ACI EUROPE on the Crisis

ACI EUROPE
AIRPORTS COUNCIL INTERNATIONAL

EMPOWER EUROPE'S AIRPORTS TO BOOST ECONOMIC RECOVERY

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The global economic and financial crisis affecting Europe keeps unfolding day after day. Despite massive injections of public funds, the banking system remains extremely unstable. Limited credit flows and decreasing levels of business and consumer confidence have resulted in all economic sectors being affected.

Due to its unique role - connecting people and businesses - air transport has always been extremely sensitive to the state of the real economy. It is therefore no surprise that the sector is being hard hit, with airlines, airports, air navigation service providers and all related businesses facing unprecedented challenges.

European airports are not immune to the crisis and are being heavily affected. While they are now fully-fledged and self-financed businesses that abide to strict fiscal discipline, European airports are also subject to market forces. The liberalisation of aviation has indeed resulted in airlines getting a virtual airport superstore in which to shop, with little commitment vis-à-vis airports and the communities they serve. Contrary to airlines, **airports cannot move to a stronger market location: they have to make their market location stronger – and therefore be competitive**. This is never more acute than in times of crisis.

European airports are reacting swiftly and proactively to the new market conditions. However, if they are to effectively contribute to the economic recovery, **urgent measures are required both at EU and national level.**

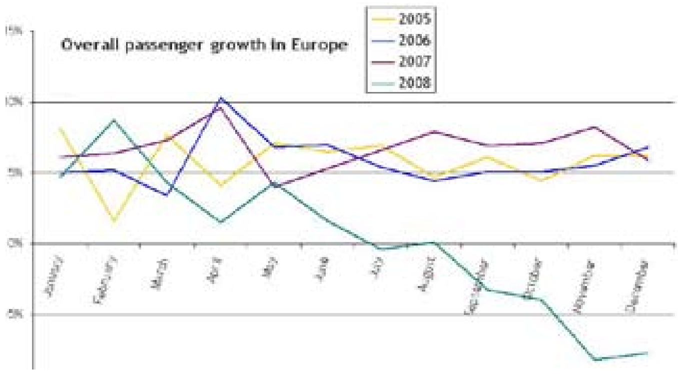
These measures should:

- address existing shortcomings in economic oversight/ regulation
- allow for more flexibility as regards start-up aid for regional air routes
- mandate one-stop security and public financing of aviation security
- abolish ill-advised national taxes on aviation
- accelerate the liberalisation of aviation with non-EU countries

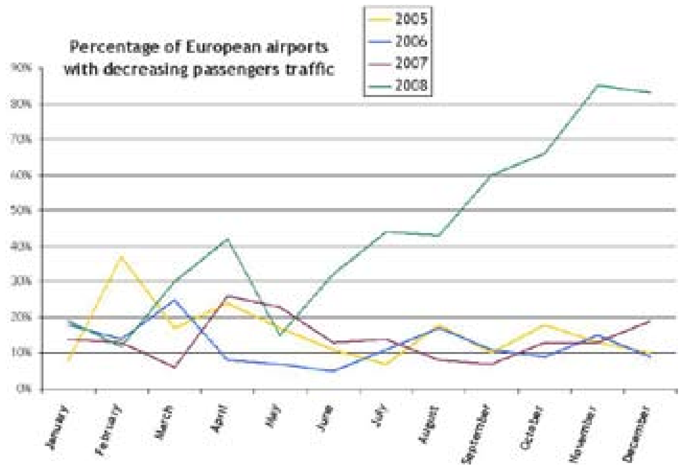
UNPRECEDENTED TRAFFIC DECLINE

The downturn hitting European airports is severe. While the last 5 years (2002-2007) saw passenger traffic growing by more than 40%, 2008 saw both passenger and freight traffic quickly decreasing quarter after quarter. By December 2008, more than 80% of European airports were registering traffic decreases, with the fall averaging –7.7% for passenger traffic and –21.4% for freight traffic.

Graph 1 – Comparative monthly passenger traffic evolution years 2005/2008



Graph 2 – Comparative monthly percentage airports with decreasing pax traffic 2005/2008



The situation has further deteriorated in early 2009, along the following patterns:

- **In January 2009, passenger traffic further decreased by -10.7% and so did freight traffic by -23.6%. In total, a staggering 92% of European airports reported a decrease in passenger traffic.**

- While airports in Central and Eastern Europe initially appeared more resilient, all European markets are now being affected by steep traffic decreases.
- All of the top 10 European hubs are seeing sharp passenger and freight decreases.
- Regional airports are facing some of the steepest passenger traffic decreases, up to -61%, due to their extreme dependence on just a few airlines. However, even though many of them are typically facing passenger traffic decreases between -15% and -30%, the situation remains contrasted with some still growing. This reflects the flexibility with which airlines can move their operations.

- Origin/destination traffic is more affected than transfer traffic.
- Domestic and to a lesser extent, intra-European traffic tends to be more affected than intercontinental traffic.
- Freight traffic has deteriorated at a much quicker and deeper pace than passenger traffic.

ACI EUROPE is now forecasting an overall decrease of -5% for passenger traffic and -15% for freight traffic at European airports for 2009, although this estimate is likely to be revised as the year progresses.

- It is already clear that the present traffic downturn is much more severe than the one experienced following 9/11. In 2001, passenger traffic and freight traffic respectively decreased by -0.5% and –5%. In 2002, passenger traffic and freight traffic respectively decreased by -0.5% and –1.5%.

- Passenger traffic may keep decreasing in the coming months for two reasons:

  1. The unusual gap between the decreases in freight and passenger traffic suggests the potential for further passenger traffic decline in the coming months. Freight traffic has historically been a barometer for international trade and its present levels reflect the deep impact of the crisis on businesses and, more generally, the economy.
  2. There appears to be still a negative demand/supply mismatch in the market and airlines will make further capacity cuts in the coming months. Airlines in Europe have started cutting capacity later and at a lower pace when compared to airlines in the US.

ACI EUROPE is unable, for the time being – to estimate the calendar of a general rebound in traffic.

IMPACT

This crisis is confronting European airports with an extremely critical situation, as they are heavily impacted both as regards their revenues and costs, and as they are facing increasing pressure from their airline customers.

As regards revenues, the competitive conditions in which airports now operate result in an increased vulnerability to economic cycles. Therefore, it is no surprise that, under the present circumstances, **European airports are facing their worst ever revenue environment.**

Indeed, airports are being hit by a **double-whammy**:

- **Aeronautical revenues** (charges paid for the use of the infrastructure by airlines and passengers) are fast declining, along with passenger numbers and freight volumes. <u>Frequency reductions and route suspensions by airlines are further aggravating the situation for airports.</u>

- **Commercial revenues** (retail, parking, real estate and property, advertising, rental car concessions, etc) are also declining, with fewer passengers and visitors, less inclined to spend.

Along with a general revenue slide, the crisis is having a significant impact on airport costs, in particular on capital costs.

- Airports are asset-heavy and capital intensive businesses, with capital expenditure typically accounting for 30% to 40% of their total costs. In recent years, airports have sought to diversify their sources of financing, increasingly relying on capital markets. The financial nature of the present crisis is challenging for airports, as accessing capital markets has become more difficult and much more costly.

  Some airports are also seeing their credit rating being downgraded, adding a further challenge. While publicly-owned airports initially appeared to be less exposed in this regard, the situation has in recent weeks become more volatile.

- Against this background, airports in Europe continue to be faced with increasing regulatory costs, in particular as regards security. Security regulations adopted since 9/11 have resulted in related costs now accounting for up to 35% of airports' total operating costs – an unsustainable level for any business and a clear impediment to the competitiveness of European aviation.

- At the same time, airport costs cannot be reduced at the same pace as the declining revenues. Being capital-intensive by nature results in a very large share of total costs associated with capital costs (interest charges, depreciation and amortisation) and in very high fixed costs. Costs for safety and security equipment as well as terminal heating and lighting are, if at all, only loosely linked to passenger numbers. Moreover, airports are less labour intensive than airlines, so the margin to reduce costs through efficiency improvements and staff restructuring is more limited.

Airports are also subject to increasing airline pressure to lower their charges. In this regard, **the crisis is likely to have a long-term impact on the relationship between airports and airlines.**

- With airline consolidation now accelerating, a new structure for the European air transport market is emerging. It involves fewer and stronger airlines, including the pre-eminence of 3 network carriers and of 2 to 3 main low cost players. Such structure will only reinforce what many airports, especially regional ones, are already experiencing: the fact that airlines are actually the very dominant party in the airport-airline relationship.

REACTION

European airports are tightening their belts, cutting costs, postponing investments and capital expenditure, wherever possible.

- Aggressive cost-cutting programmes are being rolled out, involving measures such as staff reduction, recruitment freezes, outsourcing, limits on over-time and temporary staff.

  However, as airports are closely monitoring each cost position and strive to reduce operational costs, their ability to do so is constrained by the nature of their business. While airports are not labour intensive, their operations involve a very high proportion of fixed costs and many costs which are directly mandated by regulation (safety, security, environment) and service standards.

- Investments and capital expenditure programmes are being reconsidered, along with the postponement or cancellation of non-essential projects. However, reducing capital investment is not always possible, due to existing contractual commitments, on-going maintenance requirements as well as operational and regulatory compliance.

- **Systematically reducing investments is not advisable, as the long-term development of air transport needs to be ensured.** Notwithstanding the present crisis, air traffic is expected to double by 2030 with Europe still facing an airport capacity crunch. As airport infrastructure involves extremely long lead-time in terms of planning, financing and construction, it is essential that European airports keep investing to meet the future needs of the travelling public, airlines and the communities they serve.

  Moreover, these investments also play an important role in mitigating the impact of the crisis on the real economy and in fostering economic recovery. Given their ability to create jobs and foster economic development, **airport infrastructure projects should be considered as essential in any European and national economic stimulus programme.**

European airports are also reconsidering their charging policy vis-à-vis airlines. Such action is necessary to safeguard airports' competitive position and contain the impact of the crisis on their network, in terms of destinations and frequencies.

- **European airports are already sharing the pain with the airlines:** over the last 15 years, revenues from airport charges have become much more variable, with charges paid by passengers becoming much more important than those paid by airlines. As a result, airline charges now only account for 21% of total airport revenues.

- Despite the fact that revenues are falling while costs are increasing, **airports across Europe are striving not to increase their charges to airlines or, at worst, to limit any increase in 2009**. Several airports are actually reducing charges, while others are keeping charges stable (which still means a decrease in real terms), or are limiting increases below what was initially planned and/or authorised by their regulator. However, due to their specific situation (typically already low charges and committed capital expenditure), some airports have had no choice but to increase charges in order to ensure that the airport will continue to function efficiently and continue to develop to meet the needs of its passengers and customers.

- Airports have also revised their support schemes or introduced crisis support schemes whenever possible to share the risk with airlines of starting new routes in these difficult market conditions.

URGENT MEASURES NEEDED

The evolution of the airport business in the last 15 years has allowed the European air transport network to benefit from reliable and efficient ground infrastructure. Apart from attracting aviation-related and tourism activities, airports foster wider economic activity at and around their premises, acting a catalyst for job creation. As a result, airports not only contribute to the economies of the regions and communities they serve, they actually define it.

By acting as engines of economic development, airports have, in recent years, contributed to European growth and cohesion on a very large scale. Consequently, **airports have a vital role to play in stimulating the economy, in times of severe crisis.**

This contribution has been firmly acknowledged in the US, where the recently adopted "Economic Stimulus Package" provides more than US$2.1 billion in financial aid to airports, both for direct infrastructure investment and for security financing. Indeed, the US FAA estimates that such additional airport infrastructure funding will create more than 35,000 jobs.

Contrary to other sectors of the European economy, airports are not asking for massive public funding and bailouts. What they are asking for is merely a **reconsideration of the existing policy and regulatory framework at European and national levels, so as to be empowered to effectively contribute to economic recovery.**

This reconsideration should be done in a balanced way, taking into account the interests of all aviation stakeholders – including the travelling public, and avoiding one-sided and short-sighted considerations.

ACI EUROPE is proposing 5 key urgent measures, which are fully in line with the European Economic Recovery Plan adopted by the European Commission in November 2008. These proposed measures are indeed immediate crisis relief actions aimed at reinforcing the long-term competitiveness and viability of the European aviation system.

1. Reconsideration of economic oversight and regulation of airports

The decision by the US Government to swiftly provide public aid for the financing of airport infrastructure is primarily motivated by the fact that such funding will create more than 35.000 jobs. The same potential for job creation by airports exists in Europe, without any recourse to public aid.

To boost their job creation capabilities, what European airports need is adequate economic oversight/regulation, both at national and EU level. Economic regulation/oversight of airports in Europe tends to be airline-centric. As a result, airports are not financially incentivised to modernise and develop their infrastructure.

Yet, the European Economic Recovery Plan considers that "Europe needs to accelerate its investment in infrastructure" as "speeding up infrastructure investment will not only cushion the blow to the construction sector (…), it will also enhance Europe's long term sustainable growth potential". Airport infrastructure in Europe is vital to the overall transportation system since airports are part of the larger transportation system with connectivity to roads, rail and other public transportation. With Europe still facing a severe airport capacity crunch by 2030 and with aviation well on its way to addressing its environmental impact[1] , investment in airport infrastructure clearly fulfils the objectives of the European Economic Recovery Plan.

- Therefore **ACI EUROPE is calling on Member States for an immediate revision of the objectives and methods of economic oversight/regulation of airports to ensure that they are financially incentivised to modernise and develop their infrastructure.**

Although the recently adopted EU Directive on Airport Charges is regrettably silent in this regard, such key consideration should also guide Member States in its implementation at national level by 2011.

[1] This is being achieved through the inclusion of aviation in the EU ETS (Emissions Trading Scheme), the re-launch of the Single European Sky (SES2) and the Clean Sky project. In addition, ACI EUROPE is presently developing an Airport Carbon Accreditation Scheme.

This should lead to more efficient and passenger-focused economic oversight/regulation, taking into account the fact that airlines are not paying the costs of the infrastructure they use, the competitive situation in which airports now operate and the impact of airline consolidation on the airport-airline relationship.

By calling for a freeze of airport charges across Europe and referring to the decision of the Chinese government to suspend the payment of airport charges, some airline associations jeopardise the ability of European airports to effectively contribute to economic recovery. This would result in nothing less than generalised subsidisation of airlines' shareholders by airports' shareholders. This may be justified and practicable in the specific Chinese environment, but it would be a significant backwards and dangerous step for Europe.

2. Extended duration of start-up aids granted for the opening of new routes from regional airports

The 2005 Guidelines of the European Commission on start-up aid to airlines departing from regional airports allow for such aid to be granted for a maximum period of 3 years.

- Given the severe impact that the crisis is having on regional airports, **ACI EUROPE is calling on the European Commission for an immediate extension of the duration of start-up aids from 3 to 5 years. This should apply to all endorsed schemes presently in force as well as to all scheme initiated in 2009.**

Such flexibility would allow regional airports to retain traffic and avoid loosing the return on the investment made in getting new routes started.

A 5 year period would de facto align all regional airports with the maximum duration already permitted for airports located in the outermost regions. The other conditions and compatibility criteria set out by the guidelines would remain unaffected.

3. One-stop security and public financing of security measures

The cost of the new EU and national aviation security regimes resulting from 9/11 and from the terrorist plots uncovered in the UK in August 2006 is extremely challenging for European airports, both operationally and financially. The cost of national security measures that go beyond the EU common regime is especially high and is distortive of competition between European airports.

While security accounted for up to 8% of European airports' operating costs prior to 2001, it now accounts for up to 35%, along with 41% of airport staff employed in security-related activities. Worse, airports are generally not in a position to pass these costs on to their users – airport security charges tend to recover between 70% and 100% of the costs incurred.

As these measures are aimed at protecting not only aircraft and their passengers, but also society as a whole, the financing of aviation security should be the responsibility of Member States. European governments continue to stand out, in refusing to bear this responsibility. The above-mentioned decision of the US Government to further increase public funding of aviation security by committing US$1 billion for the purchase of explosive detection equipment further widens the gap at a critical time.

The EU is presently preparing a roadmap for the elimination of existing restrictions to the carriage of liquids, aerosols and gels by passengers. This roadmap, to be effective by April 2010, will be based on the development, certification and deployment of new screening technology at European airports. This will involve significant additional costs, with a preliminary estimate in excess of EUR1 billion. Financing the implementation of the roadmap on liquids, aerosols and gels will be extremely challenging for European airports, especially in view of the present circumstances.

- Consequently, **ACI EUROPE is calling the European Commission and the Member States for:**
  - **Intra-EU "One Stop Security" to become mandatory by June 2009.**
  - **Member States to be required to finance national security measures that are going beyond the common EU baseline by June 2009.**
  - **Full operational impact assessment to be conducted in cooperation with industry stakeholders, before the implementation of the roadmap on liquids, aerosols and gels.**
  - **EU or national funding totalling EUR1 billion to be committed for the purchase of the new screening technology involved by the roadmap on liquids and gels.**

4. Abolition of national taxes on aviation

Over the last years, national taxes levied on departing air passengers have been imposed in several European countries: the UK, the Netherlands, Ireland and France. In most cases, these taxes have been labelled as part of Governmental efforts to address the impact of aviation on the environment. However, the reality is that the proceeds are just directed to fill holes in national budgets with negligible gains in environmental efficiency. Furthermore, the economic rationale for imposing such taxes is highly questionable, as evidenced by the recent change of position of the Belgian government.

Under the present circumstances, these taxes are proving exceptionally harmful for the aviation sector and are disturbing what has become an extremely sensitive level playing field. Since the environmental impact of aviation on climate change is being addressed at European level, there is simply no justification for national levies on aviation.

- **ACI EUROPE is calling for the abolition of these taxes with immediate effect.**

5. Priority to aviation negotiations with non-EU countries to liberalise traffic rights and ownership and control restrictions.

Since 2002, the European Commission has developed an ambitious and active policy aimed at exporting its aviation liberalisation model beyond the EU. Significant results have been achieved through the establishment of the ECAA (European Common Aviation Area), the conclusion of agreements with the US and Canada and the opening of negotiations with selected neighbouring countries across the Mediterranean and towards the East of Europe. This policy has greatly contributed to the normalisation of the airport sector, bringing both increased traffic development opportunities and heightened competition among European airports.

The European Economic Recovery Plan states clearly that "keeping trade links and investment opportunities open is also the best means to limit the global impact of the crisis, since global recovery will depend crucially on the sustainable economic performance of emerging and developing economies". It further stresses that the EU "must therefore maintain its commitment to open markets across the globe".

Therefore, further accelerating liberalisation efforts for aviation with non-EU countries would be fully in line with the European Economy Recovery Plan and should be immediately pursued. As evidenced by the results achieved so far, this can only benefit all aviation stakeholders. In the short term, aviation liberalisation can create new business opportunities and contribute to passenger and freight traffic recovery. In the medium to longer-term, it paves the way for airline consolidation by repealing outdated regulatory impediments.

- **ACI EUROPE is therefore urging the European Commission and the Member States to:**

- **Accelerate negotiations with all neighbouring countries so as to ensure the establishment of a pan-European and Mediterranean Aviation Area by 2010.** Such negotiations should become a top priority, in particular with **North Africa** and **Eastern Europe**. The ultimate objective of creating a single aviation market of 58 countries with 1 billion consumers will be key for Europe's long-term competitiveness.

- **Pursue negotiations with the US and initiate negotiations by 2010 with other main trading partners including Brazil, Russia, India and China.**

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