ACI EUROPE
AIRPORTS COUNCIL INTERNATIONAL



AIRPORTS & STATE AID:

HOW TO PROTECT BOTH GROWTH & COMPETITION

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INTRODUCTION

On 3 July the European Commission published draft *'EU Guidelines on State Aid to Airports and Airlines'*. This document is part of a wider ACI EUROPE response to the proposed new rules.

ACI EUROPE shares the same objectives as those pursued by the European Commission (EC) – **the boosting of economic growth and the facilitation of objectives of common European interest, but not at the expense of distortions to competition[1].**

ACI EUROPE counts more than 450 airports amongst its membership, of very different sizes, business models and locations. Where one airport receives an unfair competitive advantage it is generally the case that one or more of our members then face a corresponding unfair competitive disadvantage. Therefore as the airport industry representative body, ACI EUROPE advocates for State aid guidelines which promote and protect undistorted competition, while still reflecting the economic reality of the airport industry. It is for this reason that the fundamental message of ACI EUROPE's position on State aid is that a level-playing field **must** be promoted and protected within the airport industry[2]. Indeed, in some respects ACI EUROPE has a more holistic approach to the issue of competition within the transport sector – *inter-modal* competition should also be protected from distortions, and in particular such competition between rail and air[3].

So given that both the EC and the airport industry share the same objectives in the treatment of State aid, why does ACI EUROPE believe that the EC's proposed new guidelines on State aid in the aviation sector[4] would benefit from changes?

For guidelines to be fit-for-purpose, they must reflect the **market realities** which the industry in question faces, as well as the wider **economic positive externalities** generated. It is precisely because there is no 'one size fits all' approach that these guidelines specifically for the aviation sector are required. From a European airport perspective, while the underlying approach of the EC is correct, **the draft guidelines do not reflect the fundamental economics of the industry, and therefore will not optimally balance the twin objectives of economic growth and undistorted competition.**

This paper highlights the core economic attributes of the airport industry, and advises how the EC's proposed guidelines could be altered to best meet the needs of the aviation sector, as well as the needs of EU citizens and the wider EU economy as a whole.

[1] *'Speech - Introductory Remarks on New state Aid Rules for Airports and Airlines'*, EC Vice President Almunia, July 2013 – available at http://europa.eu/rapid/press-release_SPEECH-13-606_en.htm

[2] *'A level playing field for European airports – the need for revised guidelines on State aid'*, ACI EUROPE, June 2010 – available at https://www.aci-europe.org/component/downloads/downloads/1455.html

[3] See *'Air & Rail: Setting the Recod Straight'*, European Regional Airlines Association, September 2011 – available at http://www.eraa.org

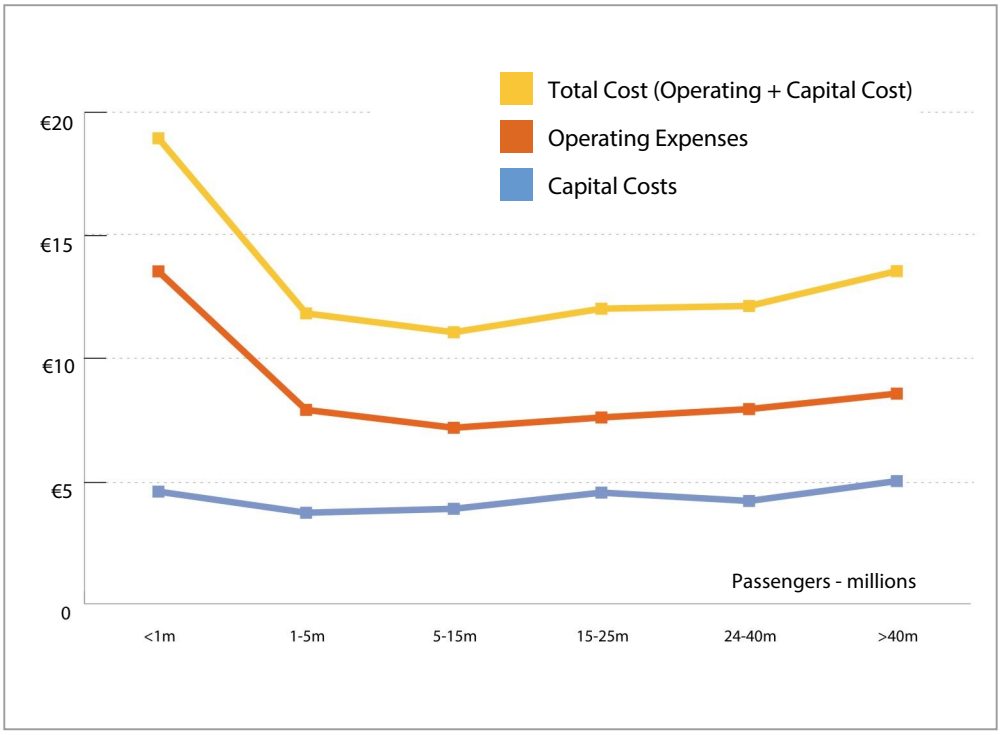
[4] *'Draft Communication from the Commission - EU Guidelines on State aid to airports and airlines'*, European Commission July 2013 – available at: http://ec.europa.eu/competition/consultations/2013_aviation_guidelines/index_en.html

SMALLER AIRPORTS

The draft EC guidelines propose that there should be no operating aid for airports after a 10 year transition period. To reach this point, smaller airports receiving such aid should be required to progressively increase their operating cost coverage by at least an average of 10% per annum, which implies equivalent increases in airport charges (or in theory lower equivalent costs) - until such time as any operating aid has been eliminated[5] within the 10 year period.

However, the presence of operating aid at smaller airports in the first place is precisely a consequence of their structural inability to price at a level which covers their full costs, as the EC itself acknowledges[6]. For a fuller appreciation of this point, the cost and revenue structures of airports must be considered.

Figure 1: Operating, capital and overall costs per passenger experienced by airports of increasing size.



Source: 2012 ACI Airport Economics Report, ACI World €1 = US$1.33

[5] Ibid, Paras. 104 - 107

[6] *'Draft Communication from the Commission - EU Guidelines on State aid to airports and airlines'*, European Commission July 2013, Paras. 5 & 80.

THE UNDERLYING PROBLEM

• Costs

For airports it is estimated that approximately 80% of costs are fixed[7] - this means that airports have to bear these costs regardless of the number of passengers they have. These 'sunk costs' are not just capital costs for infrastructure but also operating costs, a significant proportion of which are driven either by regulatory requirements (safety & security), or by existing infrastructural requirements rather than the traffic volumes. For example irrespective of the number of passengers, an airport has to maintain a minimum rescue and fire fighting service, has to ensure the security of the aerodrome perimeter, and has to ensure basic facility maintenance and cleaning.

In practice, this means that smaller airports will always have higher costs on a per passenger basis compared to their larger peers. They can't escape many of the costs, and at the same time don't have the passenger numbers to spread the impact. Figure 1 illustrates how airports only fully escape this 'sunk cost trap' once they serve several million passengers per annum. It shows that smaller airports are at a structural competitive disadvantage relative to their larger peers.

• Revenues

Smaller airports also face structural competitive disadvantages in their revenue streams.

For airports non-aeronautical revenue streams - such as those from retail, car parking, advertising and food & beverage - are a key driver of economic sustainability and competitiveness. In 2011 such revenues accounted for 41% of overall European industry revenues[8]. Airports, as a matter of course, subsidise the price of their aeronautical services (e.g. use of runway, aircraft parking, passenger processing through terminal) with these non-aeronautical revenues to attract and retain airline and passenger customers. The EC acknowledges the importance of such revenues in its guidelines[9], as well as in wider previous decisions.

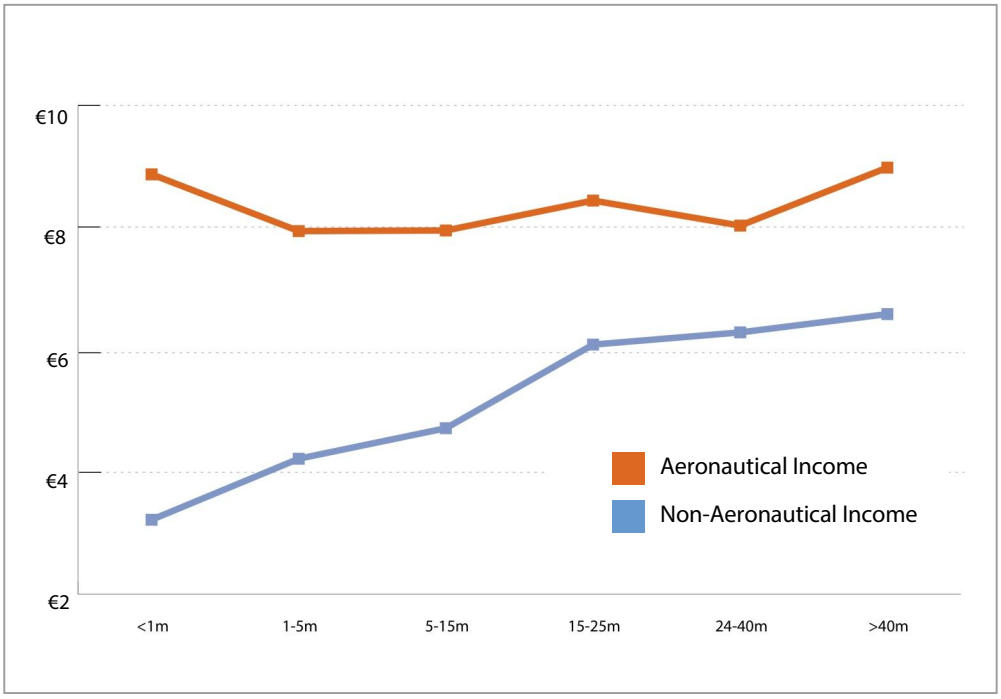
However smaller airports, and in particular those with less than one million passengers per annum, face much larger structural difficulties in generating these non-aeronautical revenues. They do not have the positive network externalities available to their larger counterparts. On a per-passenger basis, larger airports generate over TWICE the non-aeronautical revenues that their smaller counterparts have access to. See Figure 2.

[7] *'Airport Competition in Europe'*, Copenhagen Economics, June 2012 – Page. 19

[8] *'ACI EUROPE Economics Report 2012'*, ACI EUROPE, June 2013, Page 8

[9] *'Draft Communication from the Commission - EU Guidelines on State aid to airports and airlines'*, European Commission July 2013, Para. 59.

Figure 2: Aeronautical & Non-aeronautical revenues per passenger experienced by airports of increasing size.



Source: 2012 ACI Airport Economics Report, ACI World. €1 = US$1.33

• Airport Charges

Smaller airports have higher per-unit costs, and much more limited access to non-aeronautical commercial revenues than their larger counterparts. Why then are airport charges at these smaller airports not higher so as to cover the associated costs (as the EC proposes)?

Simply put, the market does not allow it.

When the impact of both the structurally higher operating costs and structurally lower non-aeronautical revenues are considered, it can be seen that if smaller airports were to price at a level that covered their costs, all other things being equal their airport charges would be several times higher than the equivalent charges of their larger counterparts.

Figure 2 clearly shows that in contrast with per passenger costs and non-aeronautical revenues, aeronautical revenues per passenger (for the traditional airport services such as for the use of runway, terminal and aircraft parking) remain broadly consistent across all airport sizes.

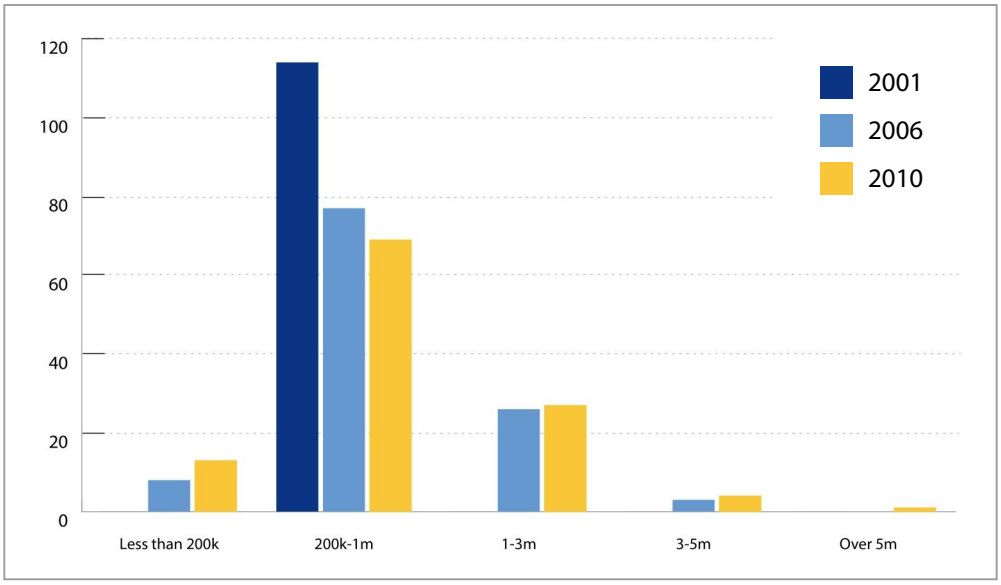
Airlines in particular are not willing to pay a substantially higher price for an airport which serves a smaller and often less affluent population, which offers more limited connectivity (and transfer passenger potential) and which will therefore offer routes with lower airline margins. Smaller airports are simply not as attractive as their larger counterparts to most airlines. Pricing which allows airlines to make a profit has to be a basic requirement of their business models. Nobody can force airlines to pay more for less.

This is all the more reinforced by the fact that smaller airports in Europe face very strong competitive pressures. They are typically served by origin-destination services such as point-to-point services which can be switched to another airport at very short notice. In 2011, circa 15 % and 20% of all intra-European routes were either closed or opened respectively[10], illustrating the choice and flexibility that airlines have. Airlines can also have strong buyer power *vis-à-vis* individual smaller airports. 84% of European airports have a dominant airline with greater than 40% of the airport's capacity[11].

• Growth

Some of Europe's smaller airports will grow. Others will not. This will be dictated ultimately by population and income-per head in their catchment areas. Typically airports which do not experience significant growth tend to serve more sparsely-populated communities, and generally have a social rather than a commercial mandate.

Figure 3: Numbers of EU airports in different size categories in 2001, 2006 & 2010



Source: ACI EUROPE traffic stats

[10] *'Airport Competition in Europe'*, Copenhagen Economics, June 2012, Figure 3.3

[11] Ibid, Table 3.2

Figure 3 demonstrates that of the 114 EU airports which had between 200,000 and 1,000,000 passengers in 2001, by 2010 only circa 28% had grown beyond 1mppa, with 61% remaining in the same size category, and with a small number even decreasing in size.

Those airports that can grow need State aid guidelines which incentivise this growth. Those airports which serve more sparsely-populated communities need State aid guidelines which allow a strictly-necessary degree of public funding.

The final EC guidelines to be adopted therefore need to be sufficiently comprehensive so as to address both categories of smaller EU airports.

• Positive Economic Externalities

The inherent unprofitability of such airports might not be a wider public concern, were it not for the major positive economic and social roles which these airports play in their communities. This is particularly so for more sparsely-populated areas which lack alternative transport modes – for these communities, air links are a key tool necessary to remain connected with the wider world and economy. The final section of this paper considers the wider positive externalities of these airports.

There are more effective responses than capping growth of these airports below 200,000 passengers per annum, or even condemning them to closure. Instead the appropriate approach is to take into account broader economic factors, and to construct a system which prevents abuse but which also properly incentivises growth.

APPROPRIATE POLICY RESPONSE - OPERATING AID

The dynamics of the airport industry simply do not support the EC's proposals. Requiring all airports with more than 200,000 passengers per annum to cover all their operating costs will not alter the underlying supply and demand-side forces. Nor will the proposed 10 year transition period alter this reality – a structural problem requires a structural solution, rather than a transient one. In fact, operating aid is a key component to smooth the potential competitive distortions caused in particular by the uneven cost structures and revenue generating opportunities facing airports of different sizes.

If done correctly therefore, the injection of operating aid can protect and enhance such competition within the industry, rather than undermine it. The appropriate policy response should be to police this operating aid to ensure that it reflects the underlying market fundamentals i.e. as an airport gets decreased operating cost per passenger, and increased commercial revenues per passenger, then its operating aid should decreases correspondingly.

This could be achieved with an approach similar to the EC's proposed treatment of investment aid – diminished allowed intensities as the airport grows in size (Table 1). Such an approach could be permanent (i.e. no 10 year transition phase) or at least until such point as the EC reviews the guidelines[12].

Table 1–ACI EUROPE's Proposed Allowed Operating Aid Intensities

Airport Size (passengers per annum)	Allowed Intensity of Operating Aid
< 200,000	100%
200,000 - 399,999	50%
400,000 - 599,999	40%
600,000 - 799,999	20%
800,000 - 999,999	10%
> 1,000,000	0%

If implemented correctly, and properly enforced, this approach would be in line with ACI EUROPE and the EC's shared objective **of maximising economic growth while still protecting a level competitive playing field.**

- Firstly, it would limit distortion of competition, with strict thresholds and allowed intensities for the provision of operating aid.
- Secondly, it would allow operating aid where there is a genuine need for such aid, reflecting the structural financial challenges facing smaller airports.
- Thirdly, it would also provide the correct growth incentives to airports, offering an achievable path towards self-sustainability for those airports which can credibly expect to achieve this. In particular it would remove the dangerous incentive to intentionally maintain airports below 200,000 passengers per annum, which the EC's draft guidelines would create[13].

Based on the above this approach can be considered to be consistent with the principles of **proportionality** and **objectivity** thus **strictly limiting any negative impact on competition**.

[12] Para 127 of the proposed guidelines envisages a review no later than 7 years after the entry into force of those guidelines.

[13] The draft EC guidelines exempt from notification State aid in the form of public service compensation for airports with less than 200,000 passengers per annum – Para 68.

More generally, such an approach would allow all the regions of the EU to benefit from a level playing field, with the economic benefits associated with connectivity not being excessively pooled at the core of Europe. Currently 68 airports (circa 20%) which have been designated by the EC as 'core' or 'comprehensive' within the Trans-European Transport Networks (TEN-T)[14] , have between 200,000 and 1,000,000 passengers per annum (Annex 1). These are the very airports which are most at risk from the new proposed guidelines.

Therefore they could potentially represent a major hole in the European transport network should the proposed guidelines be enforced in their current form. This suggests that considerably more policy alignment within the EC would better support the realisation of its strategic goals for the transport sector.

APPROPRIATE POLICY RESPONSE - INVESTMENT AID

In terms of investment aid for smaller airports, those with annual traffic of between 3-5 million passengers under the proposed EC new guidelines are obliged to repay with interest all investment aid, if the project for which the aid has been granted is successful. It must be considered whether such conditions really allow these airports to receive proper investment aid in practice. Figure 1 clearly demonstrates that airports only gain equivalent competitive economies of scale as they approach the 5 million passenger threshold. The guidelines themselves acknowledge that airports with 3-5 million passengers per annum can in principle cover all their costs only *'to a large extent'*[15].

Therefore it seems appropriate that the proposed intensity of aid (25%) for such airports need not be repayable, as the reduced intensity reflects the inherent cost and revenue structures facing these airports, and is therefore unlikely to undermine competition if enforced correctly.

[14] The Trans-European Transport Networks (TEN-T) are a planned set of road, rail, air and water transport networks in Europe. The Trans-European Transport Network Executive Agency (TEN-T EA) was created to implement and manage the TEN-T programme on behalf of the European Commission.

[15] *'Draft Communication from the Commission - EU Guidelines on State aid to airports and airlines'*, European Commission July 2013, Para 80 (4)

LARGE INFRASTRUCTURE PROJECTS

While the requirement for public funding of smaller airports has long been understood, more recent considerations of the possible role of private finance in large once-off greenfield airport developments (as oppose to the extension of existing airport infrastructure) are increasingly suggesting that such projects are not viable without some form of public funding. There are two main reasons why this is the case, revolving around the long timescales involved and the massive investment sums required:

• Length of Time

Investments in landmark greenfield airport projects may ultimately be profitable, however the length of time required to achieve this may dissuade many investors. Such projects can require close to 20 years to provide positive returns. In the absence of public funding, commercially viable economic engines such as Munich Airport would not exist today.

• Degree & Concentration of Risk

While the financial and wider social and economic benefits of such projects can be significant, reliance on private investors alone would imply a concentration of major risk upon the shoulders of these investors, who may be unwilling to accept this. Such projects face many uncertainties – as well as the complexities of the projects, the long lead times mean that regulatory environment, the economy and the market for air services can all be very different from the initial assumptions by the time the project reaches completion.
Examples of this include step changes in a region's economic fortunes, the demise of specific airlines, new transportation options for passengers, changes in government regulatory or policy approaches, shifts in consumer preferences, demographic changes, etc.
In such cases some form of public involvement is required, both to share the significant risks but also to reduce those risks by credibly demonstrating strong government support for the project in question.

While the large once-off nature of such projects precludes any macro-level analysis there is an increasing range of case studies and examples to demonstrate this reality:

[16] *'Would a New Hub Airport be Commercially Viable?'*, Oxera, January 2013, Para. A83

[17] *'SA.35378 Financing of Berlin Brandenburg Airport (BER)'*, European Commission, December 2012

[18] *'ACI EUROPE Economics Report 2012'*, ACI EUROPE, June 2013, Page 17

[19] *'Would a New Hub Airport be Commercially Viable?'*, Oxera, January 2013,

Berlin Brandenburg Airport - originally envisaged as having at least partial private investment, in practice all equity has come from the German government, and all debt has been subject to a full government guarantee[16]. The European Commission approved support for the project in 2009, on the grounds that *'it was not possible to find sufficient funds on the financial markets for such a large infrastructure project[17]'*.
At the time the EC decision was justified by the on-going financial crisis. Given the subsequent massive increase in capital costs for Europe's airports (these increased by +29% between 2009 and 2011[18]) it may well be the case that the decision was reflective of the new world economic order rather than any particular transient crisis.

London Gateway Airport projects – several proposals have been put forward concerning the creation of a new gateway airport in London, to deal with the severe capacity issues in southeast England. A recent report by Oxera[19] for the House of Commons concluded that under most scenarios, expected revenues would be less than the expected costs and that a new hub airport would not be commercially viable. Substantial taxpayer support would likely be needed if any project were to go ahead.
The report explicitly states that EC State Aid guidelines would need to be taken into account in such a case – this may imply that, with the current proposed guidelines, the fierce debate in the UK on airport capacity may be altered, if the EC will subsequently not permit some of the options being considered.

Munich Airport – the current Munich Airport was designed to replace the older Munich-Riem Airport. The greenfield project required the settlement of a small town to progress. Construction started in 1980, with operations beginning in 1992. The airport operating company only turned a positive net profit 16 years after construction began, and 27 years after the decision was taken to build the airport. This was despite the airport starting off with 12 million passengers who transferred from the airport it was replacing. Munich Airport is owned by a combination of federal, regional and city governments.



[16] *'Would a New Hub Airport be Commercially Viable?'*, Oxera, January 2013, Para. A83

[17] *'SA.35378 Financing of Berlin Brandenburg Airport (BER)'*, European Commission, December 2012

[18] *'ACI EUROPE Economics Report 2012'*, ACI EUROPE, June 2013, Page 17

[19] *'Would a New Hub Airport be Commercially Viable?'*, Oxera, January 2013,

APPROPRIATE POLICY RESPONSE

The proposed EC guidelines on State aid explicitly rule out investment aid for airports with more than 5 million passengers per annum. Yet the above examples clearly demonstrate that public funding has a key role to play in the development of large scale airport projects.

Unless this is acknowledged and accounted for in the final guidelines, the EC may be in effect precluding the development of any future major airport infrastructure. This would be a particularly destructive move not only in light of the successful efforts of Middle Eastern and Asian countries to forge ahead with extensive publically-funded major new airports[20] but also in the context of the well-documented capacity crunch in Europe. EUROCONTROL in its latest report[21] envisages that 12% of demand for air transport in Europe will be unmet due to inadequate airport capacity by 2035. This will cost the European economy €230 billion in lost GDP annually[22].

EU funding is not a solution – firstly it is a limited resource. €31.7 billion has been allocated to the entire TEN-T (road, rail, water and air sectors) across 2014-2020[23]. Of the 130 pre-identified projects of the core network in the field of transport, only 2 projects concern airports, and even then these individual projects are also concerned with rail and port facilities also[24]. In contrast the new London gateway airport alone is estimated at costing anywhere between €23 to €58 billion depending on the option chosen[25].
Secondly, EU funding like the Connecting Europe Facility takes the form of support for Member State projects – if these projects are not compatible with State aid guidelines then EU funding is effectively also excluded.

It is very important for Europe's long-term future that the new guidelines acknowledge in some form the need for public involvement in these large infrastructural projects. The alternative is to risk the door being completely closed to new major airport developments in Europe.

[20] For example, traffic at Beijing Capital Airport has tripled in the preceding decade with a second major airport opening in the city by 2018. The current Five Year Plan calls for 55 new civil airports in China by 2015, bringing the country's total to 230.

[21] *'Challenges of Growth 2013'*, EUROCONTROL, July 2013.

[22] *'Airport Capacity Crunch Will Cost European Economy €230 Billion'* ACI EUROPE press release, June 2013

[23] *'Connecting Europe: The new EU core transport network'*, European Commission Memo, October 2011

[24] *'Proposal for a Regulation of the European Parliament and of the Council establishing the Connecting Europe Facility'*, European Commission, October 2011, Annex.

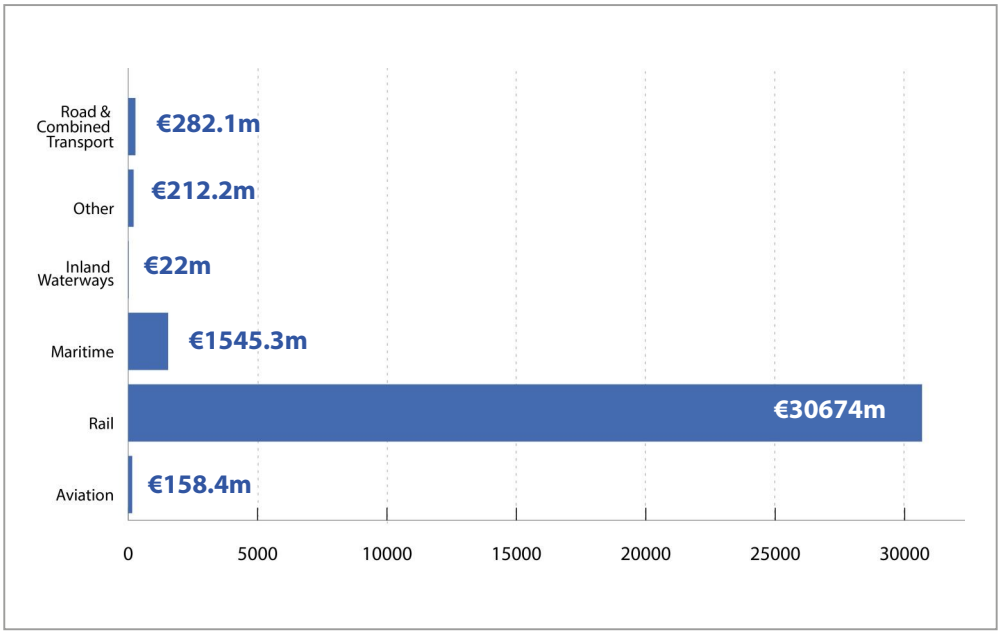
[25] *'Would a New Hub Airport be Commercially Viable?'*, Oxera, January 2013, Para. 4.2. £1 = €1.16

STATE AID & AVIATION - THE COSTS AND BENEFITS FOR EUROPE

According to the EC, in 2011 State aid to the entire aviation sector across all of the (then) 27 Member States amounted to €158.4 million[26]. This is in the context of an annual sectoral contribution to EU GDP of €475.2 billion[27].

In comparison, the road and combined services sector received aid of €282.1 million, maritime transport received €1545.3 million, and rail received a staggering €30674 million[28]. These figures indicate that public funding to the aviation sector should perhaps not be a priority concern for Europe. This is particularly so given that the accessible quality connectivity generated by aviation is significantly higher than that generated by other transport modes – especially in the context of ever greater dependence of the European economy on trade with other continents. This suggests that the economic benefits of aviation are also proportionately far more significant than other modes.

Figure 4: Notified State aid to various modes of European transport sector in 2011.



Source: European Commission

[26] *'Table - State aid to the transport sector'*, DG Competition – available at http://ec.europa.eu/competition/state_aid/studies_reports/stat_tables.html#4_4

[27] *'Aviation Benefits Beyond Borders- EU Section'*, ATAG & Oxford Economics, March 2012, Page 27

[28] *'Table - State aid to the transport sector' & 'Table – Subsidies to the railway sector, EU- 27 (2000-200)'*, DG Competition – available at http://ec.europa.eu/competition/state_aid/studies_reports/stat_tables.html#4_4

As an exercise, ACI EUROPE estimated the value of the losses that airports under 1mppa are making annually – i.e. the total sum of public funding which would be required for these airports to break even, all other things being equal. Secondly, the economic value of these airports was calculated, in terms of contribution of Gross Domestic Product and employment.

If public funding were used to entirely eliminate the losses of all EU airports in Europe with less than 1mppa, it is estimated that this would cost circa **€445 million** per annum[29].

In contrast, it is estimated that these airports allow an overall contribution of **€16.15 billion** to annual GDP. This includes to **265,000 jobs**[30].

While indicative, the above figures show that measured public involvement in the air transport is a highly efficient means of delivering positive economic externalities to EU citizens.

CONCLUSIONS

To best meet the goal of protecting competition, but also the boosting of economic growth and the facilitation of objectives of common European interest, the new EC guidelines need to be further tailored for the specificities of the market. In particular:

- **Strictly digressive operating aid should be allowed for smaller airports**, to reflect the inherent cost structures facing the market;
- What limited investment aid (25% intensity) is permitted for airports with 3-5mppa should **not be refundable**;
- Some provision must be made for **investment aid for major landmark greenfield airport projects** in Europe – the alternative is to deny Europe key transport infrastructure which is already needed and which will be crucial in the years ahead.

[29] ACI EUROPE extrapolation, based upon analysis of financial performance of 89 airports with less than 1mppa in 2011.

[30] Figures derived by considering these airport's proportion of overall EU traffic and extrapolating EU-specific GDP and employment figures sourced from 'Benefit Beyond Borders' study. For the purposes of the analysis it is assumed that the 'per-passenger contribution' towards GDP and employment does not vary according to overall airport size.

ANNEX

TEN-T Comprehensive and Core Airports with 200,000 – 1,000,000 Passengers per Annum

AUSTRIA	**Klagenfurt-Villach** **Linz-Wels** **Graz** **Innsbruck**
BELGIUM	**Oostende, Zeebrugge** **Liège**
CROATIA	**Zadar** **Pula**
CZECH REPUBLIC	**Ostrava** **Brno**
FINLAND	**Kittilae** **Koupio** **Vaasa** **Rovaniemi** **Turku-Naantali** **Tampere**
FRANCE	**La Rochelle** **Limoges** **Clermont-Ferrand**
GERMANY	**Memmingen**
GREECE	**Alexandroupolis** **Skiathos** **Preveza** **Samos** **Kavala** **Kefalonia** **Mykonos** **Mytilini** **Santorini** **Zakinthos**
IRELAND	**Kerry-Farrenfore** **Knock**

ITALY	Forlí Pescara Ancona Reggio Calabria Trieste
LITHUANIA	Kaunas
NETHERLANDS	Groningen Maastricht
POLAND	Szczecin, Swinoujscie Łódź
PORTUGAL	Ponta Delgada
ROMANIA	Bacău Cluj-Napoca
SPAIN	San Sebastián Melilla Valladolid Zaragoza Granada Almería Vigo A Coruña Jerez Reus La Palma
SWEDEN	Ronneby Sundsvall Skellefteaa Visby Ostersund Angelholm
UNITED KINGDOM	Norwich Derry Inverness Sheffield Bournemouth Exeter

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