ACI EUROPE Response to European Commission on its Communication on Draft EU Guidelines on State Aid to Airports and Airlines

About ACI EUROPE

ACI EUROPE is the European region of Airports Council International, the only worldwide professional association of airport operators. ACI EUROPE represents over 450 airports in 44 European countries. Member airports handle 90% of commercial air traffic in Europe, welcoming over 1.5 billion passengers, 18 million tonnes of freight and more than 20 million aircraft movements each year.

Our membership is comprised of airport operators of all sizes, along with national airport associations, educational establishments and world business partners. Working together in an active association to ensure effective communication and negotiation with legislative, commercial, technical, environmental, passenger and other interests, the members of ACI EUROPE are competitors in the airport marketplace and support free and fair competition as a trade policy and a legal concept.

Document Structure

ACI EUROPE’s response to the Consultation is comprised of two Annexes:

- **Annex 1:** ‘Airports and State Aid – How to Protect Both Growth and Competition’ is an analysis paper which considers the draft Guidelines in the context of the economics of the industry. It outlines ACI EUROPE’s general response to the proposals, and sets out three key changes to the Guidelines, which ACI EUROPE considers to be fundamental if aviation’s positive contribution to the EU and the regions in particular is to be maintained, without undermining competition. These are:
  
  o Allowing strictly digressive operating aid for smaller airports, up to a threshold of 1mppa with a subsequent review of the situation;
  
  o Not requiring that the proposed investment aid for airports with 3-5 million passengers be refundable;
  
  o Not fully disallowing investment aid for large once-off airport infrastructure projects to address potential “funding gaps”.

- **Annex 2:** ‘Specific Comments on the Draft Text’ – individual comments on specific points within the text. In some instances these individual comments overlap with the three key changes proposed in the analysis paper – where this is the case, comments are kept short, and the reader is advised to refer to the Analysis Paper for further information and argumentation.
Annex 2: Specific Comments on the Draft Text

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<th>ACI EUROPE Comments</th>
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<td>Externalities</td>
<td>In Paragraph 2, the European Commission (EC) has emphasised that, amongst other considerations, the ‘internalisation of externalities’ is a priority within the context of the Europe 2020 Strategy and its ‘Roadmap to a Single Transport Area’ White Paper. Within this context it is important to remember that there are many positive economic externalities generated by aviation. Even if the EC is not minded to take a fully symmetric approach to both positive and negative externalities, then at least due account should be taken of the positive economic impact of aviation.</td>
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| Airport Ownership                           | The EC is correct to note the growing involvement of private undertakings within the European airport industry. However this is not the full picture. 74% of European airports in public ownership are run as corporatised, commercial and profit-driven enterprises, operated at arms-length from the State. Such profit-oriented airports by their nature abide by the market economy operator principle (MEOP), and compete against privately-owned counterparts, and should be afforded the maximum possible commercial freedom to operate. Their situation should be explicitly referenced in the Guidelines, and subsequent enforcement should reflect this.  

See below point on ‘Use of State Resources’ and ‘Start-Up Aid to Airlines’. |
| Operating Aid: Financial Viability of Smaller Airports | The EC notes in Paragraph 5 that airports with fewer than 1 million passengers per annum (<1mppa) typically struggle to cover their operating costs. ACI EUROPE agrees with this assertion, but considers that the EC’s proposed response (an attempt to eliminate operating aid over a 10 year transitional period) does not resolve the issue. This structural problem requires a structural policy response.  

The issue of smaller airports and financial viability seems to be a global one, and not just limited to the EU. Therefore it is not realistic to believe that changes to EU State Aid guidelines will somehow allow airports with between 200,000 and 1,000,000 passengers per annum (mppa) to fully cover their operating costs, irrespective of any transitional period.  

Paragraph 8 refers to the EC ‘Communication on State Aid Modernisation’ statement that State Aid policy should focus on facilitating well-designed aid, and that State Aid measures can, under certain conditions correct market failures, and thus enhance competitiveness.  

ACI EUROPE believes that the issue of operating aid falls into this category, and that an alternate proposals to the problem can indeed enhance competitiveness.  

Please see Analysis Paper for further material on this point. |
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<th>Topic</th>
<th>Description</th>
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<tr>
<td>Operating Aid: Distortions to Incentives Facing Smaller Airports</td>
<td>The EC’s current proposals, after the transition period, envisage a strict cut-off of operating aid once an airport surpasses 200,000 passengers per annum. As well as being unrealistic (see above point) this proposal risks undermining smaller airports’ incentive to grow. Smaller airports, when faced with the prospect of foregoing all public operating support, will consider whether they can realistically expect to reach financial viability (i.e. sufficient traffic) before their resources are exhausted. If there are prospects for growth, but not immediate growth, such airports may be incentivised to avoid the risk of a ‘race against the clock’, and instead choose to remain below the 200,000 threshold. In this case the Guidelines will have the perverse impact of discouraging growth where it had otherwise been possible, and thus undermining the potential of smaller airports to reach financial viability. Ultimately this could lead to a situation where the restrictions on operating aid could actually lead to a situation where MORE aid was entering the industry, than would have been the case otherwise. ACI EUROPE has proposals for the treatment of operating aid which would avoid such a scenario. Please see Analysis Paper for further material on this point.</td>
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<tr>
<td>Airport Overcapacity</td>
<td>The proposed Guidelines make several references to airport ‘overcapacity’. A distinction must be made between overcapacity within a region (a region being served by multiple airports, which could be served by a lesser number of airports in the medium term) and overcapacity within an individual airport. Given the fixed nature of airport infrastructure investment, an airport can either be overcapacity or undercapacity but very rarely exactly matching demand. Indeed overcapacity at an individual airport-level is far preferable to undercapacity given the long-lead times to deliver extra capacity, and the associated efficiency, environmental and financial costs associated with congestion. Ultimately, overcapacity is necessary for an airport to attract airlines – without excess capacity the airport has nothing to sell. Indeed, overcapacity can occur within a day (airlines all want to depart at a specific time) or within a year (airlines want to arrive and depart during a particular season only). Indeed this ‘peakiness of demand’ can be associated with specific positive economic externalities. Where there is demand for use of a runway at a specific time, it is often the case that an airline (or airlines) has aircraft based at that airport – with additional economic activity associated with the servicing, maintenance, staffing and supplying of those aircraft. Where there is demand for use of an airport during specific seasons, this often corresponds to significant tourism activity, boosting an area which would otherwise lack other substantial economic activity.</td>
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<tr>
<td>Start-Up Aid to Airlines</td>
<td>Regardless of the specific proposals the Guidelines make concerning start up aid to airlines, it should be made explicitly clear that any limitations apply solely to those situations where State Aid is being channelled via the airport to the airline. The large majority of airports in Europe are commercially-driven (and therefore satisfy the MEOP). They are operating in a competitive environment and are incentivised by market forces to provide discounts, incentive and risk-sharing schemes to current and prospective airline customers. This is a positive development in the European aviation sector and should not be discouraged. The Guidelines should explicitly reaffirm the commercial freedom of airports to undertake such initiatives, where the MEOP is satisfied. Please see ‘Airport Ownership’ and ‘Use of State Resources’ for more on this point.</td>
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Separately, it may be inconsistent that start up aid to airlines is allowed to continue indefinitely, whereas operating aid is limited to a transitional period, in the proposed Guidelines.

### Non-Economic Activities

The Guidelines offer an opportunity for the EC to clarify what it considers to be ‘non-economic activities’ and which therefore do not fall under the scope of State Aid rules. Further clarity would provide regulatory certainty, and thus facilitate investment by private interests and expenditure by States. However the proposed Guidelines do not go into detail on this point.

In particular ACI EUROPE considers that investment in safety should be explicitly considered as a non-economic activity, in the same manner as airport traffic control, police, customs, etc. Specifically investment required to comply with the incoming EASA rules, should be specifically referenced within the Guidelines as non-economic activities. It cannot be considered that such expenditure will give airports any commercial advantage.

In addition, fire protection services were explicitly stated as being non-economic activities by the Court of Justice of the EU in the Leipzig-Halle case. Within this context the Guidelines should reaffirm the Court’s decision.

ACI EUROPE also believes that the Guidelines position on non-economic activities offers an opportunity to further the integration of the European transport network. See also below section on ‘Intermodality’.

### Use of State Resources

ACI EUROPE respects the Courts ruling concerning States’ control/dominant influence over public entities, as referenced in Paragraph 36 of the draft Guidelines. As stated above, 74% of publically-owned European airports are run in a completely commercial manner. Given the predominance of this ownership model, the Guidelines should reference the position of these airports, and reaffirm that the application of the MEOP will allow these airports the commercial freedom they need to operate as commercial business in their own right. This should be followed by enforcement which is fully cognisant of the position of these companies. Excessive regulatory burden for these operators will put them at a competitive disadvantage to their privately-owned counterparts.

### Intermodal Competition

The proposed Guidelines make much reference to rail, and in particular high speed rail. Specifically the EC references the possibility that distortions to intermodal competition may arise from public funding of airports or airlines. Given the massive public spending bias towards rail, the reality is that public support to aviation will in many cases actually go some way towards remedying some of the damage from intermodal competition distortions.

The Guidelines state that public funding of aviation will require extra scrutiny, or will not be allowed, if there are alternative travel modes such as High Speed Rail. ACI EUROPE believes that there should be a symmetrical approach towards rail – where a transport need can be met in a more cost-effective way by aviation, public funding of rail projects, and in particular expensive High Speed Rail projects, should be treated with equivalent caution.

### MEOP

Application of the MEOP should take full account of the long timeframes which can be required to deliver a return on airport investment, given the high capital costs, and the need to deliver capacity in excess of current demand (It is impossible to invest in ½ a runway, and modular expansion of terminal facilities may induce more expense than larger once-off investments. See previous point on ‘airport overcapacity’) Application of the MEOP test should take into account a discount rate which reflects this – if a project requires a longer
timeframe to deliver an appropriate return, this should not be taken as evidence that the project was not a commercially-oriented, profitable endeavour.

The application of the MEOP should take into account the seasonality of demand, particularly for airports with a high proportion of inbound traffic serving tourist destinations. Such airports may still have reasonable prospects of an appropriate return, however the timeframe for achieving this will be longer than for counterparts with year-round traffic.

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<tr>
<th>Airport Charges Benchmarking</th>
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| ACI EUROPE agrees in principle with the approach of benchmarking of airport charges to establish adherence with the MEOP. However, ACI EUROPE does not share the confidence of the EC that an application of the proposed Guidelines will allow a general market price for smaller airports (<1mppa) to emerge over time. In particular, ACI EUROPE does not consider that forcing airports to cover their operating costs via a transitional period will deliver this. Either airports will shut down, or full enforcement of the operating aid rules will be impossible, as indeed has been acknowledged by the EC as being currently the case. In either case, there will be no credible market price to benchmark against.

There may be grounds for benchmarking against those commercially-operated airports with >1mppa, and which are not part of wider airport networks, as these airports would not be incentivised to charge at a rate which was not sustainable in the longer-term. However, any benchmarking exercise should take into account local circumstances when choosing comparator airports. In particular the level of capacity utilisation, the level of service being provided, and the business model of the airlines being served should all be considered. These variables can have significant impact on airports’ finances and subsequent ability to charge.

The EC should ensure that there is a sufficient number of commercially-operated, non-network smaller airports to allow credible comparator groups to be formed, which take into account the variables referenced above.

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<tr>
<th>Incremental Pricing</th>
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| There are several issues with the application of marginal/incremental pricing to industries with high levels of fixed costs (both operating and capital expenditure) such as airports. Since marginal costs are lower than average costs, such a pricing policy does not allow a full recovery of costs. It is for this reason that where pricing levels are externally determined via economic regulation, a price cap model is often applied which uses average cost pricing rather than marginal cost pricing.

Marginal pricing makes economic sense for such industries, but only where long-run marginal pricing is used.

In the context of State Aid to airlines, approving an airport-airline deal on the basis of short-term marginal pricing implies that users other than that airline may well be shouldering the full fixed costs associated with the airport, or that the airport is making an economic loss on its overall operations.

ACI EUROPE considers that the necessary commercial freedom should be afforded to airports to make pricing decisions – this is necessary to deliver the best use of capacity. Within this context, ACI EUROPE supports the EC’s approach of using incremental cost pricing tests to determine whether the MEOP has been reflected, but cautions that any such assessment should take account of the longer term marginal costs associated with any deal. If it can be reasonably expected that subsequent traffic increases resulting from a bilateral deal are likely
to require infrastructural development at a future date, this should be factored into the assessment of the deal.

Finally, an ‘incremental pricing’ approach should be sense-checked where possible with some form of airport charges benchmarking, as proposed by in the Guidelines, subject to the cautions referenced above. This would allow the EC to determine whether the marginal pricing really equates to a long-term market outcome in the airport industry.

| Services of General Economic Interests | Paragraph 68 of the proposed Guidelines state that airports with less than 200,000 passengers per annum are exempt from notification, if they fulfil the requirements of the SGEI decision. ACI EUROPE considers that this should be amended to a system of reduced operating aid intensities, decreasing as airports decrease in size, and limited to airports with <1mppa, in line with the proposals in the Analysis Paper. See also ‘Operating Aid: Financial Viability of Smaller Airports’ section. |
| Investment Aid | The Guidelines should make provision for multi-year investment programmes, and within this allow aid intensity for individual projects to deviate from the proposed threshold limits, so long as the overall aid intensity of the programme stayed within those limits. This would afford more flexibility to operators to respond to financial and aviation market conditions, while not undermining competition. Such flexibility would also allow such aid to be spent in a more effective and efficient manner. |
| Investment Aid for Airports with 3-5mppa | Airports with 3-5mppa face some of the financial disadvantages that their smaller counterparts do. What limited investment aid is allowed in the Guidelines (25%) should be allowed fully, with no requirement to repay. At a minimum any repayment should exclude interest costs – otherwise the ‘aid’ afforded to these airports may well just be a standard load which provides limited real support. See Analysis Paper for further information. |
| Investment Aid for Airports with >5mppa | ACI EUROPE agrees in principle with the proposal to allow airports with >5mppa to be precluded from receiving operating aid. However the Guidelines make no allowance for the development of once-off large scale airport project, such as the various proposed London Gateway airport projects. Such projects typically require some degree of public funding, and will not happen if EU State Aid Guidelines do not at all make allowance for this. For large hub airport access, Europe is competing in a global market, where public funding of such projects is an unquestioned norm.

Currently State Aid rules concerning Research & Development & Innovation contain a ‘matching clause’ which allows the restoration of a level playing field in situations when non-EU competitors are receiving public support in excess of allowed intensities under EU rules. The December 2012 EC ‘Issues Paper on the Revision of the State Aid rules for research and development and innovation’ states that this clause has never been used, but that it seemed suitable to maintain the provision. Given the very limited circumstances in which airports with > 5mppa would need investment aid, and given the evidence that the Research & Development & Innovation ‘matching clause’ has not opened the door to abuse or excessive use, it may well be that a similar clause for aviation would avoid closing the door to major airport expansion in Europe, without undermining the protection of competition.

For more information and argumentation concerning large airport projects, see Analysis Paper for more information.
<table>
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<th>Content</th>
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<tr>
<td>Cumulation</td>
<td>In some instances, independent of the airport, local authorities provide support to airlines as part of wider activities to boost tourism &amp; economic growth. So long as the airport is abiding by the MEOP, and other support activities are within the scope of the Guidelines, this situation should be allowed to continue.</td>
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<tr>
<td>Transparency</td>
<td>ACI EUROPE welcomes attempts by the EC to deliver increased transparency.</td>
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<tr>
<td>Application</td>
<td>ACI EUROPE welcomes the provision to apply the elements of the Guidelines concerning investment aid only to such aid which has been notified or granted after the entry into force of the Guidelines. Such an approach facilitates investor certainty. To continue this approach, the EC could signal that the review in 7 years’ time will adopt a similar approach where possible, thus allowing investor certainty to be maintained going forward.</td>
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<tr>
<td>Review</td>
<td>ACI EUROPE welcomes the proposal to review of the Guidelines within a maximum of 7 years.</td>
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<tr>
<td>Application</td>
<td>If the EC is minded to adopt ACI EUROPE’s proposals concerning operating aid, a review after 7 years would also be appropriate, as it would allow a reassessment of the situation, and an analysis as to whether full coverage of operating costs by airports with &lt;1mppa is actually a viable expectation, without risking the unnecessary prior closure of individual regional airports.</td>
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<tr>
<td>Intermodality</td>
<td>The Guidelines should clearly facilitate the public funding of airport access projects (e.g. people-movers, light rail, metro connections, road) by specifying that the EC considers such projects to be ‘non-economic activities’. The EC’s 2011 White Paper on transport policy states that swift action should be taken to integrate all modes of transport - supportive State Aid Guidelines are a prerequisite for this.</td>
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| Initial Investment| In the Guidelines ‘Initial Investment’ is defined as ‘an investment in airport infrastructure provided the airport had been closed, or would have been closed, if the investment had not been pursued’. This definition includes investment required to fulfil compliance in areas such as security or safety – if an aerodrome does not meet minimum standards in these fields then it must be closed. A
Yet Paragraph 81 of the Guidelines states that ‘Any initial investment, which does not have satisfactory medium-term prospects for use or deteriorates the medium-term prospects for use of existing infrastructure in the catchment area, cannot be considered to serve an objective of common interest’. This means that funding of essential compliance areas for society’s benefit, and which do not provide a competitive advantage, boost capacity or improve service levels, could be de facto considered as inappropriate, despite such investment having no discernible impact upon competition. To clarify this point, the definition of ‘Initial Investment’ in Annex 1 should exclude that which is necessary to meet regulatory compliance requirements. Alternatively this situation could be avoided via a clearer definition of non-economic activities is required. See section on ‘Non-economic activities’. |
| Enforcement      | In its 2010 Position Paper on State Aid, ACI EUROPE called for clear and simple rules, to allow full and consistent enforcement, which is necessary to allow both public and private investor certainty. In parallel to clear and simple rules, investor certainty would be further increased if there was an expedient process in place to consider both State Aid notifications and |
complaints. No matter how clear and simple the final Guidelines are, there will still be some
degree of uncertainty as to decisions of the EC on individual cases. The major positive
economic benefits associated with investment in aviation should not be postponed or
abandoned due to a backlog of State Aid decisions backing up, and long waiting times before
the granting of approval.

Therefore the EC should consider the issuing of the Guidelines as an opportunity to examine
how the process for the consideration of complaints and notifications could be speeded up.
This could encompass additional provisions within the Guidelines, or internal process changes
and resource-reallocation within the EC.

| Treatment of Freight Airports | The proposed Guidelines acknowledge that at present the EC does not have sufficient expertise in this area - ACI EUROPE considers it may be overly restrictive to require individual notification by pure or mixed passenger-freight airports with >200,000 tonnes of freight, or freight airports wishing to expand capacity.

A better approach would be to adopt a flexible approach towards such circumstances, rather than an automatic strict approach. Assessing circumstances on a case-by-case basis will allow the EC to build up expertise in this area, which can then inform the planned review of the Guidelines, which will occur at most 7 years subsequently. |
AIRPORTS & STATE AID: HOW TO PROTECT BOTH GROWTH & COMPETITION

www.aci-europe.org
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.

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. 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.

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 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.
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 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. 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.
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 firefighting 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.
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, 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.

• 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
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\textsuperscript{12}.

**Table 1–ACI EUROPE’s Proposed Allowed Operating Aid Intensities**

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<tr>
<th>Airport Size (passengers per annum)</th>
<th>Allowed Intensity of Operating Aid</th>
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<tr>
<td>&lt; 200,000</td>
<td>100%</td>
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<tr>
<td>200,000 - 399,999</td>
<td>50%</td>
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<tr>
<td>400,000 - 599,999</td>
<td>40%</td>
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<tr>
<td>600,000 - 799,999</td>
<td>20%</td>
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<tr>
<td>800,000 - 999,999</td>
<td>10%</td>
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<tr>
<td>&gt; 1,000,000</td>
<td>0%</td>
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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\textsuperscript{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**.

\textsuperscript{12} Para 127 of the proposed guidelines envisages a review no later than 7 years after the entry into force of those guidelines.

\textsuperscript{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)\textsuperscript{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’\textsuperscript{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.

\textsuperscript{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.

\textsuperscript{15} ‘Draft Communication from the Commission - EU Guidelines on State aid to airports and airlines’, European Commission July 2013, Para 80 (4)
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,
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 but also in the context of the well-documented capacity crunch in Europe. EUROCONTROL in its latest report 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.

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. 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. In contrast the new London gateway airport alone is estimated at costing anywhere between €23 to €58 billion depending on the option chosen. 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.
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. This is in the context of an annual sectoral contribution to EU GDP of €475.2 billion.

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. 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
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\(^\text{29}\).

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\(^\text{30}\).

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.

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\(^{29}\) 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.
## TEN-T Comprehensive and Core Airports with 200,000 – 1,000,000 Passengers per Annum

### ANNEX

<table>
<thead>
<tr>
<th>Country</th>
<th>airports</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUSTRIA</td>
<td>Klagenfurt-Villach, Linz-Wels, Graz, Innsbruck</td>
</tr>
<tr>
<td>BELGIUM</td>
<td>Oostende, Zeebrugge, Liège</td>
</tr>
<tr>
<td>CROATIA</td>
<td>Zadar, Pula</td>
</tr>
<tr>
<td>CZECH REPUBLIC</td>
<td>Ostrava, Brno</td>
</tr>
<tr>
<td>FINLAND</td>
<td>Kittilae, Koupio, Vaasa, Rovaniemi, Turku-Naantali, Tampere</td>
</tr>
<tr>
<td>FRANCE</td>
<td>La Rochelle, Limoges, Clermont-Ferrand</td>
</tr>
<tr>
<td>GERMANY</td>
<td>Memmingen</td>
</tr>
<tr>
<td>GREECE</td>
<td>Alexandroupolis, Skiathos, Preveza, Samos, Kavala, Kefalonia, Mykonos, Mytilini, Santorini, Zakinthos</td>
</tr>
<tr>
<td>IRELAND</td>
<td>Kerry-Farrenfore, Knock</td>
</tr>
<tr>
<td>Country</td>
<td>Cities</td>
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<tr>
<td>--------------</td>
<td>----------------------------</td>
</tr>
<tr>
<td><strong>ITALY</strong></td>
<td>Forlì, Pescara, Ancona, Reggio Calabria, Trieste</td>
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<tr>
<td><strong>LITHUANIA</strong></td>
<td>Kaunas</td>
</tr>
<tr>
<td><strong>NETHERLANDS</strong></td>
<td>Groningen, Maastricht</td>
</tr>
<tr>
<td><strong>POLAND</strong></td>
<td>Szczecin, Swinoujscie, Łódź</td>
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<tr>
<td><strong>PORTUGAL</strong></td>
<td>Ponta Delgada</td>
</tr>
<tr>
<td><strong>ROMANIA</strong></td>
<td>Bucău, Cluj-Napoca</td>
</tr>
<tr>
<td><strong>SPAIN</strong></td>
<td>San Sebastián, Melilla, Valladolid, Zaragoza, Granada, Almería, Vigo, A Coruña, Jerez, Reus, La Palma</td>
</tr>
<tr>
<td><strong>SWEDEN</strong></td>
<td>Ronneby, Sundsvall, Skellefteå, Visby, Ostersund, Angelholm</td>
</tr>
<tr>
<td><strong>UNITED KINGDOM</strong></td>
<td>Norwich, Derry, Inverness, Sheffield, Bournemouth, Exeter</td>
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