CHAPTER 34

AIRPORT EXPANSION

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"Why are we spending billions to expand the Honolulu Airport?"

The airports development plan, approved by the State in 1990, will involve about $2.5 billion of construction by 1996. Most of that is going toward new terminals and other expansion at Honolulu International Airport, in a section of urban Oahu where three massive public works projects now are under way. Scheduled to start late in 1992 for completion in 1997 is the $1.7 billion Honolulu rapid transit system, a 15-mile-long elevated railway whose 22 stations will include one at the airport. In the brick-red hills just above the airport, the new H-3 freeway punches through the Koolau Mountains to connect Leeward Honolulu with rural Windward Oahu. When it's completed in 1993, that project will have cost federal and state taxpayers $850 million.

In a perfect world, these projects eventually would be paid for by those who use them, either through direct user fees, such as the fares to be charged rapid transit passengers, or special taxes. This is not going to happen. Still, that doesn't stop local government from borrowing the money to pay for them on the far more solid theory that if the projects don't generate the cash to pay back the loans, the taxpayers will.

Of the billions being spent on Oahu, nowhere are the costs more concentrated than at Honolulu International Airport, where three new terminals are being built. First to be completed will be an interisland terminal, serving intrastate flights. Then comes the overseas terminal, to handle flights to and from the U.S. Mainland. The largest and centerpiece of the program is the new international terminal. It will contain more than 1.5 million square feet of floor space, the size of Ala Moana Center.

Necessary expansion? State officials, from Governor John Waihee down, say that a new international terminal is needed to handle the growing number of foreign visitors that have become an important market for Hawaii's tourism industry.

Passengers arriving from Japan have had to spend up to three hours clearing customs—certainly an unpleasant beginning to their visit. But much of the delay has been the result of a shortage of U.S. customs agents. That's being corrected, in any event, with increases in customs service staffing. So now the problem is said to be a shortage of facilities. That's the main argument supporting the huge, half-billion-dollar international terminal.

This alarms people who believe the present bottleneck in foreign arrivals is due to the timing of the arrivals as much as the number of passengers. Because of operating restrictions at Japan's principal overseas airport, Narita, outside Tokyo, most flights from there arrive in Honolulu during the early daylight hours. Return flights are similarly bunched in the evening. In between, the airport's present international passenger and baggage-handling facilities are little used. Spend a day in the present international terminal and you'll find that it is packed twice a day, and all but deserted the rest of the time.

A change is in the works that would eventually relieve the crowding at Honolulu. Japan is building new international airports that will lessen the dependence on Narita. Operating hours at the new facilities will be unrestricted, meaning the arrival times here will be better dispersed. No one can say whether this alone would beat today's logjams unassisted by a half-billion-dollar terminal, but it's a possibility.

Our new international terminal has been designed to eliminate the logjams of tomorrow. This assumes international activity will grow rapidly. The fickleness of international travel makes any projection almost a statement of faith. But Hawaii's political leaders and their planners are counting on an at least 33 percent rise in total visitor arrivals by the turn of the century, with most of the growth in the international category.

That's despite a number of ominous world-travel trends. One is the increased availability and use of long-range jets. The Boeing 747-400 and other new models eliminate the need for trans-Pacific passengers in either direction to stop in Hawaii. Many already bypass the islands. Airline officials believe that soon the only people coming to the state will be those intending to stay awhile.

Proponents say the airports program is a cornerstone of Hawaii's strategy for winning a major role in the Pacific Century. Bigger airports, they say, both in Honolulu and on the neighbor islands, fill a key need not only of the pivotal tourist industry but other businesses from agriculture to high tech by providing better access to worldwide markets.

"Field of Dreams." This reminds me of the movie, "Field of Dreams." For those who didn't see it, it is about an Iowa farmer who builds a baseball diamond in the middle of his corn field on the assumption that, if the diamond is there, the spirits of baseball's immortals will show up to use it.

Hawaii's politicians too seem to think supply can create its own demand. They dream of tourists showing up because the new airport is there. The rationale is reminiscent of the Hilo airport, which was expanded in the 1970s to handle swarms of mainland flights that never materialized. That airport is today grossly underutilized, a lasting monument to bad planning.

In order to service the $2 billion in debt required to finance its new airport plans, the State is having to perform a major overhaul of the airports' income sources. Revenues from the one source counted on to produce two-thirds of the airports' total annual income suddenly were chopped in half. This came as a rude surprise to state transportation officials who have done their best to play down its significance.

Big surprise. How such a thing could have happened at the beginning of the biggest capital-spending program in state history is only one of the questions that needs to be asked. Another is why it came as such a surprise. And still another is why, once the huge shortfall became known, the State proceeded with the airport program as if nothing had happened. Here's how the surprise came about.

The Airports Division of the State Department of Transportation uses airport revenues to pay for operations and service debts. Airport revenues are made up of the fees and taxes charged for the commercial use of airport facilities. Traditionally, the largest single source of the revenues has been concession fees—charges assessed by the State for giving vendors exclusive rights to do business with airport customers. Economists call it monopoly rent.

In fiscal 1991, the State's concession fees—about $275 million—amounted to 80 percent of the total airport revenues. Other revenue sources, including the landing fees and rents charged to the airlines that use the airports, were relatively minor contributors. About 84 percent of the $275 million in fees came from a single concessionaire, Duty Free Shoppers, DFS as it's now called. In 1991, DFS' $231 million in fees represented 63 percent of the airports' revenues. At least, that's the way it was budgeted. In practice, it didn't work out that way.

That same year the combination of the U.S. recession and the Persian Gulf war gave Hawaii's tourist industry its worst setback since 1949. Especially hard-hit were the businesses most dependent on Japanese visitors, who stayed home in droves. Japanese make up 90 percent of DFS' clientele, and in the early months of 1991, the retailer's duty-free sales dropped out of sight. In Hawaii, the plunge amounted to 40 percent below projections.

For 30 years, DFS has been the bulwark of airport revenues in Hawaii. Its last concession contract, for five years starting in mid-1988, was the biggest duty-free contract ever awarded in Hawaii or anywhere else: $1.15 billion in guaranteed fees over the life of the contract. The record bid was based on DFS' estimate of the growth over the next five years of its prime Japanese market, and DFS was *the* expert on this subject. It had never missed. But something went terribly wrong this time.

Practically from the start, the forecast was in trouble. Under the contract, DFS was supposed to pay the State the greater of a guaranteed annual minimum or 20 percent of sales. In the past, the percentage fee always exceeded the guarantee. But in both fiscal 1990 and 1991, the guarantee far exceeded the usual 20 percent, reaching 47 percent in

1990 and, had the full guarantee been paid, more than 60 percent of actual sales in 1991.

What went wrong. While the number of Japanese visitors continued to rise, the composition of the market was changing toward younger, budget-conscious travelers who spend far less than their predecessors on the pricey gifts that are DFS' trademark. The company should have spotted the trend before it made its billion-dollar bid for the Hawaii contract. But it didn't.

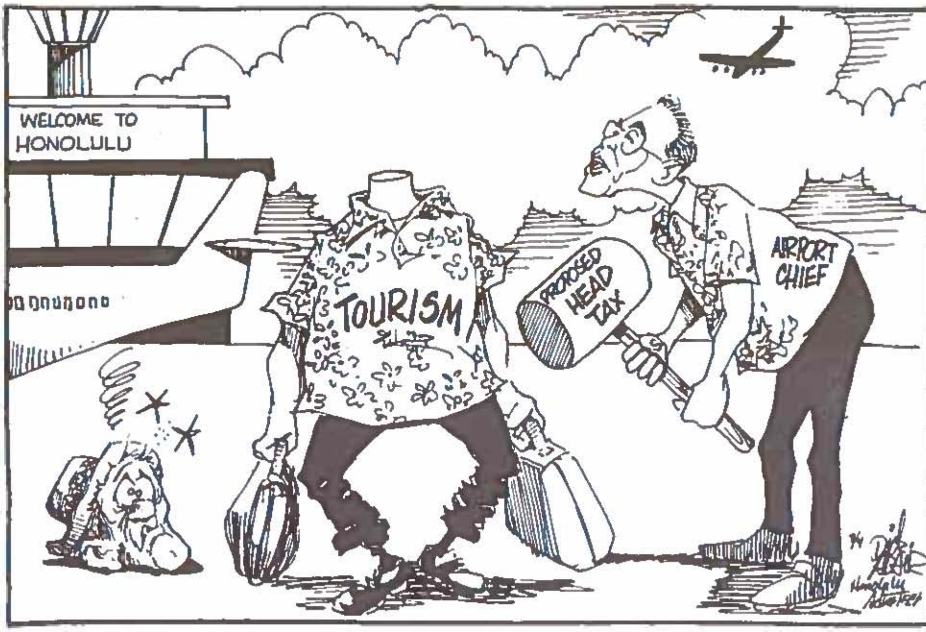
Neither did the state planners, who happily accepted DFS' expert forecasting as the basis for their ambitious airports expansion plan. DFS' $1.15 billion guarantee under the current contract was relevant but, mostly, the expansion was premised on the assumption that this was only the beginning, that DFS' revenues would continue to compound at the late 1980s rates. This "money tree" was to be used to pay for the expansion.

Although DFS surely realized by 1990 that its projections were off, it was the 1991 Persian Gulf war, helped along by the U.S. recession, that popped everybody's balloon. When the Gulf war brought a sharp drop in its Japanese business, DFS asked the airports division for relief from its guaranteed payments. The division's shocked planners had to run for their drawing boards.

DFS was permitted to defer payment of $105 million of its guaranteed fees due in 1991 until after the present contract expires on May 31, 1993. The State's airport officials really had no choice. Several admitted that to have declared DFS in default and to re-award the duty-free contract would only have hastened the day of reckoning. Any new contract would surely have guaranteed the State much lower revenues. Early in 1992, with its Japanese business recovering, at least in head count, DFS said it would be able to meet its fee schedule for the final two years of the old contract. Of course, that was a relief to state planners, but the bigger problem is that future revenues not only will not grow as projected, but likely will fall.

Less revenue. The next duty-free contract probably will not only be for a shorter term, but, more significantly, will produce only about half the revenues envisioned by the current contract.

Prior to this debacle, concession fees, led by DFS, made life easy not only for the State but for others who did business at the airports. The


WELCOME TO
HONOLULU
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TAX
AIRPORT
CHIEF

huge concession revenues sheltered them by enabling lower than normal rents, landing fees and other airport payments. In effect, it was a giveaway. But nobody saw it that way. Airport authorities were interested only in covering their operating and financing costs. And the airport users, like business people everywhere, were interested in saving money.

In the future, the State wants to replace the present use-charge schedule based on the facilities' "market" value with one based on actual costs. The aim would be to cover the airports' operating costs, whatever they are.

But the airlines are skeptical. They are looking at enormous increases in their airport costs per passenger. The State's own estimate is for these costs to zoom from 69 cents in 1991 to $8.18 in 1995.

The airlines will pass the increase on to passengers, who may not notice another $8 tacked on their airfares. But, the $8 figure assumes passenger numbers will continue to grow. If they don't, the charge will have to be higher, perhaps much higher. Ironically, the airport expansion could increase costs to the point that even more flights get routed over, rather than through Hawaii.

The airports expansion is a perfect example of what economists call "revenue driven" spending. Only in this case, the revenue may have been a mirage. State officials, meanwhile, are off in a corner assuring each other, "if we build it, they will come."

"WHO GETS THE CHECK?...UH, WHERE'S EVERYBODY??..."