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Briefing Aviation competitiveness submission

Summary

The aviation industry is a significant sector contributing about 1% of Europe's GDP. Competitiveness is important as European aviation faces continuing challenges to adjust to deregulation, decarbonisation and to globalisation.

Given aviation's almost total reliance on fossil fuels and the ever-rising contribution of the sector to climate change, fuel efficiency and sustainability are additional challenges that directly impact competitiveness. In evaluating these competitiveness challenges, it is important to recall that the sector is a diverse one, with a broad range of actors that face differing circumstances. In any aviation package that results from this review, it is important that these different aspect of competitiveness across the entire sector are taken into account. Particular challenges to the competitiveness of commercial aviation in Europe include inefficient market conditions - lack of consolidation, legacy national structures, and oversupply - the unsustainability of aviation's growing fossil fuel consumption and the efficiency imperative, as well as market distortions due in part to government intervention.

Context

The contribution of aviation to Europe's economy is often articulated by industry. Overlooked however is that the sector represents a large and growing share of Europe's GHG emissions, which will work against European efforts to reduce its dependence on imported fossil fuels. Civil aviation represented 12.8% of EU transport's GHG emissions in 2012 and 3% of the EU's total GHG emissions[1]. The situation is in fact more stark as this excludes indirect effects of aircraft emissions, such as cruise NOx and cirrus formation which drives aviation's contribution to global warming significantly higher. The EU has to import around 1mbpd of oil to satisfy aviation's energy requirements, at a cost of around €20bn a year[2].

Extra and intra-EU aviation activity is expected to grow by over 80% between 2010 and 2030[3]. Aviation emissions and fossil fuel demand will increase in proportion, unless effective measures are taken and this reliance on imports will act as a drag on Europe's economic competitiveness as a whole. Improving European aviation's sustainability will be a challenge but it can also lead to a competitive advantage for the sector.

The European Commission's Energy Union Communication stated that the Commission's vision is "of the Energy Union as a sustainable, low-carbon and climate-friendly economy that is designed to last". All Commission initiatives, including the forthcoming aviation package, need to keep this vision at their centre.

Some segments of the aviation sector are negatively impacted by market distortions resulting from a lack of consolidation and oversupply. Restructuring state aid approved by the Commission largely to failing legacy carriers has contributed to this situation as has state aid to airports. Addressing these problems, in a way that doesn't negatively impact other actors in the sector, can produce a more competitive sector as well as reduce emissions.

Problems with the survey

[1] DG Clima, http://ec.europa.eu/clima/policies/transport/index_en.htm (Retrieved May 28 2015)
[2] Based on a price of oil of $60 a barrel
[3] 2011 Transport White Paper

Many survey questions were too general, forcing us to choose between agreeing to or rejecting over-generalisations. Important opportunities to improve competitiveness were also either missing or glossed over. Examples include ending subsidies to the sector which could only enhance competitiveness by improving efficiency; introducing environmentally meaningful aircraft efficiency standards at either ICAO or EU level which, by raising the technology bar, would give European manufacturers and operators a greater competitive advantage; and effective implementation of the SES which would remove an enormous cost burden on the sector. Central questions such as the need for consolidation and how legacy carriers can be encouraged to diversify from historical hubs and national focus were not raised at all. Two decades after the European aviation market was liberalised, resolving these issues is key to the sector's competitiveness.

Measures to produce a competitive and sustainable aviation industry

Reduction of subsidies to EU and non-EU aviation sectors

Aviation is by far the most carbon intensive form of transport, yet it continues to benefit from a range of what are effectively fossil fuel subsidies which were first put in place in the aftermath of WWII to stimulate the sector's growth. These subsidies are economically inefficient for the aviation sector itself as well as for the European economy, serving as a disincentive to greater operational efficiency and hence competitiveness. They include direct subsidies, such as the fuel tax and VAT exemptions, and indirect subsidies such as state aid for airports and operators. Given that the minimum diesel tax for road transport in the EU is 33 cents per litre and the average standard rate of VAT at member state level is around 20%, these subsidies constitute very significant amounts – we estimate at around €40 billion per annum[4]. Their economic effects are no less significant - artificially inflated demand for air transport, misallocation of resources, distortions of competition within the sector and inevitably a greater tax burden on other sectors of the economy to replace lost revenue. Yet they live on as if climate change didn't exist; aviation's sacred cows. And of course they didn't feature in the Commission's survey.

Were the Commission to begin by effectively tracking subsidies currently received by the sector this would enable decisions to be made on phasing out the most inefficient ones. The VAT exemption on intra EU aviation distorts competition with competing modes, inevitably leads to misallocation of resources and encourages EU governments to impose less economically efficient departure taxes on their own. The absence of fuel taxation again distorts competition with other modes but more particularly removes an important incentive for carriers to improve operational efficiency and hence competitiveness.

Reform to state aid rules for airports

State aid to airports has been characterised by a vast network of hidden and often illegal subsidies granted by state actors (local, regional and national) to the sector. Instead of the rationalisation option, the Commission chose to legalise operating aid for a period of 10 years. Despite safeguards, there seem to be few guarantees of lasting improvements to connectivity or commercial viability. Many of the regional airports receiving this aid were and will remain economic basket cases. Some will continue to stand virtually idle, monuments to cohesion funding incompetence. Those airports which were funded to expand in close proximity to each other will spend their time cannibalising each other's traffic leading to market distortions and a further waste of resources. A 2014 Court of Auditor's report found that enormous sums of EU money had been wasted on airports that will never achieve their projected passenger numbers. This had led to catastrophic circumstances for many airports and perpetual economic burdens. This staggering misallocation of member state and EU resources represents a long list of missed opportunities for wise investment decisions that might well have made significant enhancements to the sector's competitiveness. Even the

[4] "Does aviation pay its way?" (Transport & Environment) http://www.transportenvironment.org/publications/does-aviation-pay-its-way

US seems to have a better grip; airport expansion is partly funded by the industry through ticket taxes and even from overflight charges of aircraft transiting US airspace.

Legalising operating aid effectively gives low cost carriers 10 more years to continue shopping around for the most lucrative subventions from airports to launch new routes, leaving in their wake those airports serving routes they have now discontinued, bereft of any meaningful prospects. All this points to the need to further review the state aid guidelines to ensure that public money for infrastructure support only – not operating aid - is targeted solely on those airports that can become profitable in the short term and contribute to Europe's connectivity. Continued restructuring aid to failing carriers will only prolong market distortions and prevent needed capacity rationalisation. Both these effects have negative impacts on available infrastructure and capacity.

Competition and Competitiveness

Unfortunately the questions about fair international competition were too general to allow specific and useful comment. In the first instance the failure of member states over many years to agree robust air services negotiating strategies that treated the EU as a single market has led to truly disastrous overcapacity situations in many important extra-EU markets. The negative commercial, competitive and environmental consequences are very significant. The onus for this overcapacity lies squarely in Europe, not with foreign governments or foreign carriers. The solution is not to demonise foreign competition but to reform the way Europe negotiates bilateral air service agreements (ASAs). Fair competition clauses should be a feature of all air service agreements. Only by abjuring subsidies at home can Europe insist on similar provisions conditioning foreign access. Fair competition clauses should require transparency from both EU and non-EU states regarding the level of subsidies granted to operators or airports, and should contain clauses which allow both sides to enforce such fair competition requirements. Bilateral provisions which effectively give foreign governments a veto on imposing fuel taxation, above all on intra EU sectors, need to go. There must be moves through ICAO to advance fair competition clauses and the reduction of subsidies on a global level.

Address potential capacity crunch through modal shift

A first question is really whether the oft-forecast capacity crunch will indeed materialise or is inevitable. The aviation market is likely to have matured significantly, with more subdued growth rates a consequence. Europe is well-advised to start chipping away at the numerous subsidies as outlined earlier in this consultation, again diminishing traffic growth to the benefit of society at large.

Where European airports may face a capacity crunch alternatives to simply adding capacity need to be properly examined. To address this, but also to contribute to Europe's objective of reducing emissions by 2030, the EU and member states should look at measures that will encourage a modal shift from air to rail and bus as the transport white paper stipulates. Rail can now compete on routes up to 1000km, and bus is an expanding mode of intra-EU travel. Such measures include putting a stop to aviation subsidies by ending the aviation fuel tax and VAT exemptions which stack the cards against cross border rail and bus. A quid pro quo for state aid to the rail sector needs to include a requirement for the proper commercial functioning of the cross border rail market and its antiquated approach to distribution. In order to promote modal shift, resources can be far better spent with far greater environmental benefit generated, by connecting city centres with fast - not necessarily always high-speed – rail. Spending taxpayer billions on high speed lines connecting airports does not take people out of aircraft, it helps put them in. Before any extra airport capacity is added, an audit should be conducted to determine if a modal shift, the use of nearby underused airports or incentivising upgauging can help address the problem.

Enhancing Europe's position internationally by better coordination at ICAO

Working through ICAO is crucial to achieving key EU aviation objectives including enhanced competitiveness. The development of an environmentally meaningful and effective global

'market based mechanism' (MBM) which seriously addresses aviation's climate challenge can lay the essential groundwork for a more competitive industry where more sustainable European carriers will have a natural advantage. Failure to put effective global standards in place will either result in a patchwork of measures, or the sector's deteriorating environmental performance will lead to future, less manageable, environmental crises.
If one accepts the industry argument that global environmental regulations fairly and equitably enforced are preferable to regional action, then one would assume that working to ensure ICAO agrees an environmentally meaningful MBM in 2016 would be a high priority for the competitiveness of the European aviation sector.

Yet this work is not even mentioned in the survey. EASA, which is an agency of the European Union overseen by DG Move, even disproportionately cut the travel budget of its staff playing key roles in ICAO's development of a CO2 standard for new aircraft – a central element of ICAO's 'basket of measures'. Limiting EASA attendance at ICAO working groups to one person decimated EASA's role at possibly the most critical stage of the work – deciding stringency. This is inexplicable. European CAEP members have consistently failed to resist industry pressure to dumb down the CO2 standard for new aircraft that ICAO is developing. Instead of a standard which is essentially business-as-usual, we could have had a standard which incentivised technology advances. This would have led the Europeans to having a natural advantage. For Europe to achieve its objectives in ICAO, it is essential for member states to work together at all levels of decision-making within the organisation. There should be an increased use of Art 218(9) TFEU to establish common positions that member states must abide by.

ICAO's effectiveness can also be improved by modernising the organisation's approach to Air Service Agreements. The model agreements should be amended to have stronger fair competition provisions, end the obsolete fuel tax ban and give a higher priority to compliance with environmental standards and recommended practices. These should be a tool to improve global aviation industry standards promoting market and environmental efficiency.

EASA as setting benchmark standards

The EU must continue to engage closely in international standard setting for aviation. However there is no guarantee that global standards produced by ICAO will be sufficient to ensure a technologically advanced, competitive aviation sector. The EASA Opinion on the possible review of Regulation (EC) No 216/2008 found that if there was compelling case, in the interests of European citizens and stakeholders, it should be possible to deviate from or go beyond such global standards. This option should be made available through the Commission making a proposal to so revise 216/2008. First of all because it would enable Europe to move ahead if it so wished. And secondly, to act as an additional tool for pressure on global standard-setting processes. Good precedents for doing so exist in the shipping sector where in several important respects (eg sulphur, MRV) EU legislation is well ahead of the IMO.

Europe's ability to produce and operate technologically advanced aircraft and air navigation systems should be noted. Given the location of manufacturers, the strong and positive relationship between governments and industry and the significant advantage that Europe has on R&D, such standards would be more beneficial to European operators than non-European operators. They would raise global standards in a way that benefits the European aviation industry.

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