Targeted review of the General Block Exemption Regulation (State aid): extension to ports and airports

Response by Transport and Environment

Reference number: HT.4691

The European Commission proposes to apply a block exemption from state aid rules for investment aid to airports with up to 3 million passengers annually. The Commission seeks to justify this on the grounds that having gained the necessary experience, the state aid rules should be simplified and clarified, and the administrative burden lessened, thereby allowing the Commission to focus on the most distortive cases.

T&E recommends that this block exemption for investment aid to aviation should be withdrawn.

Under current state aid guidelines, all airports handling over 5 million passengers per annum are not eligible to receive state aid. There are 60 of them out of the approx. 460 commercial airports in Europe. There are some 366 airports in the EU handling less than 3 million passengers per annum. So the effect of the block exemption will be to leave DG Competition with the heavy task of focussing its attention on 34 airports – less than 8% of the total. Many airports involved in controversial legal cases, including over state aid, would be covered by the block exemption; Rome-Campino, Naples, Frankfurt-Hahn, Leipzig-Halle, Pisa, Dortmund, Bratislava, Verona, Girona, Reus, etc.

The Commission's revised Guidelines on state aid to airports and airlines issued in 2014[1] set out very specific tests requiring member states to justify state aid to airports. It noted that

> *Smaller airports display the greatest proportion of public ownership and most often rely on public support to finance their operations. The prices of these airports tend not to be determined with regard to market considerations and in particular sound ex ante profitability prospects, but essentially having regard to local or regional considerations. Under the current market conditions the profitability prospects of commercially run airports also remain highly dependent on the level of throughput, with airports that have fewer than 1 million passengers per annum typically struggling to cover their operating costs. Consequently the vast majority of regional airports are subsidised by public authorities on a regular basis.*

It further noted that

> *Airports with average traffic below 1 million passengers per annum should contribute at least 25% to the financing of the total eligible investment costs. However, investment projects at certain airports with average traffic below 1 million passengers per annum located in peripheral regions of the Union may*

[1] European Commission (2014*), Guidelines on State aid to airports and airlines 2014/C 99/03,* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0404(01)

result in a funding gap which is higher than the maximum permissible aid intensities. Subject to a case-by-case assessment and depending on the particular characteristics of each airport, investment project and the region served, intensity exceeding 75 % may be justified in exceptional circumstances for airports with traffic volume below 1 million passengers per annum.

The 2014 Guidelines encouraged Member States to notify State aid schemes for investment aid for airports with average annual traffic below 3 million passengers. It stipulated that "*investment aid granted to airports either as individual aid or under an aid scheme will be considered compatible with the internal market pursuant to Article 107 (3)(c) of the Treaty provided that the cumulative conditions in point 79 are fulfilled as set out in points 84 to 108".*

This block exemption proposal would remove this provision along with virtually all the detailed conditions governing such aid as set out in the 2014 Guidelines. The only justification provided for doing so is an assertion by the Commission that "*following the application of the Guidelines on State aid to airports and airlines, investment aid to regional airports does not give rise to undue distortion of trade and competition, provided certain [new] conditions [set out in the block exemption proposal] are met*." [2]

The Commission had said in the 2014 Guidelines with respect to Services of General Economic Interest (SGEI) in which detailed cases for aid must be must be made in advance, that

> *As far as airports are concerned, the Commission considers that it is possible for the overall management of an airport, in well-justified cases, to be considered an SGEI. In the light of the principles outlined in point 69, the Commission considers that this can only be the case if part of the area potentially served by the airport would, without the airport, be isolated from the rest of the Union to an extent that would prejudice its social and economic development. Such an assessment should take due account of other modes of transport, and in particular of high-speed rail services or maritime links served by ferries. In such cases, public authorities may impose a public service obligation on an airport to ensure that the airport remains open to commercial traffic. The Commission notes that certain airports have an important role to play in terms of regional connectivity of isolated, remote or peripheral regions of the Union. Such a situation may, in particular, occur in respect of the outermost regions, as well as islands or other areas of the Union. Subject to a case-by-case assessment and depending on the particular characteristics of each airport and the region which it serves, it may be justified to define SGEI obligations in those airports*[3].

By removing virtually all conditions requiring Member States to justify state aid to airports below 3 million passengers in the block exemption proposal, the Commission is effectively removing the distinction between regional airports and SGEI airports subject to strict rules.

This block exemption proposal for investment aid for regional airports is a gross abrogation of Commission responsibility and should be withdrawn. It is a well-known fact – as the need for the revised 2014 Guidelines showed – that national, regional and local governments have been ignoring the aviation state aid rules for years with impunity. Hence the large backlog of Commission legal cases. Now, however, with no attempt whatsoever to explain or detail what experience has been gained that would

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[2] European Commission (2015), *Draft Regulation amending Regulation (EU) No 651/2014*, p. 0, http://ec.europa.eu/competition/consultations/2016_gber_review/draft_regulation_en.pdf

[3] European Commission (2014*), Guidelines on State aid to airports and airlines 2014/C 99/03*

justify the move, the Commission proposes to effectively release all brakes, allowing the guilty parties to return to their old ways regarding aid to airports handling up to 3 million passengers.

In the interests of Better Regulation, the Commission has an obligation to reconsider this proposal – not simply on the strict grounds governing state aid but in the wider context of its 2015 Aviation Strategy[4] and ongoing attempts to address aviation's soaring GHG emissions, especially in line with EU 2030 economy-wide GHG reduction target and the EU's Paris commitments.

T&E does not oppose state aid to the sector where it is justified – to link isolated regions to the aviation network – either through PSOs or well planned and coordinated subsidies. But the past 15 years has shown that there has been little or no effective coordination and planning; no effective consultation at the regional or national level concerning individual airport cases; wholesale abuse of the rules; poor or non-existent enforcement of state aid rules leading to many instances where the investments have proved to be a gross waste of public money. In case of the ghost airports, the corruption, abuse and mismanagement of public funds has been on a fantastic scale.

In revising the 2014 Guidelines the Commission that there are many unprofitable airports with unused capacity and poor commercial prospects in the EU – indeed "*the vast majority of regional airports do not generate sufficient revenue to cover their costs.*"[5] "*In the EU, 60% of all airports (2012: 62%) and 77% of airports with fewer than one million passengers/year were loss making in 2014*"[6].

According to the Airports Council International (ACI) Economics Report 2011[7], airports with over 5 million passengers per year can operate profitably, airports having between 1 and 5 million passengers per year can meet their operational expenses, and the revenues of smaller airports cannot cover even their variable costs.

One condition (Article 56A) the Block Exemption proposal does place on aid to these airports is that the investment concerned shall have medium term prospects for use of the airport capacity on the basis of reasonable traffic forecasts. "Medium term prospects" are not defined. No conditions governing "reasonable traffic forecasts" are set out. This condition can effectively mean anything - including throwing good money after bad.

At the end of 2014, not long after the Commission had issued its revised state aid guidelines for airports and airlines, the European Court of Auditors issued a scathing report – 'EU funded airport infrastructures – poor value for money' – on aid to the sector.

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[4] European Commission (2016), *An aviation strategy for Europe*,http://ec.europa.eu/transport/modes/air/aviation-strategy/index_en.htm

[5] European Commission (2014), *New State aid rules for a competitive aviation industry, p. 2,* http://ec.europa.eu/competition/publications/cpb/2014/002_en.pdf

[6]European Commission (2015). *Commission Staff Working Document, an Aviation Strategy for Europe*, p. 25, http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=SWD:2015:261:FIN

[7] Airports Council International (ACI) (2011), *Economics Report 2011,* pp. 13-14 https://www.aci-europe.org/policy/position-papers.html?view=group&group=1&id=6

The Economist summed up the situation: "*the lesson, as the report notes, is that the EU and other large central governments should carefully analyse whether airport infrastructure investments will be worth the cost—and pay particular attention to whether the airport is financially sustainable. It seems especially bizarre to pour money into a failing enterprise, but in some cases that's exactly what the EU did*."[8]

So it seems even more bizarre that the Commission would now propose to loosen the purse strings – and abrogate totally its oversight responsibility - leaving decisions up to national, local and municipal governments. The record of these bodies has invariably been poor.

The EU Court of Auditors report recommended that *"the Commission should ensure during the 2014-2020 programme period that Member States only allocate EU funding to airport infrastructures in those airports which are financially viable and for which investment needs have been properly assessed and demonstrated. This should also be part of the approval and monitoring of Operational Programmes carried out by the Commission"*[9]

The Commission is ignoring this recommendation in its entirety.

The Auditors also set out starkly the risks of subsidising very small airports:

> *In Kastoria, airport revenue was 176 000 euro for 2005-2012 whilst, during the same period, the total cost of keeping the airport open was 7,7 million euro. For the period given, the total number of passengers was 25 thousand people representing a loss of about 275 euro per passenger. Some 16,5 million euro (5,6 million euro of EU-funds) has been invested in an extension to the runway at this airport which has up to the time of this report never been used by the type of aircraft for which the extension was built. This cannot be considered as an effective use of public funds.*[10]

The Court of Auditors went on to conclude that *"in 9 of the 20 airports audited, one or more of the projects sampled for audit were not needed at all. This represented 28 % or 129 million euro of the EU funding to airports examined."* Furthermore, it found that *"seven of the 20 audited airports are not financially self-sustainable" … "investments in airport infrastructure also imply costs in future years for both operations and maintenance. Therefore, any decision to invest in such airports needs to be based upon convincing evidence that the socio-economic benefits will outweigh the often significant costs involved. "*[11].

It is important to note that these airport state aid costs underestimate the true societal costs borne by governments. In all cases where airport or traffic expansion is funded by state aid, all costs for services such as air traffic, safety and security costs are additional and met via state aid. These additional costs – and they can be substantial – are all borne by state authorities not airports.

The Court of Auditors "*also calculated a profit or loss per passenger using the airports' financial statements and categorised the airports using three thresholds based on the number of passengers served on average during the audited period: fewer than 100 000 passengers, between 100 000 and 1 500 000 passengers, and*

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[8] The Economist (2014), http://www.economist.com/blogs/gulliver/2014/12/funding-european-airports
[9] European Court of Auditors (2014), *EU funded airport infrastructures – poor value for money*, p. 5, http://www.eca.europa.eu/Lists/ECADocuments/SR14_21/QJAB14021ENC.pdf
[10] European Court of Auditors (2014), p. 27
[11] European Court of Auditors (2014), p. 25

more than 1 500 000 passengers." The analysis showed "that airports with fewer than 100 000 passengers per year made an average loss per passenger of 130 euro over the period." [12]

130 euro may well exceed the average ticket price per passenger. There were 68 EU airports handling 100,000 passengers or less in 2015. Total passenger traffic at these airports was 2,525,669 so the total loss, alone, exceeded EUR 328 million.

The EU Court of Auditors recommended that *"the Member States should have coherent regional, national and supranational plans for airport development to avoid overcapacity, duplication and uncoordinated investments in airport infrastructures. "*[13]

The provisions in Article 56a of the block exemption proposal are wholly inadequate in this respect. Moreover, they contradict the Commission's own strictures about airport duplication and cannibalization set out in the 2014 Guidelines where the Commission said that: *"any investment which deteriorates the medium term prospects for use of infrastructure in the same catchment area cannot be justified and would simply be a waste of public money"... "It will not be possible to subsidize more than one unprofitable airport located in the same catchment area".*

Without providing any justification whatsoever, the Commission now proposes via the block exemption to waive all limiting conditions including the restriction on aid to airports within 100 km of each other for airports with up to less than 50,000 passengers a year.

The findings of the Court of Auditors as regards duplication were damning:

> *There is a proliferation of airports very close to each other which invested in similar infrastructure (terminals, aprons, runways): although most airports had significant overlaps, there was little consideration given to investments in neighbouring airports, which would have been necessary for rational planning and optimizing the use of EU-funds. An alternative analysis carried out by the Court, using the 90 minutes' driving distance as criterion which has also been used by the Commission in a 2013 study, has resulted in similar findings. Only some airports used catchment area analysis in their future investment planning. However, each airport had a differently defined catchment area as none of the Member States had established a common definition. Catchment area analysis was generally not used to identify overlaps between airports in close proximity to each other and their consequences on growth potential. This often resulted in the double counting of potential passengers in the totals used by each airport to justify its expansion (for example, the master plans of Catania and Comiso airports, both of which received significant EU funds, double counted a major part of the population living in the catchment area of both airports).*[14]

The European Commission now proposes to leave all these sorts of decisions up to local and regional governments, even though the Court of Auditors found that *"the Court also noted that the EU-funding is*

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[12] European Court of Auditors (2014), p. 25
[13] European Court of Auditors (2014), p. 5
[14] European Court of Auditors (2014), p. 31

not well co-ordinated by the Member States and, in particular as regards Major Projects and Cohesion fund Projects, is insufficiently supervised by the Commission, leading to overcapacity and poor value for money."[15]

Further analysis shows that the Commission is indeed failing to administer properly the revised 2014 Guidelines as regards proximity and duplication.

Barely a week after approving the new 2014 Guidelines, the Commission inexplicably approved state aid to the company operating the airports of Brescia and Verona – located barely 40 km apart[16]. The €12.7 million of approved infrastructure aid – including to Brescia which handles about 29 passengers per day – is a perfect example of the complete waste of public money granted to proximate airports that the Commission in its Impact Assessment so squarely condemns.

In September 2015 the Commission approved EUR 42.5 million in state aid to four Irish airports (Kerry, Knock Donegal and Waterford). Kerry Airport is within 100 km of both Shannon and Cork airports and also serves similar routes (London, Alicante). Waterford airport is 103 km from Cork airport but serves exactly the same routes (London and Birmingham). Meanwhile, Knock and Shannon airports are only 140 km apart[17]. This duplication will make it less likely that Ireland will develop a strong network of self-sustaining airports.

The ongoing controversy surrounding local plans to extend Florence airport, even though Pisa airport is only 60 km away, highlights the necessity of retaining the requirement for prior approval for such projects. The Commission has become bogged down in cases seeking legal recourse over aid grants made without Brussels' approval and in breach of state aid rules. Local Florence officials persist with their airport expansion plans when they clearly breach the Guidelines concerning proximity of airports and despite repeated written advice from the Commission that the plans breach state aid rules. The local officials do so in the knowledge that they have the full backing of the Italian Prime Minister – himself a former Mayor of Florence. Such examples only serve to underline that proceeding with the GBER for such small airports will result in massive flouting of the regulation, the wastage of vast amounts of public funds on duplication and the creation of large future legal backlogs.

In April the Commission approved the first new aid to French airports for many years – but as no details are available, we cannot judge what experience they may have drawn on in making this decision.

The European Commission also places great emphasis on the importance of "connectivity" for European aviation in its 2015 Aviation strategy. The staff working document goes to some length to describe the disparities in connectivity between the EU 15 and EU 13. It cites the UK Airports Commission finding that

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[15] European Court of Auditors (2014), p. 70

[16] Transport & Environment (2014*), State aid for airports & airlines*, p. 4, https://www.transportenvironment.org/sites/te/files/publications/2014%2005%20state%20aid%2023%20aiports_final.pdf

[17] Transport & Environment (2015). *Ireland, backed by Brussels, pours extra €42.5m into aviation black holes,* https://www.transportenvironment.org/press/ireland-backed-brussels-pours-extra-%E2%82%AC425m-aviation-black-holes

"*airport connectivity is also unevenly spread across Europe*"[18] . Business connectivity on average level per country is 7.5 times higher in the EU15 than in the EU13 Member States. Similarly, the leisure connectivity shows more than nine times higher values for EU15 countries than for the EU13 Member States. The Commission also noted a CESE study that shows that the following is important: "*Connections are safeguarded to primary/secondary hubs, which is key to business/onward connectivity*." [19]

Although there is no explicit requirement to connect an underserved regional airport to a hub airport in the provisions governing aviation PSOs in Europe[20], the Staff Working Document reports that

> *a fitness check of Regulation 1008/2008 conducted by the Commission in 2011-2013 considered PSO rules as fit for purpose i.e. ensure connectivity when the market does not deliver it. Recommendations were made by stakeholders and Member States to enhance cooperation between national authorities and the EU, and ensure a good articulation between state aid rules and PSO rules including by issuing possible guidance.*[21]

Regrettably we see a complete absence of any good articulation between state aid rules and PSOs as regards this block exemption proposal even though the Court of Auditors recommended that "*the Member States should have coherent regional, national and supranational plans for airport development to avoid overcapacity, duplication and uncoordinated investments in airport infrastructures.*"[22]

By way of contrast, the US' Essential Air Service (EAS) program is specifically focused at ensuring connectivity by linking subsidies directly to connectivity.

> "*The EAS program is administered by the Office of the Secretary of Transportation [*of the U.S. Department of Transportation (DOT)*]*, "*which determines the minimum level of service required at each eligible community by specifying a hub through which the community is linked to the national passenger airline network; a minimum number of round trips and available seats that must be provided to that hub; certain characteristics of the aircraft to be used; and the maximum permissible number of intermediate stops to the hub. In general, DOT subsidizes two to four round trips a day with small aircraft from an EAS community to a large or medium hub airport*"[23].

Finally, aviation is the most carbon intensive form of transport. Intense and difficult negotiations are ongoing at ICAO to agree a global market based measure (GMBM), requiring airlines to offset emissions above 2020 levels. ICAO is unlikely to agree a measure that gets anywhere near that goal, besides the fact that emissions up to 2020 levels will be permanently grandfathered. The aviation EU ETS has been restricted by 75% to cover intra-EU flights only. By 2020, EU aviation traffic levels are predicted to grow

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[18] European Commission (2015). *Commission Staff Working Document, an Aviation Strategy for Europe*, p. 43
[19] European Commission (2015). *Commission Staff Working Document, an Aviation Strategy for Europe*, p. 43
[20] Articles 16-18 of the Air Services Regulation 1008/2008, http://ec.europa.eu/transport/modes/air/internal_market/fitness_check_en.htm
[21] European Commission (2015). *Commission Staff Working Document, an Aviation Strategy for Europe*, p. 43
[22] European Court of Auditors (2014), p. 5
[23] Congressional Research Service (2015), p. 4, https://www.fas.org/sgp/crs/misc/R44176.pdf

by up to 80%, by which time the EU has committed in the Paris Agreement to reduce its economy-wide emissions by 80%. It seems difficult to reconcile the enormity of this task with this proposal to drop almost all oversight of state aid to airports and airlines and with the Commission's overall commitment to Better Regulation.

T&E Recommendation

This block exemption for investment aid to aviation should be withdrawn.

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