Submitted to the European Commission on 1 June 2023

ACI EUROPE

Response to the consultation on extending the transitional period for operating aid to regional airports (Aviation Guidelines)

ACI EUROPE, the voice of European airports, welcomes the opportunity to respond to the consultation on the Commission's proposal to extend the transitional period for operating aid to regional airports in the Aviation State aid Guidelines for a period of three years.

ACI EUROPE supports a prolongation of the transition period for operating aid to regional airports, not just for a period of 3 years as proposed by the Commission, but for a longer timeframe - at least 6 years.

This prolongation is essential to maintain and preserve vital air connectivity, territorial and social cohesion as well as regional development – these are all recognized as valid EU policy objectives for operating aid to regional airports.

The draft Communication from the Commission published as a basis for this consultation points out the aviation sector has faced a major crisis as a result of the COVID-19 pandemic and the aggression of Russia against Ukraine. The Commission considers the impact of travel restrictions during the pandemic on airports and the energy crisis resulting from the Russian aggression on regional airports.

However, the Commission does not consider other factors that will perpetuate a structural inability for smaller regional airports to reach full cost coverage of their operating costs:

- Structural changes in the aviation market resulting in increasing competitive pressures upon airports and thus difficulty to attract and retain airline businesses – and therefore increase revenues.

- The impact of EU climate action policies, and in particular the legislative Fit for 55 package, on air fares and demand for air travel. This impact will be more pronounced for traffic serving regional airports, and will compromise their ability to develop air traffic and generate more revenues needed to cover their operating costs.

Therefore, the period during which regional airports are eligible to receive operating aid should be prolonged for at least 6 years – after which the situation should be reviewed.

ACI EUROPE wishes to point out the need for a prolongation of the transitional period was already acknowledged by the Commission before the occurrence of the COVID-19 pandemic and the Russian aggression against Ukraine, as per the Fitness check carried out in 2019.[1]

We have provided evidence to that effect in our responses to the EC's consultation on the Aviation Guidelines (2019) and the Call for Evidence (2022).[2]

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[1] Commission Staff Working Document, 'Fitness Check of the 2012 State aid modernisation package', Brussels 30.10.2020 SWD(2020) 257 final

This response summarizes our previously submitted evidence on how the need for a prolongation has become even more pressing following these exceptional occurrences, and presents new evidence on how the situation of regional airports will be further aggravated by the (1) current structural changes in the market place and (2) the impact of the EU Fit for 55 package.

1. Evidence submitted so far: regional airports before & during the COVID-19 pandemic

ACI EUROPE already called for a prolongation of the transition period in response to the targeted consultation in 2019. In the same year, we submitted empirical economic evidence produced by Oxera on the need to continue operating aid for airports with no more than 1 mppa.[3]

In 2020, the Commission's fitness check report[4] concluded many airports below 1 million passengers per year will continue to need operating aid beyond 2024 – thus requiring a prolongation of the transition period.

> *"As the assessment suggests, the transitional period allowing operating aid under the Aviation Guidelines does not seem to be sufficient for many regional airports to become cost covering by 2024. In particular, many airports below 1 million passengers per year will continue to need operating aid after 2024. (EC Fitness Check report, para. 6.2.7, p. 128)*

We note the underlying technical support study is based on airports' forecasts for the period 2019-2024, which obviously have now become irrelevant as a result of COVID-19 pandemic. Furthermore, the support study already identified a number of structural risks: in particular the rise of Low Cost Carriers (LCCs) and stronger seasonality. These risks have materialised in the recovery from the pandemic, as will be explained below.

In the Call for Evidence issued in 2022, the Commission was therefore right to consider that the basic premise of the Aviation State Aid Guidelines – of a ten year transition period allowing regional airports to become viable – no longer holds. In our response to the Call for Evidence, we agreed the proposed prolongation should reflect the impact of the pandemic and support the economic recovery. At that point, we provided relevant evidence on the impact of the COVID-19 pandemic (passenger numbers, connectivity, revenues and finances) and the recovery forecasts.

Towards the end of 2022, ACI EUROPE presented recommendations on State aid policy post-pandemic to the Commission.[5] We urged the Commission to:

- Provide legal certainty about operating aid well in time before 2024.

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[2] ACI EUROPE response to EC Call for Evidence on the prolongation of the transition period (COVID-19 response), 2022

[3] Oxera, 'The European Commission's consultation on the 2014 Aviation Guidelines – an economic analysis of airports' profitablity' – prepared for ACI EUROPE, (2019)

[4] Commission Staff Working Document, 'Fitness Check of the 2012 State aid modernisation package', Brussels 30.10.2020 SWD(2020) 257 final, p. 128

[5] Presentation to the 17th Florence Air Forum on 'Short- and Medium-term impact of COVID-19 on the Aviation Sector', held on 22 October 2021

- Stabilise further the regulatory environment and the situation of smaller regional airports by increasing the operating aid threshold in the General Block Exemption Regulation (GBER) – extending the exemption from airports with no more than 200,000 passengers per annum to airports with no more than 700,000 passengers per annum.
- Recalibrate in the longer-term the Aviation Guidelines with a focus on *simplification*, *affordable air connectivity* and *decarbonization*.

2. *New evidence: impact on regional airports of structural market changes & Fit for 55*

ACI EUROPE supports the prolongation of the transitional period and further calls on the Commission to extend it not just to 2027 but to at least 2030.

While an extension to 2027 is fully justified by the impact on regional airports of the COVID-19 pandemic and the war in Ukraine, a further extension to at least 2030 is necessary to reflect the impact of structural market changes and of the EU policy and regulatory framework for the decarbonization of aviation – in particular the the 'Fit for 55' legislative package.

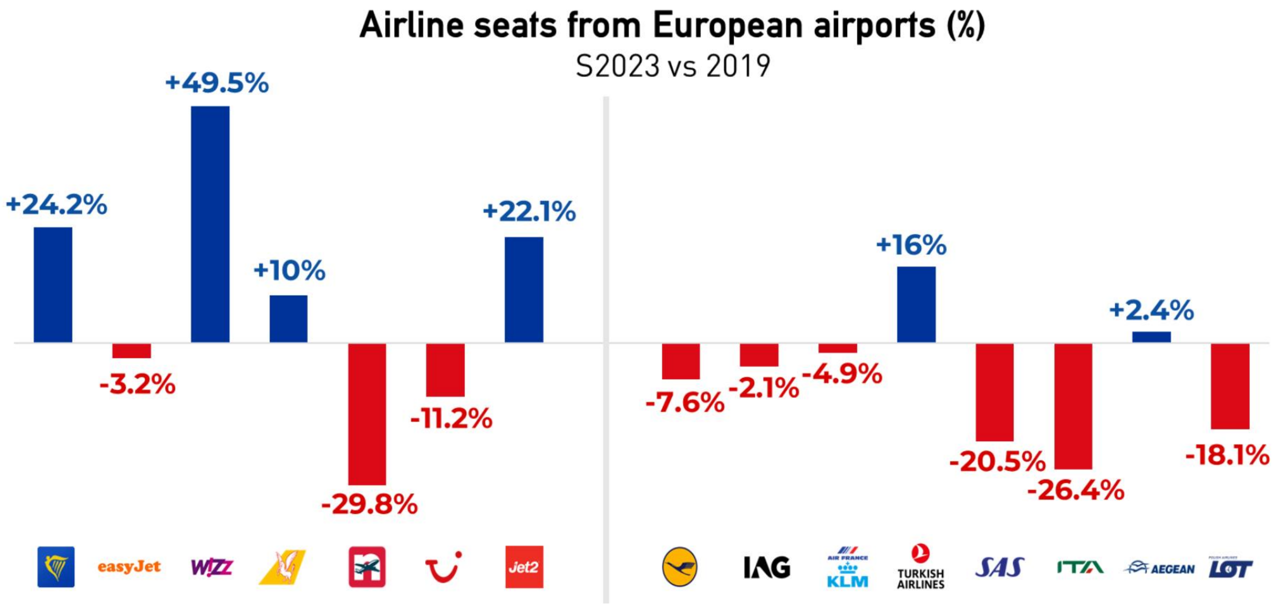
2.1. Structural market changes

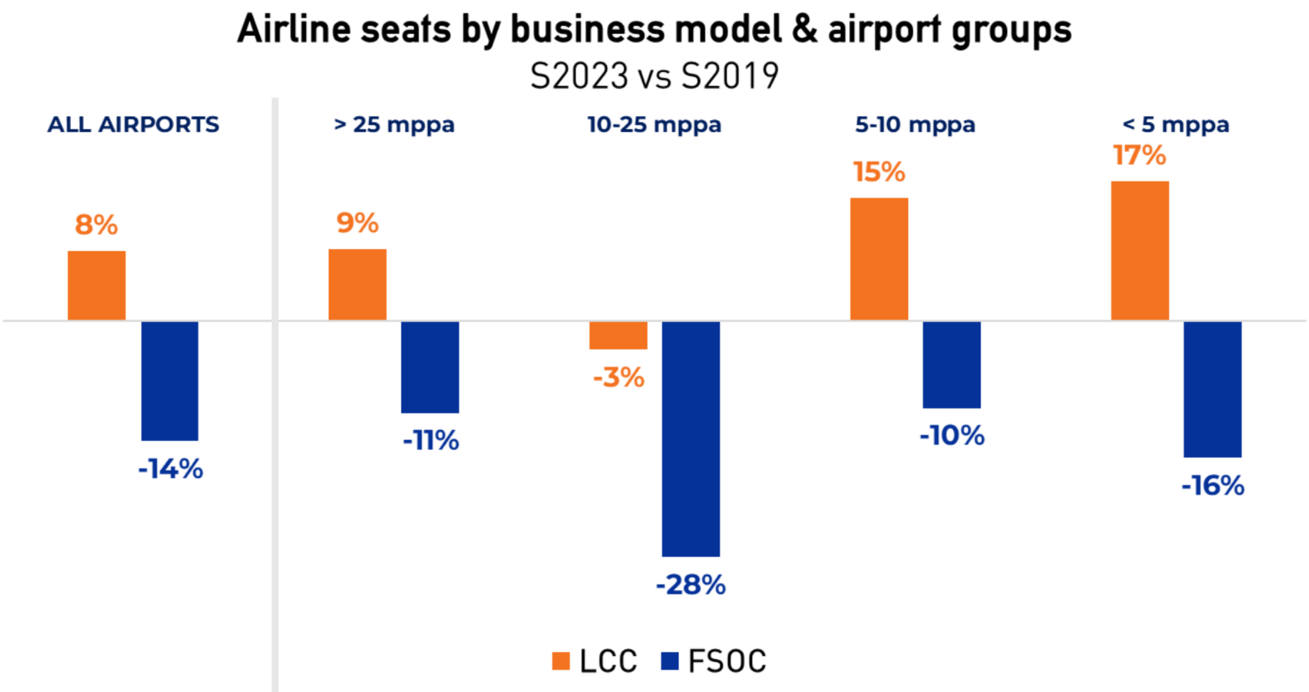
According to the EC support study for the fitness check, the longer term viability of regional airports depends on their ability to build a durable relationship with airlines – beyond the temporary use of incentive schemes and notwithstanding competitive pressure from other airports[6]. The study mentions in particular how smaller airports are not able to reach financial viability, as they continue to rely upon a few airlines which they can only attract by heavy incentives and discounts on airport charges. The report describes how smaller regional airports remain fragile and exposed to external shocks due to their revenue concentration and lack of critical mass.

The traffic and connectivity recovery from the Covid-19 pandemic only confirms these findings. In fact, a number of distinctive recovery patterns – in particular the relentless expansion of Ultra-LCCs and relative retrenchment of Full Service Carriers around their major hubs, along with the predominance of leisure/VFR demand – are structurally reshaping the European aviation market. This impacts the viability and future prospects of regional airports.

[6] European Commission, 'Support study for the evaluation of the rules for operating aid under the EU aviation framework' (2020), p. 24

This is obvious when looking at the capacity being deployed by European airlines this Summer at European airports as shown below.





These figures mean that essentially just 2 ultra-LCCs (Ryanair and Wizzair) are increasingly dictating the fate of regional airports.

But not only are these two airlines able to exert significant buyer power onto airports – typically requiring incentives and discounts on airport charges and threatening to leave in case these incentives and discounts are not meeting their expectations or if they consider that other routes/airports would provide them better returns. Their logic is one of constant optimization as regards their network and the airports from which they chose to operate.

Airport charges at regional airports (with less than 10 mppa) have been constantly decreasing over the past 3 years; in 2023 they are -13.4% lower than in 2019 in real inflation-adjusted terms. High inflation has a severe impact, as charges are not adjusted.

In contrast, airline fares in Europe have increased by +26% so far this year. This means that airlines' pricing freedom enables them to earn excessive revenues when there is demand, without any change for regional airports to increase charges accordingly.

In addition, the above mentioned structural market changes are also evidenced by key findings from the 2023 ACI EUROPE Connectivity Report (to be published in June 2023)

- Only 34% of European airports have recovered their pre-pandemic (2019) direct connectivity levels as of June 2023.
- LCCs accounted for all of Europe's gains in direct connectivity over the past 10 years.
- When compared to pre-pandemic (2019), LCCs now exceed their direct connectivity levels by +12%, whereas Full Service & Other Carriers (FOSCs) are at -13%.
- Large airline groups have increased their share of direct connectivity at their hub airports to 66%, while LCCs have reinforced their position at regional and smaller airports – which points to a re-segmentation of the market, along with increased competitive pressures upon smaller regional airports

The 2023 Connectivity Report shows that 35% of smallest airports (group 4 – less than 5mppa) had recovered pre-pandemic connectivity levels as of June 2023. This means many other regional and smaller airports are still struggling to recover and fully rebuild their connectivity.

It is important to understand that even a successful recovery is not unequivocal:

- The recovery of traffic is **driven by incentives and rebates on airport charges** - as airlines have claimed longer term waivers or discounts from airport charges to resume traffic and build post-pandemic business.[7] The viability of airports will depend on their ability to retain airlines beyond the duration of these incentives.
- Regional airports cannot rely on stable LCC's aircraft base to develop growth and earn back investments – as **LCCs are easily closing and (re)opening bases**, citing a variety of reasons: the pandemic[8], local airline staff costs[9], the economic climate[10], ATC costs and airport charges[11]. Most of these reasons are outside the control of airports.

[7] Budget airlines put squeeze on airports in coronavirus cost drive | Reuters
[8] Ryanair closes Cork and Shannon bases after row with Irish government | The Independent
[9] Ryanair warns of further base closures | Routes (routesonline.com)
[10] Hungary's Wizz Air closes Bacau, Bari, Cardiff bases - ch-aviation
[11] Ryanair to close its Brussels Airport base | Reuters

- Traffic to popular tourism destinations is still defined by **seasonality** - as airlines limit operations to peak seasons and remain reluctant to operate shoulder seasons. The volume variations between traffic in January and July can be as much as 30 times. Regional airports may look at incentives to attract airlines during shoulder seasons, which will need to come on top of existing incentives. Even if they find the necessary resources, the effectiveness of such incentives is limited as leisure travelers remain dependent on school or business holidays.

As a result, it is clear that the smaller regional airports that were less successful during the recovery will continue struggling to attract airlines, without even considering the prospect of building durable relationships with airlines. Structural market changes have aggravated that situation.

ACI EUROPE recently published new evidence **on the increasing buying power of airlines over airports**.[12] In particular:

- **Airlines have reset their relationship with airports following the pandemic** – with different dynamics between airlines. While network airlines and some LCCs have downsized or remain cautious in redeploying capacity, ultra-LCCs (e.g. Ryanair and Wizzair) have used the pandemic as an opportunity to expand and increase market share. These airlines remain much more flexible and opportunistic than ever in allocating capacity between airports. Whereas the EC support study already pointed to the risk that "*large LCCs tend to have the upper hand in negotiations with smaller regional airports*"[13] – this has now become systemic.

- **LCCs have structurally increased their market share.** Before the COVID-19 pandemic, LCCs accounted for 43% of flights but 52% of seats departing from regional airports. By 2022, the same LCCs had increased their market share to 60% of departing seats. This contributes to stronger buying power of LCCs.

- **Full Service & Other Carriers (FSOCs) are retrenching from regional airports.** These airlines are lowering their feed into hub airports. They are not expected to go back to 50% of departing seats, without this gap being fully compensated by LCCs in many cases. This trend can be illustrated by looking at how FSOCs are replacing their operations with LCC entities (for example, Air France being replaced by Transavia).

- **LCCs but now also FSOCs are moving around capacity & routes at a record pace.** Airlines are moving around capacity towards the most profitable routes. Especially the smaller regional airports are struggling with volatility in developing their route network, given the concentration of their revenue.

These market developments represent new risk factors for regional airports – especially smaller ones. They will only reinforce the challenge of their economic viability – considering that such viability remains largely dictated by their size in terms of traffic volumes and their ability to grow traffic.

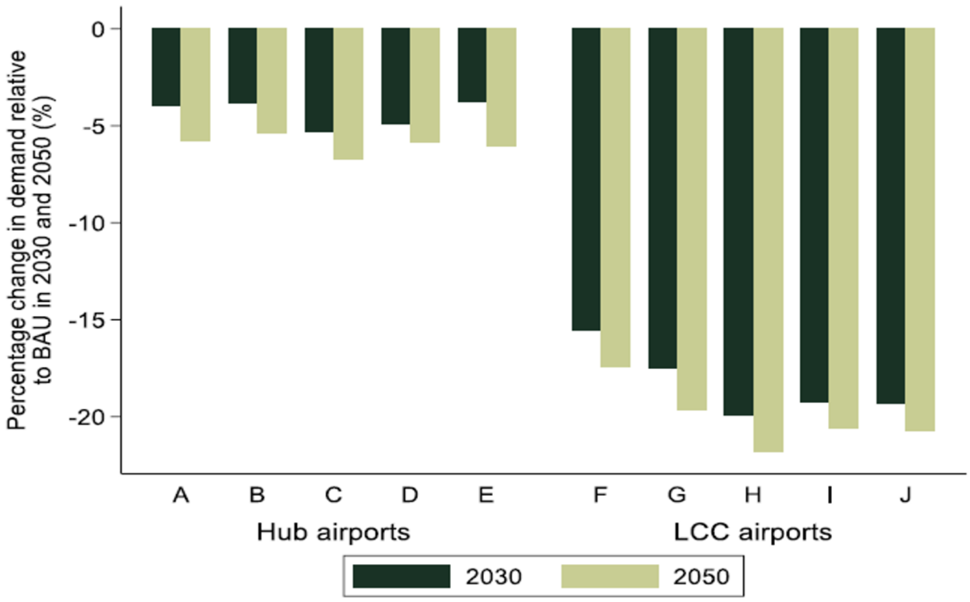
[12] ACI EUROPE, 'Fierce competitors, fragile foes – competition between airports in Europe' (2023)
[13] European Commission, 'Support study for the evaluation of the rules for operating aid under the EU aviation framework' (2020), p. 34

2.2 The impact of Fit for 55

Another defining challenge to the longer term economic viability of regional airports is the impact of Fit for 55.

While the Commission has not produced any impact assessment of the Fit for 55 package on the aviation sector and air connectivity, analysis carried by Oxera[14] shows that it will result in significant fare increases, which will reduce demand and thereby impact the EU's air connectivity. In concrete terms, the fare increases on intra-European flights is set to result in a demand reduction of -11% (2030) to -12% (2050).

Regional airports with a large share of intra-EU flights will be most affected. The report considers that regional airports have a larger share of LCCs operating at the airport with lower average fees will see demand reducing by -20%.



- "*Airports with a higher proportion of intra-EU+ traffic/LCC traffic are likely to experience larger demand impacts <u>for direct traffic</u> than airports with significant external traffic*"
  = **regional/secondary airports more impacted than hubs**

The observations above do not yet take into account necessary investments related to Fit for 55 and infrastructure developments to facilitate the development of clean aviation (electricity and hydrogen).

[14] Oxera, 'Assessment of the impact of the Fit for 55 policies on airports' – prepared for ACI EUROPE (2022)

The need to also increase the General Block Exemption Threshold (GBER)

The introduction of block exemption (GBER) rules on aid to airports in 2017 aimed at simplification and meeting social objectives (i.e. connectivity of citizens in remote regions), without a risk of distorting competition – by exempting operating aid for regional airports with no more than 200,000 passengers.

The EC Fitness Check report already pointed out the need to increase the GBER threshold:

> *In addition, there seems to be a structural need for operating aid for airports with less than 200,000 passengers per year, currently covered by the GBER. Therefore, it may be necessary to prolong the transitional period beyond 2024. It also appears from the assessment that aid to regional airports below 500,000 passengers per year has usually a limited effect on competition, although it needs to be notified to the Commission. Therefore, reflection is needed how to further simplify rules for aid to that category of regional airports to allow the Commission to focus its State aid control on the potentially most distortive cases." (EC Fitness Check report, para. 6.2.7, p. 128)*

ACI EUROPE is urging the Commission to increase the GBER threshold for operating aid to airports from 200,000 passengers per year to 700.000 or 1mppa – at least until 2030.

The proposed measures would be proportionate, as there would be a limited risk of competitive distortions since airports below 700.000 passengers handle only 2.41% of passenger traffic in the EU**.** The GBER is the adequate solution to a structural problem. It is therefore the optimal tool to allow for continued support to smaller regional airports, at least until a further revision of the Aviation State Aid Guidelines. This measure would also help to decrease the administrative burden for public authorities, with an average case length of 18 months.