge would have added $13.5 million to general fund revenues.

- No determination has actually ever been made of the central overhead costs attributable to the airport system so that it is impossible to know whether or not a 5 percent surcharge is sufficient to cover such costs.

Recommendation. To deal with these two apparent cases of implicit external subsidies for the airport system, the study report recommends that the legislature examine sections 39–67, 36–27, and 36–28.5, HRS, to determine:

- The purposes of these sections.
- The impact and advisability of amending the statutes to require the payment of interest on general fund advances for capital improvement construction and the payment of a reasonable surcharge on expenditures by
  - the airport system
  - all state agencies and programs for state general fund overhead expenditures incurred in servicing the airport system and other agencies and programs.

Internal subsidies within the airport system. After disposing of the matter of external subsidies for the airport system, the study focuses upon the question of possible internal subsidies within the airport system. As a prelude to the issue of who should pay for what costs, inquiry was made into who at present is actually paying what costs, and whether or not the burden is being shared on a fair and reasonable basis.

Examination reveals that, under existing financing arrangements, the two primary users and beneficiaries of the Hawaii's airport system—i.e., the overseas carriers and the interisland carriers—are not paying the full airport system costs attributable to them, but rather are being highly subsidized by off-airport concession revenues. This result is produced if the airport system is broken down according to its three basic components of programs—i.e., overseas services, interisland and general aviation services, and general support services—and if revenues and expenditures are then allocated among these three programs.

Inasmuch as present use charges represent only those residual costs which are not covered by revenues from other sources, the costs which the overseas and interisland air carriers impose upon the airport system may not be the most significant factor in determining the level of use charges which they will have to pay. Indeed, as a result of the very large growth experienced in recent years in airport revenues generated by off-airport concessions (principally the duty-free concession revenues at Honolulu International Airport), these off-airport concession revenues now have the most important effect upon use charges and explain why the present heavy subsidies to the air carriers exist.

However, the continued receipt of large amounts of duty-free concession revenues is by no means assured. This source of revenue is subject to factors which are beyond the control of the State of Hawaii. It is quite possible that such revenues will diminish in amount in the future—perhaps even drastically. Such a turn of events would cause a jump in the use charges imposed upon the airlines which, in turn, could trigger an increase in air fares affecting Hawaii. This great dependence upon subsidies from off-airport concession revenues places the airport system in an extremely vulnerable fiscal position and casts serious doubt upon the efficacy of the present airport financing policy.

The present system of airport financing also contains other disadvantages, such as the following: (1) it masks, rather than surfaces, the subsidies which flow to the air carriers from off-airport revenue sources and hides the relationship which exists between off-airport revenues and air fares and (2) it combines with the "9 percent rule" for interisland use charges (i.e., the policy agreed to by the airlines under which interisland carriers are charged only 9 percent of the use charge imposed on overseas carriers) to reduce interisland use charges so low that no incentive is provided to the interisland carriers to control costs or to promote lower costs for the interisland services program of the airport system.

Basic economic differences exist, however, between the overseas carriers and the interisland carriers which justify different treatment of the two types of carriers by the airport system. These economic differences may be summarized as follows:

- Overseas flights are long-haul and involve relatively few landings and take-offs. Hence, airport costs constitute a small portion of their total operating costs.

- Interisland flights are very short-haul and involve frequent landings and take-offs. As a result, airport costs make up a very large portion of the total operating costs of the interisland carriers.

In view of the foregoing considerations, the present airport financing policy should be replaced by one which will accomplish the following objectives:

- Make the airport system less dependent upon a potentially unreliable source of revenue.

- Establish a closer relationship between user charges and program costs and make the air carriers more fully responsible for bearing the costs they generate.

- Recognize the inherent economic differences which exist between the overseas carriers and the interisland carriers.

In line with carrying out the above objectives, the study report recommends that the financing policy for the Hawaii airport system be revised to incorporate the following features:

- The accounting for and allocation of all costs and revenues on the basis of the three following components or programs:

  - Overseas services

  - Interisland and general aviation services

  - General support services.

- The assignment to the general support services program of all costs and expenses not reasonably allocable elsewhere and all revenues from off-airport sources.

- The attainment of self-sufficiency as follows:

  - The overseas services program be fully self-sufficient.

- The interisland and general aviation services program be self-sufficient to the extent of 50 to 60 percent of the costs of the program.

- The accumulation and use of revenues (surplus) from off-airport concessions and other sources as follows:

  - To pay for general support expenses not otherwise covered by other general support revenues.

  - To subsidize the interisland and general aviation services program to the extent of 40 to 50 percent of the costs of the program.

  - To subsidize the overseas services program should the program be unable to pay for all of its costs without raising the use charge to such a level as to cause an increase in air fares.

- If the surplus is more than sufficient to cover all of the above items, it is to be accrued to the airport fund. The sums so accrued could from time to time be made available by the legislature for any purpose, such as to finance capital improvements for general aviation, and to finance capital improvements at interisland airports.

CONCLUSION

In conclusion, the study report recommends that the State revise its airport financing policy to provide for the following:

- The self-sufficiency of the overseas services program.

- The limited subsidization of the interisland and general aviation services program.

- The generation of surpluses from off-airport and other revenue sources.

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