State Aid to Airlines and Airports

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Timely Questions

• Why is there so much aid to National carriers?

• Where is the demand for airport infrastructure?
  ➢ The Davies airport commission got 50 proposals of where to put a new runway in South East

• How much should airports be allowed to charge airlines and passengers?
Purpose to State Aid Modernisation

• Foster growth in a strengthened, dynamic and competitive internal market
• Focus enforcement on cases with the biggest impact on the internal market
• Streamline rules and faster decisions

Business perspective

• Remove the politics
• Enhance transparency and improve the quality of evidence based review
• Accept market exit if the airline is not efficient
• Recognise globalisation of many markets
I. Why so much direct subsidy to airlines

• Massive competitive challenges means that many European carriers remain chronically loss making

• Perception that a national carrier is needed to provide connectivity
  ➢ Not true as the market fills that gap
  ➢ Since Spanair shut BCN has seen more growth (more flights/more destinations/more passengers); since Malev exited the airport has replaced the flights and passengers with Ryanair and Wizz bases

• The national carrier is needed to “prop up” state owned hub airports (see recent comments about Alitalia and the political desire for FCO to remain a hub)

• For local political reasons – “the need for a flag carrier”

• With a view to their sale to a sovereign wealth fund/ third country airlines
Rescue and restructuring aid to Airlines

• R&R Guidelines are not fit for purpose (though heavily used for banks)
  ➢ Each case looked at case by case; no sector type review is currently possible
  ➢ Easily circumvented
  ➢ Oxymoron “one time last time”

• Presently being reviewed as part of review of Modernisation of State Aid
  ➢ Require the recipient to undertake the necessary and painful restructuring steps of its own accord before even applying for aid
  ➢ Should focus on a realistic counterfactual as happens in the merger regime (i.e. the assets/routes may not exit the market even if the carrier does)
Recent cases
Restructuring an airline is harsh

• Commission needs to show healthy scepticism around restructuring plans
  - If the plan looks too good to be true it probably is (particularly growth)
  - Be mindful of resistance and backsliding
  - Long term viability implies sufficient level of return across the cycle in order to be able to invest

• Iberia is an example of a radical restructure to restore long term viability
  - Iberia was losing €1m a day
  - Required 15% reduction in capacity for 2013
    - Fleet reduction: 5 long-haul aircraft  20 short-haul aircraft
    - Reduction of the network reach / routes
  - Headcount reduction of 3,141 employees and salary cuts:
    - 18% for flight crew and 11% for ground employees
  - Restructuring charges
    - A provision of €590m
Current regime – Restructuring aid

- Based on a feasible, coherent and far-reaching plan to restore a firm’s long-term viability

- Restructuring aid can only be granted if the following criteria are met:
  - a firm must qualify as a firm in difficulty
  - a restructuring/recovery programme is submitted to the Commission to restore viability in a reasonable time period
  - compensatory measures are taken to avoid undue distortions of competition
    - (e.g. for airlines this means cutting fleet and route network)
    - Beneficiaries have to make a significant own contribution and aid is limited to the minimum needed for the implementation of the restructuring measures.
  - restructuring aid can be granted once only (“one time, last time principle”)
  - strict monitoring and annual reporting is required to ensure no backsliding
Current regime – Don’t ask permission just seek forgiveness

- The procedure is a State to State process with private competitive interests having little rights or influence; Competitors have little procedural rights to see the restructuring plan and comment in a meaningful way.

- Even though there is standstill obligation in practice for restructuring aid the Member States seek forgiveness rather than permission.

- Harsh truth is that no rational shareholder will commit significant funds to capital investment for a perennial loss-maker until it provides clear evidence that it can earn a suitable return on that investment in the short and medium term.
II. Airport Incentives to Airlines

• Feature of two sided markets
  - Akin to having an anchor tenant
  - No “Harm” in targeting growth – an airline that tries to grow one side of the market (the airline side) is behaving rationally if profits increase overall (from the passenger/concession side)
  - It is the LCCs who are growing

• An airport should be able to set fees/charges or pay incentives to make the airport as self-sustaining as possible
  - Increasing revenues generated at the airport is a legitimate airport goal which provides tangible benefits to airports and is consistent with the aim of airports being self-sustaining
  - Adding new passengers increases airport revenues from concessions such as parking, food and beverage, ancillaries from car hire and ground transportation fees.
  - At what level do subsidies and incentives hamper self-sustaining

• An airport should treat similarly situated airlines in a like manner
  - Incentives should be offered to other carriers willing to provide same service But an airport should be able to limit number of carriers, such as through an RFP, at least for small airports.
Market realities

• The rules for evaluating air service incentives programmes should:
  ➢ Recognise that there is an active market for airports and airlines to match supply and demand
  ➢ Should not unduly restrict airport prerogatives

• In an increasingly complex environment, airports must be able to offer higher service at lower costs:
  ➢ An airport should be able to provide incentives only to air service that meets its goals e.g. for low fare service
  ➢ and be able to respond to changing airline industry (M&A), travel and trade trends.

• Airlines in seeking incentives to provide or expand service need to be sure:
  ➢ There is demand for a route
  ➢ An incentive cannot suddenly make an otherwise unprofitable route viable for an airline.
  ➢ Airlines have to limited assets and will deploy where most profitable taking into account the revenue risks and costs of starting new service as well as retaining existing service
Risk Sharing Model

More

Risk

Less

Gold
- Revenue guaranteed

Silver
- Start up costs

Bronze
- Reduced fees/Waivers
Margin of discretion for start up aid

• Eligible service should include network, passenger and/or capacity growth
  ➢ New routes or frequency only? Airports may wish to reward the introduction of new routes / reward growth of passenger volumes / including through upguaging with increased number of seats on existing flights
  ➢ Service retention incentives? Repeated seasonal service incentives

• Type of incentive(s)
  ➢ A reduction in charges
  ➢ Promotional payments to airlines that realise route or passenger growth
  ➢ Promotional payments can be either granted without earmarking or specifically aimed at financing a part of airline’s marketing efforts
Disqualifying services

- Airports under 3 million passengers
  - This represents about half of the European airports
  - Not sure of the logic of moving away from 5 million passenger

- Value of incentive
  - No logic to limiting the amount of the incentive to 50% [No caps in the US system]
  - Local communities can usually market service more cost-effectively than carriers

- Length of program
  - Routes should be viable without support but the “Promotional” period of 2 years does not seem to match with market realities; some routes take longer to stimulate; may have seasonal travel
Third party sponsors

• Incentives from tax revenue unrelated to the airport should be able to be used broadly

• Organisations such as local tourist body/economic development authority/chamber of commerce should be able to provide incentives to a carrier [provided there is no imputation to the airport]

  ➢ To undertake destination marketing
US FAA Rules

- Single Federal Aviation Regulator enforcing common federal rules which makes it illegal for grant aided airports to misuse airport revenue.

- Airports may not provide subsidy of operating costs to airlines so cannot make a direct payment to defray start up costs.

- But the FAA does permit incentives for new service as (a) service to an airport destination not currently served, (b) nonstop service where no nonstop service is currently offered, (c) new entrant carrier, and/or (d) increased frequency of flights to a specific destination which includes upguaging.

- There is no limit/cap on the value of the incentive.

- Airport revenue can be used for pay marketing support provided it is used in promoting the Airport and its services.

- New service incentives are limited to a 2 year promotional period.