

# CIVIL AVIATION SECTOR REFORM AND PRIVATE SECTOR PARTICIPATION

(TC-96-09-17-6)

## EXECUTIVE SUMMARY

**BENEFICIARY:** The Civil Aeronautics Directorate

**EXECUTING AGENCY:** The Ministry of Economic Affairs, through the program coordination unit in coordination with the Civil Aeronautics Directorate and the Comisión de Desincorporación (Divestiture Commission) in the office of the Vice President of the Republic.

**MIF FACILITY:** Window 1 (Technical Cooperation Facility)

**FINANCING:**

Total:	US\$3,650,000
MIF:	US\$1,150,000
Local counterpart:	US\$ 900,000
IDB loan (TC):	US\$1,600,000

**OBJECTIVES:** The purpose of the MIF financing is to attract technical and operational capacity and to mobilize financing and private sector resources to provide and extend the coverage of services in the civil aviation sectors.

**DESCRIPTION:** The MIF resources would be used to finance technical advisory services in the field of air transportation as well as legal and financial advisory services. The project resources would finance the preparation of the following outputs and activities: (i) the master plan for the sector; (ii) the investment plan (specifying investment and expansion needs during the concession period); (iii) economic and financial analysis of the concession; (iv) design of the transaction; (v) the sales memorandum; and (vi) the design and negotiation of the concession contract. The financing would supplement IDB resources for the organization and training of the Civil Aeronautics Directorate (DGAC), and for private sector participation in air traffic control.

**EXECUTION PERIOD:** The execution period for the project will be 24 months and the disbursement period will be 30 months.

**CONDITIONS PRECEDENT TO THE FIRST DISBURSEMENT:** The proposed conditions precedent to the first disbursement of resources are as follows: (i) approval of the law establishing the basis for the new regulatory and institutional framework for the sector; (ii) submission to the Bank by the program coordination unit (PCU) of a plan of action

for project execution during the first six months; and (iii) evidence that an agreement, acceptable to the Bank, has been signed between the United Nations Development Programme (UNDP) and the Ministry of Economic Affairs.

**IDB AND MIF  
STRATEGY FOR THE  
SECTOR:**

The Bank's strategy for Guatemala for the period 1996-1998 is to support the efforts of the government to accomplish four main objectives: (i) bringing the poor, indigenous and rural populations into the mainstream of sustained development; (ii) expansion and improvement of social services; (iii) modernization of the State; and (iv) development and growth of the productive sectors, through the promotion of private sector activity in the economy.

The strategy entails a combination of Bank resources from ordinary capital, the MIF, and the IIC, and emphasizes that the projects and programs must be technically complete as well as simple and easy to execute; they must be consistent with the resources of the government; they must be flexible and directly relevant to the country's priorities; and they must have clear political support.

A priority of the MIF strategy is to provide resources to finance the advisory services required to establish and/or strengthen the regulatory agencies. This strategy is consistent with the recent recommendations by the MIF Working Group supporting the development of the legal, regulatory, contractual and supervisory framework to give priority to the promotion of private investment in the infrastructure and public services sector.

**EXCEPTIONS TO  
BANK POLICIES:**

It is proposed that the UNDP be engaged directly as the agency responsible for providing administrative support to the PCU as well as the contracting of technical cooperation (TC) services (see paragraph 6.6).

**RISKS:**

There is an element of risk connected with private sector participation in Guatemala's civil aviation sector. This risk is increased by the fact that there are other countries in the region that are executing programs of this type. To control this type of risk it is proposed that highly qualified experts be engaged to provide technical, legal and market support to the national technical teams. It is also hoped that international private operators will respond favorably to the content and scope of the government's economic reform program, a program which is characterized mainly by the strengthening of

legal security for private investors, the elimination of regulatory discretion, and the promotion and strengthening of market mechanisms.

**SPECIAL ASPECTS  
OF EXECUTION:**

For the air transportation consulting services there is a limited number of eligible specialized firms. It is therefore proposed to follow the limited international bidding procedure as set forth in the *Basic Procurement Policies and Procedures of the IDB*. Under this method, participation is by express invitation rather than a public announcement.

For the selection of consulting firms it is proposed that the lowest bid method be used. Under this method, technical and economic bids are presented in two separate envelopes, and a "minimum acceptable technical level" is established for assessing the technical bids. The technical bids are opened first and evaluated. Bids that do not meet the minimum acceptable level are rejected, and the only economic bids opened are those of the remaining bidders. The firm with the lowest bid is accepted. The minimum level will be clearly defined in the invitations to submit bids.

**MODALITY:**

Grant

**ENVIRONMENTAL  
CLASSIFICATION:**

The Environment Committee considered the Environmental Brief at its meeting of August 29, 1996, and classified this as a Category III operation. The Environment and Social Impact Committee, at its meeting of March 14, approved the environmental summary.

## I. ELIGIBILITY OF THE COUNTRY

- 1.1 The Donors Committee of the Multilateral Investment Fund (MIF) declared Guatemala eligible for all types of MIF financing on March 30, 1995.

## II. FRAME OF REFERENCE

- 2.1 The MIF financing forms part of the support provided for the infrastructure and investment sector reform program (GU-0019). The purpose of that program is to reform the telecommunications, electricity, civil aviation and hydrocarbons sectors and to modernize the investment climate.
- 2.2 The MIF resources would be supplemented with a prospective fast-disbursing sector loan (GU-0019) to meet Guatemala's needs for external financing and with a technical cooperation loan to implement reforms in the investment regime and the civil aviation and hydrocarbons sectors. On a parallel basis, the World Bank is preparing a technical assistance loan (TAL) to finance reforms in the electricity and telecommunications sectors.

## III. BACKGROUND

### A. Sector problems

- 3.1 The aviation sector lacks the resources and institutional structure necessary to provide proper service. The resource base is not sufficient to meet minimum acceptable levels of maintenance for equipment and installations, to purchase new equipment, or to keep up with technological progress affecting the standards of service required in the world market. This situation makes it difficult to maintain the minimum levels of efficiency and safety recommended by the International Civil Aviation Organization (ICAO). At present, the Federal Aviation Administration of the United States (FAA) has set entry conditions for Guatemalan carriers, entailing corrective measures by regulatory authorities that they have not as yet been able to implement.
- 3.2 The sector is regulated by the Civil Aviation Act, which dates back to 1949. The Civil Aeronautics Directorate (DGAC) is responsible for administering airport infrastructure and providing navigation support as well as technical supervision at all levels. The DGAC lacks the financial, operational and administrative autonomy to perform those functions. Approximately 90% of the sector's revenues are transferred to the central government.

Investment needs over the next five years for modernization and expansion of the National Aviation System (SNA), to meet reasonable standards of safety and efficiency, come to US\$150 million. These requirements are substantially greater if funds are included for construction of a new airport for Guatemala City in order to comply with internationally accepted safety recommendations.

- 3.3 With the support of the Bank, the Government of Guatemala has already prepared a bill for submission to Congress. The bill provides a foundation for the sector's new legal framework, private sector participation in financing, expansion and operation of the airports and air transport control systems, and basic principles to guide sector policies (see paragraphs 3.5, 3.6 and 3.7).

B. Program objective and strategy

- 3.4 To solve the structural problems faced by the civil aviation sector, the sector reform program aims to:

- (i) transfer responsibility for operating, developing and financing air transportation infrastructure to the private sector;
- (ii) strengthen the institutional capacity of the State to carry out its policy-setting and regulatory responsibilities efficiently.

- 3.5 The main elements of the strategy are as follows:

1. **Reform of the institutional and legal framework**, redefining the roles of the public and private sectors, establishing the competence of the Civil Aeronautics Directorate (DGAC), reforming the regulatory framework and opening up the sector to private participation in airport and air transportation services.

2. **Institutional strengthening of the DGAC** to enable it to effectively perform its technical and economic regulatory functions. This element of the strategy entails a complete restructuring of the current DGAC, as well as the modernization and automation of its practices and procedures (in accordance with ICAO standards) <sup>1/</sup> and the introduction of management information systems and related training.

---

<sup>1/</sup> Review and updating of administrative and control functions to ensure application of standards and regulations established by ICAO; adoption of internationally accepted standards, as set out in the 18 annexes of ICAO; development of communication and updating mechanisms with the international organizations.

### 3. Participation by the private sector

(a) **Airports:** The strategy proposes, as the main but not the only alternative for analysis, to transfer the operation, development, maintenance and management of the three main airports in the SNA, in the present condition, to the private sector. If the analysis concludes that it is feasible the maintenance and development of the remaining SNA airports (i.e., small landing strips and secondary airports) would be financed through the payment of the concession fee by the concession holder for the three main airports. This fee would be used to set up an airport development fund to defray the maintenance and operating costs for the rest of the system (less than 2.5% of total movement in the system).

(b) **Air traffic control:** The strategy also calls for exploring the possibility of transferring to the private sector responsibilities for financing, expansion and operation of air traffic control services. Unlike the airports, however, air navigation services in Guatemala may very well not provide sufficient revenue streams to cover capital costs (i.e., procurement and financing of equipment) after covering the operating costs. Depending on the final design of the transaction to be used to attract private sector participation, an investment component could be included within this operation to finance the procurement of equipment and systems on the condition that their operation and maintenance would be privatized.

### C. Policy elements of the program

- 3.6 The bill establishes a new regulatory framework based on such principles as: promoting competition and efficiency through market mechanisms, market liberalization, based on an open skies policy, and minimizing the State's regulatory discretion with regard to air transportation, airports and aerodromes, navigation services and air traffic control.
- 3.7 The bill is based on a recognition that sector efficiency can be increased by encouraging competition. Accordingly, regulation is kept to a minimum and is intended primarily to favor a competitive market. Article 20 of the bill establishes the principle of free competition in the operation of air services and favors free negotiation of charges and tariffs by the services covered under the law. For cases in which free negotiation does not result in an agreement, the bill provides for efficient arbitration mechanisms for the settlement of disputes, which are explained in detail therein. The criteria for settling such disputes are based on the economic cost recovery principle.

#### IV. THE PROJECT

##### A. Objectives

- 4.1 The MIF financing is intended for those activities necessary to attract technical and operational capacity, and mobilize financing and resources from the private sector for the provision and expansion of civil aviation services.
- 4.2 The proceeds of the Bank's technical cooperation loan will be used to strengthen the capacity of the DGAC as an administrator, an oversight body, and a regulator of contracts with the private sector. In addition, Bank resources will be used to develop the private sector participation subcomponent in the air traffic control systems.

##### B. Proposed strategy

- 4.3 The proposed privatization transaction includes the following elements: (i) design of the contract for long-term concession to the private sector for the operation, management and development of airports in La Aurora, and possibly San José and Santa Elena; (ii) the transfer of responsibilities to the private sector including all activities (aeronautic and commercial) from the moment the aircraft reaches the terminal (point of embarkation, door or access tunnel), up to the moment that the aircraft with passenger/cargo on board departs from the terminal; (iii) the concession would entail an investment commitment by the concession holder to develop the airport infrastructure and serve increased demand based on current international standards; (iv) inclusion of an international airport operator in the consortium; and (v) the master concession would be awarded through a process of international public bidding.

##### C. Expected outputs and description of activities

###### 1. MIF financing

- 4.4 To finance the *Private sector participation in the air transportation infrastructure* component, the MIF resources will be used to hire three consulting firms to prepare the following outputs: (i) the investment plan (specifying investment and expansion needs during the concession period); (ii) an economic and financial analysis of the concession; (iii) design of the transaction; (iv) preparation of the sales memorandum; and (v) the concession contract.
- 4.5 The air transportation consulting firm will prepare the master plan and investment plan for the sector, the economic analysis, and a financial evaluation of the possible scenarios under which the

concession would be developed. The main outputs of this consulting process are as follows: (i) a model for estimating demand (analysis of passenger and cargo traffic); (ii) the investment plan; (iii) the financial simulation model (analysis of tariff consistency, airport fees, the investment plan, volumes of traffic, etc.); and (iv) a proposal for formulating tariff and airport fee policy. Working with the legal and financial advisory firms, basic information will be compiled to design the transaction, prepare the sales memorandum, and negotiate and award the concession contract.

- 4.6 The legal advisory firm will have responsibility for: (i) a legal audit of assets and liabilities in respect of the prospective concession; (ii) in cooperation with the financial advisor, development and preparation of the documentation necessary for the concession contract; proposal and design of the legal configuration of the transaction; (iii) with the support of the financial advisor, preparation of tender documents (including the investment plan for the first five years, the payment of concession rights, etc.); (iv) advising the government (CEDE and MCTOP) during the process of bidding, selection, negotiation, award and conclusion of the transaction. Notwithstanding the provisions in the annex to the agreement concerning the selection and hiring of consulting firms and experts, it will not be necessary to obtain Bank approval with regard to the concession contract negotiated to effect the final payment to the legal advisory firm.
- 4.7 The financial advisory firm, with the cooperation of the legal advisor and the advisor on air transportation, will be responsible for: (i) preparation of the sales memorandum; (ii) "road-show" marketing of the investment opportunity; (iii) preparation of the tender documents to be used in the bidding process; (iv) the bidding process; (v) proposing a system for qualifying, evaluating and selecting bids; (vi) conclusion of the negotiations.
- 4.8 The preparation of the master plan, including the investment plan and financial simulation model, should be completed within a period of four to five months. By that date, the legal and financial advisory firms will have begun their activities. During the second half of the year, concession alternatives would be evaluated, the transaction designed, and the sales memorandum prepared. It is proposed that during the first quarter of 1998 the strategic private investor be selected and negotiated with. It is expected that the concession will be awarded during the first half of 1998.

## 2. Technical cooperation loan

- 4.9 To finance the *institutional strengthening* component, the proceeds of the Bank's technical cooperation loan will be used to finance the following outputs and activities: (i) design of the new organization of the current DGAC (regulatory and oversight body for contracts with the private sector), including the preparation of operations and procedures manuals, proposed job descriptions and



salary structure, and management information systems; (ii) adaptation of technical rules and procedures to comply with ICAO standards, including the preparation of technical regulation manuals; (iii) training of DGAC management and technical staff; (iv) procurement of equipment and information systems.

- 4.10 Within the *private sector participation in air traffic control* component, the technical cooperation loan proceeds will be used to finance preparation of the investment plan, evaluation of the economic and financial feasibility of participation by the private sector in the operation, system financing and expansion, and possibly the preparation of bidding documents for a contract with the private sector.

## V. COST AND FINANCING

- 5.1 The total cost of the program for which technical cooperation support is to be provided is US\$3.65 million, with the cost and financing breakdown described in Table I. The MIF would contribute a total of US\$1.15 million in the form of a grant, the Bank would contribute US\$1.6 million from the ordinary capital, and the government would contribute counterpart funds equivalent to approximately US\$900,000.

TABLE I  
CIVIL AVIATION SECTOR REFORM AND PRIVATE SECTOR PARTICIPATION  
(in US\$000)

	COMPONENTS	IDB (OC)	MIF	LOCAL	TOTAL
A.	INSTITUTIONAL STRENGTHENING	900		300	1200
B.	PRIVATE SECTOR PARTICIPATION	250	1150	550	1950
1.	Airports		1150	500	1650
1.1	Air transportation advisor <u>2/</u>		450	150	600
1.2	Legal advisor		400	100	500
1.3	Financial advisor		300	100	400
1.4	Divestment unit <u>3/</u>			150	150
2.	Air traffic control	250		50	300
C.	ENVIRONMENTAL PROTECTION	150		50	200
D.	CONTINGENCIES	150			150
E.	INSPECTION AND MONITORING	150			150
	TOTAL	1600	1150	900	3650

## VI. EXECUTION AND DISBURSEMENT

### A. Executing unit

- 6.1 The consulting services will be hired by the program coordinating unit (PCU), with the support of UNDP, in accordance with the relevant Bank and MIF procedures.
- 6.2 The main functions of the PCU will be to: (i) administer the technical cooperation funding in accordance with contractual stipulations; (ii) present the reports stipulated in the agreement and carry out monitoring and evaluation activities thereunder; (iii) supervise and monitor the participation of UNDP in the technical cooperation project; (iv) present disbursement requests to the Bank; (v) present the audited financial statements to the Bank in accordance with the relevant contractual stipulations; (vi) supervise the performance and evaluation of the consulting services engaged with the support of the corresponding technical unit; and (vii) respond to all reasonable requests for information made by the Bank with regard to execution of the technical cooperation activities.

2/ Short lists compiled by direct invitation.

3/ Includes expenditures by the Civil Aviation Division and the Divestment Commission directly related to this subprogram.

- 6.3 The Office of the Presidential Commission for Modernization and Strengthening of the Executive Branch, through CEDE, will have technical responsibility for the program and will perform the following functions: (i) prepare the documentation necessary to engage the services required, carrying out this process in coordination with the PCU and in a manner to complement the work of UNDP; (ii) coordinate the work of the various consulting firms and act as a technical and administrative counterpart for the consulting firms; (iii) monitor and prepare the necessary reports on execution activities for presentation to the PCU; (iv) evaluate the performance of the consultants; and (v) prepare technical documentation required by the PCU.

B. Contracting procedure

- 6.4 Since there is only a small number of specialized firms eligible for the air transportation advisory services component, it is proposed that the limited international bidding procedure, as set forth in the *Basic Procurement Policies and Procedures of the IDB*, be followed. Under this method, **participation in the bidding is by express invitation rather than a public announcement**; that is, there is no need for publication in *Development Business*.
- 6.5 For the selection of consulting services, **the lowest bid method of selection will be used**. Under this method, technical and economic bids are presented in two separate envelopes, and a "minimum acceptable technical level" is established for assessing the technical bids. The technical bids are opened first and evaluated. Bids that do not meet the minimum acceptable level are rejected and only the economic bids of the remaining bidders are opened. The firm with the lowest bid is then selected. The minimum level will be explicitly indicated in the requests for proposals.
- 6.6 The procurement of services to be financed with technical cooperation funds will be administered by UNDP under the National Execution-Government of Guatemala/UNDP modality. According to this methodology, the UNDP will work with the PCU to prepare the project document containing the activities to be carried out and the outputs to be provided by UNDP, which, if the Bank does not object, will serve as a basis for the assistance to be provided by UNDP.

C. Execution period and disbursement conditions

- 6.7 The proposed execution period is 24 months. Disbursement of the grant funding would take place in the 30 months following the signature of the technical cooperation agreement. The following conditions precedent to the first disbursement are proposed: (i) approval of the law establishing the basis for the new regulatory and institutional framework of the sector; (ii) presentation by the PCU to the Bank of the action plan for project

execution during the first six months; and the agreement with UNDP approved by the Bank.

## VII. SUPERVISION AND EVALUATION

- 7.1 From the outset of the program, the executing agency will present semiannual progress reports to the IDB to ensure proper monitoring of the program. The reports are to outline: (i) progress of planned program activities and degree of completion of the execution plan, including highlights and difficulties encountered during program execution, if any, as well as the steps taken to address them; (ii) disbursements made compared to the disbursement schedule, as well as outlays charged to the counterpart financing; (iii) a summary of the recommendations of the consultants hired with program resources; (iv) proposals to the MIF from the executing agency concerning program changes it may consider necessary with regard to the timing or type of contracting activities; and (v) a summary of the activities to be carried out during the following six-month period. The executing agency will also provide the Bank with copies of the consultants' final and intermediate reports and other documents considered relevant for the purposes of analyzing their recommendations.
- 7.2 The cooperation agreement will also specify the executing agency's obligation to present financial statements for the program, audited by independent auditors acceptable to the Bank in accordance with standards satisfactory to the Bank.
- 7.3 Within six months following program completion the executing agency will submit a final report with a summary of: the activities conducted; the nature of expenses paid with MIF and counterpart resources; the results obtained; the decisions taken as a result of the program, and the expected outcome of those decisions.
- 7.4 The program will be evaluated by means of interim reports and a final report. As agreed with the executing agency and beneficiary of the program, these reports, as well as those on the various activities, will provide the information necessary to conduct an ex post evaluation of the operation.

## VIII. ELIGIBILITY CRITERIA

- 8.1 The technical cooperation project, which has been designed to support modernization efforts and private participation in the infrastructure sector, is fully compatible with the MIF's general objective, to facilitate significantly increased levels of private

investment, thereby accelerating the economic and social growth and development of the country.

- 8.2 The proposal is compatible with Article 3, Section 2 (c) and (d) of the Agreement Establishing the MIF, which provides for grants from the Technical Cooperation Facility to governments for advisory services to establish and/or strengthen regulatory agencies. The proposal is also consistent with the recent recommendations of the MIF Working Group to support development of the legal, regulatory, contractual, and supervisory framework to give priority to the promotion of private investment in the infrastructure and public service sector.

#### IX. CONSISTENCY WITH THE BANK'S COUNTRY PROGRAM

- 9.1 This financing complements the support being provided by the Bank to the Government of Guatemala for the reform of basic infrastructure sectors. This operation is an integral part of that effort, and is considered essential to promote private sector participation in these sectors.

## PROJECT SUMMARY

<b>TECHNICAL COOPERATION FACILITY</b> <b>GUATEMALA TC-96-09-17-6</b> <b>CIVIL AVIATION SECTOR REFORM AND PRIVATE SECTOR PARTICIPATION</b>		
<b>General objective:</b> Mobilizing private sector resources for the provision and expansion of air transportation services.		
<b>Specific objectives:</b> Financing the activities necessary to: (i) transfer responsibility for operating, developing, and financing air transportation infrastructure to the private sector (financed by the MIF); and (ii) strengthen the institutional capacity of the State to effectively perform its responsibilities for formulating policies and regulations (financed by the technical cooperation loan).		
COMPONENT	ACTIVITIES	EXPECTED OUTPUTS
Institutional strengthening	Design and implementation of the organization and management information system	Operating and procedural manuals and proposed salary scale and management information system of the regulatory agency.  March 1998
	Setting of technical standards	Standards adapted to ICAO standards. Operating manuals for technical regulation.  March 1998
	Provision of computer systems and equipment	Equipment procured  June 1998
	Training and retraining	Personnel trained  December 1998
Private sector participation	Definition of the sector master plan.	Master plan  October 1997
	Development of the investment plan for the concession period.	Investment plan  October 1997
	Economic and financial analysis of the concession.	Traffic projections. Proposed air transportation fares and charges  October 1997
	Design of the transaction and preparation of the sales memorandum.	Sales memorandum  March 1998
	Preparation of the concession contract. Support for bidding, evaluation, negotiation and the award of contracts.	Contract prepared  June 1998
	Air traffic control (CTA).	Investment plan and strategy for privatization of the CTA  March 1998

PROPOSED RESOLUTION

GUATEMALA. NONREIMBURSABLE TECHNICAL COOPERATION FOR A PROGRAM  
FOR SECTOR REFORM AND INCORPORATION OF THE PRIVATE SECTOR IN CIVIL AVIATION

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Government of Guatemala, and to adopt such measures as may be pertinent for the execution of the plan of operations referred to in document MIF/AT-\_\_\_\_\_ with respect to a nonreimbursable technical cooperation for a Program for sector reform and incorporation of the private sector in civil aviation.

2. That up to the amount of US\$1,150,000, or its equivalent in other convertible currencies, is authorized for the purposes of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.