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COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on safeguarding competition in air transport, repealing Regulation (EC) N° 868/2004

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ABBREVIATIONS

ASA	Air Services Agreement
ASK	Available Seat Kilometre
ATM	Air Traffic Management
ATC	Air Traffic Control
CAGR	Compound Aggregated Growth Rate
CRS	Computer Reservation System
CAA	Common Aviation Area
DOT	(US) Department of Transportation
EEA	European Economic Area
ETS	Emission Trading Scheme
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
IATA	International Air Transport Association
IATFCPA	International Air Transportation Fair Competitive Practices Act
ICAO	International Civil Aviation Organisation
JC	Joint Committee
MFN	Most Favoured Nation
MoU	Memorandum of Understanding
NT	National Treatment
RPK	Revenue Passenger Kilometre
SARPS	Standards or Recommend Practices
TBR	Trade Barriers Regulation
WTO	World Trade Organisation

GLOSSARY OF TERMS

Air Service	Any scheduled air service performed by aircraft for the public transport of passengers, mail or cargo (Article 96 of the Chicago Convention)
Air Services Agreement	A treaty containing a bilaterally agreed legal framework upon which scheduled air services operate
Air carrier capacity	Quantitative measure of air transport services offered by one or more air carriers in a city or country pair market over a route which may be expressed in terms of aircraft size, aircraft type, number of seats or frequency of operations
Available Seat Kilometres	A measure of capacity available calculated by multiplying the number of seats available on a flight leg by the number of kilometres flown during that flight leg (i.e. segment of a flight)
Designation	Nomination by a state of the airline or airlines to operate particular routes
Fair competition clause	Article in bilateral/comprehensive air services agreement laying down agreed principles and/or specific provision governing competition in the provision of air services by the parties' designated airlines
Freedoms of the air	Traffic rights granting an airline of one country the privilege to enter another country's airspace and land in its territory. There are, in total, nine freedoms of the air (see the box on next page)
Hub and spoke	Airline network concept whereby small aircraft carry passengers between small airports (feeders) and main airports (hubs). From there passengers connect to large aircraft to fly longer part of their journey
Operating Licence	Authorisation granted by the competent licencing authority to an undertaking, permitting it to provide air services as stated in the operating licence
Revenue Passenger Km	A measure of passenger traffic that is calculated by multiplying the number of paying number of paying passengers by the number of kilometres flown during a flight leg (i.e. segment of a flight)
Slot	A particular time allocated to an airline to land or take-off from a particular airport
Tariff	The price charged for the public transport of passenger, baggage and cargo on scheduled air services including the conditions

governing the availability or application of such price and the charges and conditions for services ancillary to such transport

Traffic right

Market access right expressed as an agreed physical and/or geographic specification of whom and what may be transported over an authorised route in the aircraft authorised

Freedoms of the air

The **first freedom** of the air is, according to ICAO, 'the right or privilege, in respect of scheduled international air services, granted by one State to another State or States to fly across its territory without landing'.

The **second freedom** refers to the right or privilege granted by one state to another state or states to land in its territory for technical and maintenance purposes, without picking up or dropping off any passengers.

The **third freedom** is the right or privilege, granted by one state to another state 'to put down, in the territory of the first State, traffic coming from the home State of the carrier'.

The **fourth freedom** is the right or privilege, 'to take on, in the territory of the first State, traffic destined for the home State of the carrier'. The third and fourth freedoms are granted together.

The **fifth freedom** is the right or privilege 'to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State'. Under the fifth freedom, a carrier can transit passengers between two foreign countries, provided the flight either begins or ends in the carrier's base country.

The **sixth freedom** is the right or privilege of transporting, via the home State of the carrier, traffic moving between two other States. The so-called Sixth Freedom of the Air, unlike the first five freedoms, is not incorporated as such into any widely recognized air service agreements such as the "Five Freedoms Agreement".

The **seventh freedom** is the right or privilege of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e. the service need not connect to or be an extension of any service to/from the home State of the carrier.

The **eighth freedom** is the right or privilege of transporting cabotage traffic between two points in the territory of the granting State on a service which originates or terminates in the home country of the foreign carrier or (in connection with the so-called Seventh Freedom of the Air) outside the territory of the granting State (also known as an Eighth Freedom Right

or "consecutive cabotage").

The **ninth freedom** is the right or privilege of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State (also known as a Ninth Freedom Right or "stand alone" cabotage).

1. GENERAL CONTEXT

1.1. EU aviation sector today

Aviation plays a fundamental role in the European economy both for EU citizens and industry. With more than 150 scheduled airlines, a network of some 450 airports, and 60 air navigation service providers, the aviation sector employed in 2014 5.5 million people and contributed over €510 billion to GDP in the EU¹. Overall, aviation supports up to 9.3 million jobs². Over 918 million passengers travelled by air in the European Union in 2015 and more than 1.45 billion passengers departing or arriving at EU airports on the same year³. Linking people and regions, air transport plays a vital role in the integration and the competitiveness of Europe, as well as its interaction with the world. Aviation also makes a vital contribution to economic growth, employment, people-to-people contacts as well as the regional and social cohesion of the Union. There are indications that one Euro value added in the air transport industry creates a value of almost three Euro value added for the overall economy while one job in the air transport industry added creates more than three jobs in other sectors⁴.

1.2. Legal context

1.2.1. Regulation of international air transport

International aviation is a regulated service sector operating in a framework of state sovereignty⁵ and governed by a dense network of bilateral air services agreements (ASAs) which are concluded between States to regulate the operation of the international air services. In particular, ASAs cover: route selection, that is, the freedoms of the air that they intended to grant (see box on page 6), from basic bilateral air traffic rights involving overflight to more complex patterns involving transit through third countries; the designation of the airline(s) serving the agreed routes; provisions on capacity, that is, the number and frequency of flights, and type of aircraft on the agreed routes, as well as pricing. In the absence of binding multilateral regime, bilateral ASAs are worldwide the only method used for exchanging traffic rights and hence, enable governments to exercise detailed control over all aspects of the

¹ Steer Davies Gleave – Study on employment and working conditions in air transport and airports, Final report 2015. It should be noted that these figures include considerable indirect and induced effects which multiply the impact of aviation on the economy.

² Communication from the Commission "An Aviation Strategy for Europe", COM(2015) 598 final, 7.12.2015.

³ Eurostat.

⁴ Jan K. Brueckner, Airline Traffic and Urban Economic Development, Urban Studies, 2003.

⁵ The 1944 Convention on International Civil Aviation (Chicago Convention) states: 'The contracting States recognize that every State has complete and exclusive sovereignty over the airspace above its territory'.

air services which serve their territory. In this context, the degree of liberalization of air transport services between the two States is determined by the specific design of each ASA.

Traditional bilateral ASAs regulate the level of competition on the market by restricting the number of airlines allowed to operate on given routes, the number of flights and the possible destinations. Under such ASAs, the market for operation of the agreed air services is shared exclusively between the two airlines of Parties and the capacity and tariffs are regulated by the governments of the two contracting sides. This traditional system allowed the governments to fully control their markets, as they could dictate the terms on which airlines could serve points from and within their territories. It also allowed the states to use their prerogatives to defend and promote the interests of their national air carriers (called ‘flag’ or ‘legacy carriers) through close and detailed regulation.

Since 1980s the sector has been undergoing progressive liberalisation triggered by the deregulation process of the internal US market and the new US foreign aviation policy that accompanied it. Internally, the US adopted the 1978 Airline Deregulation Act which eliminated the regulation of fares, routes and schedules in the US domestic market. In the following step, the US applied the same approach to international aviation which manifested in the renegotiation of a number of its bilateral ASAs and the subsequent conclusion of so called ‘open skies’ agreements⁶. The latter constitute a new kind of air service agreement granting multiple designations (a greater number of airlines is allowed in traffic between the counterparties), more routes and greater airline freedom to set fares and frequencies according to their needs and on market terms. The new US open-market approach fuelled the debate about the future of air service regulation in Europe which eventually resulted in the adoption of three legislative packages leading to the completion of the internal EU air transport market in the beginning of 1990s.

1.2.2. Internal EU air transport market

Before the creation of the internal market for aviation in the 1990s, European air transport had traditionally been a highly regulated industry, dominated by national flag carriers and state-owned airports. Since then, by removing historic barriers, the EU has transformed and integrated fragmented national aviation markets of its Member States into the single largest and most open regional aviation market in the world.

The EU internal market, set out as an objective of the Single European Act in 1987 and established in 1993, has removed all restrictions for airlines flying within the EU, such as restrictions on the routes, the number of flights or the setting of fares. Today, all EU airlines irrespective of the Member State in which they are legally established may operate air services with full commercial freedom on every route between and within EU Member States without any restrictions as to frequency or fare-setting. In other words, it is only for EU carriers to decide what services they operate, when and how frequently, and what tariffs to charge for them. There is no longer anything to stop an airline from Ireland, for instance, operating flight between two Italian airports or between a British and a Greek airport.

⁶ In 1978, the U.S. reached a partially liberalised air services agreement with the Netherlands, followed by liberal agreements with Israel and Belgium. After a lull in liberalization efforts during the 1980’s the U.S. reached its first open skies agreement with the Netherlands in 1992. By the end of 1995, it also had open skies agreements with Belgium, Finland, Denmark, Norway, Sweden, Luxembourg, Austria, Iceland, Switzerland and the Czech Republic. Today it has open skies agreements with over 100 nations.

Following the establishment of the internal air transport market, prices have fallen dramatically, in particular on the most popular routes. But it is especially in terms of choice of routes that progress is impressive⁷. European policy has profoundly transformed the air transport industry by creating the conditions for competitiveness and ensuring both quality of service and the highest level of safety. Consumers, airlines, airports and employees have all benefited as this policy has led to more activity, new routes and airports, greater choice, lower prices and an increased overall quality of service.

The creation of the EU single air transport market stimulated competition between EU airlines. Hence, to ensure a level playing field for all entities the comprehensive regulatory framework of common rules was developed in parallel to market opening. To eliminate any possible discrimination by national governments against the carriers of other states, EU air carriers are licensed according to a set of specified requirements laid down in Regulation 1008/2008⁸. Any airline which meets these criteria must be granted an operating licence by the Member State which received the application. Moreover, the airline applies in to the Member State where it has its principal place of business and its registered office, so that there is no scope for the licencing authority of another Member State to raise difficulties if its own authorities are satisfied. All EU airlines are governed by the common concept of "EU air carrier", regulated and supervised under the same rules which grant them equal rights and obligations.

Another relevant indeed complementary part of the EU regime resides in competition rules (including State aid rules) which are applicable to the activity of undertakings, including air carriers and airports. As regards rules on State aid, these are intended to prevent that government support, by EU Member States, entails distortion of competition and effect on trade between Member States. EU Member States' governments cannot subsidise their airlines and airports in contravention of those rules. The latter permit the granting of aid only subject to strict requirements which, insofar as of interest here, are mainly explained in the guidelines on State aid in the aviation sector⁹. Hence, airlines may receive (under certain conditions¹⁰) "start-up aid" that gives them the necessary incentive to create new routes from regional airports, increases the mobility of EU citizens and stimulates regional development¹¹. Moreover, in line with Guidelines on State aid for rescuing and restructuring¹², EU airlines facing difficulties may receive rescue and restructuring aid, though under very restrictive conditions. For restructuring aid to be approved, three main principles must be complied with: i) there must be a credible restructuring plan capable of restoring the long-term viability of the airline without further public support¹³; ii) the airline must make an own contribution, at the appropriate level, to the costs of restructuring, to avoid the entire burden falling on

⁷ The number of intra-EU routes between EU Member States increased from 874 in 1992 to 3,522 in 2015 (+303%, 6.2% average growth p.a.).

⁸ Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (OJ, L 293, 31.10.2008, p. 3–20).

⁹ Communication from the Commission "Guidelines on State aid to airports and airlines" (OJ, C 99, 4 April 2014, p.3).

¹⁰ As set out in points 139 to 153 of the Guidelines on State aid to airports and airlines.

¹¹ Guidelines on state aid to airports and airlines, section 5.3 'start-up aid to airlines'.

¹² Communication from the Commission "Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty" (OJ C 249, 31.7.2014, p. 1–28).

¹³ The main elements of the return to viability in the airline industry consist of streamlining operations in order to focus on the core business of passenger transportation. Airlines also try to improve their cost base by focusing on a more unified fleet of aircraft, reducing catering costs in economy class, minimising personnel costs.

taxpayers¹⁴; and iii) measures should be introduced to mitigate the distortions of competition created by the aid. Finally, a given airline cannot receive rescue and restructuring aid more than once every 10 years (the "one time last time" principle). With regard to airports, the guidelines allow public authorities to support investments into airport infrastructure and equipment as well as, for a transitional period of 10 years, to cover the operating losses of small airports (below 3 million passengers), before they become profitable. Very small airports with annual traffic of less than 700,000 passengers may benefit from operating aid to cover losses for a period of 5 years, after which the Commission reviews their situation to decide whether and for how long they should receive further operating aid.

In recent years the Commission has conducted numerous in-depth investigations into cases of possible aid granted by Member States to the European aviation sector. During 2014 for example the Commission adopted 17 decisions concerning investment or operating aid to airports or operating aid to airlines granted by Member States. With regard to airlines, a number of State aid investigations found that arrangements between state-controlled airports and airlines amounted to a selective economic advantage given to those airlines, which distorted competition. In these cases, the recovery of the incompatible state aid from the airlines was ordered.

1.2.3. *External dimension*

Rules applicable within the EU internal market have been geographically extended, by way of agreements, to include the European Economic Area (EEA) States and Switzerland.

To overcome continued fragmentation and restricted market access in international aviation the EU is also concluding Comprehensive EU Agreements which supersede the bilateral agreements of EU Member States¹⁵ with the respective third country and in their scope go beyond liberalising traffic rights. These agreements include comprehensive provisions to address and synchronise the regulatory conditions for fair competition and for a sustainable aviation industry including essential aspects such as safety, security, environment and economic regulation. There are two main sub-groups of Comprehensive EU Agreements.

Firstly, Neighbourhood Agreements, which aim at including a third country into a wider Common Aviation Area (CAA) of the EU and its neighbouring countries to the South, South-East and East¹⁶ through full market access and complete regulatory convergence (acceptance of the entire EU aviation acquis). The process of regulatory convergence ensures the application of EU rules and the implementation of common safety, security, environmental and other standards in the entire Common Aviation Area.

Secondly, comprehensive agreements with EU key partners¹⁷ (strategically important third countries and country blocs) which are based on the pillars of market access liberalisation, removal of investment barriers (airline ownership), regulatory cooperation and convergence and resolution of "doing business issues". The EU have signed comprehensive agreements inter alia with the US, Canada, Morocco, Israel, Moldova, Jordan and Western Balkans.

¹⁴ The guidelines require that large companies finance at least 50% of the restructuring costs with a real contribution, meaning money that the company managed to receive and excluding any theoretical potential future profits.

¹⁵ The Council grants the Commission the authorisation to negotiate Comprehensive agreements on a case-by-case basis.

¹⁶ The EU has concluded such agreements with the Western Balkans (the ECAA Agreement), Georgia, Israel, Jordan, Moldova and Morocco.

¹⁷ Comprehensive agreement have been concluded with inter alia U.S and Canada.

Beyond the EEA and geographic areas covered by CAA-type agreements or indeed by EU Comprehensive agreements, the aviation markets regarding routes between the EU and third countries are still governed by the network of bilateral air services agreements between EU Member States and third countries. Together with associated memoranda of understanding, agreed records etc., these usually cover traffic rights, capacity, frequency of air services, the number of designated airlines and other commercial arrangements such as pricing mechanisms. In addition, bilateral ASAs usually provide for a number of provisions covering aviation safety, and security as well as other organisational aspects of bilateral relations.

It is estimated that a number in the order of 1,600 of such ASAs are in place between EU Member States and third countries.

In 2002, the European Court of Justice ruled that bilateral aviation agreements of EU Member States with third countries were in breach of fundamental provisions of the EU Treaty ("freedom of establishment") as they did not allow airlines from other Member States to benefit from the provisions of those agreements¹⁸. Following the court's judgement, the EU developed an external aviation policy to restore legal certainty to the bilateral agreements including by negotiating at EU-level so-called Horizontal Agreements (HA) with partner countries which allow amending all bilateral agreements that EU Member States have with a third country. Bilateral negotiations between each EU Member State concerned and its partners have also been carried out with a view to amending each bilateral ASA separately. It is estimated that out of the existing 1,600 ASAs around 1,100 ASAs have been amended or newly concluded and as such are considered to be in line with EU law (notably include the EU designation and revocation provisions and are considered compatible with Article 101 of the TFEU).

Within the last two decades, the reduction of limitations and constraints to provision of air transport services through a number of bilateral and comprehensive ASAs have liberalized the aviation market between the EU and third countries. Although some old-type ASAs containing restrictions on competition remain in place today, they do not concern main EU partners representing the key markets for EU airlines.

However, the ASAs between the EU and third countries cannot effectively promote competition if the level of liberalisation and deregulation of internal markets of contracting parties is not the same. As mentioned, within the EU internal air transport market, regulatory framework and common rules were developed to provide for equal rights and obligations for all companies, ensure fair competition between them and address possible market distortions. However, similar rules and procedures regarding competition, environment, social rights or consumer protection do not exist in many air transport markets to/from the EU and the vast majority of liberalised bilateral ASAs do not contain any provisions on these either.

1.3. Economic context

The liberalisation and deregulation of international air transport fostered unprecedented competition on a global aviation market. According to the 2012 Communication on the EU's external aviation policy¹⁹, global competition is expected to further intensify in coming years with expected **international aviation growth** of around 5% annually until 2030. The

¹⁸ For example, a German airline established in France could not benefit from the traffic rights accorded in the agreement between France and the United States. These rights were only available to French airlines.

¹⁹ Communication from the Commission "The EU's External Aviation Policy - Addressing Future Challenges" (COM(2012)556), 27 September 2012.

Communication predicts that this aviation growth will see a relative shift to areas outside the EU in particular to Asia and the Middle East meaning that EU carriers will be losing market shares to non-EU airlines in most regions. According to the International Air Transport Association (IATA) Airline Industry Forecast 2013-2017²⁰, the Asia-Pacific region - led by China, and the Middle East are expected to deliver the strongest growth with United Arab Emirates expected to add an estimated 29.2 million passengers (Compound Annual Growth Rate²¹ of 6.6%), nearly as many as China, whereas Europe will see international passenger demand growth of merely 3.9% CAGR.

These forecasts are based on the market trends observed over the past decade. It is relevant to note that the starting base for aviation traffic is much higher in regions such as North America and Europe, which have relatively mature aviation markets, in comparison to regions where the aviation has been expanding considerably in recent years.

In recent years, there have been substantial developments in the **market shares** of EU airlines in virtually all intercontinental markets to and from the EU. In the African region, EU carriers' market share has declined overall by 2% between 2004 and 2013. At the same time, carriage by Middle East carriers between Africa and the EU has increased some 600% to a point where their passenger carriage is about 30% of that of EU carriers. A similar picture emerges on Europe-Asia routings, where carriage by EU airlines has largely stagnated since 2004, versus a nearly 700% increase in carriage by Middle East airlines. In 2013 the passenger carriage of Middle East carriers represented about 70% of that of EU carriers on routes between Asia and EU28, as compared to merely 10% in 2003. Even in markets where European carriers benefit from natural geographic advantages – namely on routes from the East Coast of North America to Asia or the Indian Subcontinent, Middle East airlines have achieved growth in excess of 2000% since 2004, and now exceed EU airline carriage on some of these routes²². It should be noted that in a strongly growing aviation sector with emerging markets in many regions, the market share indicator should not exclusively be held as undisputable evidence that airlines are affected by competition. Indeed, in such a context, an overall decrease in market share is also likely to be the mere effect of growing markets on the global scale. The market share indicator must be considered with caution, and must be put into perspective with the overall market developments.

The Middle East carriers have also been successful on the European market where their growth in transport capacity is significant. Between 2004 and 2015 traffic between Europe and the Gulf increased by 430% with 140 daily flights (80% of which was undertaken by Gulf companies)²³. This means that today, there are more seats offered between Europe and the Gulf than between Europe and China, Japan and South Korea together, whilst the GDP of the latter is 250 times that of the UAE and Qatar together²⁴.

Similar trends may be observed when the **traffic growth rates for EU passengers** carried on routes between the EU and key world markets are analysed²⁵. Throughout the last 5 years for

²⁰ IATA, Airline Industry Forecast 2013-2017.

²¹ The compound annual growth rate (CAGR) is the mean annual growth rate over a specified period of time longer than one year.

²² PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

²³ It needs to be noted that strong growth rates of Middle East carriers since 2004 is to some extent caused by a low starting base in terms of operated routes.

²⁴ <http://www.robert-schuman.eu/en/european-issues/0371-the-european-airline-industry-re-establishing-free-fair-competition>

²⁵ Mott McDonald, Annual Analyses of the EU Air Transport Market, 2013.

which figures are available (2008-2013), the total volume of EU worldwide passenger traffic has been growing slowly and was unequally distributed. On some markets the aggregated traffic growth was relatively strong - EU-South America (+14%) or rather slow - EU-Central Africa (+5%), whereas on many others the traffic actually decreased - EU-Central America (-12%); EU-Northern Africa (-7%); EU-Asia (-3%); EU-North America (-1%). Only on the EU-Middle East market the growth was very strong (+47%).

On each of those markets the **total number of passengers carried by EU carriers** (measured in Available Seat Kilometres) between 2008 and 2013 either stagnated (EU-Africa: +1.8m; EU-South America: +0.6m) or slightly fell (EU-North America: -1.2m; EU-Middle East: -0.6m; EU-Asia: -0.1m). Most notably, all of the dynamic passenger traffic growth on the EU-Middle East market (from 29.1m to 40.5m) was generated by non-EU carriers (+12m). It is highly likely that most of this added capacity is actually feeder traffic to the hubs of the Gulf region²⁶.

The trend is even more visible when looking at **transfer traffic**. Despite Europe continuing to be the region with the largest transfer market in the world, with 45m passengers in 2013, an increase of only 3m passengers (i.e. 7%) was recorded since 2004. On the other hand, the Middle East, Asia and Turkey experienced considerable growth. Asian region grew by about 40% from 17m to 24m in 2013, the Middle East has almost quadrupled from 8m to 30m (i.e. a growth of 275%) and Turkey is now capturing 5 times the transfer traffic that it was capturing in 2004 (i.e. 2m in 2004 vs. 10m in 2013)²⁷.

The EU aviation sector and EU airlines in particular are on the front line of this competitive challenge and are increasingly struggling in a tough international market characterised by diverse regulatory frameworks and cultures, and by enhanced international competition from fast-growing third countries and regions.

1.4. Political context

The Commission's Communication of 27 September 2012 on 'The EU's External Aviation Policy – Addressing Future Challenges'²⁸ points that "while EU airlines are ultimately responsible themselves for their competitiveness and must continue to adapt their products and business models to the prevailing market conditions (...) it is equally important that competition, both within the EU and externally, is based on openness, reciprocity and fairness and that it is not distorted by unfair practices". Therefore, as indicated in the Communication, "it is both important and legitimate that the EU is able to act effectively internationally to safeguard the competitiveness of EU airlines against unfair competition and/or practices wherever they may come from".

The Council, in its Conclusions of 20 December 2012²⁹ acknowledged that actions aimed at enhancing competitiveness and ensuring fair competition need to be taken both in the EU's internal and external policies. The Council encouraged the Commission "to use its bilateral and multilateral relations to actively support the establishment of a level playing field favouring open and fair competition in international air transport". The Council also

²⁶ Own calculations on the basis of data presented in the PwC study.

²⁷ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

²⁸ Commission Communication "The EU's External Aviation Policy - Addressing Future Challenges".

²⁹ Council conclusions on The EU's External Aviation Policy-Addressing Future Challenges, 20 December 2012.

considered that "Regulation (EC) No 868/2004³⁰ has proven not to address adequately the specific characteristics of the aviation services sector" and supported "the Commission's intention to analyse (...) possible options for a more effective instrument to safeguard open and fair competition and its intention, on that basis, to present a proposal for a revision or replacement of Regulation (EC) No 868/2004".

In the resolution of 9 September 2015³¹, the European Parliament (EP) called upon the European Commission to "address the major challenges to competition in the European air sector". To this end, the EP urged the Commission to engage in an Aviation Dialogue with several third countries with a view to "enhancing financial transparency and safeguarding fair competition; inclusion of 'fair competition clauses' in air transport agreements, detailed provisions on subsidies, unfair practices and competition, and efficient means of action in the event of non-compliance with those provisions". The Parliament also called for "the revision of the current Regulation (EC) No 868/2004 in order to safeguard fair competition in EU external aviation relations and reinforce the competitive position of the EU aviation industry, ensure reciprocity and eliminate unfair practices, including subsidies that distort the market".

As noted in the recent Commission Communication on an Aviation Strategy, if the EU aviation industry is to remain competitive, it is essential that market access is based on a regulatory framework which promotes EU values and standards, enables reciprocal opportunities and prevents distortion of competition³². Europe must address the challenge of unfair competition and cannot afford to lose the competitive edge of its aviation industry which today is at the centre of the global network connecting Europe with the rest of the world and secures a high level of intra-European connectivity. In this respect, the strategic role of a well-developed aviation sector in general must be taken into account, as well as the particular role which is played by EU carriers, airports, manufacturers and service providers in terms of growth, jobs and the major contribution that aviation can make to the EU's growth strategy "Europe 2020" as well as Commission President Juncker's agenda³³.

2. PROBLEM DEFINITION

2.1. Description of the main problem

Concerns about unfair practices by third countries and third country entities negatively affecting EU carriers continue to exist

2.1.1. Competitive position of EU aviation globally

The liberalisation of international air transport has made the airlines from very diverse world regions (in economic, legal and cultural terms) compete in the same international markets. This means a new competitive challenge for European airlines which face new competitors, in particular, from growth markets to the East. Over recent years a number of large economic

³⁰ Regulation (EC) No 868/2004 of the European Parliament and of the Council of 21 April 2004 concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community (OJ L 162, 30.4.2004, p. 1–7)

³¹ European Parliament resolution of 9 September 2015 on the implementation of the 2011 White Paper on Transport: taking stock and the way forward towards sustainable mobility (2015/2005(INI)).

³² Commission Communication "An Aviation Strategy for Europe".

³³ "A new start for Europe, my agenda for jobs, growth, fairness and democratic change"; <http://www.eesc.europa.eu/resources/docs/jean-claude-juncker---political-guidelines.pdf>.

powers and several developing countries have recognised the strategic role of aviation in their economic development policies and created opportunities for further growth of their respective national air transport industries. Several new and highly competitive airlines and airports have emerged in particular in the Middle East and Asia, which pose a considerable challenge to some European hub airports and carriers. When ranked by revenue passenger kilometre (RPK) as a measure of sales volume of passenger traffic, one can observe the rapid rise of these emerging competitors to EU airlines. In terms of RPKs, a comparison of 2007 and 2014 data shows that leading EU airlines have been, or are increasingly left behind fast-growing competitors such as Emirates, Southwest and China Southern while others like China Eastern Airlines, Air China, Qatar Airways and Turkish Airlines are growing considerably faster³⁴.

Some of the reasons negatively influencing the international position of the EU aviation sector stem directly from competitive advantages of third country carriers and the linked competitive disadvantages suffered by Europe-based airlines in the European market.

2.1.2. *Competitive advantages of third country carriers*

Over the last decade, the aviation sector outside Europe has been supported by extremely **rapid growth in some world regions**. As a result, international aviation growth is increasingly characterised by a relative shift to areas outside the EU with the emerging industrialised and services-providing economies in Asia and the Middle East in particular becoming the focus of international air traffic flows. Scheduled passenger traffic in the Asia Pacific region is forecast to grow faster than in other regions at rates of more than 6% per year until 2033 when it will account for over 40% of world air traffic. Due to above-average growth rates, EU carriers are expected to lose global market share to non-EU airlines. In 2003, EU carriers had a market share of 29% of all inter-regional capacity in the world. By 2025, this share is expected to fall to 20%³⁵. Meanwhile, China is expected to become the world's largest air transport market, overtaking the United States in 2023 in terms of number of passengers carried³⁶.

Secondly, the competition between world airlines today is gradually shifting toward access to third country markets. Bilateral agreements focus increasingly on the requirement to meet not only the market demand between the signatory partners, but to enable passengers to combine services between the signatories to connecting flights into third countries. This gives another important competitive advantage to the Middle East and Asia regions linked to the **geographic location of their hubs** which are "naturally" located as crossroads between many world destinations³⁷, in particular on routes towards dynamically growing Asian continent³⁸. The business strategy of the non-EU airlines which hub at these airports has focused on building their networks by linking secondary airports via their hubs (so called 'hub and spoke system') and bypassing primary hubs elsewhere.

A most striking example of this practice is the competition for passengers between several European airlines and the Gulf States' carriers. The latter have a comparative advantage in international hub operation on many routes between Europe and South Asia/East Africa. In

³⁴ Commission Communication "An Aviation Strategy for Europe".

³⁵ Booz & Company: "Development of the EU's Future External Aviation Policy", Final Report, April 2012, based on OAG and AEA Research.

³⁶ Airbus Annual Report 2014.

³⁷ European carriers have traditionally enjoyed such an advantage in respect of East-coast North America – South Asia traffic (where non-stop services are impractical due to distance).

³⁸ Two thirds of the world's population is placed within an optimal 4-8 hours' flying time from Dubai.

the absence of significant domestic demand, Gulf airlines geared their business model globally to connecting highly populated markets (e.g. in Asia and Europe) with a stop at their respective hub airports. They employ the so called hub-and-spoke model in which the passengers/freight are gathered, predominantly from long-distance flights, at the airline's hub airport and carried onward from there, also on long-distance flights. The waves of arrivals and departures are optimally coordinated with the corresponding passengers flows. This provides their passengers with advantages such as more convenient travel itineraries, higher frequencies, and a wider range of destinations within a certain flight time. The ability to concentrate services over a hub also reduces costs for non-EU airlines, enabling them to pass on savings to the consumer in an attempt to drive higher demand. This business practice has enabled the dynamic growth of their carriers. These developments have led some EU airlines to exit several markets. For instance, according to a US Congressional Research Service report, 'Lufthansa claims that its Frankfurt hub has lost nearly a third of its market share on routes between Europe and Asia since 2005, and that more than 3 million passengers now fly annually from Germany to other points via Gulf hubs instead of using direct services of German, Asian and African airlines'³⁹.

The above trend is confirmed when analysing hub connectivity i.e. hubs facilitating travel from one world region to another. It is clear that the EU is losing significant market share as global hub for inter-continental flight connections. While the top 3 European hubs⁴⁰ still have the highest total connectivity level, the hub connectivity⁴¹ of Abu Dhabi, Doha and Dubai respectively grew by +1,913%, 1,861% and 485% between 2004 and 2014 while Istanbul-Ataturk airport registered a growth of +1,222%⁴².

Technological advances and trends on the aircraft manufacturing market may influence the balance between the hub and spoke and point to point models and thus give a competitive advantage to EU or non-EU air carriers. Indeed, EU and non-EU aircraft manufacturers have different visions of the strategic evolution of the international air transport market, which results in different characteristics of the manufactured aircrafts. As the hub and spoke model consists of the transportation of large amounts of passengers from hub to hub followed by transportation of smaller amounts of passengers from the hub to a multitude of smaller destinations, manufacturers which rely on this model (mainly EU manufacturers) tend to develop wider bodied aircrafts, capable of carrying larger amounts of passengers. On the contrary, as the point-to-point model consists of the transportation of smaller amounts of passengers directly from one point to another without necessarily a hub connection, manufacturers which rely on this model (mainly non-EU manufacturers) tend to develop aircrafts with a slightly lower passenger capacity. Although depending on the manufacturing market evolution, the models on which air carriers rely may be strengthened or weakened, one cannot determine at this stage if technological advances favours EU or non-EU air carriers. However, it should be noted as well, that EU network carriers are also subject to the strategy developments of other kinds of carriers, such as low cost carriers increasingly flying to nearby third countries, or bypassing big hubs by providing direct flights (in opposition to the hub-and-spoke model). As such, these market strategic evolutions also have an effect on the manufacturing requirements and may cause difficulties to EU network carriers.

³⁹ Congressional Research Service, International Air Service Controversies: Frequently Asked Questions, 4 May 2015.

⁴⁰ Paris-Charles de Gaulle Airport, Frankfurt Airport and Amsterdam Airport Schiphol.

⁴¹ The measure of the number of destinations, the quality of connections and the frequency of services offered at hubs which facilitate travel from one world region to another.

⁴² ACI-Europe Airport Industry Connectivity Report 2014.

The hub and spoke strategy of third country carriers is supported by a high level of **investment in airport infrastructure** at their home hubs. Whilst within the EU, aid to airports and airlines can be approved only in few cases and under very strict conditions⁴³, few such requirements exist outside the EU. Indeed, in terms of investment in airport infrastructure in the EU, this is all but forbidden since airports with greater than 5 million passengers per year, such as all the major EU hub airports, must be fully self-financing and cannot receive any aid except under exceptional circumstances⁴⁴. Many governments worldwide are making heavy investments in state-owned airports creating large increases in capacity – and to the extent that the cost of these investments is not passed on to airlines potentially providing the airlines concerned with significant cost advantages not available to EU carriers⁴⁵. As an example, airport infrastructure investment in the Middle East over the past 10 years has exceeded 35 billion US dollars and continues to grow. According to IATA another 40 billion US dollars is being invested in aviation infrastructure by the Gulf-region governments with infrastructure development being concentrated at the largest airports in the region, including Dubai, Doha, Jeddah, Riyadh, Abu Dhabi, Muscat, Kuwait, Dammam and Manama. Dubai alone is expected to invest over 8.1 billion US dollars in new infrastructure until 2020. Abu Dhabi's new airport terminal complex which will be the future base of Etihad Airways will be commissioned by 2017 with the initial capacity to of 27 million passengers per year. Massive capacity expansion is also planned for Turkish airports with the anticipated opening of a new airport at Istanbul by the end of 2018 with a capacity of 150 million passengers annually. Similarly, the Government of Singapore has announced in the beginning of 2014 that it plans to almost double the capacity of Changi Airport over the next decade with two new terminals at the cost of 1.28 billion US dollars⁴⁶.

Heavy investment in airport capacity whose cost is not passed on to airlines, would appear to allow airlines based in Asian and the Middle East to benefit from considerably **lower airport charges** as compared to airlines based in the EU and other regions of the world. For example, Dubai airport's landing and terminal charges with baggage and check-in are around one third below Heathrow's and two thirds below the average of Paris-Charles de Gaulle, Frankfurt and Amsterdam Schiphol which gives Emirates a competitive advantage in this area in comparison to European airlines. According to 2009 Travel and Tourism Competitiveness Report⁴⁷, Bahrain and the United Arab Emirates are the best performers in the category of average ticket taxes and airport charges, both with scores of 6.78, followed by Qatar, at 6.68 out of 7. Asia Pacific countries are also very attractive from this indicator's point of view, with an average score of 5.82 out of 7. In contrast, Europe enjoys a much lower average score of 5.69.

The rapid growth of Asian and Middle East aviation sectors is also supported by large **investments in aircraft fleet**. Already today the airlines based in the Middle East - Emirates, Etihad and Qatar Airways - have a combined fleet of wide-body aircraft (1283 units) larger

⁴³ See more in section 1.2.2 of this report.

⁴⁴ See in particular points 97-105, which outline how investment aid (which does not include state support that meets the "Market Economy Operator test", see footnote 70) to airports with average passenger traffic (passengers per annum) of more than 5 million, is banned in all but "very exceptional circumstances, characterised by a clear market failure".

⁴⁵ As indicated in section 2.1.5, the investment into airport infrastructure may be linked to subsidization by third countries.

⁴⁶ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

⁴⁷ World Economic Forum, The Travel & Tourism Competitiveness Report 2009, Managing in Time of Turbulence.

than the combined one of the three leading EU Airlines (Lufthansa, Air France and British Airways) which currently amounts to 714 units⁴⁸. While the currently largest existing wide-body aircraft fleets are with Emirates, Air France-KLM and United, the largest orders of wide-body aircraft (exceeding airlines' current fleet size) are placed for Emirates, Singapore Airlines, Qatar Airways, Etihad and Air Asia⁴⁹. It is also in the Middle East where wide body aircraft represent the largest proportion of total orders – around 63%. In Europe the proportion is 20%⁵⁰, and in Asia Pacific it is 26%. This indicates that carriers based in the Middle East and Asia anticipate the continuation of strong growth of their long haul networks.

The increased capacity arising from fleet and airport capacity expansion gives scope for continued **route expansion**. As indicated by aircraft orders, the greatest expansion is planned by airlines based in the Middle East: if growth rates over the period 2008-2013 are continued in the period 2013-2018 (as aircraft orders indicate likely), Etihad could offer an additional 44 routes from Abu Dhabi, Emirates an additional 46 from Dubai and Turkish Airlines an additional 114 from Istanbul⁵¹. The considerable increase in routes, allows the Middle East carriers to strengthen their market shares by further consolidating traffic at their home hubs and using additional fleet capacity to service an extended range of final destination services.

Last but not least, non-EU carriers are not burdened by **costs** to the degree experienced in Europe. According to statistics provided by CAPA⁵², the biggest source of unit cost advantage for Emirates is having much lower labour cost per employee than European carriers. For comparison IAG's average labour cost per employee is almost 94,000 US dollars, which is more than 80% higher than the figure of 51,500 US dollars for Emirates, while Virgin Atlantic pays 9% more than Emirates. The average of the IAG and Virgin figures is 75,000 US dollars, which is 45% higher than the Emirates figure. Emirates benefits in this area from the absence of income tax in Dubai. In addition to the tax benefits, Emirates does not have significant legacy pension costs.

2.1.3. *Competitive disadvantages of EU carriers*

A key competitive disadvantage of EU aviation stems from the fact that Europe is generally acknowledged as an expensive place for airlines to do business. EU airlines operate (especially) long haul networks in markets that are global, against competitors whose cost bases are often substantially lower. An end result is that airlines in the EU have some of the **lowest profit margins** of any region globally. The European airline industry, including also companies based in Russia, Turkey, Switzerland or Norway, reported an average net profit margin of 0.5% in 2013 and 1.6% in 2014, falling short of the global average margins in both years. In 2014 there were 32 EU airlines among the leading 150 airline groups by revenue (comprising passenger, leisure and cargo airlines), 30% less than in 2001 and 20% less than 2008. During that period of time, EU airlines fell behind their global competitors in terms of net profit and posted an average net loss while the non-EU top 150 airlines are on average profitable⁵³.

⁴⁸ The numbers include fleet in service and on order as of 2014 according to CAPA.

⁴⁹ Commission Communication "An Aviation Strategy for Europe".

⁵⁰ European airlines have large narrow-body fleets which reflect their reliance on short-haul operations on regional and domestic market, as opposed to Middle East carriers whose business model is focused on long-haul hub-and-spoke operations.

⁵¹ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

⁵² CAPA Centre for Aviation is the leading provider of independent aviation market intelligence, analysis, reports and data services.

⁵³ Ibidem.

High costs in the EU are in part due to regulatory costs, which are result of high levels of protection to consumers, fair conditions for workers and other social benefits. The EU also has some of the **highest labour standards** in the world with regard to *inter alia* working conditions, work time, health and safety at work, equal treatment and social rights which represent costs borne by the EU air sector, as well. Many airlines established in third countries do not bear such costs.

Significant differences between the EU's and most third countries' regulatory environments also exist in terms of **environmental protection**. In the EU, growth in air traffic is being reconciled with the necessity to reduce aviation's environmental footprint and contributing to the fight against climate change. EU carriers have to comply with specified noise standards and may face noise-related operating restrictions (e.g. bans on flights during the night) on the basis of Regulation 598/2014⁵⁴. In the third markets where similar restrictions do not apply, the carriers are allowed to carry out 24-hour-a-day operations. By contrast, in the EU, stringent regulatory measures, such as more restrictive noise abatement operational procedures and airport operational noise quotas, pose challenge to the already constrained capacity of EU airports (see below) and generate additional costs for EU airlines. In the EU aviation has also been included in the EU Emissions Trading System (ETS) by Directive 2008/101/EC⁵⁵, in line with the International Civil Aviation Organization's (ICAO) resolution on incorporating international aviation into existing trading schemes. However, for the period 2013-2016, the legislation has been amended so that only emissions from flights within the European Economic Area fall under the EU Emissions Trading System (ETS). This constitutes an extra burden for the international competitiveness of EU airlines.

The regulatory framework is not the only reason for an expensive business environment in EU. Not less important are the **airport capacity and efficiency constraints** which are seriously impeding the European aviation sector's ability to grow sustainably, compete internationally, and which are causing congestion, delays and raising airlines' operating costs. As concluded in the Aviation Strategy, European airspace as a whole is inefficiently managed and unnecessarily fragmented. The Single European Sky initiative launched ten years ago was meant to cope with sustained air traffic growth through reform and consolidation of Air Transport Management systems of EU Member States. The implementation of SES aims *inter alia* at raising EU airports' capacity and consequently increasing flight efficiency and reducing delays and costs related to air service provision. However, the project is still not delivering as the level of cooperation between Member States air navigation service providers is far from optimal, and the technology used is not harmonised. Slow implementation of the Single European Sky framework means higher costs for the airlines, which directly affects their competitiveness. The estimated costs of the EU's fragmented airspace represent at least €5 billion a year⁵⁶.

Meanwhile, major European airports are predicted to face a capacity crunch in the near future. Eurocontrol predicts that in 2035 European airports will be unable to accommodate some 2 million flights due to capacity shortages. There will be more than 20 airports operating at or

⁵⁴ Regulation (EU) No 598/2014 of the European Parliament and of the Council of 16 April 2014 on the establishment of rules and procedures with regard to the introduction of noise-related operating restrictions at Union airports within a Balanced Approach and repealing Directive 2002/30/EC (OJ L 173, 12.6.2014, p. 65–78).

⁵⁵ Directive 2008/101/EC of the European Parliament and of the Council of 19 November 2008 amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community (OJ L 8, 13.1.2009, p. 3–21).

⁵⁶ Commission Communication "An Aviation Strategy for Europe".

near full capacity for 6 or more hours per day, against just 3 in 2012, leading to an additional average airport-related delay of 5-6 minutes per flight. The estimated economic cost of being unable to accommodate demand has been estimated at an annual loss in GDP of between €28 billion and €52 billion at EU level. At the same time, many airports in the EU are chronically underused and facing overcapacity.

Finally, the competitive position of EU hub carriers is also heavily impacted by the **emergence of competition from low-cost carriers (LCCs)** on a short-haul, intra-EU market. Before the liberalisation of the EU internal aviation market, the EU network carriers used their short/medium haul operations to feed their more profitable long-haul network. The creation of the EU single aviation market liberalised intra-EU market access for EU airlines and led to the emergence of new – low-cost – business model. Contrarily to more complex hub-and-spoke model of EU network carriers which operate one or more hubs and combine feeder traffic with long-haul routes, the low-cost business model focuses on short-haul, point-to-point routes, maximisation of flying hours, use of secondary airports and high frequency of service. This model has proven to be very successful and has allowed the LCCs to claim a growing share of the intra-European market. Virtually non-existent on EU internal market until 1995, and with a share of below 10% of weekly scheduled seats prior to 2002, the low cost sector outperformed and by 2012 left behind the network carriers' sector. In 2015, LCCs accounted for 48% of seat capacity in the EU market while network carriers provided less weekly seats than in 1998⁵⁷. The growing competition from LCCs on intra-EU market confronts most European network carriers with increasing price pressure and makes their cost basis more vulnerable. The cost disadvantage of a hinterland hub network compared with those of short haul only networks are reflected in the structurally lower unit costs of the EU LCCs as compared to EU network carriers⁵⁸. This is also the case for the competition between expensive hub-and-spoke systems of EU network carriers and some third country carriers (in particular from the Gulf) operating a cheaper long haul network at their hourglass hubs (e.g. Dubai airport where all Emirates passengers are transferred). The intensifying competition has growing impact on European full service carriers, which have to look not only for further cost-cutting opportunities but into improving their hub connectivity to keep their networks as attractive as possible. Several EU network carriers have rationalised their networks since the beginning of the century in response to this increasing competition from both inside the EU market (low-cost carriers) and outside the EU market (Turkey and the Gulf)⁵⁹. Others are still struggling to reform their business model and have not or are still in the process of adaptation. Drawing from the above, it should be noted that not all EU carriers suffer from the recent market evolutions. EU LCCs are mainly present on the intra-EU market and therefore almost not exposed to competition from third country air carriers, whereas EU network carriers are much more present on the international market and more exposed to competition from third country air carriers. Being exposed to different markets and having adopted different business approaches, notably the intra-EU point-to-point model, the LCCs are not as exposed as EU network carriers to the competition exercised by third country carriers.

Without prejudice to the above factors, the competitive situation of EU aviation also depends upon fair conditions of competition in international aviation which may be distorted by unfair practices by third countries and third country entities. Throughout the last years a number of

⁵⁷ Ibidem.

⁵⁸ OECD International Transport Forum, EU Air Transport Liberalisation Process, Impacts and Future Considerations, Discussion Paper No. 2015.04, January 2015.

⁵⁹ Some airline bases have been "de-hubbed" by their respective home carriers, such as Milan Malpensa (Alitalia), Barcelona (Iberia) or have been drastically downsized (Copenhagen by SAS).

cases of competition distortion through subsidies or other distortive practices have been alleged by the EU industry (described further below). As presented in the PwC study⁶⁰, a number of European airlines and several other industry stakeholders have repeatedly expressed concerns that the market share gains by third country carriers have occurred not only because of their geographic advantages and lower cost structures, but also because of market-distorting subsidisation and unfair practices by third country governments, carriers or airports.

2.1.4. Concerns about the existence of subsidies and other practices seen as distorting competition to the detriment of EU carriers

Over the last two decades, many EU stakeholders have argued that the competitive playing field in international aviation has not been level, with both overt and more subtle government support for airlines in several regions of the world affecting the ability of EU airlines to compete in the market for traffic to and from third countries.

The concern over the existence of subsidies and unfair practices and their harmful effect on EU carriers was strongly echoed in the comprehensive public consultation on "aviation package for improving the competitiveness of EU aviation sector".

A large proportion of respondents (96 out of 123) agreed that EU carriers face challenges when competing with third country carriers. A thin majority of stakeholders (68 out of 104) were also of the opinion that the state subsidies for third country carriers are an important competitive disadvantage for EU carriers, though several respondents argued strongly against the existence of such support. The same response pattern could be identified with regard to the question of unfair commercial practices by third country entities (53 agreed, 21 disagreed and 21 were neutral). More neutral opinions were expressed with regard to the question of possible discrimination of EU carriers by third country governments or non-EU service providers (41 agreed, 19 disagreed and 26 were neutral)⁶¹.

When asked to rank the challenges/obstacles which EU carriers face on extra-EU markets, the issues most mentioned by the respondents were cost advantages of non-EU carriers, more favourable tax regimes and the issue of possible subsidies. When asked about the main areas for future work to improve the framework conditions of the EU's aviation sector in international competition, respondents particularly highlighted three areas: fair competition, regulatory harmonisation and taxation.

These views closely correspond to responses provided by stakeholders in the less representative online public consultation on a "proposal for improved protection against subsidisation and unfair pricing practices"⁶². Noticeably, EU and non-EU entities participating in the consultation expressed opposite views on the subject. It should be noted that most EU respondents (6 out of 8) taking part in the consultation believe that EU air carriers are currently facing unfair practices whereas most non-EU air carriers disagreed with this statement. The majority of respondents to the public consultation also agreed or strongly agreed that the injury is caused by the existence of subsidies in the supply of air services from

⁶⁰ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

⁶¹ A detailed analysis of stakeholders' input can be found in the summary of Stakeholder Consultation attached in Annex B.

⁶² 20 entities took part in public consultation, representing EU airlines, EU airport and industry associations, Member States, EU citizens, non-EU airlines and industry associations and EU trade unions.

non-EU countries to and from the EU market (all but one EU airline were in agreement, with the remainder declared neutral on this issue). Half of respondents declared that unfair pricing practices were causing injury to EU carriers.

The review of the qualitative responses provides more interesting insights into stakeholders' opinions. There seems to be a general consensus among the respondents of both public consultations that the EU competitiveness vis-à-vis dynamic Asian and Middle East economies, is dwindling. It is broadly believed that EU airlines are less and less able to compete on pricing, capacity and route choice on a global basis. Stakeholders also agree that, should the growth of non-EU airlines continue at the present pace, many EU carriers will be required to pull out of numerous markets which would represent a damaging blow to the EU aviation market. However, respondents remain divided on the question of the underlying reasons for the declining EU market position on international air transport market.

Most of individual stakeholders' inputs indicate a general view that third country carriers are potentially distorting the market through the **subsidiisation** they receive from governmental bodies which requires regulatory attention at EU level. Stakeholders perceive that there is often a close link between non-EU carriers and their governments who grant a range of advantages which airlines operating in the more open EU market are unable to compete with. Respondents point that foreign governments distort competition, not only by subsidisation (e.g. by covering airline's or airport's operating losses through public funding or by offering favourable tax treatment), but also by **protectionist measures** in order to secure their national carriers' advantages over foreign competitors. It is also suggested that significant **marketing expenses** are committed each year by third-country carriers which cannot be matched by EU entities. Respondents believe that these expenses vastly exceed what could realistically be expected to be invested by a carrier operating entirely within the confines of its own financial limitations and therefore subsidisation must exist. It is believed that this practice unfairly disadvantages EU carriers as the marketing expenses of third-country carriers can exceed the profit generated by some airlines.

When asked about other kinds of unfair practices, several stakeholders point that the daily business of EU carriers is also hindered with respect to **access to airport facilities, ground-handling and slot distribution** whereby third-country carriers are given precedence over EU competitors. Respondents also report cases, where European carriers need a local sponsor to offer services in a third country and have **no access to direct sales**. Other examples of quoted unfair practices are the obligations made to some European carriers to enter into **compulsory commercial agreements** with third country airlines so as to be in a position to exercise traffic rights including overflying rights. It is further noted by respondents that the non-EU carriers are often **protected against insolvency**, whilst their ultimate aim abroad is not to be a profitable entity but to represent the country of its origin abroad. The national governments thus have an intrinsic interest in the operations of their carriers which they believe represents them abroad. Such an interest is perceived as less prevalent in the EU market, where the open market has seen many national carriers move into private hands.

Some respondents also pointed that third-country entities are making **strategic investments in EU airlines**. Once in control of the entity in question, it is suggested that they seek to channel as many passengers as possible to their non-EU airlines and hubs to maximise returns. This then allegedly damages the EU airlines themselves and by extension the airports where they operate. Some respondents expand on this point, citing that where the airline in question is partly owned by a non-EU entity, it can then avail of non-EU sources of capital which EU entities may find far more difficult to have access to. This exacerbates the problems and increases the gap between two groups of airlines.

Several representatives of third countries who responded to the public consultation rejected the claims put forward by their competitors. These stakeholders (mostly non-EU entities), suggested that there is no substantiated evidence of subsidies and unfair practices and the difficult situation of EU aviation internationally stems rather from the **inefficiencies and structural problems of EU airlines** themselves. They point to the ‘objective’ competitive advantages of non-EU carriers, such as advantageous geographic location and modern fleet and airport infrastructure, as the drivers of their unprecedented growth. In conjunction with a wide route network, this has made the airlines in question the service provider of choice for many consumers. It was also suggested that it is the general **economic crisis in Europe**, with a number of EU nations remaining in recession and others requiring financial rescue, that contributed to a decline in EU aviation services offered which third-country entities.

One stakeholder also suggested that the increasing **prevalence of low cost carriers** operating within the EU aviation market is adversely impacting the services which EU flag carriers can offer on routes where there was previously no low-cost carrier presence. The respondent implied that the EU-based low cost carriers have more flexible approach and lower cost structures which give them the capacity to successfully compete with EU flag carriers through increasing competitive pressure on prices. It is therefore implied that the pricing issues reported by EU legacy carriers stem from competing against low-cost carriers rather than against carriers reliant on subsidies.

The views expressed in both public consultations resonate with the positions expressed by major EU airlines. One of the main concerns of the newly founded largest EU airlines association - Airlines for Europe (A4E)⁶³ is that the EU air transport sector is in urgent need of capacity and efficiency improvements to remain competitive and continue to grow. However, the airlines remain divided on the reasons behind EU aviation problems and the necessary response to competition with third countries. Some carriers, like International Airlines Group⁶⁴ or Alitalia (not a member of A4E) strongly dispute the claims that alleged unfair subsidies are being provided by certain third countries to their airlines and stress that the EU and other national **unnecessary regulatory costs** are ultimately responsible for putting European companies on a competitive disadvantage. They also point to **national taxes** (e.g. passenger/ticket taxes) applied in some Member States which lead to a higher production cost base and subsequently hamper the competitive position of EU aviation. IAG, along with Air Berlin consider liberalisation with third countries as best means to sustain EU air industry growth. On the other side of the spectrum are Lufthansa and Air France-KLM who claim that third country carriers are ‘offering **unnecessary capacities at non-economical prices** with the objective of gaining market shares at the expense of airlines operating under normal commercial conditions’⁶⁵. Air France-KLM has said that the financial statements from certain third countries carriers are proving that ‘**subsidies** appear to keep in the market non-commercially viable players’. Both airlines call for strong EU measures to tackle unfair competition.

⁶³ A4E is a new association founded in 2016 by Europe’s five largest airline groups – Air France KLM, easyJet, International Airlines Group, Lufthansa Group and Ryanair who left the Association of European Airlines (AEA) – to represent the interests of its members when dealing with the EU institutions, international organisations and national governments on European aviation issues. Today, A4E counts the following members: Air France KLM, easyJet, Finnair, International Airlines Group (IAG), Lufthansa Group, Norwegian, Ryanair and Jet2.com.

⁶⁴ International Airlines Group is a multinational airline holding company formed in January 2011 by the merger of British Airways and Iberia.

⁶⁵ <http://centreforaviation.com/analysis/af-klm-lufthansa--iag-weigh-in-on-us-gulf-dispute-pt-2-marketshare-loss-who-owns-the-passenger-245293>.

The positions of main EU flag carriers and their Member States of origin are often in line. Noticeably, in their responses to the public consultation, as well as separate position papers, all public authorities (Austria, France, The Netherlands and UK) have all expressed the need to address the issue of unfair competition in international aviation, though without prejudging on the best conceivable solution. French representatives were most vocal in denouncing a wide range of market-distorting practices, including state subsidies, price dumping or various types of doing business issues (e.g. requirement to employ local sales agent). Austrian authorities agreed with the statement that subsidies and other unfair practices exist and mentioned possible discrimination with regard to access to airport facilities and ground handling as commonly reported distortions of competition. The UK authorities' position in the public consultation stood out as manifestly neutral to all the questions regarding the existence of subsidies and unfair practices.

Finally, a distinctly neutral position on the subject is presented by Airbus - the major EU aerospace manufacturer. The company has consequently refrained from positioning itself in the debate on how best to promote 'European' interests in aviation. According to the PwC study, Airbus refused to answer questions on its position on trade defence instruments quoting "numerous EU and non-EU clients" and potential conflicts as reason⁶⁶.

Although, the EU stakeholders are not unanimous on the question of subsidies and unfair practices used by third countries and third country carriers or other third country entities, the responses provided in public consultations as well as individual opinions of key EU airlines indicate that a considerable part of EU air transport industry considers them a prominent problem today.

2.1.5. Allegations regarding subsidies and other practices seen as distorting competition to the detriment of EU carriers

The perceived problem with subsidies and unfair practices by third countries and third country entities is brought forward by a number of alleged cases reported by EU governments, air carriers and media over the last years. Although, they have never been examined or proven in a formal investigation under EU law, these cases suggest that currently the term "unfair practice", as referred to in the grievances raised, encompasses a broad range of measures which amount to providing direct or indirect support to third country air carriers and other third country entities. A non-exhaustive catalogue of possible unfair practices, whether by airlines, airports, air navigation service providers or governments themselves, along with examples of each of them is presented below. These have not been subject to investigations and as such are not proven. This does not prejudge of any action or investigation that could be undertaken by the Commission.

A **subsidy** is one of the most commonly alleged and overt unfair practice in international aviation. Regulation (EC) No 868/2004, hereafter "Regulation 868/2004", defines a subsidy as a financial contribution by a government, regional body or other public organisation, which confers a benefit on a recipient of the subsidy. Under the same Regulation, subsidies qualify for redressive measures against third country carriers if they are limited in law or in fact to an enterprise or industry or group of enterprises or industries within the jurisdiction of the

⁶⁶ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

granting authority. In practical terms, subsidies of the kind, independently from the form they take, can have a major impact on the growth and operation of third country air carriers.

EU network carriers operate essentially on a commercial basis, and therefore for financing their activities they must rely on the strength of their respective corporate balance sheets. The EU has detailed rules on State aid, applicable also to the aviation sector, within which dedicated Guidelines explain the Commission's understanding and application of those rules⁶⁷. Public support for airports or airlines of whatever form escapes scrutiny if it can be demonstrated that it was granted under normal market conditions⁶⁸. As regards aid to airports, this is only permitted if certain strict conditions are met to ensure that its distortive effects have been minimised⁶⁹. In turn, aid to airlines is largely banned, with a small number of exceptions⁷⁰. For instance, government rescue and restructuring aid for an ailing EU airline could only be permitted if the following criteria were met: the aid envisaged forms part of a comprehensive restructuring programme aimed at restoring the short-term viability of the carrier cost reduction or return to profitability; capacity reduction or constraints on expansion are planned; no fleet expansion takes place; aid is not used to acquire other airlines; aid does not increase direct competition with other airlines; there is no government interference in the airline's management and; no further aid is envisaged or likely in the future. Moreover, where the rescue and restructuring aid is paid in tranches, the Commission must give its approval for each tranche, which is subject to the progress made and the conditions being respected⁷¹. By contrast, outside the EU it would not appear that comparable control exist, and therefore some third country carriers may benefit from more favourable treatment in terms of financial support by the State.

Over recent years, a large number of media reports, academic articles and informal industry complaints have been suggesting that in some non-EU countries, government intervention would provide direct or indirect commercial advantages to selected carriers and airports in a manner which reduces their costs, or increases their revenues to the detriment of competitors. These carriers would then allegedly be able to offer lower fares for their services or offer extra capacity which may in turn allow them to increase their market share by pushing competitors out of the market.

The PwC study presents a number of examples of alleged subsidisation by non-EU countries. For instance, various forms of subsidies were alleged to exist in the Asian market. As an example, in 2014, four major State A airlines collectively received over 1.1 billion US dollars of subsidies and grants, including 162 million US dollars for Airline A1, 589 million US dollars for Airline A2, 276 million US dollars for Airline A3 and 82 million US dollars for Airline A4. The receipt of the above government aid is incontestable as the government funding was openly stated in the carriers' accounts. Also Airline A2 who successfully merged with Airline A5 received an injection of more than 3 billion US dollars from State A

⁶⁷ Commission Communication "Guidelines on State aid to airports and airlines"

⁶⁸ The so-called "Market Economy Operator test" is used by the Commission in an initial phase of the investigation (when it is notified of state's intention to transfer funds) to decide whether the prospects of an airline are so positive that a private investor would plausibly make a similar investment. For more information, see points 48 and 53 inter alia of the Guidelines on State aid to airports and airlines.

⁶⁹ See sections 4 and 5.1 of the Guidelines on State aid to airports and airlines.

⁷⁰ See sections 4, 5.2, and 6 of the Guidelines on State aid to airports and airlines.

⁷¹ Commission Communication "Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty".

government. In another case State B Government provided a 5.8 billion US dollars bailout to the ailing Airline B1 which allegedly enabled the carrier to charge below-cost fares.

Recently, leading State X airlines have claimed that the three largest States C and D carriers together would have received 42.3 billion US dollars in subsidies from their governments since 2004. According to these claims (strongly disputed by States C and D carriers), this amount would include interest free loans, equity infusions, cash injections, grants, passenger fee exemption, additional committed subsidies, union ban resulting in below-market labour costs, avoided interest from government loans, government assumption of fuel hedging losses and subsidised airport charges. This is in contrast to rules in the EU where State support largely has to be under market conditions. State X carriers moreover claim that the three leading carriers from States C and D also would have received further subsidies that could not be quantified due to lack of financial transparency. The issue is not so much that airlines may receive loans or capital injection by their governments, but whether or not the terms of such advances are in line with those that might be expected from private investors. Media recently reported about the State C alleged 3 billion US dollars loans to Airline C1 on interest-free terms not requiring any repayment until 2027 and apparently not in exchange for shares. It would seem very unlikely that a market investor would enter into such transaction. A recent study by transport research firm GRA⁷² on States C and D carriers' profitability on State X routes makes the rationality of alleged subsidies schemes even more questionable. According to the report, of the 23 routes operated by the States C and D carriers to State X in calendar year 2014, 19 appeared to be loss-making. More than half of these routes are estimated to have loss margins in excess of 20 percent and the overall loss margin for the three carriers combined is -14.4%. The report concludes that 'the preponderance of loss making routes and the size of the losses suggest that the three carriers have over-expanded in State X markets beyond levels one could justify from the operating results'⁷³.

Experience in the EU⁷⁴ has shown that subsidies which are not granted directly to airlines may also result in market distortion. As mentioned in section 2.1.4, many EU stakeholders express concerns that certain third country governments would be financing the growth of airport infrastructure in order to accommodate for the growth of their incumbent carriers through deviation of traffic from "traditional" routes. According to major EU airlines, this trend is particularly apparent for traffic that is being deviated via the major States C and D hubs and via major hub of State E. There are many reported examples where state-owned airports provide capacity above the actual demand without passing on the cost of that extra capacity to their incumbent airlines in the form of higher airport charges. With this practice, the airports provide those incumbent airlines with significant cost and service advantages over EU carriers (since in the EU, state support for large airports is essentially outlawed)⁷⁵.

⁷² GRA Incorporated, 11.11.2015 - <http://www.openandfairskies.com/wp-content/uploads/2015/11/GRA-Report-on-ME3-Profitability.pdf>.

⁷³ The allegations made by the State X carriers were rebuked by State C in a paper published in June 2015. The study suggest that the State X legacy carriers in question benefit from massive federal, state, and local government support.

⁷⁴ See point 65 of the Commission Communication "Guidelines on State aid to airports and airlines" concerning the question of whether the advantage resulting from aid to an airport operator can be passed on to a specific airline.

⁷⁵ See in particular points 97-105, which outline how investment aid (which does not include State support that meets the "Market Economy Operator test") to airports with average passenger traffic (passengers per annum) of more than 5 million, is banned in all but "very exceptional circumstances, characterised by a clear market failure".

According to information provided, the most notable example of this kind of alleged subsidisation are investments made in States C, D, E and F, currently in the process of expanding their airports' capacities which combined will ultimately accommodate 450 million passengers per year as compared to the region's current capacity of 140 million passengers per year⁷⁶. In another example, the Government of State G announced at the beginning of 2014 that it plans to almost double the capacity of G1Airport ahead of demand over the next decade with two new terminals.

The concerns of the European airline industry are not limited to subsidies as such, but also extend to the **lack of access to information** about such potential actions, which leads to the perception that subsidies are being offered to the airlines and airports in question. In a number of world regions, there is no clear institutional or functional separation between the government, civil aviation authority, airport management, and sometimes even airlines, making it often impossible for outsiders to trace the flow of finances, other resources and information. The complex inter-linkage of the various entities (e.g. airlines, airports, catering companies, leasing companies, ground-handlers etc.) which are often vertically integrated and controlled by the State raises the perception of market distortion among competitors. In this regard the lack of transparency regarding the finances of the hub airports in question is particularly important, since they form the central nexus between State, airline and third parties. Although problematic, it is not to be expected that any modification of the current Regulation would be able to provide a solution to this issue but only in to a limited extent.

The restrictions of access to infrastructure and facilities for non-incumbent operators are other kinds of most commonly alleged unfair practices. EU stakeholders suggested several cases of possible discriminatory treatment at third country airports, where privileged access to airport infrastructure and airport services was granted to the incumbent carriers at the expense of EU competitors.

One example of such alleged unfair practice concerns is the suggested discriminatory treatment of EU carriers by Airline H1 - the incumbent operator at State H's main airport. It is alleged that some EU airlines which fly to and from State H capital face restrictions of access to ground handling services and are forced to pay higher prices than Airline H1. A similar discrimination in access to ground handling services has allegedly been experienced by EU carriers at State I airports.

Discriminatory airport slot allocation and discriminatory airport charges are other type of allegedly used unfair practices negatively affecting the EU airlines' competitive position on international market. Congestion at airports as a consequence of the increase of air traffic, coupled with environmental concerns often leads to a shortage of slots. This alleged phenomenon would impede market access for EU entrants as third country authorities would tend to allocate the slots in a biased, non-transparent manner.

As an example, State J authorities would have allegedly been discriminating against EU airlines by excluding them from using slots at State J Airport J1 during daytime. Due to unequal slot distribution by State J authorities, the EU and North American carriers' long-haul services were limited to overnight hours, while services by regional airlines to State K, State L, State A capitals and other regional destinations continued to be allowed during the day

⁷⁶ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

which allowed them to get better opportunities for onward connections. The latest allocation of daytime international slots (October 2013) led to increased flight capacity between city J1 and many regional markets, but did not have a major effect on capacity between State J and Europe.

Problems with slots were also allegedly experienced by two EU low-cost carriers in State M. In 2014, Vueling's and easyJet's summer season slots to airport M1 were allegedly revoked last minute and replaced by the slots to airport M2, on the basis of new State M memo on slot allocation (circulaire nr 2399). For Vueling the transfer of passengers to another airport posed a risk of cancellation of its services and mandatory reimbursement of some 14 000 tickets already sold. Following the analysis of the case, the Commission concluded that the new State M circular comprised discriminatory criteria openly favouring the national carriers at the expense of EU airlines. Following the discussion under the EU- State M Joint Committee, State M authorities ceased the discriminatory treatment and committed to modify the disputed circulaire in order to bring it to compliance with IATA guidelines as well as Council Regulation (EEC) No 95/93 on slot allocation⁷⁷.

Allegations of higher airport charges which are discriminatory to EU carriers and favour incumbent operators have been, in turn, suggested at State N and State I airports. State I authorities are charging a special tax (35.9% surcharge) applied to the fee for domestic and international boarding and fees for the use of air navigation aids and telecommunications. This surcharge is imposed on foreign air carriers as the collected airport charges do not recover costs for State I airports⁷⁸. EU airlines have expressed concerns on many occasions about the level of State I charges and the way they are calculated. In another case, airport N1 authorities have been reported to have prepared a tailor-made incentive scheme that favours one incumbent airline and its transfer passenger-focused business model. Low-cost EU airline has raised complaints that the above practice unfairly protects high fare monopolist and jeopardises access of State N consumers to low cost air travel⁷⁹.

Third country governments and other public bodies may substantially distort the fair competition on the market by using what may be labelled as "**soft" measures**, though displaying some form of discrimination. Practices of the kind are generally harder to detect and prove as the advantage offered to incumbent carriers may often be of non-commercial nature. This capacious group of alleged unfair practices may include a broad range of **obstacles to "doing business"** for foreign airlines, such as unnecessary red tape, burdensome customs clearance procedures, discriminatory accommodation rates and visa schemes⁸⁰ for foreign carrier's staff, as well as limited access to airport sales outlets, marketing restrictions or obligations to appoint a General Sales Agent in the third country. Although the European parties have difficulties in obtaining concrete evidence of such soft discriminatory measures there has been a number of allegations of this type over recent years.

For example, EU carriers have allegedly faced several problems with "doing business" in State I. The issues reported by the EU aviation industry include unjustified long waiting times to obtain routes authorization, engine start-ups or taxi clearances; burdensome customs

⁷⁷ Council Regulation (EEC) No 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports, (OJ L 14, 22.1.1993, p. 1–6).

⁷⁸ https://www.wto.org/english/tratop_e/tpr_e/s283_e.pdf

⁷⁹ https://wizzair.com/en-GB/about_us/news/wizen239

⁸⁰ Certain third country carriers act as visa sponsors for entries into their states, while this is not available for foreign airlines including EU airlines.

procedures for airline spares and equipment; or imposition of special fees on indirect service provisions including the sale of a ticket issued by a Travel Agent.

Allegations on the potential discrimination against full fare carriers applied in State O were also formulated by EU Member States. According to MS reports, State O law grants advantages to low-cost carriers by exempting them from the rule allowing passengers to cancel their tickets up to 14 days after the purchase, and by allowing them to use the main terminal at airport O1 for lower fees.

Another example of doing business issue reported by an EU airline concerned State P. The new State P Air Services Price Advertising Regulations require that any person who advertises an air service should display the total price in State P currency when selling flights within or originating in State P. All companies whether or not they are legally established in State P are obliged to display the prices in State P currency on all their global websites, even if an airline does not operate in State P (company might be 'present' in the market through interline and/or code-sharing arrangements only). The provisions allegedly limit the competition, since carriers not serving State P directly will effectively be prevented from holding out their services to the State P public, and to the public in other countries wishing to travel to/from State P, through their global sites, unless they accept to publish their prices in State P currency. The Commission indicated that meeting the new requirement is problematic as EU airlines would have to develop country specific websites or generic sites supporting transactions in State P currency.

EU stakeholders also complained about the lack of possibility to use facilities for their passengers at the terminal of third countries' airports, while at the same time it is possible at terminals used by local airlines. In 2014, EU air operators allegedly experienced such discriminatory treatment at airport M1. By the decision of State M Airport authority all but the incumbent carrier (Airline M1) were reportedly forced to transfer their operations to a specific terminal. As the latter was unadjusted to accommodate the high number of passengers, EU carriers allegedly faced serious operational and commercial disadvantages and additional costs.

On the basis of all of the above allegations provided by the EU member States, the industry and the media over the past years, possible unfair practices fall into two main categories: discriminatory practices against EU air carriers, and selective subsidies from third countries to third country entities.

2.1.6. Impact of the alleged practices on EU air transport market

The possible impacts of the alleged unfair practices by third countries or third country entities are difficult to assess in the absence of sufficient publicly available information and without practical experience of addressing them at EU level. While it is difficult to quantify the negative effects of the possible unfair practices on the economic performance of EU air carriers, the number of reported problems both in and outside the EU, as well as public consultation results, suggest that it is highly likely that alleged unfair practices have a negative impact on the EU entities.

Alleged unfair practices in the international air transport market, to the extent they exist, may in the first place negatively affect **EU airlines'** competitiveness and financial performance and, as a consequence, the whole air transport value chain. As indicated in section 1.3, the current trends in traffic evolution between the EU and world regions indicate decreasing

prominence of EU carriers in almost all air transport markets – to/from the EU and beyond. The extent to which the above market trends may be due to the impact of unfair practices is unknown and it is difficult to quantify it. While it is noticeable that the market share of EU airlines has declined the most in markets where unfair competition is widely alleged to exist. It is also clear for the reasons presented above, that it is difficult to establish a direct causal link between alleged unfair practices and lower market shares of EU airlines, which in absolute levels in most cases are still higher than the ones of their competitors coming from these regions.

Notwithstanding this, it is highly likely that alleged unfair practices have a negative impact on the market position of EU airlines, and accordingly, that their impact is most significant on routes where beneficiaries of these operate. Consequently, it might be assumed that EU carriers may lose an important part of their revenues on routes towards certain regions in favour of their competitors benefiting from alleged subsidies and unfair practices. The financial performance of EU carriers may also be hindered on other international routes where alleged discriminatory airport charges, additional taxes/fees or obstacles to doing business occur.

Distortions of competition resulting from practices adopted by third countries and third country entities could also have negative effect on **EU air transport sector employees**. The decline in economic position of EU airlines worldwide would translate into stagnation and shrinkage of jobs of flight crews and other air transport workers.

From the **EU consumer's** perspective the most important impacts of alleged subsidies and unfair practices, concern the ticket prices, service quality and connectivity in terms of route choice.

The impact of alleged unfair practices on the ticket fares can be very different depending on the type of practice in question and period of time. In cases where the EU airlines face higher airport charges, supplementary taxes or royalties, the additional costs will most likely be passed on the consumers and reflected in higher ticket prices.

On the other hand, in the short term, the consumers may benefit from lower ticket prices and often higher service quality, where these advantages ultimately result from subsidisation to the non-EU carrier concerned. However, in the medium and longer term, EU airlines may not survive the competition of state-owned, allegedly subsidised competitors and may cut back or abandon air services on certain routes. This could ultimately transform certain markets into oligopolies (e.g. only two or three carriers offering nearly identical service on same routes) or even monopolies. According to classical economic theory, once the competition is replaced by oligopoly/monopoly the prices are no longer shaped by changes in supply and consumer demand. This is even more so as in the long-haul international air transport market no direct, cheaper product substitutes exist (i.e. a long-haul flight by airplane cannot be effectively replaced by any other transport mode). Hence, in the medium to long-term perspective, some third country airlines might find themselves in a situation of quasi monopoly regarding certain routes and will have no further incentives to cut fares which could mean that EU passengers may face ticket price increases.

Similar rules apply to the impact of alleged unfair practices on service quality. On one hand, EU consumers may be able to benefit from better quality of service at reduced prices when flying with allegedly subsidised carriers. In 2013, States C and D carriers together with State E and State G airlines were among the top-10 both in first-class, business-class and economy-

class in terms of customer satisfaction⁸¹. On the other hand, there are number of reported cases where alleged unfair and discriminatory practices of third countries and third country entities negatively affect the quality of services provided by EU flag carriers. As mentioned in the previous section, due to the discriminatory treatment of EU carriers, EU passengers were allegedly confronted with inconveniences at a specific terminal 1 of airport M1, which was not adjusted for high passenger volumes (small number or lack of check-in counters, security gates, baggage claims, passenger boarding bridges etc.). In like manner, many long-haul services of EU carriers suffered quality deterioration as a result of alleged discriminatory slot allocation at airport J1. The unattractive overnight schedules made British Airways temporarily suspend its service on city J1-London route (which was later restored on a less than daily basis).

Finally, the direct connectivity to and from Europe would likely also be affected by alleged unfair practices. As explained, recent trends show that non-EU hubs have allegedly been increasing market share relative to EU hubs through the expanding networks of their carriers into airports in Europe. This may have implications for intra-EU connectivity as there would be a reduction in feeder services from EU airports to EU hubs (where a non-EU hub airport has set up a direct connection from the EU feeder airport), thereby reducing demand and ultimately capacity and frequency on these routes. This means that European consumers are increasingly dependent on States C, D and E to travel to distant destinations that were previously flown to directly and frequently. Hence, EU passengers are gradually losing their freedom of choice in terms of the journeys they take and the companies with whom they fly. European capitals are less and less connected via direct flights to final destinations vital to European growth⁸².

Regarding the EU aeronautical industry, some **EU manufacturers and suppliers** in the aviation sector could benefit from rapid fleet expansion in other parts of the world. The scale of aircraft orders from non-EU carriers, in particular from States C and D region, has propelled these carriers into the role of key customers for aircraft manufacturers. Airbus (along with Boeing) is a top provider of jet aircraft to the world's airlines and an export leader especially in these growth markets. States C and D airlines are big investors in European aircraft and currently buy up to 50% of Airbus A380 capacities. However, at present, the three biggest markets for Airbus in terms of volume of civil jets ordered are: Asia-Pacific (27%), Europe (22%) and North-America (13%), while the Middle East represents only 7% of Airbus orders globally, with 962 aircrafts booked as of 30 April 2014⁸³. In the long term, the growth prospects for EU equipment manufacturers will then fundamentally depend on high-demand, large aviation markets such as Europe. Hence, it is not in EU manufacturers' interest to have an EU airline industry that lacks the prospects and the means to modernise and invest.

⁸¹ EU airlines were only reported in the top-10 list for first-class with one airline being present, and in the top 10-ten list of premium economy with three airlines.

⁸² There is a range of ways in which connectivity can be evaluated and valued. Connectivity indices capture the value of connections through various measures, for example, IATA's connectivity index weights destinations based on the size of the destination airport in terms of total passenger traffic. It may be noted that for some measures, States C and D airlines' contribution to connectivity outweighs their contribution in terms of available seat capacity given that their hubs are such large, well-connected airports. However, if a measure places more emphasis on direct connections, then the increasing use of indirect services via States C, D and E hubs may decrease the quality of connectivity. This is the assumption that is made in this report. The impact of a reduction in services, especially to regional points in the EU, would therefore be likely to represent a reduction in connectivity to those regions.

⁸³ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

Hence, unfair competition in international aviation, to the extent it exists, may have a serious negative effect on EU airlines and indirectly, on EU consumers (passengers), employees, manufacturers and the EU economy as a whole.

2.1.7. Legal instruments for protection of competition in other sectors and countries

Throughout history, international trade has been driven by two contradictory pressures from the domestic market players. Some industries urged their governments to reach agreements with third countries in order to access foreign markets and export their goods, whereas the others called for protective measures against foreign competitors to be put into place. This dual pressure led governments to conclude agreements with each other and enable access to part of their respective markets by eliminating or reducing barriers to entry, while specific rules against dumped and subsidised products were established. This system was gradually developed through a series of trade negotiations, or rounds, held under General Agreement on Tariffs and Trade (GATT) and culminating into the multilateral regime established under the WTO agreement.

A number of EU instruments are relevant to the above. In part, the intention is to help imposing the respect of existing commitments that bind third countries. Other instruments are intended, even in the absence of such commitments, to outbalance the effects of practices considered unfair. The latter is the case of Council Regulation (EEC) 4057/86⁸⁴.

A short overview over all these instruments is given immediately below.

Under EU law, **anti-dumping measures** are currently governed by Council Regulation (EU) 2016/1036 of 8 June 2016 on protection against dumped imports from countries not members of the European Union. This Regulation implements Article VI of GATT 1994 and the WTO Anti-dumping Agreement and allows the EU authorities to apply an anti-dumping duty to any dumped product whose release for free circulation in the EU causes injury⁸⁵. The Commission initiates an investigation to determine the existence, degree and effect of any alleged dumping.

Anti-subsidy measures are governed by Council Regulation (EU) 2016/1037 of 8 June 2016 on protection against subsidised imports from countries not members of the European Union which implements Articles VI and XVI of GATT 1994 and the WTO Agreement on Subsidies and Countervailing Measures. Under this regulation, the Commission may impose a countervailing duty for the purpose of offsetting any subsidy granted, directly or indirectly, for the manufacture, production, export or transport of any product which release for free circulation in the Community causes injury⁸⁶.

⁸⁴ Council Regulation (EEC) 4057/86 of 22 December 1986 on unfair pricing practices in maritime transport (OJ L 378, 31.12.1986, p. 14–20).

⁸⁵ A product is to be considered as being dumped “if its export price to the Community is less than a comparable price for the like product, in the ordinary course of trade, as established for the exporting country”.

The term ‘injury’ shall mean “material injury to the Community industry, threat of material injury to the Community industry or material retardation of the establishment of such an industry”.

⁸⁶ The subsidy consists of a financial contribution by a government in the country of origin or export (or in any form of income or price support within the meaning of Article XVI of the GATT 1994), which confers a benefit and which is specific to an enterprise or industry or group of enterprises or industries within the jurisdiction of the granting authority. Injury’ means “material injury to the Community

The EU anti-dumping and anti-subsidy rules are defensive instruments protecting the EU market. They are applicable uniquely to trade in goods⁸⁷ and cover only two kinds of uncompetitive practices.

In order to ensure that the Union's trading partners would respect the rules contained in agreements to which the Union is party, the EU adopted a **Trade Barriers Regulation (TBR)**⁸⁸ - a tool with a much broader scope of application that applies not only to goods but also to services and intellectual property rights. However, the TBR only applies to those services in respect of which international agreements can be concluded by the Union on the basis of Article 207 of the Treaty, and therefore does not cover transport services.

The TBR is an instrument aimed making sure that the international rules eliminating obstacles to trade effectively deliver benefits to EU exporters. It gives the right to EU enterprises, industries or their Associations as well as the EU Member States to lodge a complaint with the European Commission who then investigates and determines whether there is evidence of a violation of international trade rules which has resulted in either adverse trade effects or injury. A wide range of obstacles to trade or trade barriers is covered by the Regulation and the Annex provides an illustrative list of some of the trade obstacles that are covered by the TBR. An obstacle to trade is defined in the Regulation as “any trade practice adopted or maintained by a third country in respect of which international trade rules establish a right of action”. In this context, international trade rules are primarily those established under the World Trade Organisation (WTO) and bilateral trade agreements⁸⁹.

Until the adoption of TBR, the only EU legislation in the services sectors aiming at defensive measures was the **Council Regulation (EEC) 4057/86 on unfair pricing practices in maritime transport**. The Regulation was modelled on the anti-dumping and anti-subsidy regulations on trade in goods. It allows the Commission to impose a redressive duty in response to unfair pricing practices “by certain third country ship-owners engaged in international cargo liner shipping, which cause serious disruption of the freight pattern on a particular route to, from or within the Community and cause or threaten to cause major injury to Community ship-owners operating on that route and to Community interests”. The Regulation was used only once in the so called Hyundai Merchant Marine case, where the complainant alleged that Korean ship operator, has implemented unfair pricing practice in the liner shipping trade between the Community and Australia (charging a freight rate that is 30% lower than the average rate on the route), causing a 7% decrease in utilisation of capacity of Community’s shippers and a decline in profits on the route. The Commission considered that the evidence presented was sufficient to justify the initiation of a proceeding and to impose, at the end of these proceedings, a redressive duty “on all containerized cargo loaded in a

industry, threat of material injury to the Community industry or material retardation of the establishment of such an industry.

⁸⁷ The trade in services was partially liberalized through the GATS (General Agreement on Trade in Services) which entered into force in 1995 and brought the services industries under multilateral trading rules laid down in the GATT. However, the GATS do not apply to air transport services which are governed by a specific annex of the GATS (see more in problem drivers section).

⁸⁸ Regulation (EU) 2015/1843 of the European Parliament and of the Council of 6 October 2015 laying down Union procedures in the field of the common commercial policy in order to ensure the exercise of the Union's rights under international trade rules, in particular those established under the auspices of World Trade Organization (OJ L 272, 16.10.2015, p. 1–13).

⁸⁹ http://trade.ec.europa.eu/doclib/docs/2005/april/tradoc_122567.pdf

Community port on vessels operated directly or indirectly by Hyundai (...) with destination Australia⁹⁰.

Following the deregulation of the internal aviation market in 1978, the US has developed its own unilateral defence instrument to prevent international competitors (for whom market access in the US was being expanded) from exploiting any “unfair” advantages. Adopted in 1979, the **International Air Transportation Fair Competitive Practices Act (IATFCPA)**⁹¹ is a legislative tool designed to protect US airlines from unfair and discriminatory practices by foreign governments or airlines as well as to protect its rights acquired in bilateral air service agreements. Under the Act, the US Department of Transport (DOT) has means of action to ensure that "U.S. flag air carriers operating in foreign air transportation are protected from all forms of discrimination and are compensated for excessive or otherwise discriminatory charges levied by foreign governments or other foreign entities for the use of airport or airway property". A basic objective of IATFCPA was to offer US national operators of international services a formal administrative possibility to lodge complaints once they deem themselves to be subject of unreasonable discrimination. In practice, the US instrument grants the American Department of Transportation great discretionary powers to protect US industry interests based upon a complaint it finds justified or acting on its initiative. The scope of the Act is very broad and allows US DOT to take actions whenever "it considers it in the public interest to eliminate an activity of a government of a foreign country or another foreign entity" (...) which is deemed "unjustifiable or unreasonable discriminatory, predatory, or anticompetitive practice against an air carrier; or imposes an unjustifiable or unreasonable restriction on access of an air carrier to a foreign market". In response to such widely defined practices, the US Secretary of Transportation has the right to "deny, amend, modify, suspend, revoke, or transfer a foreign air carrier permit or tariff"⁹².

Following a number of complaints from US carriers, the IATFCPA has, been used quite frequently between 1986 and 2004. However, in all but one⁹³ cases the processing of IATFCPA cases alone has acted as a deterrent to foreign governments and a catalyst for the international negotiations eventually leading to the amicable resolution of dispute through the removal of unfair practice in question. This was possible due to the design of the US Act which, on one hand, requires the Secretary of Transportation to pursue diplomatic resolution of disputes as a first step and, on the other, gives it powerful tools to eliminate any discrimination or unfair competitive practice it finds to exist. Hence, the primary and practical role of IATPCPA was not to serve as an independent unilateral tool, but rather to act as a catalyst for international negotiations leading to amicable dispute resolution.

⁹⁰ Council Regulation (EEC) 15/89 of 4 January 1989 introducing a redressive duty on containerized cargo to be transported in liner service between the Community and Australia by Hyundai Merchant Marine Company Ltd of Seoul, Republic of Korea, (OJ L 4, 6.1.1989, p. 1), Art. 1, <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1989:004:0001:0009:EN:PDF>.

⁹¹ 49 U.S.C. 41310, the International Air Transportation Fair Competitive Practices Act (IATFCPA), <http://law.justia.com/cfr/title49/49-1.0.1.1.34.html>.

⁹² Ibidem.

⁹³ In May 2003, four US carriers filed a joint complaint against the Government of Argentina for imposing unreasonable airport charges at Ezeiza airport, which were approximately three times higher than those paid by Argentina's flag carrier – Aerolineas Argentina. After failure of the diplomatic efforts, the DOT imposed a countermeasure: Aerolineas' permit to operate to the United States was conditioned upon the airline's depositing in a neutral account in the United States the difference, for each of its international flights landing at Ezeiza, between the user fee it was paying and the fee that United States carriers were paying there. <http://airlineinfo.com/ostpdf42/655.pdf>

2.1.8. Ineffectiveness of Regulation 868/2004

The principle of fair competition and a level playing field has been an intrinsic part of the EU internal air transport market. In the context of growing liberalisation of the international aviation market and remaining regulatory, economic and cultural differences between the competing market players, it has become essential for the EU to ensure that fair competition is also protected in its relations with third countries. Since the issues of fair competition were not so far addressed at bilateral and multilateral level (as explained in the following section) a need for an effective unilateral legal tool arose, i.e. a tool that could prevent and counteract any possible unfair practices and discrimination from third countries and third country entities negatively affecting EU carriers.

This aim was to be served by Regulation (EC) No 868/2004 (hereafter also "the Regulation"), intended to protect EU air carriers against objectively defined practices considered as "unfair" and "discriminatory"⁹⁴, namely subsidisation and unfair pricing practices causing injury to EU carriers in the supply of air services to and from third countries. The Regulation was adopted as a response to EU airlines concerns about unfair pricing practices by US carriers on the transatlantic market following the events of 11 September 2001. The US government granted its airlines 5 billion US dollars in direct grants and additional 10 billion US dollars in loan guarantees to compensate for the 4-day US airspace closure. The government financial support enabled US airlines to immediately undercut the ticket prices on the EU-US routes, seriously distorting competition and bringing harm to EU carriers. This is the main reason why the focus of Regulation 868/2004 was put on subsidies and unfair pricing practices, the other being the lack of practical examples of EU legislation aimed at competition protection for a specific service sector at the time (with the exception of Council Regulation (EEC) 4057/86 for maritime transport which, in any case, was also modelled on tools used in anti-dumping for goods). The US regulatory approach was difficult to transpose into the EU legal order, as the IATFCPA comprises vague definitions in particular as regards its scope and grants extensive discretionary powers to the US Secretary of Transportation, all of which would be difficult to reconcile with EU standards of legal certainty.

Regulation 868/2004 allows the Commission to take redressive measures to compensate for either subsidies to non-EU air carrier, or unfair pricing practices by a non-EU air carrier, which cause or threaten to cause severe injury to the Community industry. The implementation of the mentioned measures requires proof of three combined substantive conditions, namely: i) the existence of subsidies or unfair pricing practices; ii) the existence of a serious injury to the Community industry; and iii) a causal link between the subsidies or unfair pricing practices and the injury suffered. However, during more than 10 years since its adoption, the Regulation has never been used, as no complaint was formally lodged by EU air carriers in spite of many informal accusations and complaints from the EU industry about the unfair practices allegedly adopted by third countries and third country entities.

According to the potential beneficiaries of the Regulation (i.e. EU carriers and labour associations), the main reasons why the Regulation has proven ineffective is the very fact that it was conceptually **modelled on tools used in anti-dumping for goods** and is therefore not properly adapted to the specificities of the air transport sector. This results in a number of legal and practical problems.

⁹⁴

Regulation (EC) No 868/2004, recital 1.

Firstly, the Regulation uses the **concepts and definitions** drawn directly from the legal instruments **used for defence of trade in goods**. More specifically, the notion of unfair pricing practices relies fundamentally on concepts equally underlying EU anti-dumping. Another source of inspiration of Regulation 868/2004 has been Council Regulation (EEC) 4057/86 which played a pioneering role in extending concepts traditionally reserved for goods into the field of services. This approach, however, proves to be entirely impractical for the specific service industry such as air transport sector which has a network character (an air service may comprise number of different connections in different configurations⁹⁵) and complex and dynamic pricing system.

The main problem stemming from the use of trade in goods approach to air service sector is the difficulty of **determining the existence of unfair pricing practices**. The Regulation requires proof that third country airline's fares are offered sufficiently below levels of EU carriers and lays down several elements to be taken into consideration while comparing airfares⁹⁶. The provision seems to ignore the fact that, unlike other industries, air transport is characterised by extremely complex and dynamic pricing systems. The ticket prices offered for sale by airlines are heavily dependent on many factors and conditions, such as date of journey, advance purchase or ticket elasticity. Airlines attach different restrictions and conditions to their fares and apply different price categories for a typical aircraft flight. Price levels are modified rapidly and frequently in function of demand and competitors' behaviour. In order to calculate the route costs of third-country airline(s), EU carrier(s) would then require access to very detailed information about finances and nature of its competitor(s) operations, as simple assessment of publicly available price levels of different air carriers is not sufficient to argue the existence of unfair practices. The lack of official complaints under the Regulation suggests that it is extremely difficult if not impossible to identify and prove unfair pricing practices in the aviation sector. Hence, there are significant indications that the anti-dumping approach does not deliver adequate results in the field of air services.

One of the prime examples of the inadequacy of the trade defence approach resides in the "like air service" concept. The Regulation defines 'like air service" as services supplied on the same route(s) or route(s) closely resembling the route(s) on which the air service under consideration is supplied. This definition was clearly modelled on anti-dumping legislation's concept of "like product" but does not take into account much more complex network character of international air transport services and does not offer any meaningful criteria to define the actual service offered by an airline. It is unclear which air services should be perceived as comparable. For example, a point-to-point Frankfurt-Beijing (FRA-PEK) connection may (depending on the transfer time) directly compete with a hub-and-spoke operation Frankfurt – Dubai – Beijing (FRA-DXB-PEK). In another example, two routes may both originate in the same city but at different airports e.g. Paris Charles de Gaulle airport (CDG) and Paris Orly (ORY). The Regulation does not specify if such routes could be understood as the "same" or "closely resembling" which makes it difficult if not impossible to apply the Regulation to air services.

⁹⁵ Air transport network structure is complex and may include point-to-point, hub-and-spoke or multi-hub connections (or mix of all of these).

⁹⁶ These elements include i) the actual price at which tickets are offered, ii) the number of seats proposed at an allegedly unfair price, iii) the restrictions and conditions attached to the ticket sold at an allegedly unfair price, iv) the level of service proposed by all carriers providing the like air service in question and v) the actual cost of the third country carrier providing the services, plus a reasonable margin of profit.

Many stakeholders also suggest that the Regulation has never been put to use because of the **narrow scope** of unfair practices addressed. Apart from the market-distorting subsidies, the Regulation makes reference only to the unfair pricing practices which, as explained above, would be very difficult, if not impossible, to tackle. According to the Regulation, unfair pricing practices should be restricted to the cases where an air carrier is benefiting from a non-commercial advantage, which logically covers advantages other than subsidies. This term is not further defined and the question arises whether it covers all possible market distorting practices, for example, discrimination in terms of access to infrastructure, slots, ground-handling services, sales or sponsoring opportunities.

Last but not least, the **redressive measures**, laid down by the Regulation are considered inappropriate for the needs of an effective air transport defence mechanism. Remedies other than “duties” are only referred to implicitly, without even any precise indication of their scope and objective. In conclusion, the regime regarding the measures available under the Regulation is not satisfactory. Therefore, it is unlikely that airlines will rely on the Regulation, if it yields no tangible benefits.

The continued allegations of unfair practices indicate a possible threat to the competitiveness of the EU aviation sector and in particular EU airlines internationally. As there is currently no external legal framework to address unfair practices in international aviation and the Regulation has proven complex and impracticable, more appropriate and effective instruments would need to be developed to safeguard fair and open competition in the EU's external aviation relations.

2.2. Underlying drivers of the problem

This section below presents the main drivers behind the problem of alleged unfair practices in international aviation. First, it explains why the current international legal framework does not provide for effective protection against unfair practices by third countries and third country entities. Secondly, the section draws attention to the problem of transparency between parties and access to the relevant data and information. These underlying problem drivers are complementary and together contribute to the main problem of regulatory failure leading to a discrepancy between the EU's fundamental goal of fair and undistorted competition in international aviation and disposing of the means to achieve it effectively.

2.2.1. Lack of proper mechanism for protection of fair competition in international aviation

At present, unfair practices and discrimination⁹⁷ in international air transport are not covered by any binding multilateral rules and are not properly addressed by the vast majority of bilateral ASAs. This regulatory gap is recognised by a reasonable proportion of public consultation respondents who believe that bilateral ASAs (60% of respondents) and ICAO (55% of respondents) currently fail to secure fair competition and do not protect EU carriers against unfair practices in the international context. More than half of respondents additionally agreed that the lack of protection is caused by the inefficiencies or non-existence of fair competition clauses in bilateral ASAs (explained in section 2.2.1.3).

⁹⁷

Article 15 of the Chicago Convention stipulates non-discrimination in relation to airport charges, air navigation charges and similar charges.

The lack of effective mechanisms for protection of fair competition in international aviation is noted by the EU institutions, as well. In the 2015 Aviation Strategy, the Commission points that 'there is today no international legal framework to deal with the issue of unfair competition in a global aviation market that would provide for regulatory instruments to tackle this type of practices'⁹⁸. The 2012 Commission's Communication on "The EU's External Aviation Policy" remarks that 'to avoid market distortion and prevent a race to the bottom (...) changes are needed within the global context of aviation'⁹⁹.

In its resolution of 2 July 2013 on the EU's External Aviation Policy¹⁰⁰, the Parliament considered 'that bilateral air service agreements are not always the most appropriate solution to combat market restrictions or unfair subsidies', and that 'a comprehensive EU external aviation policy has not been achieved despite the efforts made over recent years'.

2.2.1.1. Non-existence of international global trade agreements applicable to the international air transport services sector

The World Trade Organization (WTO) provides a quasi-universal international legal framework for trade relations between its Members. It covers trade in goods, services and trade related aspects of intellectual property. Trade in services is regulated by the General Agreement on Trade in Services (GATS) which took effect in 1995 and is incorporated as one of the Annexes to the Agreement Establishing the WTO. Three cornerstones of GATS are the Market Access, Most Favoured Nation (MFN) principle and National Treatment (NT) principle. Under the Market Access rule, WTO Members are prohibited from adopting specific measures contributing to limitations on the market access of foreign services and service suppliers. Under the MFN rule, the rights granted to services and service suppliers of one trading partner are automatically and unconditionally granted to like services and service suppliers of any other trading partner subscribing the GATS¹⁰¹. The National Treatment (NT) principle ensures that foreign services and service suppliers of any other GATS Member do not receive treatment less favourable than domestic services and service suppliers¹⁰².

Air services are governed by a specific Annex of GATS, the Annex on Air Transport Services. The Annex excludes from its scope the largest part of air transport services, namely traffic rights and services directly related to the exercise of traffic rights. The only reference to air transport in GATS Annex on Air Transport Services states that the Agreement, including its dispute settlement procedures, shall not apply to measures affecting traffic rights, however granted; or services directly related to the exercise of traffic rights, with exemption for three ancillary services:

- aircraft repair and maintenance services;
- the selling and marketing of air transport services;
- computer reservation system (CRS) services.

⁹⁸ Commission Communication "An Aviation Strategy for Europe".

⁹⁹ Commission Communication "The EU's External Aviation Policy - Addressing Future Challenges"

¹⁰⁰ European Parliament resolution of 2 July 2013 on the EU's External Aviation Policy – Addressing future challenges (2012/2299(INI)).

¹⁰¹ See Article II (1) of the GATS.

¹⁰² See Article XVII of the GATS.

Consequently, the current WTO/GATS framework does not provide for any dispute settlement procedures to address concerns of unfair practices in international air transport. Moreover, contrary to trade in goods, there are no specific¹⁰³ WTO disciplines dealing with subsidies for services.

The exemption of core air transport services from multilateral regime stems from the fact that, unlike other service industries, historically international air transport has been mainly regulated through bilateral inter-governmental agreements granting market access on a reciprocal *quid pro quo* basis. The bilateral reciprocity in the broad network of existing bilateral aviation agreements made the application of GATS MFN principle almost impossible to the aviation sector, as it would have required extending to all WTO members the best treatment a country grants to any other country with respect to air services. In the present international aviation this could lead to the problem of “free riders” countries who could avail themselves of the most liberal concessions whilst keeping their own markets closed, as the most liberal countries could not use the concessions made as a bargaining chip to obtain reciprocal treatment. Similar difficulties could be found, although to a lesser extent, with the National Treatment principle¹⁰⁴.

2.2.1.2. ICAO rules do not currently address the issue of fair competition in the international air transport sector

Signed in 1944, the Convention on International Civil Aviation (the 'Chicago Convention') is the most important primary source of public international aviation law. It is binding upon its signatory states, which have pledged not to enter into any obligations or understandings that are inconsistent with the terms of the Convention.

In contrast to the matters of safety, security and air traffic management, the Chicago Convention does not confer a clear mandate for ICAO to act in the area of economic matters. According to Article 6 of Chicago Convention, the principle of national sovereignty governs the area of market access. In essence, this Article provides that all commercial international air passenger transport services are forbidden except to the extent that they are permitted (through ASAs). Factually, ICAO's activity in economic regulation of scheduled airline services is essentially limited to providing advisory assistance to the States that are its members who regulate the market through bilateral ASAs. ICAO rules currently do not provide for an international fair competition regime in air transport.

The idea that ICAO could play a formal role in economic regulation has been discussed for decades, but so far without resulting in adoption of either Standards or Recommended Practices¹⁰⁵ (SARPS) in areas such as fair competition. ICAO as an inter-governmental

¹⁰³ There exists no SCM Agreement for services indeed. However, the non-discrimination provisions in the GATS (MFN and NT) do apply to subsidies granted to service suppliers (contrary to the GATT).

¹⁰⁴ Unlike the MFN treatment principle, which applies across the board, the NT principle applies only to the sectors singled out by the WTO Members. Moreover, NT is subject to the WTO Members' conditions and qualifications, which often reflect existing restrictions in national legislation, such as ownership and control limitations.

¹⁰⁵ Standards and Recommended Practices (SARP) are technical rules which must be applied by all States that are members of ICAO in order to achieve consistency throughout the world. SARP are published in Annexes to the Convention on International Civil Aviation (Chicago Convention). Standards are any specification, the uniform application of which is recognized as necessary for reasons of safety or regularity of international air navigation (their application by all Member States is mandatory).

organisation has difficulties in achieving compromise solutions on sensitive issues in the absence of a consensus among all its members. In addition, States have widely differing views on economic matters, and some of them are strongly opposed to any increased role for ICAO in economic regulation. Notwithstanding these differences, there is broad agreement among ICAO members that fair competition is an important general principle in the operation of international air services and a number of States supported work by ICAO to establish core principles on fair competition, both to provide a clearer understanding and to indicate appropriate measures to address problems.

Despite the limited activity of ICAO in economic regulation of international air services, the fair competition principle has been accompanying the organisation from its very beginning. Already in the Preamble to the Chicago Convention there is a reference stipulating that "international air transport services may be established on the basis of equality of opportunity". Consistent with the Chicago Convention, the bilateral air services agreements that were negotiated between nations often refer to "fair and equal opportunities to compete" or use similar expression¹⁰⁶.

As in most intergovernmental organisations the decisions in ICAO are generally taken by consensus. Therefore, if a number of ICAO Member States do not perceive fair competition principles to be in their national interests, they can effectively impede real progress in the development of an international regulatory regime including fair competition rules. Until recently, the references to fair competition in ICAO documents have been limited mostly to the Policy and Guidance Material on the Economic Regulation of International Air Transport (Doc 9587¹⁰⁷), as well as model clauses on competition available in the Template Air Service Agreements and Doc 9626¹⁰⁸, which also describes the effects of public subsidies and other means of public support. These documents are non-binding guidance materials laid down to help the countries deal with these issues.

In recent years, the problem of subsidies and unfair practices in aviation has gained prominence at international level. The ICAO Assembly A/38 which took place in September and October 2013 recognised the importance of fair competition and agreed that: "fair competition is an important general principle in the operation of international air services" and that "ICAO should play a leadership role in identifying and developing tools to promote dialogue and the exchange of information among interested authorities with the goal of fostering more compatible regulatory approaches".

Moreover, in May 2014 the ICAO Air Transport Regulation Panel recommended for consideration by ICAO governing bodies and its Member States the text of a long-term vision for international air transport liberalisation:

Recommended practice is a specification the uniform application of which is recognized as desirable (not mandatory).

¹⁰⁶ In practice, however, governments were hardly willing to allow their carriers to really compete. Rather, they seemed to give more weight to objectives of stability (i.e., preventing service failures and destructive competition) than they were on actually providing equality of opportunity. What governments appeared to seek for their respective flag carrier(s) was an "equitable" split of a pool of revenues that were based on controlled (and high – above marginal cost) fares to achieve sound and economic operations. Routes and capacity were typically divided among carriers in such a manner as to ensure each carrier could operate profitably.

¹⁰⁷ http://www.icao.int/sustainability/Documents/Doc9587_en.pdf

¹⁰⁸ http://www.icao.int/sustainability/Documents/Doc9626_en.pdf

"We, the Member States of the International Civil Aviation Organization, resolve to actively pursue the continuous liberalisation of international air transport to the benefit of all stakeholders and the economy at large. We will be guided by the need to ensure respect for the highest levels of safety and security and the principle of fair and equal opportunity for all States and their stakeholders".

Although the text did not use directly the word "fair competition", it addressed the principle of "fair and equal opportunity". Another important outcome of the Panel was the establishment of a working group on competition matters.

The question of competition in international aviation was also discussed during the ICAO International Air Transport Symposium on 30 and 31 March 2016 which was followed by a meeting on 1 and 2 April of the working group set up by the Air Transport Regulation Panel. The theme of the symposium was "Addressing competition issues: towards a better operating environment". Panels dealt with issues such as comparison of competition regimes applied to air transport, the role of government in liberalised air transport, connectivity and competitiveness in a liberalised market; and the role of aviation-specific safeguards. The symposium noted a positive trend of growing number of jurisdictions which apply competition rules to air transport (even though a number of States have aviation-specific safeguards in place). Nevertheless, the meeting revealed divergent views among attendees over the issue of competition, the role it can play in international aviation and the approaches that should be taken to address competition issues such as abuses of a dominant position or the granting of state aid. Most fundamentally, the symposium illustrated the fact that for many states, competition problems are secondary as compared to the problem of connectivity and market access.

In conclusion of the symposium, the Secretary-General of ICAO highlighted the need to continue to pursue liberalisation while making effort to understand better the different competition rules around the world. Since there was prevailing scepticism expressed over the likelihood of an international framework for rules on fair competition emerging, the Secretary-General stressed the role of regulatory cooperation as a first step in a long process towards regulatory convergence on competition matters, considered the end goal.

Even though the declarations and decisions presented above are important steps to enhance the exchange of information, cooperation and dialogue on issues concerning fair competition, they still fail to effectively address these issues on the global scale. Since the establishment of ICAO, some ICAO Member States have been reluctant to pursue a far reaching policy on economic regulation in general and fair competition in particular, and without consensus among Member States any changes in ICAO policies will not be possible. Hence, in spite of various efforts by some states to address fair competition issues at ICAO level, for the time being, the current international regime remains ineffective in assuring fair and undistorted competition on the international air transport market.

2.2.1.3. Bilateral Air Service Agreements between EU Member States and third countries do not effectively guarantee protection for EU air carriers against unfair practices

ASAs are international agreements regulating economic rights under which airlines may operate between signatory countries. Together with associated memoranda of understanding, agreed records etc. they usually cover traffic rights, origin and intermediate points, capacity,

frequency, the number of designated airlines and other commercial arrangements such as pricing mechanism principles.

As mentioned above, ASAs normally fail to address competition related issues in general, and fair competition in particular. The most commonly used “fair and equal opportunity to operate/compete” clause is not capable of properly addressing possible unfair practices. First of all, these clauses are in general vaguely drafted and subject to very different interpretations, and ICAO has been unable, so far, to develop commonly accepted guidance. For example, “fair and equal opportunity” may be interpreted by some states as meaning unrestricted competition by the airlines of the parties with no government control of capacity and prices, while other states may argue that the airlines of the two sides should have an equal share of the market. Moreover, if any dispute arises regarding the alleged distortion of competition, it is limited to consultations between the parties to the relevant ASA. In practice, this kind of disputes are usually raised to a political level or not settled for a long period thus creating tensions and hindering the development of air services.

As explained earlier, the liberalisation of the EU internal air transport market did not cover the extra-European market dimension. Only the so-called “open skies” judgments of 5 November 2002¹⁰⁹ of the Court of Justice of the European Union triggered the development of a genuine EU external aviation policy. These "open skies" judgments implied the need to bring existing ASAs between EU Member States and third countries in line with EU law. In order to do so, in 2004 Member States together with the European Commission developed standard clauses for inclusion in ASAs between Member States and third countries in accordance with Article 1(1) of Regulation (EC) No 847/2004¹¹⁰. EU standard clauses cover the following issues:

- designation and revocation ("EU air carrier designation");
- references to nationals or air carriers of a Member State;
- groundhandling

Following up on the progress, in 2012 in its Communication on the EU's external aviation policy, the Commission proposed: "... to develop – most appropriately at EU level – standard "fair competition clauses" to be agreed and included in the respective bilateral air services agreements with EU Member States". The template fair competition clause was adopted in November 2013. It lays down some basic principles to follow to ensure fair competition; a consultation mechanism; and, as a last resort, safeguard measures ("actions") in case the partner country does not engage in consultation or is not willing to make remedies to restore fair competition. However, unlike standard clauses required for compliance with EU law, the fair competition clause is not mandatory, and it is up to Member States to consider how to use it when negotiating with third countries. In many ways, making the fair competition clause mandatory does not appear to be a credible possibility, and may on the contrary trigger reluctance from third countries to engage into negotiations with EU Member States.

¹⁰⁹ http://ec.europa.eu/transport/modes/air/international_aviation/external_aviation_policy/index_en.htm

¹¹⁰ Regulation (EC) No 847/2004 of the European Parliament and of the Council of 29 April 2004 on the negotiation and implementation of air service agreements between Member States and third countries (OJ L 157, 30.4.2004, p. 7–17).

It should be added that some Member States have already pursued to include fair competition clauses in their bilateral ASAs with third countries. However, for the time being, there is a very limited number of ASAs that have been amended to include such clauses, mainly due to reluctance among third countries to subscribe to them. More success has been achieved through EU level negotiations which introduced fair competition clauses in the EU comprehensive aviation agreements with the US, Canada, Israel, Jordan, Morocco, Moldova and Georgia as well as the initialled agreement with Brazil. It should be also stressed, though, that fair competition is addressed in different ways in the above-mentioned agreements, as a consequence of a compromise necessary to conclude the agreements.

2.2.1.4. Lack of access to information about the support received and financial accounts of third countries air carriers

In order to secure the proper functioning of the intra-European market the EU developed appropriate transparency measures. In fact, the EU single market is framed by a comprehensive set of financial oversight rules and functions. For example, competent EU or national bodies are authorised to demand and obtain access to the relevant information in case of an investigation of alleged anti-competitive practices or State aid. Moreover, Regulation (EC) No 1008/2008 on “common rules for the operation of air services in the Union” has established a common air carrier licensing system based on non-discriminatory and transparent licensing conditions. Without such an operating licence undertakings are not allowed to operate on the European market. An undertaking that applies for or holds operating license must meet certain strict requirements, *inter alia* on financial fitness. For the purpose of verification of its financial fitness each undertaking is obliged to provide the relevant information. The competent licensing authority is responsible for close monitoring of the compliance of an air carrier with the requirements underlying the operating license. If an EU carrier breaches its obligation to submit the relevant information the Regulation provides enforcement measures. The competent licensing authority is obliged to suspend or revoke the operating license if the Union air carrier knowingly or recklessly furnishes the competent licensing authority with false information. It is entitled to do so if the audited accounts are not communicated in a due time. It should be noted that the financial fitness verification mentioned does not constitute a check on subsidisation, and nor does it entail publication of the information obtained.

The US and other countries, such as Australia and New Zealand, use economic licence requirements for foreign air carriers wishing to operate to/from their respective territories. The authorisation may require, among others, compliance with: nationality requirements; financial fitness criteria; ‘relevant’ national laws and regulations, and the ‘public interest. Subsequently, the permit may be granted, or refused, or made subject to conditions as formulated by the competent civil aviation authority.

At the same time, the availability of information and data from third country airlines is limited. At EU level no such information requirements for third country airlines exist. Similarly, there is no adequate mechanism to obtain the information required from parties other than airlines.

The financial licencing of third country carriers is not part of bilateral/EU-level air service agreements, either. The standard provisions on operating authorisations included in ASAs oblige the competent authorities of EU Member States to grant appropriate authorisations with minimum procedural delay, on the basis of operating licence received in accordance with national law of the Signatory state. The only condition for granting the operating authorisation

is in fact the ownership and effective control of third country carrier by the Signatory third country¹¹¹.

A significant part of EU industry perceives the lack of access to information as an important obstacle to effectively addressing unfair practices by third countries and third country entities. The industry stakeholders, who responded to the public consultation, stress the lack of transparency of the financing arrangements of foreign carriers and airports and point that whereby foreign carriers are granted access to the EU market, the EU does not impose any obligation on them to provide transparency on financing arrangements. In this context, the respondents complain that under Regulation 868/2004, the burden of proof regarding the unfair practice and the injury lays with the injured EU airline itself. However, European airlines often find it difficult to establish any proof of unfair practice due to the lack of mechanisms allowing them to obtain the necessary information. Possible unfair practices as stipulated by Regulation 868/2004 can therefore not be appropriately identified and dealt with as essential information necessary for the investigation is lacking.

Therefore, the stakeholders suggest that the revised legal framework should facilitate access to financial data of third parties in order to gather sufficient evidence of unfair practices by third country airlines, subsidies provided by third countries to airlines and consequential damage caused to the EU aviation industry and the causal link between a price and the damage.

2.3. Does the EU have the right to act? Legal basis and subsidiarity

As it was the case for adopting the current Regulation 868/2004, the legal basis of any new initiative is Article 100(2) of the Treaty on the functioning of the European Union.

Compatibility with the principle of subsidiarity was recognised in the 26th recital of Regulation (EC) No 868/2004, insofar as it concerned the terms of that Regulation.

As explained in the previous sections, in international aviation the balance between competition in the market and regulatory framework for competition is determined between countries through air service agreements which have the legal quality of national laws and are adopted by national Parliaments. Bilateral ASAs traditionally focus on opening market access opportunities to competition, but do normally not harmonize the regulatory framework that should ensure that competition is not distorted, as these are understood to be essentially national policy issues. Market access issues covered in ASAs address primarily designation of the carrier, destinations, and points served, as well as capacity limitations, but in most cases not the conditions for competition.

The liberalisation by way of Open Skies Agreements, such as those concluded by the United States of America form the 1990s, or EU legislation in form of the Third Package (1992)¹¹², abandoned route specific limitations. As far as relations with third countries are concerned, the liberalisation of traffic rights was hardly followed by any harmonisation of regulatory frameworks that should ensure that the competition between and/or in the signatory countries

¹¹¹ A standard authorisation article requires that: an air carrier has its principal place of business in signatory country; effective regulatory control is exercised and maintained by the signatory country; and that the air carrier is owned, directly or by majority participation, and effectively controlled by the signatory country or its nationals.

¹¹² Notably Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers (OJ L 240, 24.8.1992, p. 1–7) and Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes (OJ L 240, 24.8.1992, p. 8–14).

is not distorted. Most of the bilateral ASAs between the individual Member States and non-EU countries today still do not contain provisions with regard to fair competition, unfair trade practices and illegal state aids. Even though, the EU countries whose air carriers face problems with alleged unfair competition could, theoretically, limit the allocation of traffic rights to the airlines of unfair competitor, in practice, this would mean the similar limitations to their own airlines on the basis of reciprocity. This is best exemplified by the high number of liberal bilateral agreements (granting unlimited traffic rights) concluded by 23 EU Member States with Gulf countries.

As far as international negotiations and, more generally, interventions in international fora are concerned, it is clear that collectively, the EU has much greater leverage in pursuing and defending EU aviation interests than Member States individually in their relations with third countries. Comprehensive international air service agreements negotiated by the Commission based upon a Council mandate, while opening third country markets, are usually also achieving a higher levels of regulatory convergence. The relative political and economic weight of the EU makes the negotiating partners keener on, either directly transposing EU competition rules to their national legislative framework, or including fair competition clauses which prohibit unjustified state aid and other forms of anti-competitive practices and offer dispute settlements mechanisms and safeguard measures.

The leverage of individual EU Member States within ICAO is also considered insufficient to effectively make a difference with regard to the promotion of fair competition in multilateral international fora. Even if not formally a member of ICAO, it is the EU as a whole, that offers a viable example of market liberalisation and parallel fair competition framework that could serve as potential model for future multilateral regime. As for the WTO, the EU as single customs union with a single trade policy and tariff has been (next to 28 MS) the official member since 1 January 1995 and the European Commission represents all EU member States at almost all WTO meetings.

Since the objectives sought could not be achieved without action at EU level, such action is necessary to this effect and, by definition, adds value.

3. OBJECTIVES

The objectives of this initiative and the link with the identified problems are presented below.

Table 1 – Objectives and the linkage to problem drivers identified

Main Problem	General objective
Concerns about unfair practices by third countries and third country entities negatively affecting EU carriers continue to exist	Ensure a fair level playing field between European and third country air carriers by effectively protecting European air carriers from unfair practices by third countries and third country entities
Problem driver 1 Absence of adequate and effective mechanisms to safeguard fair competition in a context of increasing liberalisation of international aviation market	Specific objective 1 Provide effective defence and redress measures against possible unfair practices by third countries and third country entities
Problem driver 2	Specific objective 2

Lack of transparency and information about the support received and financial accounts of third countries air carriers	Ensure access to relevant data and information from third country parties
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These objectives are also in line with the following political priorities of the Commission for the period 2014-2019: 1) more jobs, growth and investments, 2) a fairer and deeper internal market with a strengthened industrial base, 3) the EU as a global actor.

3.1. Policy options

The stakeholder consultation, independent research and own analysis have allowed identification of a set of policy options having the potential to address the problem drivers identified in section 2. The baseline scenario presents the problem evolution and expected impacts in case where no changes are introduced.

Furthermore, one policy option will not be further considered in this document, since it is very unlikely to be preferred, for the reasons explained in section 3.3.

3.2. Baseline scenario (how would the problem evolve, all things being equal)

If no action is to be taken the most probable scenario for EU air carriers is the continuation or even aggravation of the current situation. Namely, to the extent unfair practices exist, some EU airlines will continue to suffer from absence of effective instruments to address them in the global market. Moreover, the negative impact on some European airlines not having at their disposal an effective instrument for addressing alleged unfair practices will most probably magnify, as global competition in international air transport is expected to intensify in the coming years (see section 2.1.2) and possible concerns about alleged unfair practices may arise in relation to different third country governments and third country entities¹¹³.

As described in section 1.3, the **international air traffic growth** of around 5% annually is expected until 2030. The Airbus forecast¹¹⁴ estimates this average annual growth rate at 4.6% and predicts that over the next 20 years Europe will record second lowest yearly traffic growth (+3.6%) in the world. The highest average annual growth will be at the same time realised by the Middle East (+6.0%) followed by Asia-Pacific region (+5.6%). Similar trends are expected by Eurocontrol¹¹⁵ which predicts that "in terms of air traffic growth, Europe will be in the slow lane, with the Middle East and China (Asia/Pacific) growing much more rapidly". Eurocontrol forecast until 2035 presents even more alarming estimations for European growth. In its 'most-likely' scenario, it is estimated that there will be 14.4 million flights in Europe in 2035 (1.5 times the 2012 volume) which translates into an average increase of merely 1.8% per year.

¹¹³ The below figures presenting expected market developments do not suggest that these developments are result of alleged unfair practices. These figures are simply showing expected market developments in general, taking account of various factors that may influence these (e.g. shift of economic growth; geographical position of certain countries).

¹¹⁴ Airbus Global Market Forecast, Flying by Numbers 2015-2034.

¹¹⁵ Eurocontrol, Challenges of Growth 2013, Summary Report, <http://www.eurocontrol.int/sites/default/files/content/documents/official-documents/reports/201307-challenges-of-growth-summary-report.pdf>

Under the baseline scenario, the anaemic growth of European aviation in the 20-year perspective will most likely translate into further decrease in **global market share**. Airbus forecasts that while the European's market share will drop by 5 percentage points between 2013 and 2033, the Middle-Eastern carriers and airlines from Asia-Pacific region will increase their market participation by 5 and 6 percentage points respectively. Boeing forecasts that the share of European traffic will drop from 34% in 2013 to 29% in 2033. At the same time the share of Middle Eastern traffic (including intra-Middle-Eastern operations) is predicted to increase by 2 percentage points from 10% in 2013 to 12% in 2033. Unsurprisingly, Asia-Pacific is expected to become the largest market by 2034, responsible for 40% of the world air traffic measured in revenue passenger-kilometres (RPKs).

As in case of the whole market the baseline scenario predicts the decline in major **extra-European direct traffic flows**. Traffic between Europe and North America is expected to lose its global share from 7% in 2013 to 5% in 2033. At the same time, the share of the air traffic flows between Europe and the Asia-Pacific is only expected to be maintained at the same level. Meanwhile, traffic to and from today's emerging markets is expected to grow much more strongly both in terms of actual traffic and its share. In 2034, more than 70% of the traffic is expected on routes from, to and between emerging regions. Most noticeably, the flow between Middle East and Asia is expected to increase its global market share by half over the forthcoming 20 years. This market share growth is expected to be realised to the disadvantage of Europe and North America, which Airbus expects to account for a combined share of 37% in 2033 (vs. 48% in 2014 and over 60% at the beginning of the century).

If all things stay equal, the future position of **EU airports** is expected to be difficult as well. In Eurocontrol most-likely scenario EU airports will lose around 1.9 million flights amounting approximately 12% of demand in 2035 due to congestion, noise restrictions and resulting higher costs. It is estimated that this would amount to some 120 million passengers unable to make their there-and-back trip. The economic cost of not being able to accommodate future demand for travel in the EU is estimated at between 400,000 and 800,000 fewer jobs by 2035 and an annual contribution to EU GDP lower by €28 billion to €52 billion¹¹⁶.

Under the baseline scenario the **orders of new aircrafts** will most likely continue to grow at strong pace. According to Airbus, total new deliveries between 2015 and 2034, are expected to be close to 32,600 aircrafts. Most deliveries are forecast for Asia-Pacific with 39% of the demand, or nearly 12,600 aircraft. North America and Europe, more mature markets, will still require 11,900 aircraft equalling to 37% of total deliveries (Europe: 20%, N. America: 17%) to meet their airlines' needs. Only 7% of world deliveries are predicted for the Middle East region.

¹¹⁶ Upon request of the Commission, the issue of the economic cost of not being able to accommodate future demand for travel at EU-28 level was addressed by the Airport Observatory. Although there is no 'silver bullet' approach which completely and indisputably quantifies such cost, and considering that it was not possible for the Observatory to quantify the adverse impacts associated with airport related activities (noise), due to the lack of appropriate methodology at EU level, figures considering the foregone direct, indirect and induced benefits would be as follows (two different estimates¹⁷⁰): according to the Oxford Economics approach prepared for Air Transport Action Group (ATAG): a total of 818,000 fewer jobs by 2035 and an annual contribution to GDP lower by €52 billion; according to the InterVISTAS approach prepared for ACI Europe: a total of 434,000 fewer jobs by 2035 and an annual contribution to GDP lower by €28 billion.

The orders of new types of aircrafts, able to fly longer distances and carry more passengers, thereby making travel more efficient, will most likely continue to expand. Many airlines, in particular from the Middle East are expected to increasingly use larger aircraft¹¹⁷, suggesting that the latter region would continue to concentrate on long-haul hub flights (Middle Eastern carriers on average use the largest aircraft, with an average 208 seats per flight).

The expected **impacts of the above trends** on EU airlines, EU air sector employees, EU consumers and EU manufacturers of air equipment in the short and medium/long term is described under section 2.1.6. The analysis suggests that there is a need for appropriate and effective mechanisms to prevent or correct market distortions and imbalances which may arise from the unfair practices.

However, there are no indications that in the foreseeable future the General Agreement on Trade in Services (GATS) would be fully extended to international air transport and that subsidies disciplines will be developed for the service sectors. It is more probable that an appropriate and mandatory fair competition framework could be developed by ICAO, however, this could take some time since decisions are made by consensus and currently certain ICAO members oppose international provisions in the area of fair competition. Furthermore, ICAO decisions are not necessarily legally binding since they are often in the form of recommendations.

As mentioned under section 2.2.1.3, there is also no prospect for a rapid change in terms of including and enforcing fair competition provisions in bilateral Air Service Agreements. Currently, most ASAs concluded either at EU level or by the Member States individually with third states only include a basic commitment to “fair and equal” opportunity which does not provide legal means to act against unfair practices. More modern agreements, especially at EU level, do include expanded fair competition clauses, but there are only very few in existence with only a minimal impact. In addition, even where these may be introduced (mainly EU-wide ASAs), they may differ significantly depending on the dynamics of each individual negotiation.

In this context, it should be noted that under the framework of the Aviation Strategy, the Commission had recommended the issuance, by the Council, of an authorisation to open negotiations on comprehensive air transport agreements with inter alia the States of the Gulf Cooperation Council (GCC)¹¹⁸, Association of Southeast Asian Nations (ASEAN)¹¹⁹ and Turkey. Such approval was granted by the Council with respect to ASEAN, Qatar, the United Arab Emirates and Turkey on 7 June 2016. At this point it is very difficult to foresee the outcome of the negotiations, in particular given Parties' divergent views on the question of fair competition.

This does not mean that this aspect is unimportant. It only means that mechanisms that operate outside specific clauses in international agreements (currently Regulation (EC) No 868/2004) need to be available and effective.

¹¹⁷ Nevertheless it is generally expected that the biggest orders will still be realised for short and medium haul aircrafts (around 88% single-aisle and small twin-aisle aircrafts combined) worldwide in the next 20 years. The same share in Europe is 81%, in Asia-Pacific 86%, in North America 95% but in the Middle East only 61%.

¹¹⁸ Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates.

¹¹⁹ Indonesia, Malaysia, the Philippines, Singapore, Brunei, Cambodia, Laos, Myanmar, Vietnam, Thailand.

Lastly, with no action by the EU, it is also highly unlikely that the current Regulation will be used by EU stakeholders to pursue cases of (genuine) distortion arising from subsidies and unfair practices. In like manner, the simple repeal of the current Regulation without proposing alternative legislative tool is not expected to improve the situation of EU aviation stakeholders. Member States and the European airline industry have systematically requested the revision of the EU regulatory framework. As mentioned under section 1.4., the Commission, the Council and the Parliament all concluded that there is a need to develop more effective instruments to safeguard fair competition in EU external aviation relations. The simple repeal would contradict that approach and could indeed be interpreted as meaning that the EU institutions consider the issue of unfair practices as less significant. Such position would also be at odds with the results of the public consultation, according to which most European stakeholders are calling for a strengthened EU legislative framework for protection against unfair and discriminatory practices in international air transport.

3.3. Discarded policy options

Considering a wide range of approaches to address the alleged unfair practices that cause harm to EU air carriers in the international air transport markets, one policy option can be immediately discarded based on a preliminary analysis.

3.3.1. Improved functioning of the current Regulation (EC) No 868/2004 through a limited revision and the adoption of interpretative guidelines

The assumption of this option is that the objectives, core principles and structure of the current Regulation (EC) No 868/2004 have merit and only require revision and supplements to clarify its standards and improve its functioning. It is assumed that the main problems that impede the use of the Regulation reside in the fact that definitions and concepts it contains merely require further clarification / explanation, and the difficulty of complainants to gather the necessary information on alleged subsidies/unfair practices and their impact.

The objective of this option would then be to provide such clarifications / explanations in the interest of easier implementation of the Regulation, i.e. through a revision compounded by the adoption of Commission guidelines on the interpretation of the Regulation.

In order to facilitate the application of the Regulation a number of terms such as "like air services", "community industry", "unfair pricing practices", "non-commercial advantage" and "injury" would be reviewed for content and relevance and, if necessary, replaced or clarified through amendments to the Regulation. Wherever relevant, new definitions would be added to Article 3 (Definitions) of the Regulation. All key terms and concepts would be further explained in the guidelines, which would take account of their rationale and context, namely the air transport sector.

Procedural issues related to the filing of complaints and the conduct of investigations would be revised and, if required, simplified. Any necessary help in respect of interpretation would be provided in the guidelines. Through the clarifications they would provide, the guidelines would ease the initiation of proceedings, minimise the time of investigation, and make the investigation procedure as transparent as possible.

This option is not further considered in this document for the following reasons.

Firstly, such limited intervention would not address the essence of problem driver 1, namely that the Regulation is unfit for purpose because it is unadjusted to specificities and dynamics of international air transport. The fact that the Regulation is impracticable does not stem from the lack of legal clarity (or ambiguity) of its provisions. It results from the fact that the Regulation is largely inspired by anti-dumping rules for trade in goods without consideration for the specific nature of international air services, in particular its network character of the airline business and operations and dynamic revenue management mechanisms used by airlines¹²⁰. Hence, without significant changes to the material substance and logic of the Regulation, it is very unlikely that the current legislative tool would be able to impact market behaviour and re-establish a fair playing field. The EU air carriers would still be essentially deprived of an effective instrument that would provide for protection against possible unfair practices by third country governments and third country entities. This view is also supported by the majority¹²¹ of public consultation respondents who do not perceive a limited amendment of the Regulation as a viable option.

This applies apart from the implementation and compliance costs entailed by such an instrument.

3.4. Considered policy options

3.4.1. Policy option A: Baseline scenario

The baseline scenario is described in section 4.1. Under this option, the Regulation would remain unchanged which implies a high probability that it would not be applied also in the future.

As no changes would be made to the current internal framework applicable to the international air transport services sector as well as to external framework (in the short and medium terms), EU airlines would most probably continue to suffer from the lack of effective protection against unfair practices by non-EU countries and non-EU entities¹²².

3.4.2. Policy option B: Increased international efforts at WTO and ICAO level aimed at the adoption of a multilateral legal framework for fair competition in aviation and inclusion of expanded fair competition clauses in ASA ensuring protection for EU air carriers against unfair practices (non-regulatory option)

Option B equally implies that Regulation 868/2004 would remain unchanged, but assumes an intensification of the EU's efforts at international level aimed at ensuring protection for EU air carriers against unfair practices in international aviation. The EU would undertake parallel negotiations at multilateral fora (ICAO/WTO) and in relations with third countries and

¹²⁰ Revenue management is a process based on demand forecasting. These forecasted demand patterns define which ticket prices, when and under which conditions are offered to customers. The ticket prices offered for sale are heavily dependent on many factors and conditions, such as date of journey, advance purchase, number of days at destination or ticket elasticity. The complexity of fares' management is also aggravated by the practice of code-share agreements, interlines agreements or even consolidated fares between the airlines. This makes the airline fares hardly comparable.

¹²¹ 10 of 13 respondents who offered the opinion did not support a mere amendment of Regulation 868/2004.

¹²² Around 10% of the respondents to the online public consultation considers that Regulation 868/2004 should remain unchanged. Whereas 30% of the 20 respondents are neutral, 50%, including several EU airlines and trade unions, consider that it is necessary to bring changes to the Regulation to make it more effective.

country blocs (via negotiations of EU-level comprehensive air services agreements) to achieve a viable framework for fair competition in international air transport services without taking any legislative action.

At the multilateral level, the EU would promote the idea to cover subsidies and other unfair practices in air transport by binding multilateral regulation. The need to obtain efficient instruments to protect the European air transport sector against possible unfair practices and subsidies would be pursued at **WTO** or **ICAO** level. Given that ICAO is already working on a possible multilateral air services liberalisation agreement under the Aviation Transport Regulatory Panel (ATRP)¹²³ and that the application of WTO/GATS principles of NT and MFN to the existing web of ASAs will be almost impossible in practice, the EU would focus mainly in the work at ICAO.

The EU would increase its international activity within ICAO by actively supporting the ICAO role in modernising the existing framework governing the global aviation market, just as it does in other key areas such as safety and security. To that end, the EU would strongly advocate fostering the role reserved for ICAO in the area of economic regulation for the global aviation sector. In particular, the EU would continue to **promote the conclusion of a multilateral aviation agreement** that would include provisions on fair competition.

To that end, the EU would make efforts (in coordination with Member States) to reinforce cooperation with like-minded partners concerned about alleged unfair practices and therefore having similar interests in ensuring a fair competition on the international air transport markets. The cooperation would also go beyond the multilateral agreement and seek to achieve a degree of **coordination** in respect of **policies** conducted by the respective partners **against unfair practices**, i.e. their definition and implementation. One aim would be to promote a common regulatory approach at ICAO level. In this context, the EU would be actively engaged in exchange of information, cooperation and dialogue on issues concerning fair competition in recently established ICAO working group on competition matters.

In a final step, the EU would concentrate its efforts to **achieve a global understanding of 'fair competition'** in the context of ICAO which could allow for the formulation of ICAO recommended provisions on fair competition conditions. Ultimately, these actions could lead to the adoption of an international fair competition regime for the global aviation sector and new policy instruments within the ICAO framework¹²⁴.

At the same time the EU could actively **promote the developments of disciplines for subsidies for services** in the context of the GATS/WTO. Such disciplines already exist today for goods¹²⁵ and GATS Article XV recognised that under certain circumstances subsidies may have distortive effects in trade in services and provides that WTO members should enter into

¹²³ In March 2013 the Sixth Worldwide Air Transport Conference of the International Civil Aviation Organization (ICAO) mandated the ICAO Air Transport Regulation Panel (ATRP) to consider and develop multilateral international agreements in the liberalization of market access and in further liberalization of air cargo services, as well as develop an international agreement in the liberalization of air carrier ownership and control. This important endeavour is being undertaken by the Panel to foster a long-term vision for international air transport liberalization.

¹²⁴ Commission's Communication on "The EU's External Aviation Policy" calls for changes within the global aviation market and indicates that ICAO could play a leading role in that process by helping to further develop the economic regulatory framework, including in ensuring a worldwide framework for fair competition.

¹²⁵ WTO Agreement on Subsidies and Countervailing measures

negotiations with a view to developing the necessary multilateral disciplines to avoid such trade distortive effects. Work on this matter has already started in the WTO, but negotiations on this issue are not yet underway. These subsidies disciplines could potentially be applied to all services sectors, including aviation, and could complement well efforts done at ICAO.

Outside the framework of the WTO and Chicago Convention the EU would focus efforts on strengthening Member States' and EU-level air service agreements through negotiating the comprehensive fair competition clauses (see section 2.2.1.3). The enhanced ASAs with **comprehensive fair competition provisions** would contribute to a fairer competition regime for air transport services ensuring third Party's compliance with the principles of fair competition by explicitly prohibiting unfair practices and providing for efficient dispute settlement mechanisms and safeguard measures.

As mentioned in section 2.2.1.3, the main difficulty of the bilateral process resides in the lack of fair competition clauses in bilateral ASAs, and little prospect that this changes following renegotiations¹²⁶. That is why, under option B, priority would be given to the EU-level negotiations of comprehensive air service agreements. This would be in line with the Commission's stated view on EU external aviation policy according to which '**EU-level negotiations**' which are based on EU unity and authorised by the Council generally represent a more appropriate and effective way in pursuing the European interest. This approach should therefore be developed as the general practice with all major partners, rather than as an exception to the rule - as at present¹²⁷. Indeed, practice shows that the relative political and economic power of the EU combined with the interest of third countries in broader access to the European market (e.g. through additional traffic rights) provides the EU with more leverage to successfully include fair competition provisions in the aviation agreements. Another important advantage of EU-level negotiations is that one comprehensive ASA with a third country replaces a high number (up to 28) of MS-level bilateral agreements. This in turn could alleviate the problem of time-consuming renegotiation of around 2000 bilateral ASAs between EU MS and third countries (as explained under section 2.2.1.3). Thereby, a successful inclusion of fair competition clauses even in a few EU comprehensive agreements with strategic EU partners (representing the key markets for EU airlines) could potentially have significant impact on establishing more effective protection for EU carriers against unfair competition. Under option B, the EU would insist on the introduction of comprehensive fair competition clauses in all newly concluded EU-level ASAs.

The level of fair competition protection granted under the EU-level agreements will naturally depend on the negotiating partner and respectively EU leverage in negotiations. Whenever possible, the EU would pursue the ambitious goal of extending the principles of EU fair competition law regime to cross border air services through the **regulatory harmonisation** of third countries' competition rules with EU *acquis*. Negotiating partners would be encouraged to align their aviation policies and laws with those of the EU in return for access to the attractive EU internal market. The obligation to adopt the EU *acquis* has already been included in several agreements with EU neighbourhood countries. In this context, particularly consistent and coherent regimes are contained in the Euro-Mediterranean Aviation Agreements, which lay down detailed substantive provisions and procedures for fair

¹²⁶ Regulation (EC) No 847/2004 provides notably for a mechanism ensuring that ASAs between Member States and third countries are in line with EU law, specifically with freedom of establishment as guaranteed by the Treaties.

¹²⁷ Commission Communication "The EU's External Aviation Policy - Addressing Future Challenges".

competition and State subsidies. In the case of Morocco, competition between the EU and Morocco is basically governed by Chapter IV of the EC-Morocco Association Agreement which provides that the EU competition rules must be applied to the trade of goods and services between the parties. The EU-Morocco Aviation Agreement provides though for special rules in regard to State subsidies. State subsidies for airlines are nor forbidden *per se* but the Contracting Party must demonstrate that such subsidies are 'proportionate to the objective, transparent and designed to minimise their adverse effect to the carriers of the other Party'. The agreement between the EU and Swiss Confederation contains provisions that mirror EU competition law. For example, under Article 13 of this agreement contains, in respect of State aid, substantive provisions mirroring relevant parts of Article 107 TFEU.¹²⁸ Article 14, ensures mutual information, possibilities to make comments, as well as possibilities to discuss in the Joint Committee.¹²⁹.

In cases where harmonisation with EU rules is not an option, the EU would attempt to reach a **common understanding of fair competition principles** with negotiating Party through laying down specific references to practices considered as unfair and thus prohibited under the agreement. The EU-Canada Agreement is a useful example of such arrangement, as both Parties agree on how to deal with "conditions that [...] adversely affect a fair and competitive environment". In the Agreement both sides recognise that subsidies fall to be treated under those provisions and may give rise to consultations and, where they produce significant disadvantages or harm, to unilateral action by one party.

One of the most important weaknesses of many present air service agreements between EU MS and third parties is the lack of appropriate framework for consultation and settlement of potential disputes. Therefore, the EU would work on equipping ASAs with **enhanced consultation and arbitration mechanisms** to encourage pro-active regulatory coordination and facilitate the amicable dispute settlement whenever market distortions due to unfair practices occur. Such mechanisms should preferably involve Joint Committees (to be) set up under the respective agreements.

As explained in section 2.2.1.3, the standard bilateral agreements do not provide for any mechanisms allowing Member States or the EU to require financial information from third country carriers when those are applying for operating authorisation in the EU. That is why the EU would ensure that the harmonised (on an EU level) introduction of a 'fair competition' clause in ASAs would also include rules on **access to financial data** of undertakings or any other relevant information to ensure the proper implementation of the Agreement, as market access condition.

¹²⁸ In this respect, account must be taken of Article 1(2) of the Agreement, which contains the following provisions: *Insofar as they are identical in substance to corresponding rules of the EC Treaty and to acts adopted in application of that Treaty, those provisions shall, in their implementation and application, be interpreted in conformity with the relevant rulings and decisions of the Court of Justice and the Commission of the European Communities given prior to the date of signature of this Agreement. The rulings and decisions given after the date of signature of this Agreement shall be communicated to Switzerland. At the request of one of the Contracting Parties, the implications of such latter rulings and decisions shall be determined by the Joint Committee in view of ensuring the proper functioning of this Agreement.*

¹²⁹ Article 14 reads: *The Commission and the Swiss authorities shall keep under constant review [...] all systems of aid existing respectively in the EC Member States and in Switzerland. Each Contracting Party shall ensure that the other Contracting Party is informed of any procedure initiated to guarantee respect of the rules of [Article] 13 and, if necessary, may submit observations before any final decision is taken. Upon request by one Contracting Party, the Joint Committee shall discuss any appropriate measures required by the purpose and functioning of this Agreement.*

Lastly, the provisions on prohibited unfair practices and consultation mechanism under fair competition clauses would be linked to **safeguard clauses** that give Parties scope to act unilaterally without formally breaching the ASA. Such clauses, where they could be agreed, would give scope to condition traffic rights. As an example, under the EU-Israel Agreement, failure to reach agreement on an issue of subsidies raised by a Contracting party may lead to the withdrawal or the refusal or suspension of the operating authorisation of the subsidised carrier by the other Contracting party. Similarly, under EU-Canada Agreement on Air Transport the aggrieved Parties may take unilateral action that is "appropriate, proportionate and targeted at the entity benefiting from the positive conditions", if consultations within the Joint Committee fail to resolve the issue.

3.4.3. Policy option C: Major changes to the regime contained in Regulation 868/2004 which would be repealed and replaced by a new comprehensive and effective EU legal instrument (regulatory option)

Option C would **abandon the current approach based on a trade defence** instrument for goods and would resort to a better adapted approach, giving rise to a genuine sector specific instrument. The key elements of the new Regulation would address deficiencies identified under problem drivers and include *inter alia* better adapted scope, streamlined and more appropriate procedures and improvements as regards possible redressive measures, while maintaining strong investigative powers for the Commission.

As explained in section 2.1.8, the inadequacy of a trade defence approach to air transport sector is most clearly reflected in the contested scope of the practices addressed by the current Regulation. In particular, the concept of "unfair pricing practices", inspired by GATT rules on product dumping, is not suitable for the aviation sector characterised by complex pricing and revenue management mechanisms. For that reason, the new Regulation would **abandon the objective of addressing unfair pricing practices** in aviation and focus on action against subsidies which negatively affect EU competitors as one of the most common forms of alleged unfair practices distorting competition¹³⁰. As in other trade defence instruments, the new Regulation measures would only act against the subsidies which are proven to exist and cause injury to EU carriers.

The current **scope** of the Regulation is also disputed for being too limited to cover various types of potential market-distorting practices reported to bring injury or adverse effect to EU carriers (as described in section 2.1.8). This is why, in addition to subsidies, the Regulation would establish a right of action in respect of discrimination in favour of third country carriers from third countries as such or from third country entities. Discrimination would be considered relevant in respect of all inputs, in the widest sense, to air services, and the relevant rules would hence cover areas, such as air navigation or airport facilities and services, fuel, ground handling, security, computer reservation systems, slot allocation, charges, and the use of other facilities and services necessary for the operation of air services. It would encompass not only the supply of goods and services, but also relevant government decisions, be it in the operational or technical field. Such definition, albeit sufficiently precise, would be general in nature so as to cover practices of the kind, whether or not there have been earlier cases of the same category. Hence, any practice adopted by a foreign government or

¹³⁰ EU competition rules already provide for a mechanism that could tackle pricing practices that are considered to be incompatible with Articles 101 or 102 TFEU.

entity discriminating an EU carrier or EU carriers vis-à-vis non-EU competitors, and leading to injury on EU carrier(s) could open the possibility for a complaint and/or investigation.

The new Regulation would extend its scope to cases of **violation of applicable international obligations**. These "applicable international obligations" would be defined as obligations contained in an agreement to which the Union is a party, and which contain provisions relating to fair competition.

The new Regulation would also clearly specify the **eligibility for lodging a complaint** and the **information** that such a complaint should contain. With regard to the former, the new Regulation would provide standing for bringing a complaint to both individual EU carriers and associations of EU carriers. This would imply a relaxation of the entitlement to file a complaint, currently confined to the Union "industry" as defined in Article 3(b) of Regulation (EC) No 847/2004. Under the new Regulation, Member States would also have the right to file a complaint to the Commission against discriminatory practices or selective subsidies by a third country party. The Commission would also retain its right to initiate the investigation on its own initiative. This may be important in cases where the interests of some EU carriers in a third country might militate against their joining a specific complaint (e.g. threat of retaliation) and thus compromise the ability of other carriers to gain standing for a complaint.

Under the new Regulation, the complainant(s) would be required to present **prima facie evidence** that there is an unfair practice taking place and that EU companies or EU industry have been harmed or threatened by adverse effects linked to it. Should the Commission consider that the evidence provided is sufficient to justify initiating an investigation procedure and that it would be in the EU's interest do so, an official investigation would be launched. A complaint would be rejected where there is insufficient prima facie evidence of unfair practices and of adverse effects resulting therefrom or where the unfair practices alleged in the complaint neither raise (in the Commission's view) a systemic issue, nor have a significant impact on the Union air transport industry or Union air transport enterprises.

The problem of **lack of access to financial information** of third countries and third country entities would be improved through the investigation modalities. As in the Trade Barriers Regulation, the Commission would be allowed to seek all the necessary information it would deem necessary from all interested parties, as well as carry out investigations in the territory of third countries concerned upon notification and provided that no objections are raised within a reasonable time. The means for the Commission to proceed with the treatment of the file, in the absence of cooperation by the third country entities, would be reinforced. Where access to the information requested by the Commission would be refused or would not be supplied within appropriate time limits, the Commission findings would be made on the best available information. The Regulation would specify that, where parties do not cooperate satisfactorily, other information may be used to establish the relevant findings even if it cannot be excluded that the outcome is less favourable to the parties than if they had cooperated. To alleviate the potential reluctance of Parties to disclose their sensitive commercial data, a specific treatment would be granted to confidential information supplied during the investigation. Such information would not be disclosed at any stage without the prior approval and authorisation from the party of dispute.

The **investigation** under the new Regulation would be fully transparent, inclusive and non-discriminatory to third Parties. Interested parties, both EU and foreign stakeholders would be able to participate in the conduct of the investigation. The complainants and the representatives of the third countries or third country entities concerned would have the right to: inspect all non-confidential information made available to the Commission; ask to be

informed of the principal facts and considerations resulting from the investigation and be heard by the Commission. This would ensure that all the interested parties have ample opportunity to present all relevant evidence and to defend their interests.

The Commission's investigation would be terminated without the imposition of redressive measures in four cases: (a) if the complaint is withdrawn, or (b) if it concludes on the absence of injury or threat of injury to the Union air carrier(s) concerned, of practice affecting competition conditions from a third country or a third country entity, or of causal link between the injury or threat of injury and the referred practice; or (c) it concludes that adopting redressive measures would be against Union interest; or (d) if the third country or third country entity concerned has eliminated the practice affecting competition conditions; or (e) if the third country or third country entity concerned has eliminated the injury or threat of injury to the Union air carrier(s) concerned.

By contrast, where the facts established during the investigation would indicate the existence of unfair practices and adverse effects caused by them to EU enterprise or EU industry, the Commission would impose redressive measures, provided it is compatible with the Union's interest. In such case, the Commission would present a summary of its findings, a proposed course of action including further consultations with the third country if necessary, and a timeframe for the proposed actions.

As regards the redressive measures, they could include the following:

- (a) financial duties; or
- (b) any measure of equivalent or lesser value.

These measures would remain in force only for as long as, and to the extent that, it is necessary to eliminate the unfair practices.

As already explained, the new Regulation would also ensure that any measures taken are in full accordance with the **Union interest**. The assessment of the Union interest involves the identification of any compelling reasons which would lead to the clear conclusion that the taking of measures would not be in the overall interest of the Union. Such compelling reasons could, for example, include cases where the disadvantage to consumers or other interested parties would be clearly disproportionate to any advantages given to the Union air transport industry or Union air transport enterprises by the imposition of measures.

The new Regulation would be fully **compliant with international law and bilateral ASAs**. This also includes provisions of such agreements that require, before any measure against an airline of the other party is taken, the prior discharge of an international procedure for consultation or for the settlement of disputes. Hence, countermeasures under the new Regulation, to the extent they would draw upon possibilities offered by existing ASAs, would be taken only once these procedures are terminated and would have to take into account their results. The same principles apply to the terms and scope of any measures taken, including insofar as the competent body for the settlement of disputes may have powers to determine such terms and scope.

In accordance with Article 291 TFEU, redressive measures would be imposed by the Commission via **implementing acts**. Control by Member States would be governed by

Regulation (EU) No 182/2011 on control by Member States of the Commission's exercise of implementing powers¹³¹.

The principle of the Commission's implementing powers would carry advantages for Member States. They would be less exposed to third countries' pressure triggered by the adoption of redressive measures and could avoid the risk of retaliation.

The **legal enforceability** of measures imposed by the Commission would vary depending on their nature. The financial countermeasures targeted at third country entities would be enforceable in accordance with Article 299 TFEU.

3.4.4. Policy option D: Adoption of a new comprehensive EU legal instrument combined with increased efforts on the international scene and work on enhancing ASAs through inclusion of fair competition clauses

Option D combines the actions proposed under options B and C to define and enforce a comprehensive regulatory framework ensuring fair and equal opportunities to compete for EU airlines in the international air transport market. The three building blocks of this integrated approach would work together, complement and reinforce each other and create a synergy to answer the challenge of responding to practices that distort competition to the detriment of EU air carriers.

Under Option D, the EU would continue to work on the establishment of a **multilateral framework for economic matters in international aviation at ICAO and/or WTO level** (option B). In the long-term perspective, such a global agreement would be the most effective solution to the problem of subsidies and discrimination in international aviation, if one considers the cross border nature of air transport. However, as explained in section 2.2.1, any fundamental change of the current bilateral system for air transport through GATS and/or ICAO cannot be expected in the near future, given the diversity of economic interests of ICAO and WTO Member States, the present lack of global consensus on principles and approach to fair competition matters, and intrinsic limitations of decision-making procedures in both international organisations (required unanimity of all Members). Hence, under the current circumstances, the increased efforts by EU and Member States to address fair competition issues at global level are not, in and of themselves, likely to deliver results in the short or medium term in respect of the fair competition issues at hand.

Another component part of a possible solution would consist in negotiations of **comprehensive fair competition provisions under ASAs** with third countries. The existence of more ASAs containing appropriate clauses would most certainly act as a catalyst and encourage other countries to work together with the EU on a long-term solution at the multilateral level. The negotiation of strengthened ASAs with stronger fair competition provisions containing e.g. improved consultation procedures, detailed dispute settlement mechanisms and concrete safeguard measures would allow the EU and the MS to effectively deal with subsidies and discrimination against EU air carriers. In addition, a positive effect could be achieved through the conclusion of higher number of EU comprehensive agreements covering the key strategic markets for EU carriers.

As mentioned under section 2.2.1.3, the negotiating process of fair competition clauses in ASAs is expected to be burdensome and time-consuming, and therefore in the short and

¹³¹ Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (OJ L 55, 28.2.2011, p. 13–18).

medium term will not be sufficient to single-handedly and globally address the issue of unfair practices injuring EU carriers.

Therefore, the basis of option D would consist of the **adoption of new EU legal instrument** to address issues of market distortions in international transport (option C). This action is both indispensable in view of persisting industry concern over the existence of unfair practices and their possible harmful effect on EU carriers, as well as politically legitimate as the need to develop an effective instrument to safeguard fair competition in EU external aviation had been expressed by the Council, the European Parliament and the Commission. As proposed in option C, the new Regulation would be provided with a number of improvements, regarding notably its scope, definitions, and procedures. This would contribute to counterbalancing the present weaknesses of multilateral and bilateral legal frameworks and aim to ensure fair competition in the international air transport in the short and medium term. To an extent, such an instrument may even prevent unfair competitive situations to be brought about by third countries or third country entities.

As described in respect of option C, the new instrument would be complementary to the ASAs and would operate in full compliance with them. It would offer means to counteract subsidies and discrimination entailing injury where the air service agreements fail to provide necessary tools to this effect. It would offer the right to EU undertakings to complain to the Commission.

On the other hand, broader fair competition provisions containing strong dispute settlement mechanisms and safeguard measures would be effectively used to deal with unfair practices covered by the Regulation in a context of bilateral and comprehensive ASAs. The new EU instrument, to the extent that its application would not depend on the application of such provision, would also offer substantial added value by providing the EU and the Member States with more leverage in international fora to negotiate broader and more binding fair competition rules within ASAs, as well as ICAO/WTO frameworks, in the longer perspective.

Option D presents the most comprehensive answer to the problem of unfair practices in international aviation. This global multi-level approach fully complies with the Commission's approach to the EU's external aviation policy as laid down in Aviation Strategy which stipulates the following:

As there is currently no international legal framework to deal with possible unfair commercial practices in international aviation, it is important and legitimate for the EU to address such practices to ensure fair and sustainable competition. (...) This issue should be addressed in the context of the negotiation of EU comprehensive air transport agreements and by intensifying corresponding policy action at the International Civil Aviation Organization level. In addition, the Commission is considering proposing new EU measures to address unfair practices as soon as possible.

3.4.5. Summary of all considered options

Table 2 - Overview of the policy options and linkage to the problem drivers identified

	POLICY OPTIONS			
	A	B	C	D
PD 1: Absence of adequate and effective mechanisms to safeguard fair competition in a context of increasing liberalisation of international aviation market				
SO 1: Provide effective defence and redress measures against unfair practices by third countries and third country entities				
1. Promote the developments of disciplines for subsidies for services in the			X	X

context of the GATS/WTO.				
2. Reaching global understanding of 'fair competition' in the context of ICAO leading to formulation of ICAO recommended provisions on fair competition conditions.		X		X
3. Provisions aligning third country(ies) aviation laws with EU law in the field in return for access to EU internal market		X		X
4. Safeguard measures giving Parties scope to act unilaterally, in case the partner country does not engage in consultation or is not willing to take remedies to restore fair competition; possibly combined with a dispute resolution mechanism.		X		X
5. Scope applicable to broad range of unfair practice including subsidies, discriminatory practices, breach of multilateral or bilateral agreements,			X	X
6. Ease the submission of complaints and improving proceedings			X	X
7. Dispute settlement within Joint Committees or any other consultation mechanism established in ASA with third country		X		X
8. Redressive measures capable of offsetting injury due to subsidies or discrimination		X	X	X
PD 2: Lack of transparency and information about the support received and financial accounts of third countries air carriers				
<i>SO 2: Ensure access to relevant data and information from third country parties</i>				
9. Include in ASAs a clause on transparency of financial data of undertakings as market access condition		X		X
10. Investigative tools for Commission to request the information from third countries and third country entities			X	X

4. ANALYSIS OF IMPACTS

As there is no experience from the analysis of concrete cases, it is very difficult to measure the direct and indirect effects of possible unfair practices by third countries or third country entities on European airlines. This difficulty is compounded by the fact that a variety of factors has to be taken into account while assessing the performance and trends in the aviation sector (presented in sections 2.1.2. and 2.1.3.). There is no doubt that the "natural" competitive advantages of foreign carriers and the parallel objective disadvantages of EU airlines play major role in the change of EU aviation position on global market. There is no quantitative data available today that would allow determining to which extent the competitive position of the EU aviation sector is also impacted by the presence of possible unfair practices and lack of an effective instrument, which would allow for addressing these. It must be noted that the impact of unfair practices would only materialise in case such practices are indeed proven and that this is also the only case when the instruments proposed under the policy options may be assessed. Therefore, it is hardly possible to have a robust estimation of impacts of various options and the impact assessment analysis must refer to certain assumptions and reported examples to qualitatively compare the relevance of the policy options.

4.1. Economic impacts

4.1.1. Functioning of the internal market and competition

It cannot be assumed with certainty that unfair practices have a direct impact on the difficult economic position of EU carriers in the global aviation sector. In particular, no direct causal link between the possible effects of unfair practices and EU carriers' market position on the markets when these practices occur can be established, on the basis of the facts available. It is not clear to what extent the assumed market developments could be attributed to alleged unfair practices and what is the impact of other factors (e.g. economic growth of different regions, geographical position, growth strategies based on hub-and-spoke connections etc.). However, based on limited available evidence and reported allegations presented in this report, it may be assumed that where unfair practices exist, the competition on the international aviation market is distorted, i.e. takes place on an uneven playing field. Hence, the objective of the policy options is to restore the economic situation as it would have been in the absence of unfair practices. The impact assessment attempts to indicatively assess to which extent different policy options can help in reinstating the competitive balance on the markets operated by EU airlines. The effectiveness in achieving this goal by the policy options will then determine the EU airlines' market position on extra-EU markets¹³² where unfair practices are alleged to exist most often. However, this assessment has to be treated with caution and like the PwC study, needs to start from a number of assumptions. These are the following:

- Where EU airlines market position has declined in markets where unfair practices allegedly exist, it is assumed that part of the impact is due to such practices adopted by third countries and third country entities;
- Unfair practices are defined as practices favouring third country air carriers to the detriment of EU carriers and include those listed under chapter 2;
- Policy options are assumed to limit (with exception of baseline scenario) to a different extent the impact of unfair practices, without eradicating them entirely;
- The impact of different policy options is assessed in a 10 years perspective, assuming sufficient time for the policy measures to produce their effects.

Considering the above restrictions, it is assumed that **option A** which foresees leaving the current framework and EU measures as they stand today would most probably mean the

¹³² As the policy options of this Impact Assessment do not correspond directly with the ones analysed in PwC study, the estimates of PwC report are not used in the analysis. However the analysis made in the present IA adopts the assumptions made and the methodology used in PwC report. No quantification could be carried out.

In PwC study, the definition of scenarios for the quantification of the impact was based on data drawn from the SABRE ADI database, which provides information on both the total traffic from the EU towards other countries as well as the breakdown by nationality of the airline carrier. This information is based on passenger carriage data, which include their number, the class of travel, the average fare paid, the origin, destination and transfer hubs (if any). As data from the SABRE ADI database are only related to current and past flights, forecasts for the future were based on the evolution of EU-based demand for air traffic using IATA's forecast by region for the period up to 2017 and long term BMI GDP projections for the period 2018 - 2025. Calculations were made at Member State level, to ensure a higher level of detail and, therefore, accuracy.

continuation or even aggravation of the current situation for EU airlines, as the weaknesses of the current framework would render an adequate response to unfair practices as defined above highly difficult. As a consequence, the EU carriers would in practice continue to suffer from uncompetitive practices, alleged subsidies for certain carriers or restrictions in the use of airport facilities and services in State I.

EU air carriers currently hold approximately 46% of the market share of passenger flying to or from the EU. As no change is expected to occur in the traffic growth and market developments compared to recent years, under the baseline scenario, EU carriers are expected to constantly lose market share on routes to certain regions, where unfair practices are expected to cause most significant distortion. Consequently, the EU long-haul carriers will lose revenues in favour of competitors on these routes.

The disadvantaged economic position of EU airlines could be partially diminished by applying measures proposed under policy **options B** which foresees diplomatic action at ICAO/WTO level and EU-level negotiations aimed at establishment of fair competition clauses in ASAs with key EU partners. The more active EU presence at WTO and ICAO and reinforced cooperation with like-minded partners alone will not be able to solve the problems of limited access to information on third country carriers or lack of necessary protection for EU airlines against unfair competition in the short and medium term (if ever). However, assuming a positive outcome of the forthcoming negotiations of comprehensive agreements with Turkey, ASEAN, Qatar and the United Arab Emirates, the EU would dispose of a set of new measures to address the allegations on subsidies and other unfair practices. Should a common understanding of fair competition principles be reached and inscribed in comprehensive ASAs with the above mentioned and other key partners in the future, the EU would gain a legal ground to address the potential practices it would deem unfair. For instance, a subsidy scheme granted by a third country could be challenged under the pertinent ASA provision as 'not [...] consistent with a fair and competitive environment and [...] resulting in a significant disadvantage or harm to EU airline(s)'¹³³. On the basis of the same provision, the alleged subsidy could be then made subject to consultations in a Joint Committee and, if needed, arbitration under a dispute settlement mechanism provided for under the agreement. Finally, should the decision of dispute settlement/arbitration body be in favour of the EU, and no satisfactory remedy be proposed by the accused government to stop the discriminatory subsidisation, the EU could take a unilateral action on the basis of safeguard clauses allowing for such action. This could potentially lead to suspension of rights granted under the agreement.

However, the diplomatic action has failed to solve the problem of unfair practices in the past. The inclusion of all of the above provisions in negotiated comprehensive ASAs with Turkey, ASEAN or GCC countries would most likely take considerable time and is highly questionable all together. As indicated by the respondents of the public consultation, many countries are reluctant to negotiate fair competition clauses with EU Member States. What is more, the respondents suggest that among these countries there is a lack of willingness to apply and enforce even the principles which are inherent within the existing ASAs. In their opinion, this has led to carriers from these regions enjoying a markedly higher percentage of capacity of seat offered which adversely impacts the EU airlines in their home market. It is further suggested by some respondents that some EU Member States may be unwilling to undertake unilateral action on behalf of carriers for fear of prompting retaliatory action by the

¹³³ Such provision exists under EU-Canada Comprehensive Agreement.

third-country in question. Since the commercial entities cannot lodge an official complaint under the ASAs, in fact the benefits offered by option B might then not be sufficient to address the problem of unfair practices adversely affecting EU airlines.

Thus, newer negotiating efforts with third countries aimed at including more advanced competition clauses in the ASAs, even if successful, would not be enough to ensure fair competition in the international aviation market. Option B, *per se* will add less value than having an effective EU Regulation which can have the effect of strengthening the EU's and Member States' position in their diplomatic efforts. Therefore, even if policy option B could have some noticeable economic impact (if some fair competition provisions are included in comprehensive ASAs with key partners), most likely it would only be able to attenuate the decline of EU carriers' market position on Asian and Middle Eastern markets predicted under the baseline scenario (to the extent unfair practices are actually affecting EU airlines' position on these markets). The effects of option B would be more positive on markets covered by the comprehensive EU ASAs with strong fair competition clauses, i.e. neighbouring third countries (Morocco, Israel, Jordan, Moldova), Canada or the US. This is to some extent confirmed by several examples of amicable dispute resolution in the past¹³⁴.

As the current approach of the Regulation would not be changed under Option B, its effects would probably not be enhanced significantly. Hence, the EU industry would still be fundamentally deprived of an efficient tool to reinstate the competitive balance in international air transport by addressing unfair practices of any form. There would possibly be high costs stemming from injury to EU industry as a result of unfair practices.

As policy **option C** envisages far reaching amendments to the current regime, it is also expected that it would trigger stronger changes in the international competitive playing field. The scope of the Regulation would be better adapted so as to cover all forms of discriminations in all relevant areas, for example in respect of the allocation of slots or access to airport infrastructure or doing business issues. Accordingly, it is assumed that the extra strength of the Regulation would result in considerable improvement of EU carriers' competitive position on routes between the EU and third countries where unfair practices are most commonly alleged. With a new Regulation serving as a deterrent as well as strengthening EU and Member States' bargaining power to prevent unfair practices, European airlines would be able to compete under fairer conditions on the international routes.

Option D which combines the measures of options B and C would bring the strongest positive impact on restoring the competitive level playing field for EU airlines. The combination of an effective and applicable instrument with enhanced EU level international air transport agreements with third countries, including fair competition clauses, would unleash the full potential for achieving a level playing field between European and third country air carriers. Under the so-called "injury track", in case of alleged unfair practices against EU air carriers, the revised structure of the Regulation would give the possibility to EU Member States, EU air carriers or EU air carriers' associations to file complaints to the Commission. Under certain conditions, the Commission would have the possibility to begin

¹³⁴

For example, the quoted case of discriminatory slot allocation for two EU low-cost carriers in State M was discussed within the EU- State M Joint Committee. During the consultation the Commission has pointed that State M Slot allocation guidelines were not in line with Council Regulation (EEC) No 95/93 on slot allocation as well as the IATA World Slot Guidelines. On the request of State M authorities, the EU prepared a proposal for the revision of State M guidelines on slot allocation to eliminate the discriminatory provisions and bring it in line with EU legislation and IATA Guidelines.

proceedings to determine if the alleged unfair practices necessitate the taking of redressive measures. If adopted, these redressive measures would enable to offset the injury caused to EU air carriers, allowing them to evolve again on fair competition grounds.

Through increased international efforts at WTO and ICAO level aimed at the adoption of a multilateral legal framework for fair competition in aviation and inclusion of expanded fair competition in EU air transport agreements with third countries, the EU air carriers will be guaranteed with a fair competition environment. The comprehensive EU approach to fair competition would, hence, benefit from synergies and help the EU aviation sector achieve a market position which can be expected to be better than in all other options. The added value of combined EU action at all levels would benefit EU industry by increasing the number of passengers carried and the revenues of EU airlines most as compared to the baseline scenario. Under option D, the market share on routes mostly affected by the alleged unfair practices while still decreasing, would be contracting at the slowest pace.

4.1.2. Competitiveness, trade and investment flows

It is difficult to estimate the possible cost savings achieved as a result of the measures that would be introduced under the analysed policy options, because most of these costs are impossible to quantify in a sound way. However, in order to show how the impacts of options could be distributed, a case study for European airports and European manufacturers is presented.

According to estimations made by the PwC study, the implementation of specific policy options would make a minor impact on the revenues of **European airports**. This would be the result of the gain in market share of EU carriers from non-EU carriers and the subsequent increased number of passengers transferring at European hubs instead of third country airports¹³⁵. In this context the main economic effect would be brought by option D. It is expected that under this option (and to a slightly lesser extent option C) EU airports will attract more passengers, as it would be somehow less convenient to fly through Gulf and Turkish hubs on many routes. It is estimated that policy option C would trigger some effect and additional measures of policy option D could potentially contribute to the highest revenue increase. Under policy options B the increase in the share of passengers flying through EU hubs would be much more modest, and therefore the growth of revenues of EU airports would be very limited. It should be noted, that the situation of EU airports is to a far greater extent affected by the insufficient capacity and ATM deficiencies than by the existence of alleged unfair practices.

It should also be noted that the implementation of the options, especially option C (and consequently option D), could to some extent negatively impact, at least in the short term, certain **smaller European airports** served by third country carriers. These airlines also connect some smaller airports to their hubs and thus increase the number of passengers in these airports. If these connections were not maintained, then these smaller airports could lose some passengers. Notwithstanding these, the third country carriers connecting EU passengers in particular to Asia and Australasia are expected to increase over time regardless of the adoption of fair competition protection instruments.

¹³⁵ ACI Economics Report 2012 reports an average of €18.77 fees related to each transfer passengers in EU airports.

Furthermore, it is also expected that following the introduction of policy options C and D, European **companies** might be affected by somewhat higher airplane ticket prices, especially in the short term, because most probably the removal of low fares applied by third country carriers and allegedly supported by unfair practices by third countries and third country entities would lead to price increase (see more in the section 4.1.5 on impacts on consumers). It is difficult to provide sound data, though as it is not evident to what extent, if at all, the prices of any European competitors are lower due to unfair practices.

One of the main concerns related to the introduction of a stronger defence instruments ensuring fair competition in the international air transport market and addressing alleged unfair practices from third country carriers is the potential risk of **retaliation** from the affected countries towards EU air carriers. Under the baseline scenario and option B, the Regulation is unlikely to be used by the EU against third country airlines suspected of unfair practices, so adverse effects due to retaliation are equally unlikely. Under option C the enhanced measures at the EU's disposal could lead to a higher risk of retaliatory actions by third countries deriving from their conviction that the EU is acting in breach of bilateral agreements. This would be the case especially when operating permits for the airline(s) of the third country would have been suspended or limited by Member States in order to enforce compliance with the new Regulation. On the substance, the EU would be able to argue that a new Regulation, proposed under option C and D, would ensure that any action directed at third country carriers is based on strong evidence obtained through transparent and inclusive investigation. The risk of retaliation would be further mitigated as the interested parties will have the possibility of recourse to the CJEU if they consider the Regulation has not been properly applied. In this context, option D presents the best ratio between the need of stronger fair competition framework and the risk of retaliation by third countries and third country entities. Diplomacy and institutional consultative mechanisms such as Joint Committees, proposed under option D (and B) could also be employed to help mitigate the risk of retaliation.

Similarly, the implementation of policy options aimed at preventing unfair practices from third countries and third country entities might lead to retaliatory actions directed at European aeronautical manufacturers. Under policy options C and D, EU companies (notably Airbus) which have established strong commercial relations with States C and D carriers in the recent past, could potentially suffer the consequences of retaliatory action in the form of reduction or even cancellation of some aircraft orders. Similarly, the envisaged negotiations of comprehensive ASA with binding "fair competition" clause¹³⁶ between the EU and Middle East countries could pose a threat of reduced purchases of EU aircraft by Gulf carriers, at the advantage of EU's foreign competitors (in particular Boeing)¹³⁷.

It should be noted however that the potential risk of retaliation would depend on a wide range of factors which are generally hard to predict. In any case, the risk of retaliatory actions against EU industry stakeholders would be strongly mitigated by the relative size and importance of the EU market. As mentioned in section 2.1.6, the long-term growth prospects for aeronautical equipment manufacturers will fundamentally depend on large aviation

¹³⁶ <http://uk.reuters.com/article/2015/11/15/uk-eu-aviation-emirates-idUKKCN0T40SB20151115>

¹³⁷ Such threats were indirectly expressed by the president of one of the leading Gulf carriers - more details in <http://www.ft.com/intl/cms/s/0/df977eee-8806-11e5-9f8c-a8d619fa707c.html?ftcamp=crm/email/20151111/nbe/AsiaMorningHeadlines/product#axzz3rGRCbSg6>

markets¹³⁸, such as Europe, whereas unfair practices that harm the EU airline industry equally undermine its ability to purchase aircraft. Lastly, the risk of retaliatory measures by third countries and third country entities could also be moderated by the diplomatic support of the EU and its Member States.

In any case, the key concern is to ensure that any EU actions are fully in line with the international obligations and that EU acts in a transparent, inclusive and proportionate way to deal with unfair practices that have a negative impact on EU industry. As in the trade defence policy, the threat of retaliation should not be the determining factor when the rights of EU industry and consumers are violated and when the EU action is lawful and justified.

4.1.3. Small and Medium Enterprises (SMEs)

Concerning specific impacts on SMEs, none of the options is likely to produce significant overall direct impacts on SMEs. The increased competitive power of EU carriers – and, overall, of the EU aviation industry, as a result of options E – is expected to lead to increased turnover for enterprises in the supply chain, irrespective whether they are big, medium or small. The increased turnover is particularly relevant at airport level, where, depending on the option considered, the traffic of passengers transiting through EU airports is expected to increase. Indirect impacts are also variable. Companies indirectly related to air services operated by EU carriers, but which are still in the air transport sector (e.g. ground handling providers, travel agencies etc.), are expected to benefit from the increased number of future passengers, regardless of whether the passengers fly EU or third country carriers. Indeed, both categories of airlines are expected to increase their presence in the European market in the future, leading to an expansion of the overall market. It is, however, expected that small and medium sized enterprises may be affected more by a possible increase of ticket prices at least in the short term (see above) as travel costs may constitute a greater proportion in their budgets in comparison to larger enterprises. Nonetheless, this increase in ticket prices is expected to be limited.¹³⁹

4.1.4. Cost of implementation

Implementation costs to be considered include: i) cost of diplomatic negotiations (i.e. prolongation of negotiations, increase in staff work for the preparation of negotiations), including the cost related to legal units and administrative personnel preparing the documentation required for negotiations (option B); ii) cost related to Member States or EU institutions to appoint and maintain additional senior official(s) and their staff for the period needed to investigate and adjudicate a complaint (option B, C, D); iii) cost for the industry to raise formal complaints (option C and D); iv) cost for the public administration to receive and process formal complaints (options B, C and D); v) cost related to additional monitoring procedures in relation to third country entities option (C and D). These costs are difficult to quantify, but can, to some extent, be assessed qualitatively.

In the baseline scenario as well as in option B, it is most likely that no use of the procedures related to the Regulation can be expected, in line with the current trend, so the costs of

¹³⁸ As indicated in PwC study, the three biggest markets for Airbus in terms of civil jets orders are: Asia-Pacific (27%), Europe (22%) and North-America (13%). Middle East represents 7% of Airbus orders globally, with 962 aircrafts booked as of 30th April 2014.

¹³⁹ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

complaint adjudication and investigation are expected to be null. However, under the option B, the EU institutions and Member States will still incur existing levels of cost for diplomatic actions to negotiate better multilateral framework for fair competition in global air transport and include more comprehensive "fair competition" clauses in ASAs.

The implementation costs for option B are generally similar to those for option A as the lack of amendment of the Regulation provides no incentives for its practical use.

Under option C and D, a new more effective Regulation would increase workload and auxiliary costs for Member State and the EU. As regards the EU, The appropriations required for human resources and missions costs are expected to be met through allocation which may be granted to the managing DG under the annual allocation procedure and in the light of budgetary constraints.

Some additional costs could also arise in relation to the redressive measures. Depending on the type of possible remedies/actions applied, both the Commission and Member State intervention might be required. For example, the enforcement of duties in accordance with Article 299 TFEU could draw on Member States resources. However, it is likely that the existing staff would absorb the additional efforts related to possible complaint adjudication, investigations and remedies, as a limited number of cases are expected to be opened.

Due to the fact that Option D includes more areas of intervention higher efforts are expected from the involved parties. The costs would be higher with the combined costs of implementation and use of new legal instrument (option C) and use of diplomacy (option B), which is also expected to be more frequent, as most of the formal complaints might be solved through the use of negotiations (taking the US experience as a benchmark). Still, the overall implementation costs are not expected to be very high as they are mainly linked with additional tasks within the existing framework and many of the tasks may possibly be covered with the same resources. The past experience shows that the cost of negotiating and managing international agreements is minor when compared to the size of potential benefits. For example, the economic benefits resulting from the negotiation of CAA agreements with Western Balkans and Morocco alone have been estimated at a total of €6 billion between 2006 and 2011¹⁴⁰. With regard to recently launched negotiations, the expected economic benefits are estimated at €8.4 billion in case of Gulf Cooperation Council States, €7.9 billion in case of ASEAN and €5 billion in case of Turkey¹⁴¹. It needs to be noted that the negotiations and management of all the existing and future ASAs between the EU and third countries (country blocs) is currently handled by a team of around 10 case-handlers in the Commission (Directorate E).

Furthermore, the additional costs linked to the implementation of option D would be outweighed by the increased revenues resulting from revised tools to ensure fair competition in air transport markets. It is expected that the EU airline industry would benefit inter alia from the removal of market-distorting subsidies, overflight charges and discriminatory fees paid to third country entities (e.g. airports, ATM providers, State agencies etc.). It is nevertheless difficult to quantify these impacts, due to the lack of available data and the fact that these unfair practices have not been proven. Only in a few cases, sufficient information is disclosed

¹⁴⁰ Booz & Company: "Development of the EU's Future External Aviation Policy", Final Report, April 2012.

¹⁴¹ http://ec.europa.eu/transport/modes/air/aviation-strategy/external_policy/index_en.htm#proposal-phase

4.1.5. Consumers and households

It is difficult to assess the impacts of different policy options on the price and quality of service from the consumer perspective (see more in section 2.1.6.). It is estimated that, with either policy option being introduced C or D, passengers could be gradually less able to benefit from the reduced prices for services offered by certain third country carriers (to the extent some of their current prices may be reduced thanks to subsidies or other unfair practices). More specifically, it is predicted for example that, at least in the short term, the revision of the Regulation (option C and D) would result in the increase of premium class fares to regions such as Asia. As policy option B is predicted to be less effective in addressing unfair practices, it is expected to keep premium class fares slightly lower in comparison to policy options C and D.

However, it can be also assumed that in the longer term, tackling unfair practices on the market would generally drive costs down and trigger the corresponding price decrease driven by market forces in a competitive environment. In addition, as mentioned under section 2.1.6, the lack of necessary instruments to restore the fair level playing field, carries risk of driving EU airlines out of certain markets which could then become mono/oligopolies. The third country air carrier(s) remaining on such markets would have no further incentives to offer lower fares from their competitors, which would mean that EU passengers could ultimately face ticket price increases.

The impact of policy options C and D could also be positive, even in the short-term, when other types alleged unfair practices are considered. Higher airport charges, additional taxes, or difficulties in doing business are all negatively influencing the prices offered by EU carriers. Airlines generally pass on the financial burden stemming from such practices directly on consumers by raising their fares. The adoption of effective instruments for addressing such discriminatory practices under option D (and to a lesser extent C) would then allow EU air carriers to cut their ticket prices bringing tangible benefit to EU consumers.

Similar assumptions refer to the impact of policy options on service quality. According to passengers' satisfaction surveys, some allegedly subsidised third country carriers score better for on-board services than EU airlines¹⁴². In the short term, EU consumers may benefit from better quality of services when flying with these carriers at reduced prices. A number of alleged discriminatory practices such as discriminatory slots, or restriction in access to airports may negatively affect the quality of services provided by EU flag carriers negatively affected by these practices, thus decreasing the perception of their service quality in the views of EU consumers. As a consequence, (under option C and D) a positive effect of adopting a new Regulation addressing such discriminatory practices may be to remove this negative effect on the service quality of EU carriers' on board service. The perceived quality of service could be brought back to a competitive level with that of third country carriers.

Therefore option D which is expected to have strongest impacts on reinstating the competitive balance on the international market would also have the most positive impact on direct air connectivity for EU citizens, as compared to the baseline scenario.

¹⁴²

PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

4.2. Social impacts

The absolute number of passengers flying on EU air carriers is expected to grow under all options.¹⁴³ As described above, under policy options C and D this increase would be higher than in case of the baseline. Consequently, it would result in the increase of employment by EU airlines and other European companies involved in the air transport value chain. It is expected that the implementation of policy options C and D would contribute to most new jobs in EU airlines. As the impacts of option B on passengers carried are predicted to be more limited, they are also supposed to contribute less to new jobs. These numbers could be to some extent reduced by the fact that foreign airlines also employ European staff in particular for the routes to/from Europe. Their employment level of the European staff would be lower than under the baseline, but the overall impact of option C and D is still expected to be positive.

Cessation of any unfair practices by third countries and third country entities is expected to have a relevant impact also on other elements of the European air transport value chain including airports and associated industries. This impact would be driven by the increase of passengers choosing to transfer via European hubs. Consequently, only employees resulting from the increase in transfers at EU hubs towards the Middle-East and Asia (the regions with the most probable impacts) have been taken into account in the estimations. According to the estimations, the introduction of policy option C would contribute to a high number of jobs at airports and other related industries. Policy option D could potentially exceed this number, while option B could generate only a modest increase in employment at airports and in related sectors.

It is also estimated that restraining the number of unfair practices by third countries and third country entities would further contribute to the development of indirect and induced employment. As new jobs could be created within a broad scope of industries ranging beyond air transport, the overall effect is estimated to be much stronger in comparison to direct employment. According to estimations, the introduction of policy option C would contribute to a high number of additional indirect and induced new jobs and option D could generate even greater benefits for employment.

4.3. Environmental impacts

Air transport negatively influences environment in two main areas, greenhouse gas emissions and aircraft noise. However, the scope of the impacts may differ depending on a few factors (see Tables 1 and 2 in Annex D). Aircraft noise is usually considered from the perspective of noise generated per passenger. Therefore, larger aircraft carrying a higher number of passengers tend to have a lower per-passenger noise emission level.¹⁴⁴ In this regard, several fast growing third country carriers should be considered as less polluting in comparison to EU airlines since their fleet mix is composed to a greater extent of wide body aircraft (Middle Eastern carriers on average use the largest aircraft in the world, with an average 208 seats per flight). They may also be considered as more environmentally friendly since they operate younger aircraft equipped with quieter and more fuel-efficient engines.

¹⁴³ This subparagraph focuses on the connections between EU hubs towards the Middle East and Asia, as an illustrative example.

¹⁴⁴ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

On the other hand, it should be emphasised that aircraft pollute most during take-off due to the higher levels of fuel burn required. Third country carriers offer long haul flights from Europe via their hubs. This usually implies additional take-off and landing operations and increased environmental pollution when compared to direct services by EU carriers. Take-off and landing are also the most perceptible from the noise perspective as both operations are performed at lower altitudes. Thus direct flights provided by the EU carriers are clearly more environmentally efficient in terms of greenhouse emissions and noise pollution for a given aircraft type. Direct flights limit the number of take-offs and landings, maximise the use of wide body aircrafts and reduces the length of flights. The number of direct flights operated by European carriers is expected to increase for options C and D, meaning that they could have some positive environmental impacts. Nonetheless, these options would also increase to some extent indirect air connections with transfers via EU hubs offsetting some of the benefits of direct flights.

Third country carriers offering long haul flights to/from Europe with a transfer could also be perceived as more polluting from the greenhouse gas emissions perspective due to in general longer flight distances between origin and destination points due to operations via a hub airport. Here again EU carriers could be less polluting when they operate direct routes. However, a transfer at an EU hub can increase the pollution level if increasing the distance flown (e.g. flying from Budapest to Mumbai via London requires a short-haul flight in the opposite direction of the destination) or operated by the older aircraft. Therefore, the overall environmental effect of transferring traffic through EU hubs instead of non-EU hubs cannot be assessed with certainty.

It should be noted that services by EU carriers may also include a first leg within Europe for passengers that travel from regions that are not directly connected to the points concerned. In this case the above comparison does not apply as such. Nevertheless, while one stop is needed for this type of passengers, many other passengers fly directly from the large catchment areas around intercontinental hub airports in Europe. Furthermore, if the stop is made within Europe the economic benefits for airlines and the whole air transport value chain materialise for European companies thus creating employment and other related benefits.

It should be also noted that flight distances have a neutral effect from the noise perspective due to the relatively high altitude of overflights.

Air traffic to/from the EU is expected to increase in the future irrespective whether it is operated by EU or third country carriers. Taking into consideration the differences in environmental performance between EU carriers and certain third country carriers, the rate of emissions is dependent on the market share between EU and third country carriers. It cannot be assessed with certainty whether the benefit of direct flights outweighs the advantages of newer aircrafts with greater capacity operated by certain third country carriers. As a result, no impact analysis on greenhouse emissions and noise pollution can be produced for the proposed policy options.

The summary of the impacts of each policy option as compared to the baseline scenario is presented in the table below.

Table 3 - Assessment of impacts per domain of policy options

	Policy Option B	Policy Option C	Policy Option D
ECONOMIC IMPACTS			
<i>Functioning of the internal market and competition</i>	+	+++	++++
<i>Competitiveness, trade and investment flows</i>	0	+	++
<i>Small and Medium Enterprises (SMEs)</i>	0/+	+	++
<i>Cost of implementation</i>	0/-	-	--
<i>Consumers and households</i>	+	0/+	++
SOCIAL IMPACTS			
ENVIRONMENTAL IMPACTS			
	0	0	0

5. COMPARING THE OPTIONS

Policy options have been assessed against the following criteria:

5.1. Effectiveness

Option B is considered more effective than option A (baseline scenario) as it is more likely to better protect European air carriers from unfair practices by third countries and third country entities. The increased international efforts at WTO and ICAO level could lead to ensure a fair level playing field; however, any tangible effects are highly unlikely in the foreseeable future. In short term, the effectiveness of multilateral negotiations in combatting the unfair practices depends solely on closer cooperation with foreign partners within ICAO and WTO framework. On the other hand, the increased EU efforts in cooperation with Member States could lead to the inclusion of more comprehensive fair competition provisions in higher number of EU-level ASAs, which might contribute to a fairer level playing field between European and third country air carriers in the short and medium term.

Option C is expected to be more effective than option B as it would lead to development and application of adequate defence and redress measures against unfair practices as well as ensure easy access to relevant data and information from third country parties. The effectiveness of policy option C would stem from the fact that the proposed tools would properly address the specificities and dynamics of international air transport. This would be mainly due to the better adapted scope of the Regulation, improved complaint and investigations procedures and strengthened enforcement measures.

Option D is the most effective one, as it entails a range of tools to combat discriminatory practices and would provide for the most effective and broad conceptual, procedural and enforcement solutions. Under option D the new EU regulatory instrument would act as deterrent for potential unfair practices and discriminatory treatment provide but also give much more power to the EU to negotiate broader and more binding competition rules within ASAs. The well-functioning EU tool along with better fair competition protection within ASAs could effectively push other countries to work together with the EU on a long-term

solution within ICAO and/or WTO. As it encompasses option C tools, it would also ensure access to relevant data and information from third country parties.

5.2. Efficiency

Option B is considered more efficient than option A as with limited extra resources the effectiveness of European intervention could be increased with benefit to the EU air carriers. The limited additional resources would mainly be needed for the increased efforts on the international scene.

Option C is considered more efficient than options A and B because the possible extra costs are even more compensated by increased benefits to the EU carriers. Certain measures proposed under option C, such as the redefinition of the scope of the European legal framework or improved complaint and investigations procedures could be introduced with little extra costs. The complaint and investigation procedures would be revised to provide for a legally defined deadline thus reducing the administrative costs of procedures. Other measures such as strengthened enforcement measures (i.e. compensatory duties, limitation or suspension of operating permits of third country entities) could entail additional costs (e.g. via potential administrative, retaliation or air services disruption costs), but such costs are expected to emerge rather in extreme situations when no other solutions could be found, and in any case are expected to be balanced out by the resulting benefits.

The costs linked to the implementation of option D is considered to be the highest (implementation of Regulation combined with diplomacy) but at the same time more than proportional benefits are expected as well so the potential benefits would outweigh costs by a greater margin than in the case of other options.

5.3. Coherence

All options are coherent with the overall transport policy objectives to promote competitiveness of EU transport as well as the general objective to ensure fair competition conditions in the internal market. They also take into account the existing international law and practices.

Option B is estimated to be more coherent and comprehensive with the overarching objectives of EU policy than the baseline scenario (option A). Option B would reflect the Commission's priority to make EU stronger at international level and would follow on the objective of the new Aviation Strategy to strengthen the negotiations on more comprehensive bilateral air service agreements with third countries. Through its positive impacts the option is coherent with the Commission's political priorities for the period 2014-2019 to provide for more jobs, growth and investments and a fairer and deeper internal market with a strengthened industrial base; and they will enforce the EU as a global actor.

Option C is also coherent with the overall objectives of the Commission, and in addition it reflects the better regulation policy of the Commission. Drawing conclusions from many problems encountered in the past, the new Regulation will address them in the most adequate and coherent manner, providing for a completely revamped system. The improved regulation would be more coherent with the Commission objective to have legislation fit for purpose and avoiding unnecessary burden.

Option D by combining options B and C is also coherent with other EU policies. By being the most comprehensive in the approach, this option will address various shortcomings in the air transport legal framework and better respond to the objective to strengthen the competitive position of EU carriers, promote EU solutions abroad and ensure a global level-playing field. Combining different measures and approaches under this options is also expected to raise additional benefits, as the options B and C are to some extent complementary and reinforcing one another. Consequently, the measures envisaged in this combined option are also internally coherent. It is not expected that any of the policy options could lead to significant trade-off across the economic, social and environmental domains.

5.4. Proportionality

The proposed policy options do not go beyond what is needed to achieve the policy objectives. The aim of the initiative is to address subsidies and discrimination practices that are market-distorting and could be well-evidenced. The options in identifying such practices do not go beyond the international and EU legal framework. Also any possible redressive measures will be in-line of the approach in the EU legislation and proportionate to the nature of injury.

Option B is focusing on the increased efforts within the existing international framework so there is no risk that the proposed approach would be excessive. The legislative changes under option C will focus on the alleged unfair practices and do not create unnecessary requirements on operators or administration. The preferred option D incorporates elements of option B and C which are complementary so no duplication of efforts and excessive requirements are expected.

The scope of the preferred option will take into account bilateral ASAs between Member States and third countries and is intended to be complementary to Member States efforts by offering a possibility and leverage to effectively counteract unfair practices in aviation.

Given that the options do not introduce any additional reporting or compliance requirements, if no investigation is launched, the costs of the proposed measures are very low. Also the costs related to the obligation to cooperate in an investigation and the costs of running an investigation are not expected to be excessive and are justified by the need to effectively deal with unfair practices in aviation.

The proposed instrument will be based on various complementary elements (international framework, ASAs and EU legislation) in order to provide a coherent and enforceable solution to the problem.

Consequently, the options comply with the proportionality principle.

Table 4 - Summary of the comparison of policy options

	A	B	C	D
Effectiveness (assessed for each operational objective)	0	+	++	+++
Efficiency	0	+	++	+++
Coherence	0	+	+/++	++

5.5. Conclusion

Based on the above, option D would be the most effective, efficient and coherent option.

6. MONITORING AND EVALUATION

The Commission services will monitor the implementation and effectiveness of this initiative through a set of core progress indicators listed in the table below that will measure the progress in achieving the operational objectives. Some of the indicators are of qualitative nature and show if the desired deliverables are achieved and implemented, while others are based on data to be collected that will need to be analysed further.

It is foreseen that 5 years after the end of the implementation date of the proposed legislation, the Commission services will carry out an evaluation to verify whether the objectives of the initiative have been reached. It will intend to verify if the new measures have improved the level-playing field and consequently reduced the concerns of stakeholders about the alleged unfair practices as well as collect information through the new mechanisms on the real impacts of identified unfair practices on EU carriers and economy. This evaluation will be carried out inter alia based on the below mentioned core progress indicators and will be in line with Commission requirements on evaluation.

Table 5 - Core progress indicators for monitoring purposes

Operational objective	Core progress indicators	Source of data
Create ICAO/WTO framework for fair competition in international air transport services	ICAO guidance issued on fair competition conditions Development of subsidies disciplines for air services within GATS/WTO framework	ICAO WTO
Ensure the protection of fair competition in air transport services at bilateral level	Number of new/updated EU-level ASAs containing and advanced fair competition clause	European Commission
Ensure financial transparency requirement at bilateral level	Inclusion of rules on access to financial data of third country operators in EU-level ASAs	European Commission
Adopt a comprehensive and effective EU legal instrument for protection of EU air carriers against subsidies and discrimination in air transport services	- Number and nature of official complaints from the sector to the Commission ¹⁴⁵ - European stakeholders' opinion about the applicability of the European legal framework	Register of complaints to the Commission from the sector Fact finding survey/public consultation
Enhance investigative powers of the Commission under EU legal framework	- Number and nature of proceedings initiated by the Commission ¹⁴⁶ - European stakeholders' opinion about the applicability of the European legal framework	European Commission Fact finding survey/public consultation

¹⁴⁵ The number of official complaints could show that the proposed legal instrument is more effective, assuming that there is no increase in the cases of unfair practices. Considering that a more effective instrument can act as a deterrent leading to a lower number of unfair practices, the indicator will need to be supported with qualitative assessment.

¹⁴⁶ The number of proceedings could show that the proposed legal instrument is better fit for purpose, assuming that there is no increase in the cases of unfair practices. Considering that a more effective instrument can act as a deterrent leading to a lower number of unfair practices, the indicator will need to be supported with qualitative assessment.

Annex A

Procedural information and summary of amendments

1. Agenda planning

The Agenda planning or WP reference is: 2014/MOVE/009.

2. Organisation and timing

The lead DG for this Impact Assessment was DG MOVE. Other involved services were: SG, SJ, DG COMP, DG TRADE, DG TAXUD, DG EMPL, DG GROW and EEAS. DG MOVE has established a formal Inter-Service Steering Group (ISSG) in the second half of 2013 to which the following Directorates-General were invited: SG, COMP, TRADE, SJ, EEAS, GROW, BUDG, TAXUD and EMPL. The ISSG held 4 meetings, the last one on 16 December 2015. The ISSG Members have also been involved intensively in the management of the external study in support of this impact assessment report.

3. Sources used and external expertise

The preparatory work was supported by an external study on “Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from the EU” (PwC, 2014)¹⁴⁷. The study analyses trends in air traffic evolution between the EU and world regions. In relation to protection against alleged unfair practices, as provided for under the Regulation, the study analysed the need for an effective regulatory tool. In view of this, four options and their potential impacts were examined. The main options covered by the study are: 1. keeping the status quo; 2. reliance on other measures (e.g. diplomacy, existing international law); 3. “light” reform of the existing Regulation 868/2004 to clarify its standards and make it more operationally relevant; 4. full revision of 868/2004 to broaden both its scope and sanctioning powers. The study also encompassed a regulatory analysis and comparison with related US legislation. It is worthwhile to note that this study was based on certain assumptions, some of which evolved in the meantime, and some estimation, in view of the fact that information in this area is generally not publicly available.

In addition, the findings of a topical report "868/2004 – A Case for Better Regulation" (Mott McDonald, 2013)¹⁴⁸ supported the work on the Impact Assessment. The report carries out an analysis of the reasons for the lack of use of Regulation 868/2004 by the European airline industry despite repeated concerns about alleged unfair practices of international competitors. The report includes an overview of existing competition and trade defence instruments as compared to Regulation 868/2004. It identifies the inherent deficiencies of current legislation and delivers suggestions on how to improve the efficiency and effectiveness of Regulation 868/2004 through developing a set of possible policy options.

The data gathered by the studies was supplemented with other sources, such as data from Eurostat, studies, reports and publications in the field, legal documents (related legislation,

¹⁴⁷ PwC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU.

¹⁴⁸ Mott Mc Donald, *868/2004 – A Case for Better Regulation*

communications), as well as reported cases of alleged unfair practices by third countries and third country entities.

4. Amendments made following the negative opinion of Regulatory Scrutiny Board (RSB) at the meeting on 6 April 2016

RSB Comment	Amendment to IAR
I. Problems, objectives and policy choices – intervention logic	
<i>1. Better explain the legal and economic context in which international aviation currently takes place.</i>	<p>Section on legal context added explaining the liberalisation of international aviation markets; the creation and functioning of EU internal market with its state aid/competition rules and; the legal framework governing the international aviation today and relations between EU and third countries (different kinds of ASAs, lack of binding competition rules on multilateral level)</p> <p>Section on economic context elaborated by adding data on international aviation growth; developments in the market shares of EU airlines; traffic growth rates for EU passengers; total number of passengers carried by EU carriers; and transfer traffic from the EU.</p>
<i>2. Establish in how far the rise of 3rd country air carriers can be attributed to "natural" economic factors, and then consider the impact of unfair practices.</i>	<p>Section 2.1.2 on Competitive advantages of third country carriers added (rapid economic growth of their regions; good geographic location of their hubs; large investment in airport infrastructure and airport fleet; lower airport charges; lower legacy costs).</p> <p>Section 2.1.3 on Competitive disadvantages of EU flag carriers added (low economic growth; high costs deriving from higher labour standards; low profit margins of carriers; cost related to environment protection; airport capacity and efficiency constraints; completion form LCCs on short-haul intra-EU market).</p>
<i>3. Reformulate the problem driver(s) behind the problem. Be careful to avoid that the problem drivers directly point to instruments.</i>	<p>The problem drivers have been reformulated as follows:</p> <ol style="list-style-type: none"> 1. Lack of proper mechanism for protection of fair competition in international aviation <ul style="list-style-type: none"> 1.1 Lack of global trade agreements for int. air transport services sector (WTO/GATS) 1.2 Lack of fair competition regime for the int. air transport sector under ICAO 1.3 ASAs not ensuring sufficient level of protection against unfair practices 2. Lack of access to information about the support received and financial accounts of third countries air carriers
<i>4. In the absence of evidence of the alleged unfair practises, the report should give a more balanced overview of the</i>	Section 2.1.4 <i>Concerns about the existence of subsidies and unfair practices</i> was developed by adding the review of the qualitative responses provided by different stakeholders of public consultations. In addition to EU airlines' opinions, the views of EU MS, third

<p><i>diverse concerns expressed by stakeholders.</i></p>	<p>countries, third country airlines and aerospace manufacturers. The section reflects the diversity of opinions.</p> <p>More anecdotal evidence was added in section 2.1.5 <i>Allegations on the use of subsidies and unfair practices</i>.</p>
<p><i>5. Explain more thoroughly the inadequacy of the existing policy instruments. What experiences other service sectors have with this policy instrument and or with alternative instruments?</i></p>	<p>Section 2.1.7 on Legal instruments for protection of competition in other sectors and countries was added providing detailed description of EU anti-dumping and anti-subsidy legislation; EU trade defence tools such as Trade Barrier Regulation (EU) 2015/1843; as well as tools used in other sectors (Council Regulation (EEC) 4057/86 on unfair pricing practices in maritime transport) and other countries (International Air Transportation Fair Competitive Practices Act in the United States).</p> <p>Section on Ineffectiveness of Regulation 868/2004 was moved from problem drivers to a separate section 2.1.8 and streamlined. It is explained why the approach taken in other instruments is inadequate for international air transport sector.</p>
<p><i>6. Apart from describing the effect on the EU flagship carriers, the report should explain how the described developments have affected the situation of consumers as they might be positively affected through lower prices and increases of service quality.</i></p>	<p>Section 2.1.6 Impact of alleged unfair practices on EU air transport market was developed to include the detailed analysis of impacts on the EU air transport sector employees; EU consumers (short/medium and long-term effects); and EU manufacturers and suppliers.</p>
<p><i>7. The baseline scenario should:</i></p> <ul style="list-style-type: none"> <i>- provide information about the expected economic developments in the global airline market</i> <i>- put the interests of EU citizens more central</i> <i>- look at likely evolution for other economic actors than flag carriers</i> <i>- provide information about the expected outcome of the proposed mandates for the Commission for international aviation agreements</i> 	<p>The baseline scenario (section 3.2) was amended by adding information on expected economic developments in: international air traffic growth; extra-European direct traffic flows; position of EU airports; and orders of new aircrafts.</p> <p>The expected impacts of the above trends on EU airlines, EU air sector employees, EU consumers and EU manufacturers of air equipment was described under section 2.1.6.</p> <p>Information on the upcoming negotiations on comprehensive air transport agreements with ASEAN, Qatar, the United Arab Emirates and Turkey was added, however without speculating about the expected outcome of these.</p>

<p>8. The objectives should be reformulated. References to specific policy options should be removed from the policy objectives. Objectives should also aim to enhance the information gathering on unfair practices</p>	<p>The objectives have been reformulated to match with problem drivers:</p> <p>General objective: Ensure a fair level playing field between European and third country air carrier by effectively protecting European air carriers from unfair practices by third countries and third country entities.</p> <p>Specific objective 1: Provide effective defence and redress measures against unfair practices by third countries and third country entities.</p> <p>Specific objective 2: Ensure access to relevant data and information from third country parties</p>
<p>9. The policy options section should provide a choice of fully valid options, each of them addressing all the problem drivers. The choice of partial options that are finally combined into one single valid option should be avoided.</p>	<p>Former options B (increased EU efforts at WTO and ICAO level) and C (negotiation of fair competition clauses in ASA) have been merged to form a fully valid non-regulatory policy option B, as an alternative to adoption of new Regulation (current option C) and combination of regulatory and non-regulatory measures (current option D).</p>
<p>10. The report should explain the policy options and their practical implementation more in detail, in particular their legal implications and constraints.</p>	<p>More details on the legal implications/enforcement issues were added to option B and C. Option C and D further explains how the new Regulation would be enforced in compliance and without prejudice to the Air Services Agreements.</p>
<p>11. The report should explain how the options will address the lack of information of the EU authorities, i.e. how they would collect evidence in case of a complaint about unfair practices.</p>	<p>All the options now address the problem of lack of access to information about the support received and financial accounts of third countries air carriers. Option B proposes that the introduction of a ‘fair competition’ clause in ASAs would also include rules on access to financial data of undertakings to ensure the proper implementation of the Agreement. Option C solves the problem by granting the Commission stronger investigative powers allowing it to seek all the necessary information from all interested parties, as well as carry out investigations in the territory of third countries concerned upon notification (provided that no objections are raised).</p>

II. Analysis of impacts and comparison of options

<p>12. The report should at all times clarify that the described impacts only materialise in case unfair practices are proven.</p>	<p>Relevant explanation added at the beginning of section 4 <i>Analysis of impacts</i>.</p>
<p>13. The report should reveal the cost/benefit ratio of the various policy options to reveal</p>	<p>Additional analysis of cost and benefits ratio of policy options was carried out to the extent possible.</p>

<i>the options' net benefits and explain it.</i>	
<i>14. Other potential costs and risks should be better taken into account, in particular the potential risk of retaliation.</i>	More explanation on potential risk of retaliation under different policy option was added in section 4.1.2. <i>Competitiveness, trade and investment flows</i> . It is explained why option D (preferred option) presents the best ratio between the need of stronger fair competition framework and the risk of retaliation by third countries and third country entities
<i>15. The impact of the policy options on prices and consumer choice should be clarified.</i>	Additional analysis of impact of policy options on prices, service quality and route choice (direct vs. indirect connectivity) offered to EU consumers was carried out in section 5.1.5 <i>Consumers and households</i> .
<i>16. The report should also assess the impacts of the policy options on other EU air carriers, such as airports and passengers.</i>	In addition to the description of impacts for EU flag carriers, the report analyses the impacts of policy options on EU hub airports, EU regional airports, EU companies (section 4.1.2) and EU consumers (section 4.1.5).
<i>17. Section on coherence seems to confuse coherence with efficiency</i>	Section 5.3 on <i>Coherence</i> was substantially amended in line with the suggestions of Unit MOVE A.3. The section now analyses the coherence of policy options with the overall EU transport policy objectives, the Aviation Strategy and Better Regulation principles .
III. Monitoring, transposition and compliance	
<i>18. The report should revise the operational monitoring and evaluation arrangements in line with the recommended changes to the report</i>	Core progress indicators for monitoring purposes have been changed in line with the amendments and better explained under section 6 on <i>Monitoring and evaluation</i> .
<i>19. The report should clearly indicate against which benchmarks the success of the initiative would be evaluated and explain the expected evolution of indicators.</i>	See previous point
IV. Impact Assessment process and presentation of results	
<i>20. The report should be understandable to a non-expert reader. Add a section listing all the used acronyms.</i>	A glossary of term and list of abbreviation were added. The language was simplified .

5. Amendments made following the positive opinion of Regulatory Scrutiny Board (RSB)

RSB Comment	Amendment to IAR
I. Problems, objectives and policy choices – intervention logic	
<p><i>1. The report should describe how technological advances in aircraft engineering may influence the balance between the hub-and-spoke and the point-to-point model, not only within the EU, but also for international flights (and how consumers will be impacted)</i></p>	<p>A paragraph was added in section 2.1.2, explaining how the technological advances on the aircraft manufacturing market may influence the balance between the hub and spoke and the point-to-point model. It is explained, that depending on the resulting evolution, EU and non-EU air carriers may find themselves with an advantage or disadvantage. However, it is noted that at this point, it is not possible to determine in what direction the market will evolve and whether the strategic evolution of the manufacturing market will actually result in a competitive for either EU or non EU air carriers.</p>
<p><i>2. When describing the competitive situation of EU airlines, it should show how some EU airlines are better adapted to these market developments than others</i></p>	<p>A short paragraph was added, explaining how certain EU airlines, notably low cost carriers because of their business model, are less sensitive to the competition developments exercised by non-EU air carriers.</p>
<p><i>3. The elements of presentation and assessment of the baseline scenario should be brought together in Section 4, before the discarded options. The first discarded option (the simple repeal of this Regulation) could also be considered as a variation of the baseline, in order to avoid repetitions.</i></p>	<p>All elements of presentation and assessment of the baseline scenario were brought together in section 3. The first discarded option is now a variation of the baseline scenario.</p>
<p><i>4. As market share is not only an indicator for diminishing competitiveness but also of developments elsewhere in the world, the report should recognise the limitations of market share indicators and focus more on the traffic to and from the EU.</i></p>	<p>A paragraph was added in section 1.3 "Economic context". It explains how the market share indicator should be put into perspective with the evolutions of the international air transport market – especially if it is growing, and not be held merely as a sign that competition conditions have changed.</p>
II. Analysis of impacts and comparison of options	
<p><i>5. With regards to option D, the report should provide, as far as possible, cost estimates that would allow the reader to grasp the (relatively limited) cost of negotiating and</i></p>	<p>The section on the cost of implementation now provides cost estimates of previous cases of international agreements negotiations, and puts these costs into perspective with the return on investment for the EU economy.</p>

<p><i>managing international agreements, compared to the size of potential benefits. This could be estimated based on past experience with such agreements (e.g. human resources that were allocated to these tasks).</i></p>	
<p><i>6. With regard to consumer impacts, apparent contradictions between more direct services and more feeder (i.e. indirect) services should be clarified, as well as its (uncertain) impact on passengers' travel durations.</i></p>	<p>The section on impacts on consumers now explains how the absence of discriminatory practices against EU air carriers may enable to improve the quality of on board services to passengers.</p> <p>The impact on the passengers' travel duration has simply been deleted.</p>
<p><i>7. Stakeholders' opinions: taking into account the diverging views of the stakeholders should be done in a more consistent fashion throughout the report.</i></p>	<p>The wording was nuanced around the use of statistical information concerning the opinion of stakeholders. For example, the use of "a majority of respondents", if justified, was then accompanied by the statistical result of the survey. In other cases, the views of the minority were also put more forward.</p>

Annex B

Stakeholder consultation

1. Public consultation on a "proposal for improved protection against subsidisation and unfair pricing practices"

Stakeholders were consulted through an online public consultation on a "proposal for improved protection against subsidisation and unfair pricing practices" from 29.10.2013 to 21.01.2014. The Commission's standards on public consultation have been respected. 20 entities took part in public consultation, representing EU airlines, EU airport and industry associations, Member States, EU citizens, non-EU airlines and industry associations and EU trade unions. 5 responses have been received from non-EU stakeholders. The results of this public consultation have to be interpreted with caution as they are not statistically representative. Nevertheless, they provide a detailed picture of the position of various key stakeholders.

The results of the public consultation have been bundled in a summary report presented below¹⁴⁹.

Summary of public consultation on a "proposal for improved protection against subsidisation and unfair pricing practices"

I. Format of the survey and key questions

The questionnaire was structured into five sections as follows:

1. Respondent's profiles; 2. Problems to be addressed; 3. Identification of policy objectives; 4. Policy options and their impacts; 5. Other

Section 1 asks respondents to identify themselves as either individuals or organisational or institutional entities, before further self-identifying themselves into a further sub-classification therein. Respondents are also asked to identify which Member State they or their company are deemed to be resident in. Following section one, the remainder of the questionnaire focuses on the EU aviation market itself and specific questions relating to Regulation (EC) No 868/2004.

In section 2, respondents are asked to consider the general aviation market in the European Union and specific "problem drivers" which have been identified in relation to Regulation 868/2004. Section 3 seeks to place this in a wider context, asking respondents to consider the ultimate goal of the regulation in question in both an individualistic and group context within the European Union itself. The penultimate section deals specifically with Regulation 868/2004, asking respondents to consider four possible future paths which the regulation could embark upon ranging from the maintenance of the status quo to a complete and full repeal of the legislation in its present form. Respondents are also asked to consider in this section which current or proposed elements of the regulation could be strengthened to provide the comfort which European entities especially are seeking. Section 5 concludes the survey,

¹⁴⁹ All related documents can be found at http://ec.europa.eu/transport/modes/air/consultations/2014-01-20-protection-against-subsidisation_en.htm

asking respondents to consider a range of “other” considerations not specifically related to the previous sections but which will provide valuable data to the European Commission.

II. Responses to Section 1: Summary of respondents

Due to the commercial sensitivities at stake within this business sector, respondents were provided with a guarantee at the outset that they would not be explicitly named within the analysis unless they expressly indicated their assent. Consistent with that guarantee, the respondents have been re-categorised into wider groupings following their initial self-categorisation and the sub-sections, with the accompanying number of respondents, has been outlined in the table below. There were ultimately twenty respondents to the quantitative aspect of this survey, with additional input provided for some of the specific qualitative issues raised further into the document.

<i>Categorisation of respondent</i>	<i>Number of respondents</i>
EU Airlines	8
EU airports and industry associations	3
Government – EU Country	2
Individuals – EU Citizens	1
Non-EU airlines and industry associations	4
Trade unions	2

III. Responses to Section 2: Unfair practices

Core problems

Respondents were asked whether EU air carriers are currently facing unfair practices causing injury to them in the supply of air services from non-EU countries and to the EU market [Q 2.1.1].

There were 20 responses to this question, with 8 stating that they strongly agreed or agreed, 3 neutral positions and 4 who either disagreed or strongly disagreed.

Unsurprisingly, 88% (7 of 8) of the EU airlines stated that they agreed or strongly agreed that they are facing unfair practices, whilst one was neutral.

There were three non-EU airlines responding. One strongly agreed, whilst the two gulf carriers disagreed or strongly disagreed, as did the single non-EU industry association responding.

All of the trade unions (2 responses) stated that they strongly agreed. Government respondents and airport associations (3) agreed or were neutral, whilst the one EU airport owner that responded disagreed. Also, the respondent belonging to the category "individuals – EU citizen" strongly disagreed.

Respondents were subsequently asked which unfair practices are causing injury to EU air carriers [Q2.1.2].

Subsidy

The existence of subsidy in the supply of air services from non-EU countries to and from the EU market was the practice that the greatest number of respondents felt was an issue, with 60% agreeing or strongly agreeing.

Only one of the 12 respondents that agreed or strongly agreed was classified as non-EU. All but one of the EU airlines were in agreement, with the remaining respondent neutral on this issue. All of the non-EU airlines and industry associations disagreed or strongly disagreed that the existence of subsidy is causing injury to the EU air carriers.

Unfair pricing

Slightly fewer respondents (50%) felt that unfair pricing was causing injury to EU carriers. The responses from the EU airlines followed the same pattern as above, with 88% agreeing or strongly agreeing that this is an issue, and one remaining neutral. The two EU Government bodies also remained neutral, whilst 75% of the non-EU airlines and industry associations disagreed or strongly disagreed.

Other unfair practices

Respondents were asked to provide narrative of other unfair practices which they had noted or areas upon which they wished to elaborate.

Review of the qualitative responses indicates a general view that third-country carriers are potentially distorting the market through the subsidisation they receive from governmental bodies. It is perceived that there is a close link between the carrier and the governments in question, further strengthening the view that they will enjoy a range of advantages which airlines operating in the more open EU market will be unable to compete with.

It is also suggested that significant marketing expense is committed each year by third-country carriers which cannot be matched by EU entities. This is a perception that this marketing investment vastly exceeds what could realistically be expected to be invested by a carrier operating entirely within the confines of its own financial limitations and therefore subsidisation must exist. It is believed that this practice unfairly disadvantages EU carriers as the marketing expenses of third-country carriers can exceed the entirely profit generated by some airlines. There is a further perception that daily business is hindered, particularly with respect to airport access and slot distribution with third-country carriers given precedence.

It is further noted by respondents that the non-EU carriers are often protected against insolvency, whilst their ultimate aim abroad is not to be a profitable entity but to represent the country of its origin abroad. The national governments thus have an intrinsic interest in the operations of the carrier which they believe represents them abroad. This is perhaps not as prevalent an issue in the EU market, where the open market has seen many national carriers move into wholly-private hands.

In response to these concerns, representatives of third-countries who responded to the survey rejected the claims put forward by their competitors, asserting that the airlines in question benefitted from geographical advantages. In conjunction with a wide route network, this made the airlines in question the service provider of choice for many consumers. Further, there is a belief that where conditions are imposed, they benefit EU airlines and do not protect the operations of non-EU airlines.

Protection to EU carriers against unfair practices

Respondents were asked their views on the statement that the current legislative framework does not effectively guarantee protection to EU air carriers against unfair practices, causing injury to them in the supply of air services from non-EU countries to and from the EU market [Q2.1.4].

The majority of respondents, including 7 of the 8 EU airlines, one of the four non-EU airlines and associations, and both of the EU-based trade unions agreed with this statement. One of the two EU airports and one of the two EU Government respondents were also in agreement; however, caution should be exercised in drawing conclusions from such a small sub-group of respondents.

25% of respondents disagreed with the statement, i.e. were of the viewpoint that current legislation offers sufficient protection to EU carriers. This group comprised 3 of the 4 of the non-EU airlines and associations and one EU airport and association.

Bilateral Air Service Agreements

When asked to qualify their responses, 60% cited the ineffectiveness or non-existence of fair competition clauses in Bilateral Air Service Agreements (ASAs) between EU Member States and non-EU countries. 91% of these respondents were based in the EU, with the one remaining respondent in agreement a non-EU airline or association. 3 out of 5 of those who disagreed or strongly disagreed were non-EU airlines or associations, while the 2 remaining were EU airports and individuals – EU citizens.

Regulation 868/2004

60% of respondents agreed that the ineffectiveness of Regulation 868/2004 was an issue exposing EU air carriers to unfair practices and causing injury. Within this group, 75% felt strongly that this was the case. The pattern of respondent types was similar to the above, with the majority of those who disagreed being non-EU airlines or associations.

ICAO rules

The lack of ICAO rules on fair competition was felt by a slightly smaller percentage (55%) to be an issue, and the majority of those agreeing felt less strongly (i.e. stated that they agreed rather than strongly agreed). The majority of those who disagreed was again the non-EU airlines or associations (75% of this group, with the remaining respondent remaining neutral).

Question 2.1.6

Respondents were then asked to consider three narrative questions. The first, 2.1.6, asked respondents to specify any other reasons they may have regarding the main cause of injury to EU air carriers.

There is a perception that the protective measures initially implemented have not kept pace with the increasing liberalisation of the EU aviation market. There is thus an imbalance between the protective measures designed to safeguard EU airlines and the reality of the present-day EU aviation market. There is also a belief that there is an inherent reluctance to apply and enforce existing legal frameworks by EU in the context of bilateral agreements. By extension, this has led to EU airlines being disadvantaged.

It is also felt that the continued toleration of monopoly structures is leading to unfair competition on routes to and from the EU. In this context, it is suggested by some respondents that EU competition authorities will assess the anticompetitive behaviour extant within foreign jurisdictions. It is suggested that such an approach should be adopted within the aviation sector also. This point is expanded upon by other respondents, who cite the lack of an appropriate body to monitor activity in which national, regional and global strategies are interconnected. It would therefore appear that the absence of an authoritative “higher body” to adjudicate on these matters is deemed to be one of the main reasons behind the injuries which EU air carriers believe they are suffering.

Mention is also made of the anti-dumping provisions within the General Agreement on Trade and Services (GATS) which does not extend to air travel, and that the lack of this legal framework may also be a cause. Also suggested as a possible reason, is a perceived lack of a collective approach, with Bilateral Air Service agreements being undertaken by either Member States individually or by the European Commission together with its 28 Member States as a whole. It would appear that the uncertainty this generates, as well as competing interests within the 28 Member States, may be a further factor.

Finally, it is suggested that the general economic malaise in Europe, with a number of EU nations remaining in recession and others requiring financial rescue, has contributed to a decline in EU aviation services offered which third-country entities, through strong home country economic performances, are in advantage to exploit.

Question 2.1.7

Respondents were then asked to identify any other core problems hindering the effectiveness of protections against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries to and from the EU market.

There is a perception that there is no coherent EU wide aviation policy currently in place to protect EU airlines and EU hubs, with short-term regional interests taken precedence in the decision making process over longer-term pan-European concerns. It is believed that a coherent pan-European policy is needed to protect EU airlines as a whole. It is also perceived that third-country entities are making strategic investments in EU airlines.

Once in control of the entity in question, it is believed that they will seek to channel as many passengers as possible to their non-EU airlines and hubs to maximise return. This then damages the EU airline itself and by extension the airports in which they are operating. Some respondents expand on this point, citing that where the airline in question is owned by a non-EU entity, it can then avail of non-EU sources of capital which EU entities may find far more difficult to come up. This exacerbates the problems and increases the competition gap.

It is also believed that EU airlines will be required to pull out of numerous markets should the growth of non-EU airlines continue at the present pace. This would represent a damaging blow to the EU aviation market, with their airlines unable to compete on pricing, capacity and route choice on a global basis. Furthermore, respondents have cited that the present Regulation only seeks to protect against injury on a route basis. This principle fails to consider the network basis upon which airlines compete, and is thus a flawed method for contextualising the injury suffered.

However, it is also suggested that the increasing prevalence of low cost carriers operating within the EU aviation market is adversely impacting the services which flag carriers can offer on routes where there was previously no low-cost carrier presence. It is therefore implied that the pricing issues stem from competing against low-cost carriers rather than against pricing structures reliant on subsidy. It is also suggested by some respondents that the International Civil Aviation Organisation (ICAO) has already developed adequate recommendations and guidance for the oversight and enforcement to ensure fair competition, however such agreements would need to be ratified on a bilateral basis.

Question 2.1.8

Finally, respondents were asked to provide information if they considered themselves to have been the subject of unfair practices by competitors or authorities from a non-EU country. The following responses were noted:

It is identified by some respondents that they believe they have been the victims of unfair practice through the imbalance of terms and conditions allowing access to the market, direct financial state support as national policy in third-countries and also the non-existence of a fair competition clause in certain markets. Further, some respondents have utilised the qualitative box to cite that should they have suffered unfair practices, they do not believe Regulation 868/2004 would have been a sufficient mechanism to resolve these issues.

It is suggested by some respondents that the substance of this question compromises the objectivity of the survey itself, with the question itself perceived as being aimed directly at EU carriers. They therefore believe that the tone of the questionnaire is weighted towards a certain outcome. This view is not supported by EU entities which have responded, however this is perhaps expected given the largely EU/non-EU split noted throughout the analysis thus far. The other responses received within this box did not directly address the issue noted, and have therefore not been included within the analysis of this question.

Problem drivers - Regulation 868/2004

The survey identifies four over-arching problem drivers and then asks respondents to consider their agreement or disagreement with a number of specific issues therein.

Problem Driver 1 – Logic of trade defence instruments

The first problem driver identified relates to trade defence instruments, with the difficulty in identifying subsidies granted by a third country to its non-EU air carrier and the difficulty in determining the existence of unfair pricing identified as the two key issues within this.

There was strong agreement that it is difficult to identify subsidies granted to non-EU air carriers by other countries. All eight EU airlines agreed with this assessment, whilst three of the four non-EU respondents disagreed or strongly disagreed with this statement. EU airports and airport industry associations were split, with one offering no opinion, one agreeing and one disagreeing with the statement. This would imply that parties which are directly affected (competing airlines) are more likely to be concerned over subsidy provision to non-EU airlines than parties not directly affected.

With respect to determining unfair pricing, respondents broadly answered along the same lines. All three non-EU parties which offered an opinion disagreed or strongly disagreed with the statement.

Problem Driver 2 – Impracticable/unclear concepts used in Regulation 868/2004

The second problem driver identified relates to the impracticable/unclear concepts used in the existing regulation. This covers difficulties of interpretation in both wording and concepts within the regulation itself, all of which could contribute to a lack of effective protection of EU air carriers against unfair practices. The four specific issues identified in the survey are denoted below.

In the first instance, respondents were asked to consider whether they agreed or disagreed that the application or interpretation of the ‘Like air service’ concept contributed to difficulty in implementing the legislation. With this particular issue, 60% of respondents neither agreed nor disagreed with the statement (ten offering a neutral opinion, and two providing no opinion). The only grouping to register a strong opinion either way was non-EU airlines and industry associations, where three of the four entities therein disagreed or strongly disagreed that the application of the ‘Like air service’ concept contributed to difficulty in protecting EU airlines.

The second issue respondents were asked to consider was the difficulty in proving injury. Unlike the previous example, all EU airlines and trade unions which had expressed a neutral opinion on the application of the ‘Like air service’ concept expressed strong agreement. All other respondents expressed the same opinion as the previous issue. This suggests the difficulty of proving injury is an issue with EU airlines and trade unions are in unanimous agreement about and upon which they feel very strongly.

The third issue which respondents were asked to consider was determining whether defining the threshold for the Community industry represented a difficulty in protecting EU airlines. 50% of the respondents neither agreed nor disagreed with the assertion that the difficulty in defining the threshold contributed to difficulties in protecting EU airlines. The Middle Eastern non-EU airlines and industry associations all expressed disagreement or strong disagreement. Both trade unions agreed (one strongly).

The final impracticable or unclear concept in Regulation 868/2004 that respondents were asked to consider related to the difficulty in proving the Community interest as required by the Article.

Seven of eight EU airlines agreed (one strongly) that difficulty in proving the Community interest as required by Article 16 contributed to difficulties in protecting EU airlines from unfair practice. Only three non-EU entities offered an opinion, all of which disagreed or strongly disagreed with the assertion.

In concluding the analysis of the responses to problem driver 2, it is apparent that there is a clear distinction between EU and non-EU respondents with the latter more comfortable with existing regulation and not necessarily believing that deficiencies therein represent significant difficulties for protecting EU airlines from unfair practice. In contrast, EU entities – specifically airlines and trade unions – consider the perceived deficiencies within the regulation as a more significant factor in protecting their interests.

Furthermore, it would appear from the analysis that EU airlines are more comfortable with the specific remits of concepts within the regulation (broadly neutral on the application of ‘Like air service’ concept and ‘threshold for defining the Community industry’) than with proving that concepts or protections therein have been breached. It is noteworthy that in the case of

both ‘difficulty in proving injury’ and ‘difficulty in proving the Community interest as required by Article 16’, EU airlines were in broad and strong agreement that they represented difficulties in protecting them from unfair practice.

Problem Driver 3 – Ineffective procedural framework of Regulation 868/2004

Respondents were asked to consider various potential deficiencies within Regulation 868/2004 and express either agreement or disagreement that they were contributing to an ineffective protection of EU air carriers against unfair practices causing injury to them in the supply of air services from non-EU countries to and from the EU market.

The first of the five potential deficiencies identified within the survey related to the point at which proceedings begin under the existing legislation. Respondents were asked to consider whether the initiation of said procedures only when sufficient evidence is already available could lead to ineffective protection of EU air carriers. Eleven of the twenty respondents indicated their agreement with this assertion, including 7 of the 8 EU airlines who expressed their strong agreement. Both trade unions also expressed strong agreement. In contrast, of the three non-EU entities which offered a response, all three disagreed (one strongly).

Respondents were then asked to consider whether the fact that the burden of proof lies with the complainant represented an issue when attempting to protect EU airlines from unfair practices causing them injury. The three non-EU entities offering an opinion all disagreed (one strongly) with this assertion, however seven of eight EU airlines agreed (three strongly).

It is notable that whilst the EU airlines did agree with the statement, they did not do so as strongly as with the previous statement relating to initiation of procedures only when sufficient evidence is already available. It was further noted that whilst the trade unions both agreed with the statement, only one did so “strongly”.

The third issue respondents were asked to consider was whether inappropriate deadlines within the framework represented an issue. None of the respondents stated strong agreement with the idea that inappropriate deadlines are a contributory factor, however, nine (including 75% of the EU airlines) indicated their agreement with the statement. The trade unions also felt less strongly on this particular issue, with one expressing a neutral opinion and one being in agreement. Of the three non-EU airlines and industry organisations which offered an opinion, all three were found to be in disagreement (one strongly) with the statement.

The penultimate issue pertained to inadequate consultation mechanisms, whereby the cooperation of third countries, their airlines and other stakeholders affected by a European Commission investigation cannot be effectively imposed. Of twenty respondents, eleven indicated their agreement with this statement (including 7 of the 8 of EU airlines) and both trade unions. Consistent with previous trends, all three of the non-EU entities which responded with an opinion did so in the negative with one strongly disagreeing and the remaining two disagreeing.

The final procedural issue which respondents were asked to consider related to the investigative powers of the European Commission and whether their scope was sufficient for the purposes of effective implementation of the Regulation. As with previous responses, there was a significant discrepancy between EU and non-EU entities with only one of the former disagreeing. All three non-EU entities disagreed (one strongly), whilst 73% of EU entities were in agreement with a further two neutral and one offering no opinion. This suggests that

EU entities hope for the European Commission to adopt a wider remit in any investigation, whilst non-EU entities consider the existing framework to be sufficient when defining the Commission's investigative boundaries.

When considering Problem Driver 3 as a whole, it is evident that EU entities are far less satisfied with the existing regulatory framework than their non-EU counterparts. Whereas the former show a broad consensus of agreement that each of the five issues identified constitutes an ineffective component of the framework, non-EU entities appear more content with the present framework.

Problem Driver 4 – Ineffective possible remedies under Regulation 868/2004 (sanctions)

The final over-arching problem driver which respondents were asked to consider related to possible remedies already extant within the Regulation, and whether they were effective in discouraging unfair practices which may adversely affect EU airlines. The first remedy which respondents considered related to the calculation of duties and the practicalities of this given existing pricing practice in the aviation market.

Eleven of the responding parties agreed with this statement, including 7 of the 8 EU airlines and both trade unions. All three of the responding non-EU entities disagreed with the statement (one strongly). This is consistent with the trends noted throughout, whereby there is a clear difference of opinion between EU and non-EU entities with respect to the issues which may contribute to the ineffective protection of EU airlines from unfair practice.

Respondents were asked to consider whether the term “other measures” was sufficiently well defined within the framework. The majority of respondents appear to believe that this all-encompassing term for additional sanctions is insufficiently defined and requires additional clarification if it is to prove an effective deterrent against unfair practice injuring EU airlines. As with previous analysis, all three non-EU airlines and industry associations which offered an opinion did so in the negative (one strongly).

The final possible remedy which respondents were asked to consider related to the voluntary conflict resolution contained within the framework and its usability in practice. Eleven respondents were in agreement that the voluntary conflict resolution as it currently stands is not useable in practice. This includes 7 of the 8 EU airlines, both trade unions, one EU airport and industry association and one governmental body. All three non-EU entities once again expressed their disagreement with the statement.

In concluding the analysis of Problem Driver 4, it is clear that EU entities are generally dissatisfied with existing remedies within the framework given the wide consensus of agreement noted. In contrast, non-EU entities appear to be broadly content with the contents of the existing framework, rejecting the notion that the possible remedies contained within the framework and identified within the survey are ineffective.

Question 2.2.1.5

Respondents were then asked to provide a qualitative answer pertaining to additional problem drivers. They were to identify any other problem driver in relation to Regulation 868/2004 which hindered the effectiveness of protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries to and from the EU market.

There is a perceived lack of transparency on the financing arrangements of foreign carriers and airports, whereby foreign carriers were granted access to the EU market without imposing any obligation on them to provide transparency on their business model. Furthermore, the burden of proof regarding injury lay with the injured airline itself. When combined with the aforesaid lack of transparency, the respondents argue that this made the proving of injury an impossible task.

This was also extended by some respondents, who cited the lack of reciprocity in the access granted in European and third-country markets, whereby third-countries will not allow EU airlines to enjoy the same access levels which the European Union grants to third-country airlines. It is perceived that this may be due to the close links which exist between many third-countries and the airlines based in those countries.

Respondents further argued that the lack of a competent European authority to investigate anticompetitive behaviour represented a significant problem also. As noted by respondents in previous qualitative answers, aviation does not form part of WTO/GATS. There are therefore no international rules which would control and sanction behaviour incompatible with a liberalised market. The respondents extend this point, highlighting that in the present framework there is an absence of adequate remedies within the existing frameworks. It is believed that only the restriction of market access would be sufficient to deter anticompetitive behaviour, however the existing frameworks do not allow for sanctions of this nature and thus anticompetitive behaviour cannot be adequately dealt with. This expanded upon further by other respondents, who cite the lack of an effective dispute settlement procedure as being a key problem.

Some respondents have also suggested that the framework as it stands at present is not properly adapted to the specificities of the air transport sector. It is believed that the regulation does not account for an important commercial reality imposed by various third-countries, namely the obligation to sign commercial agreements with the local carrier or authority. There are also potential conflicts of interest regarding this, whereby the ultimate owner of a non-EU airline may also be the same body which negotiates traffic rights for European airlines operating to that country.

In contrast, the argument is also made by some respondents that the present regulation is adequate, however the fact that it has not yet been invoked does not necessarily translate to the conclusion that it would be ineffective if that invocation were to happen. Further, some respondents have argued that lowering the threshold at which the regulation can be invoked would present significant problems and lead to vexatious complaints that would bring about unnecessary cases which do not utilise the regulation in the manner in which it was originally intended. It is further suggested by some respondents that the European Commission already has sufficient power to investigate anticompetitive behaviour and that new mechanisms are not therefore required.

Problem Drivers – Concluding comments and final considerations

Throughout the analysis, we have noted a clear and consistent discrepancy between EU and non-EU entities which implies a fundamental disagreement regarding problem drivers which are preventing an effective protection of EU air carriers against unfair practices. Three of the non-EU airlines and industry associations disagreed with every statement throughout Section 2.2.1 (one disagreeing strongly with every statement). In contrast, of the 112 overall responses offered by EU airlines within the analysis of problem drivers, 44% were strongly agreed, 34% were agreed, 21% were neutral and only 1% (1 response) was disagreed.

It is therefore difficult to envisage a resolution to unfair practices which will satisfy all entities that responded to the consultation. As previously noted within the analysis, it would appear that non-EU entities are broadly satisfied with the existing framework and do not consider the issues noted to be material. By extension, EU entities, particularly EU airlines, appear to be dissatisfied with extant regulation and would welcome a number of improved or wider definitions and clarifications within regulation 868/2004.

IV. Responses to Section 3: Competitive and regulatory environment

Respondents were asked to consider to what extent they agreed with assertions pertaining to the existing competitive and regulatory environment for EU carriers servicing non-EU countries. There were three separate questions relating to the provision of more effective protection for EU air carriers, views on the competition position of the EU aviation industry and whether more could be undertaken to deter unfair practices.

Respondents were asked whether they thought that EU air carriers should be provided with more effective protection against unfair practices causing injury to them in the supply of air services from non-EU countries to and from the EU market. Twelve respondents agreed or strongly agreed with this statement, including seven of eight EU airlines. A clear distinction was noted between EU and non-EU entities. Following the exclusion of those parties offering a “neutral” or “no opinion” response, only one EU-based entity disagreed with the need to provide more effective protection against unfair practices. Governmental bodies and trade unions were also in agreement with the need to provide more effective protection to EU carriers.

Of the four non-EU based entities, Middle Eastern carriers and industry associations were either neutral (one) or in disagreement (two). An additional non-EU airline agreed with the statement. Overall, there was a clear assent to the assertion that more effective protection for EU airlines from unfair practices was required where they are supplying air services from non-EU countries.

Policy objectives

As an extension of the previous question regarding the protection of EU airlines in non-EU markets, respondents were asked to consider whether there should also be a reinforcement of the competitive position of the EU aviation industry. There was strong agreement with this statement, with 68% of respondents posing agree or strongly agree. This included all EU airlines, both trade unions and one Middle Eastern carrier. Only one non-EU entity disagreed that a policy of reinforcing the competitive position of the EU aviation industry would be beneficial. Across all categories there was a general agreement that the competitive position of the EU aviation industry should be reinforced.

Finally, respondents were asked to consider whether there should be a policy that sought to deter unfair practices in the supply of air services from non-EU countries to and from the EU market. Given previous responses have noted a clear distinction between EU and non-EU parties, it is unsurprising that a policy which may adversely impact non-EU entities posits little support from this category. EU entity views are generally favourable.

Of the EU airlines, 88% strongly agreed, and all non-individual EU groupings averaged agreed or strongly agreed. Only three parties overall disagreed with the policy objective of deterring unfair practices. Alongside the individual EU citizen, two non-EU airlines and

industry associations comprised the parties rejecting this policy objective. This is consistent with the trends noted throughout section three, with a clear distinction drawn throughout between EU and non-EU (particularly Middle Eastern) entities.

V. Responses to Section 4: Policy options and their impacts

In section 4, respondents have been asked to consider a wide range of potential policy options and the proposed impact on a number of suggested indicators. Having discussed the general framework and the perceived deficiencies and prejudices therein in the previous sections, section four seeks to identify solutions to these issues. Further, it seeks to identify the key areas which will be impacted through the implementation of any changes in policy which have been suggested within previous sections.

Section 4.1 – Policy options in relation to Regulation 868/2004

Respondents were asked to consider four options relating to the future of Regulation 868/2004, ranging from unchanged contents to a repealing of the present framework, as outlined below:

1. Regulation 868/2004 will remain unchanged
2. Regulation 868/2004 will be repealed
3. Regulation 868/2004 will be amended
4. Regulation 868/2004 will be thoroughly revised

A consideration of the aggregated responses for each of the above will be made, alongside a final analysis to determine the most popular overall option for each respondent category heretofore identified.

Option 1 – Regulation 868/2004 will remain unchanged

Considering the trends previously identified of non-EU entities being largely content with the existing framework, it is perhaps surprising that only one entity of the three who submitted an opinion within this category did so in the affirmative. However, the remaining two entities were neutral, indicating some level of ambivalence towards a wholly-unchanged regulatory framework. In contrast, EU airlines posited a generally strong disagreement (six of eight airlines). This particular statistic is consistent with previous findings throughout this survey, where it is clear that EU airlines in particular feel especially aggrieved by the existing framework and would welcome changes which positively impact the business environment in which they operate.

Option 2 – Regulation 868/2004 will be repealed

It would appear from the responses received for this particular option that whilst EU airlines are strongly against the existing framework remaining unchanged, there is no appetite for an all-encompassing repeal of the present regulation. Whilst six of the eight airlines “disagree” with the notion of repeal, none of those therein did so “strongly”. This is in stark contrast to six of the eight airlines “strongly disagreeing” with Option 1 – Regulation 868/2004 will remain unchanged. This may suggest that whilst EU airlines would welcome amendments and

revisions to Regulation 868/2004, they would prefer repeal to the present framework remaining in place unchanged.

Further, the same non-EU entity which “strongly agreed” with Option 1 also “strongly agreed” with Option 2. Given responses for Options 3 and 4 for this entity were both “strongly disagree”, thereby seemingly ruling out amendment to the framework, it is possible to infer that the entity in question would prefer the regulatory framework to either remain in place and, if this is not possible, be repealed rather than countenance any amendments to the present contents.

Option 3 - Regulation 868/2004 will be amended

The narrative provided within the survey implies that whilst the Regulation would be amended under this option, the changes would be largely superficial and would not significantly or materially alter substance. The survey itself notes examples including “reconsidering the scope, providing additional clarifications, adjusting the procedures and introducing new sanction mechanisms, while maintaining the current logic of the Regulation (“light” revision).”

The responses received largely indicate that this is an unpopular option, with ten of the thirteen respondents who offered an opinion doing so in the negative. Whilst five bodies have indicated their neutrality towards this particular option, it is striking that there is a considerably larger body of support for the “full” revision option. This is discussed further within the “Option4” section. It should also be noted that all three entities which offered “strong agreement” or “agreement” towards this option went on to offer “strong agreement” to Option 4. It is therefore clear that respondents are significantly in favour of a “full” revision of the framework in preference to the “light” revision option offered within Option 3.

Option 4 – Regulation 868/2004 will be thoroughly revised

In contrast to Option 3 (“light” revision), Option 4 offers examples which would constitute a “full” revision of Regulation 868/2004. The survey itself notes the following: “Regulation 868/2004 will be thoroughly revised by reconsidering the current approach of a trade defence instrument and replacing it by a new, sector specific instrument e.g. a simplified instrument similar to the US International Air Transportation Competition Act (“full” revision). This policy option could also include the considerations as set out under the previous option.”

Of the sixteen entities offering an opinion on this option, eleven indicated their agreement. Only five disagreed, including all three Middle Eastern-based entities within the non-EU categorisation. As noted previously within the analysis of Option 3, all three entities offering agreement therein went on to offer “strong agreement” to Option 4. Further, six of the eight EU airlines offer agreement. This narrative is wholly consistent with the trends noted throughout the survey where there is a clear and definable split between EU and non-EU (particularly Middle Eastern-based) airlines.

In concluding Section 4.1, it is clear from the analysis that a “full” revision of the existing framework is the most popular option amongst EU entities, particularly EU airlines. The analysis also indicates that whilst EU airlines are largely dissatisfied with the present Regulation, they welcome its existence in principle with only one respondent from all categories indicating agreement towards a complete repeal.

It is therefore possible to conclude that the framework being “fully” amended would likely meet with considerable approval from EU entities, whilst non-EU entities, particularly Middle Eastern carriers and organisations, would likely have serious misgivings over any revisionary process which may adversely impact the present market conditions in which they operate.

Respondents were asked to consider alternative possible revisions of Regulation 868/2004. No qualitative responses were received in this regard.

Section 4.3 – Making Regulation 868/2004 more effective

Respondents were asked to consider, “without prejudice to [their views] whether the current Regulation should be amended or replaced by a new instrument”, whether the following indicators would allow Regulation 868/2004 to be more effective in its operation. Twelve options were presented, with all but one option ultimately demonstrating a “net positive” agreement that an amendment along the lines stipulated would allow the present regulation to be more effective.

Code	Indicator	Total agreed	Total disagreed	Net
4-3-9	Sanctions other than duties should be clearly defined together with the situations to which they apply	11	2	+9
4-3-7	The obligation to cooperate for third countries, their airlines and other stakeholders affected by a European Commission investigation should be strengthened	11	3	+8
4-3-3	The definition of subsidy as currently used in the Regulation should be widened	11	4	+7
4-3-4	The definition of injury as currently used in the Regulation should be reconsidered	11	4	+7
4-3-1	The scope of the Regulation should be extended to cover a wider range of unfair practices e.g. discrimination in setting charges	11	5	+6
4-3-8	Procedural aspects of the current Regulation such as deadlines, consultation mechanisms, investigation proceedings etc. should be reviewed	10	4	+6
4-3-11	The methodology for the calculation of duties should be revised	10	4	+6
4-3-6	The burden of proof and the required initial evidence as currently provided by the Regulation should be reviewed in order to be able to initiate proceedings more effectively when justified	10	5	+5
4-3-10	Possible sanctions should include restrictions on the use of traffic rights available under air transport agreements	10	5	+5
4-3-5	Concepts coming from trade defence instruments such as "Community industry", "like air service" and "non-commercial advantage" should be reconsidered or abandoned	4	2	+2
4-3-12	The "Community interest test" required by Article 16 of the Regulation should be dropped	7	5	+2
4-3-2	Given the difficulties in its application, the unfair pricing track of the Regulation should be abandoned	4	9	-5

It is clear that non-EU entities favour the maintenance of the status quo unless the revisions extend to the removal of existing regulations and a general relaxation of the regulatory framework. In stark contrast, EU entities, particularly EU airlines, are strongly in favour of amendments which offer greater clarification on existing terms therein. They also favour strengthening safeguards and extending various provisions to offer wider remits to the Commission.

Question 4.4

Respondents were then asked to provide qualitative responses elaborating on their quantitative replies and specifying how the Regulation could be made more effective. The following responses were garnered for 4.4:

Respondents emphasised the need for clear definitions. It is necessary to complete clearly defined list of types of injury, taking into account their effect on the EU aviation market, airlines, employees and consumers. The definition of “subsidy” also needs to be tightly defined as it is currently so broad that it would catch what may not be regarded as State aid in the EU because of the application of the market economy investor principle. Likewise, the definition of unfair pricing practice must be tightened such that it cannot unduly catch either balanced cost behaviour or otherwise sound commercial behaviour.

European competition rules are much stricter than the correspondent ones in the rest of the world. The main issue is not the current European rule but the ability to credibly implement it in case of problem with carriers of non-European sovereign countries, with whom bilateral or open skies agreements have been signed.

The application of the existing European competition law is sufficient to punish predatory, distortive and abusive behaviour that would impact the EU aviation market and negatively affect all carriers, irrespective of whether they are EU national carriers, EU low cost carriers or non-EU carriers, and these provisions are quite clearly focused on protecting the pro-competitive market dynamics for the benefit of EU consumers. Under article 101 of the Treaty on the Functioning of the European Union (TFEU) for instance, all agreements between undertakings which have as their object or effect a distortion of competition, in the common market or in a substantial part of it, in particular by the creation or strengthening of a dominant position, must be declared incompatible with the European internal market. Countermeasures within the meaning of regulation, as well as against breaching of fair competition clauses must definitively include operating restrictions (such as the limitation on using traffic rights etc.)

A dual approach of a revised Regulation 868/2004 together with regulatory convergence and fair competition clauses with like-minded countries to provide liberal traffic rights agreements would be a step forward. As international air transport services are not covered by GAT agreement, certain national legislation ensures legal protection at national level. The evolution of the air transport agreements, especially with the development of free markets and pricing and open skies agreements has led to the greater importance of fair competition practices at all levels. Fair competition discussions and fair competition clauses are now not only part of the ICAO agenda but they also begin to be included in the different air transport agreements negotiated between the European Union and third countries. The protection of fair competition should be integrated as part of the negotiations of air transport agreements and also be further discussed at ICAO level since fair competition is not a regional but a worldwide issue.

For the Regulation to be effective, the standard of evidence used for any decision should be set according to specific circumstances of the airline sector set out in 2.2.1.5 and should be as high as that used in EU competition cases and the same analytical tools and quality of evidence applied. A lack of transparency currently prohibits the ability to collect sufficient evidence. The revised Regulation should include the possibility for relief measures to be put in place as soon as the complaint is found to be valid. Mandatory rules for transparency should be included in the new regulatory framework. The revised legal framework needs to facilitate access to financial data of third parties in order to gather sufficient evidence of

unfair pricing practices by third country airlines, subsidies provided by third countries to airlines and consequential damage caused to the EU aviation industry and the causal link between a price and the damage. Market behaviour departing significantly from industry trends on a permanent basis, vertical integration of aviation actors and impossibility to identify financial flows between these actors should a priori be considered as signals of potential distortions.

The appropriate standard should be that of a substantiated legal complaint sufficient to launch civil legal proceedings and which would not be “struck out” for failure to state a case. Investigation of unfair practices should not impose high costs on the carrier being investigated. Any changes to the regulation need to be studied extensively so as to avoid undermining the sovereignty of a third country and hence being deemed extraterritorial under international law. Consider only sanctions that are targeted and proportionate to the injury caused. These should not include revocation / limitation of traffic rights. The Regulation could be made more efficient if the term ‘redressive measures’ is defined. In particular, the use of robust “free-rider” clauses should be considered as a redressive measure. Redressive measures shall preferably take the form of restrictions on traffic rights to, from, within or via the EU air market on third country air carriers. Such restrictions on market access could be applied to third country carriers concerned and should be enforced on an EU-wide basis. Article 4 on subsidisation should be amended so that the following cases are covered:

- Subsidisation resulting from a public guarantee given to the third country air carriers that allow them to obtain financing upon market basis otherwise not accessible to them or on conditions that do not meet the private investor test;
- Subsidisation resulting from the fact that an air carrier with a public participation does not behave as a private investor;
- Subsidisation resulting from a discriminatory access to airport facilities, fuel or other reasonable facilities necessary for the normal operation of air services;
- Subsidisation resulting from a measure imposed on EU air carriers by a third country that favours the adoption of agreements between air carriers, decisions by associations or air carriers or concerted practices;
- Subsidisation resulting from policies regarding protection against insolvency

Deadlines should be reduced and authorities should have the obligation to take redress measures if no acceptable solution is reached within these tightened deadlines.

Airport user charges should not fall within the scope of unfair practices as these adhere to the ICAO principles of non-discrimination in their user charges policies. Any focus on unfair practices at airports should also include the policy towards slots.

Question 4.5

Respondents were then asked to identify and rate any other measure which could improve the effectiveness of Regulation 868/2004. The responses received have been documented below:

- Introducing a fair competition clause in existing and new ASAs is an important step: This policy should be implemented as soon as possible and Member States should be encouraged

to invoke it. If Member States fail to do so, the EU Commission should be given authority to apply and enforce the clause.

- The EU Commission should address the practise of some governments to connect access to the EU aviation market with other files, such as purchase of military weapons etc. Although it is a fact of life that such relations exist, the often open and unabashed linking of these issues should not be tolerated.
- On a long term perspective, EU and Member States should thoroughly evaluate the pros and cons of including aviation in the WTO/GATS framework.
- With the aim of establishing a level-playing field at global level, it could be an option that ICAO plays a role to modernise the global framework for international air transport, including the development of basic principles for fair competition and related instruments.
- At EU level the overall aim should be regulatory convergence in order to ensure the transparency of data, the independence of national competition authorities, as well as governance and better enforcement through an appropriate dispute resolution mechanism. For easier assessment and enforcement of Regulation 868/2004, it is essential to establish an appropriate EU authority which based on EU law is controlling and sanctioning the compliance of third country airlines. To this end, the comparable body established under the International Air Transportation Act can be taken as an example.
- An EU wide comprehensive strategy to strengthen the aviation sector, its competitiveness and the quality of the employments (direct and indirect) it generates.
- Development of effective external air services negotiations strategy that puts more emphasis on advancing the EU airline industry's commercial interests, instead of an 'open market for all' approach.
- Prevention of social dumping and flag of convenience by using Europe's fragmented social, tax and employment regulation.
- Set up of a legal framework to allow and provide legal certainty trans-national bargaining (including, negotiation, agreement and enforcement). The lack of substantial trans-national representation and negotiation of labour in Europe demonstrate to some like-minded third countries – such as the US – that Europe allows unfair practices (the non-respect of the collective labour rights) to develop.
- Firm commitment to the social dimension of international air services agreements both during the negotiations and during their implementation. Liberalised air traffic rights must not be used to undermine existing social standards.
- All carriers subject to applicable competition laws worldwide. These laws are complementary to the legal provisions that govern bilateral ASAs, in turn providing operating carriers protection against practices that cause injury and distort market forces.

Section 4.6 – Impact of policy changes on suggested indicators

Respondents were asked to consider a range of possible impacts that the policy measures discussed above may have if they were incorporated into the revised Regulation 868/2004.

The nature of the question was for respondents to consider whether they agreed that the policy measures previously discussed would impact the particular indicator.

Code	Indicator	Total agreed	Total disagreed	Respondents Net with opinion
4-6-9	Market share of non-EU businesses in air services to and from the EU	11	2	+9 13
4-6-11	Flight prices for customers of air services to and from the EU	11	2	+9 13
4-6-14	Employment in the EU aviation industry	11	2	+9 13
4-6-15	Job quality in the EU aviation industry	11	2	+9 13
4-6-13	EU/Member States relations with third countries	10	2	+8 12
4-6-2	Better functioning of the internal EU aviation market	10	3	+7 13
4-6-5	Market share of EU businesses in air services to and from the EU	10	3	+7 13
4-6-4	Administrative burden for EU air carriers	9	2	+7 11
4-6-1	Fair competition in the external aviation market	9	3	+6 17
4-6-8	Administrative burden for non-EU air carriers	5	2	+3 7
4-6-10	Administrative burden for non-EU public authorities	5	2	+3 7
4-6-7	Operating costs for non-EU air carriers	4	2	+2 6
4-6-16	Employment in the non-EU aviation industry	4	3	+1 7
4-6-17	Job quality in the non-EU aviation industry	4	3	+1 7
4-6-6	Administrative burden for public authorities in the EU	3	2	+1 5
4-6-12	Service level on flights for customers of air services to and from the EU	3	3	0 6
4-6-18	Other	0	2	-2 2
4-6-3	Operating costs of EU air carriers	1	6	-5 7

The possible analysis within this section is limited as only nine of the suggested indicators garnered a response rate in excess of 50% from the twenty participants who responded with quantitative answers. Further, out of 72 possible responses for the four non-EU airlines and industry associations only 23 (32%) were received in agreement or disagreement. Consequently, it is very difficult to ascertain whether there is a significant divide between EU and non-EU outlooks with respect to the likely impact of policy changes in this sphere.

Taking the aggregated responses and considering them as part of a wider narrative, it is clear that respondents generally agree that there would be an impact on EU business alongside an impact on the market share of non-EU businesses operating within the EU itself. This would appear to be consistent with the narrative of EU entities, particularly EU airlines, viewing the current situation as unfavourable. However, the findings from Section 4.6 would suggest that respondents would consider some of the policy changes suggested in 4.3 as correcting existing imbalances within the regulation, and thus having the most impact upon EU entities and their operations.

Conclusion of Section 4.6 analysis

From the analysis completed for Section 4, it is clear that the impact on EU issues is of considerably more concern to EU entities. Whilst some responses were offered for the impact on non-EU entities, this was limited and represented an issue which EU entities were, largely, ambivalent towards. It would appear from the overall analysis that EU respondents largely favour new policy initiatives, whilst they believe that the implementation of these policies will have a resultant impact on a number of EU-specific indicators. There appears to be little interest from EU entities in any ultimate impact that these new policy initiatives may have on non-EU entities.

Perhaps the two most significant points within Section 4.6 pertain to 4-6-1 (fair competition in the external aviation market) and 4-6-2 (better functioning of the internal EU aviation market). Both received strong positive responses from EU entities and relate to the fundamental issue at the centre of the survey which seeks to redress apparent imbalances

within the existing regulation and offer stronger protection to EU airlines from unfair practice. EU entities in particular agreed that new policy initiatives would result in fairer competition in the external aviation market and a better functioning of the internal EU aviation market. Specific policy initiatives would therefore be implemented in an environment which EU entities believe will ultimately benefit the markets in which they operate and allow greater competition and opportunities to improve their own performance.

Respondents were asked to provide qualitative responses in sections 4.7 to 4.9, however no responses in this regard were received from those who completed the survey.

VI. Responses to Section 5 - General Qualitative Responses

Respondents were asked to provide general comments at specific points during the survey. The responses received are of a general nature, and contain commentary on the general aviation market and also suggestions on where improvements may be made. The responses received in this regard, which do not necessarily fall under the remit of any other question contained within the survey, have been included below.

- The IATFCPA instrument has demonstrated over time both its practicability as well as its efficiency. It could form a good basis for a European trade defence instrument.
- To look at fair balance and reciprocity; Transparency of investments' sources; Fair social conditions for employees in non-EU countries; and there is no control power of EU institutions on non-EU countries.
- The new instrument would provide sufficient tools to enable access to the financial data of third country air carriers.
- Introduction of "fair competition" clauses in EU Horizontal Air Transport Agreements is an effective instrument of control but, considering the long time frame to conclude such an agreement with third countries, this is still a long term goal.
- a scheme similar to the US International Air Transportation Competition Act 1979, would set the necessary framework to embark on an effective defence instrument, to safeguard fair competition in EU external aviation relations.
- Mechanisms and instruments of the WTO should be considered in the revision process
- Social standards and labour legislation (including job quality) in 3rd countries should not be overlooked while dealing with 'unfair practices'.
- Consideration of environmental regulations (i.e. night restrictions, operational restrictions).
- Differences in countries' economies, political and legal systems, geographical position, population size and histories of participation in civil aviation mean that "fair competition" can never equate to a requirement that identical operating conditions must exist with respect to air services offered by the airlines of ASA partner countries. An approach should be to accept these differences, to establish the broadest possible market access for airlines of all sides taking such differences into account, and then to delimit carefully and narrowly the circumstances in which intervention to address alleged "unfair practices" is legitimate.
- A fundamental objective should be to foster airline competition in the interests of consumers, economic growth, and prosperity.
- There is concern that the study appears to be more inclined towards securing the interest of EU carriers rather than the EU air transport stakeholders in general and the consumer in particular.

- Risk that revision of Regulation 868/2004 may lead to unnecessary protectionist treatment.
- Extreme options considered could trigger disputes with non-EU countries similar to the one following the inclusion of international aviation in the EU emissions Trading Scheme.
- Any changes to the regulation need to be studied extensively so as to avoid undermining the sovereignty of a third country and hence being deemed extraterritorial under international law.

2. Public consultation on the "Aviation package for improving the competitiveness of the EU Aviation sector"

The question of unfair practices was also a part of the recent public consultation in view of the Commission's work on the development of an Aviation Strategy carried out between 19.03.2015 and 10.06.2015¹⁵⁰. The Commission received 233 full questionnaire responses and 41 position papers from stakeholders, representing Member States, non-EU countries, airlines, airports, groundhandling companies, pilots, aircraft suppliers and manufacturers, industry and workers associations, consultancies, academia and individuals. The information gathered in the stakeholders' consultation complements the data gathered by the studies and was used to assess the perceived challenges and obstacles that EU carriers face on extra-EU markets.

Input from stakeholders and the external study have been taken into account and reflected in the different sections of the impact assessment report where appropriate.

The part of the summary report relevant to the impact assessment report is presented below.

Summary of public consultation on the "Aviation package for improving the competitiveness of the EU Aviation sector"

External dimension of EU-aviation

The overwhelming majority of respondents agreed that EU carriers face challenges when competing with non-EU carriers, important issues being cost advantages of non-EU carriers versus EU carriers (including lower labour cost) or a more favourable tax regime.

A majority of respondents are of the opinion that state subsidies for non-EU carriers are an important competitive disadvantage of EU carriers. Some respondents, however, strongly argue against the existence of such support. The same response pattern can be identified when it comes to the question of unfair commercial practices of non-EU carriers.

More neutral opinions were expressed with regard to the question of possible discrimination of EU carriers by non-EU States or non-EU service providers. The overall response is also rather balanced when it comes to the comparison of the attractiveness of products and services of EU / non-EU carriers, the question of potential overcapacity in the markets or the potential issue of a geographic advantage of non-EU carriers over EU carriers.

¹⁵⁰ All related documents can be found at http://ec.europa.eu/transport/modes/air/consultations/2015-aviation-package_en.htm

When asked to rank the challenges / obstacles EU carriers face on extra-EU markets, the issues that were most mentioned, were cost advantages of non-EU carriers, more favourable tax regimes and the issue of potential subsidies.

When it comes to the main areas for future work to improve the framework conditions of the EU's aviation sector in international competition, three areas were particularly highlighted: fair competition, regulatory harmonisation and taxation.

Most respondents expressed the view that these issues should best be addressed at international level (ICAO) or at EU-level, e.g. through the negotiation of comprehensive air transport agreements.

	Strongly disagree	Somewhat disagree	Neutral	Somewhat agree	Strongly agree	No opinion	Total
EU carriers do not face challenges when competing with non-EU carriers	71	25	12	13	2	38	161
Non-EU carriers have cost advantage vs. EU carriers (including lower labour cost)	3	9	12	36	60	41	161
Non-EU carriers receive uncontrolled state subsidies	10	7	19	32	36	57	161
Non-EU carriers enjoy a more favourable tax regime than EU carriers	1	7	18	34	40	61	161
There is a discrimination by non-EU States or non-EU service providers	9	10	26	29	12	75	161
Non-EU carriers offer more attractive products and services than EU carriers	10	18	39	31	12	51	161
There is overcapacity on the route served	10	21	28	25	12	65	161
Non-EU carriers have a larger global network than EU carriers	15	37	33	13	7	56	161
Unfair commercial practices are used by non-EU carriers	10	11	21	27	26	66	161
Non-EU carriers have a geographic advantage	11	27	40	24	7	52	161
Non-EU carriers are managed more efficiently than EU carriers	23	32	27	12	6	61	161

Asked to name interesting countries/regions for possible future comprehensive air transport agreements, most respondents, across industry sectors and from diverse stakeholder groups, named the Gulf States or the United Arab Emirates and Qatar. China, Turkey, ASEAN, Mexico and Russia were mentioned often. Japan and India, and to a lesser extent African States or South Korea, were mentioned also as potential candidates. Low cost airlines emphasised EU neighbourhood countries.

Annex C
Affected parties and their key interests

The table below presents the parties affected by the problem and their key interests.

Stakeholder	Description	Key interests
Consumers	Consumers on the European air transport market (both leisure and business travellers)	A wide range of convenient and reliable air services provided at high service quality and low prices (less important for business passengers).
Travel/hospitality industry	European tourism service providers (tour operators, accommodation providers, restaurants, attractions, shops, transport providers).	Good air connectivity and quality services at low prices, possibility of cooperation with airlines/airports on marketing, advertising, additional services
EU air carriers	Mainly network carriers operating intercontinental networks	Competitive and sustainable freight and passengers services
Third country air carriers	Third country air carriers competing on unfair basis	Increased market share at the expense of EU carriers
EU airports	EU airports (around 460) especially international hub airports and their feeder airports	Competitive and sustainable services rendered to air operators (aircraft movements, passengers and freight)
Third country airports	Homebase of third country air carriers	Strengthened position as global hubs
Other representatives of the air transport value chain	Aircraft manufacturers, groundhandling and aircraft repair and maintenance providers, air navigation service providers, catering companies, travel agents, computer reservation system vendors.	Profitable and sustainable services rendered to air operators.
Employees	Direct airlines employees but also employees of other entities within the aviation value chain (around 2.3 million people in the EU).	Job security, salary and employment conditions.
Member States' regulators and enforcement bodies	National, regional and local bodies regulating and enforcing air transport legislation	Facilitation of the decision-making process, well-functioning market, compliance with the rules by air operators

Annex D Environmental impacts

Table 1: Environmental impacts based on drivers broken down per air carrier nationality: greenhouse emissions generated¹⁵¹

	Aircraft type	Length of trip	Take-off emissions	Fleet age
EU carriers – direct	Wide body	Shortest possible	Direct flights have less emission	Overall older than their counterparts
EU carriers – non-direct	First leg of trip with Narrow body. Second leg of trip with wide body	Hub stops may increase length of trip	More emission due to non-direct flights	Overall older than their counterparts
Third country carrier A	Wide body	Increase flight length	More emission due to non-direct flights	Aircraft fleet is very young
Third country carrier B	Middle mix between wide-body and narrow body depending on origin. Narrow body length of flight generally short	Best to go to Asia in case of non-direct flights	More emission due to non-direct flights	Aircraft fleet is very young

Source: PWC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU

Table 2: Environmental impacts based on drivers broken down per air carrier nationality: noise pollution generated¹⁵²

	Aircraft type	Length of trip	Take-off emissions	Fleet age
EU carriers, direct	Wide body	Not relevant	Direct flights have less noise pollution	Overall older than their counterparts
EU carriers, non-direct	First leg of trip with Narrow body. Second leg of trip with Wide body	Not relevant	More noise pollution due to non-direct flights	Overall older than their counterparts
Third country carrier A	Wide body	Not relevant	More noise pollution due to non-direct flights	Aircraft fleet is very young
Third country carrier B	Middle mix between wide-body and narrow body depending from	Not relevant	More noise pollution due to non-direct flights	Aircraft fleet is very young

¹⁵¹ Light colours: least environmental impacts. Dark colours: most environmental impacts

¹⁵² Light colours: least environmental impacts. Dark colours: most environmental impacts

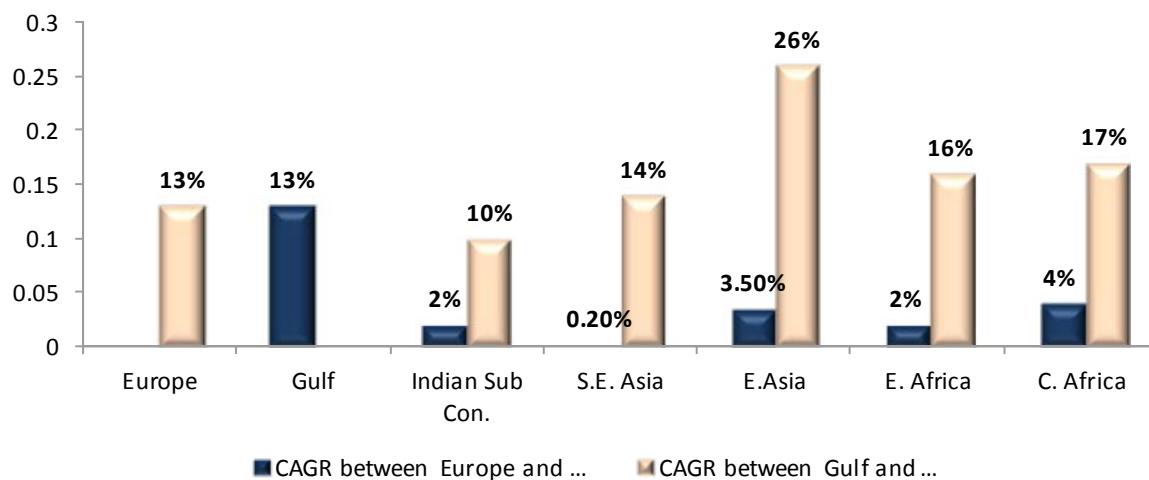
Aircraft type	Length of trip	Take-off emissions	Fleet age
origin. Narrow body length of flight generally short			

Source: PWC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from EU

Annex E Market trends in Europe and other regions

Taking the example of Europe – Asia-Pacific air traffic flows, it is evident that Europe has been lagging behind the Middle East Region over the last decade. While Europe has been struggling to record decent levels of growth on this market the Middle East Region has been experiencing double digit yearly growth. Moreover, a high growth level was also recorded on the market between Europe and the Middle East (see Figure 1). As indicated earlier, the Middle Eastern carriers use traffic rights mainly to carry EU passengers beyond their home markets, recording the 80-85% ratio of transfer passengers. It is easy to imagine that the staggering growth from the Middle East to Asia was extensively driven by origin and destination traffic from Europe. It must be underlined that the three major Gulf carriers are the biggest global airlines in terms of passenger fleet (both in service and on order).

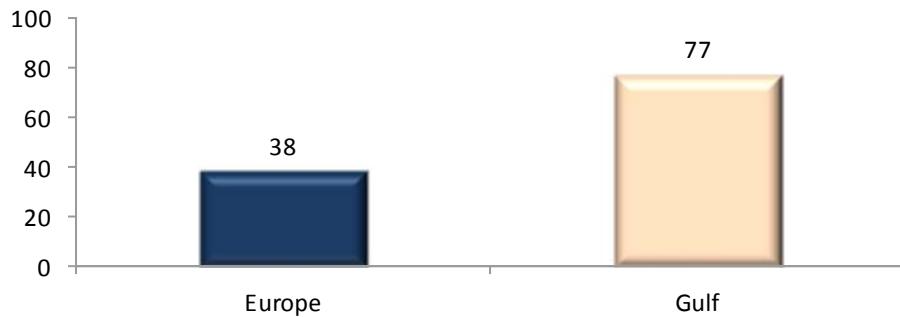
Figure 1 - Capacity growth: ASK CAGR 2004-2014 between regions



Source: Mott Mac Donald, EU Gulf Topical Report, September 2014

The imbalance between the two regions is even more evident in terms of the number of new city pairs. As shown in Figure 2 below, the Gulf Region managed to add twice as many new routes to Asia than Europe.

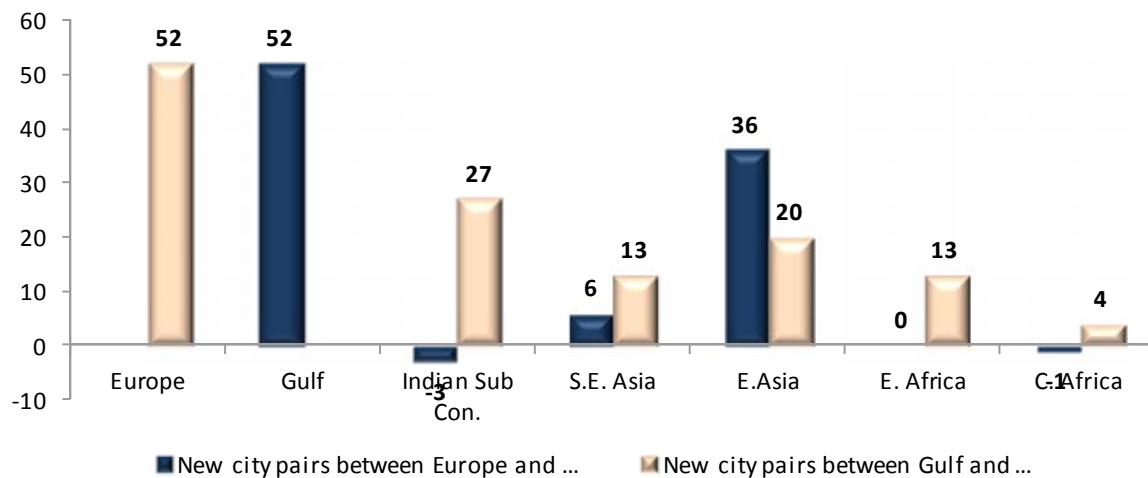
Figure 2 - New city pairs between Europe and Gulf and Indian Subcontinent, South-East Asia, East Asia, East Africa and Central Africa



Source: Mott Mac Donald, EU Gulf Topical Report, September 2014

It is also striking that the number of city pairs between the Gulf States and Asia was augmented by 77 and the market between Europe and the Gulf States was enlarged by 52 new routes.

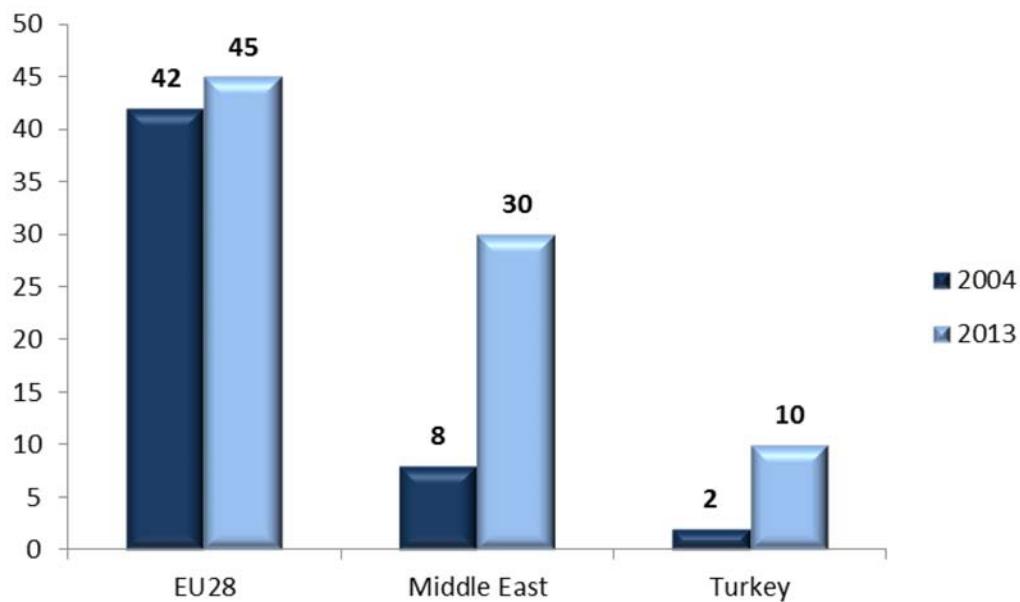
Figure 3 - New city pairs 2004 – 2014 between regions



Source: Mott Mac Donald, EU Gulf Topical Report, September 2014

This shift in network balance affects European intercontinental transfer flows. It is evident that Europe is losing its position as a global hub. As shown on the graph below European hubs managed to increase intercontinental traffic flows from 42 million passengers in 2004 to 45 million in 2013. However, at the same time, Middle Eastern and Turkish hubs increased their transfer traffic from 8 to 30 million and 2 to 10 million respectively.

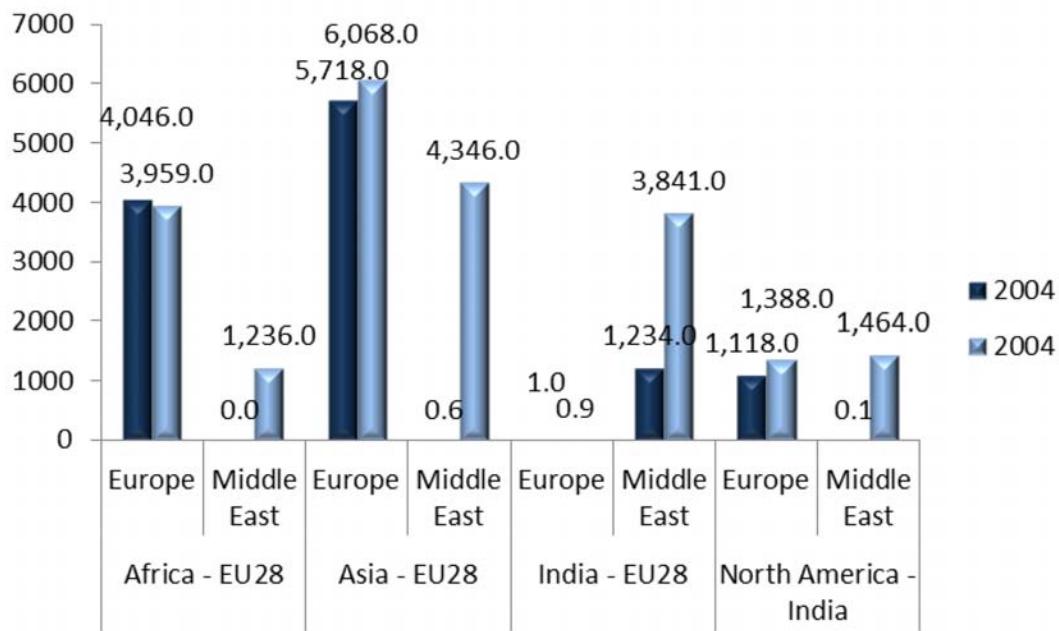
Figure 4 - Intercontinental transfer traffic (millions of passengers) by region in 2004 and 2013



Source: PWC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from the EU

The threat to the European position as an intercontinental hub is even more evident if we compare the individual traffic flows. It should be noted that only transfer traffic flows between EU28 and Asia as well as North America and India increased slightly their volume at European hubs over last 9 years. At the same time passengers travelling between all analysed regions (see Figure 4) significantly increased their presence at the Middle Eastern hubs, using them as transfer points.

Figure 5 - Connecting traffic via Europe and Middle East by destination region, 2004 and 2013

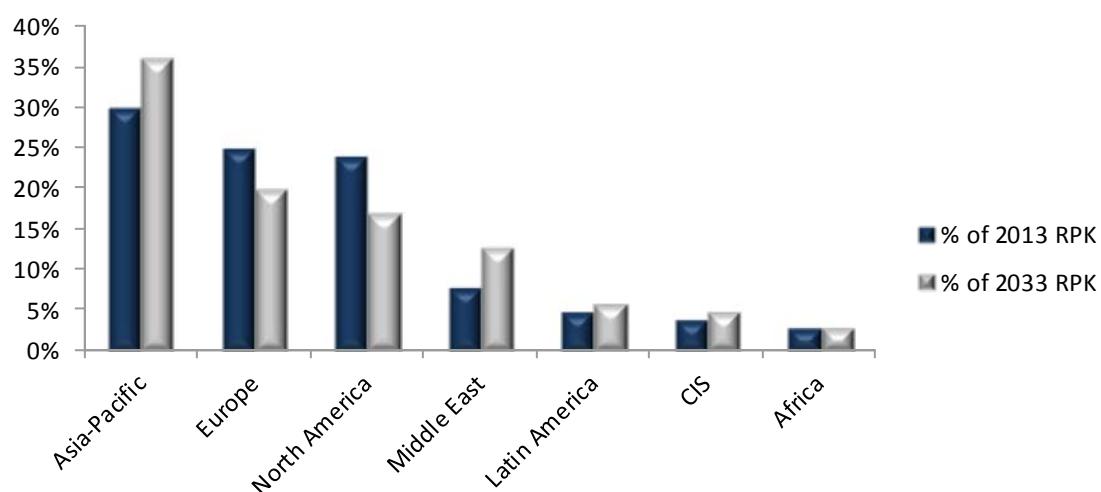


Source: PWC, Improved protection against unfair practices causing injury to EU air carriers in the supply of air services from non-EU countries on routes to and from the EU

What is also important, in the report *Challenges of Growth, Task 4: European Air Traffic in 2035*, released by Eurocontrol in June 2013, the organisation assumed growing importance of Middle East hubs (namely Dubai, Abu Dhabi and Doha) for connecting traffic between Europe and Middle-East, Asia/Pacific and Southern Africa. According to Eurocontrol, this expansion would take place at the expense of the growth of transfer traffic to those regions at European hubs. The study forecasts also the growing role of the hub in Istanbul, but to lesser extent in comparison to Middle-Eastern hubs.¹⁵³.

These prospects for European hubs are also mirrored in Airbus's latest market forecast¹⁵⁴. It predicts that European carriers will significantly lose their global market share from 25% in 2013 to 20% in 2033 (see Figure 6). At the same time Asia-Pacific and Middle Eastern carriers will increase their market presence.

Figure 6 - RPK traffic market share by airline domicile.



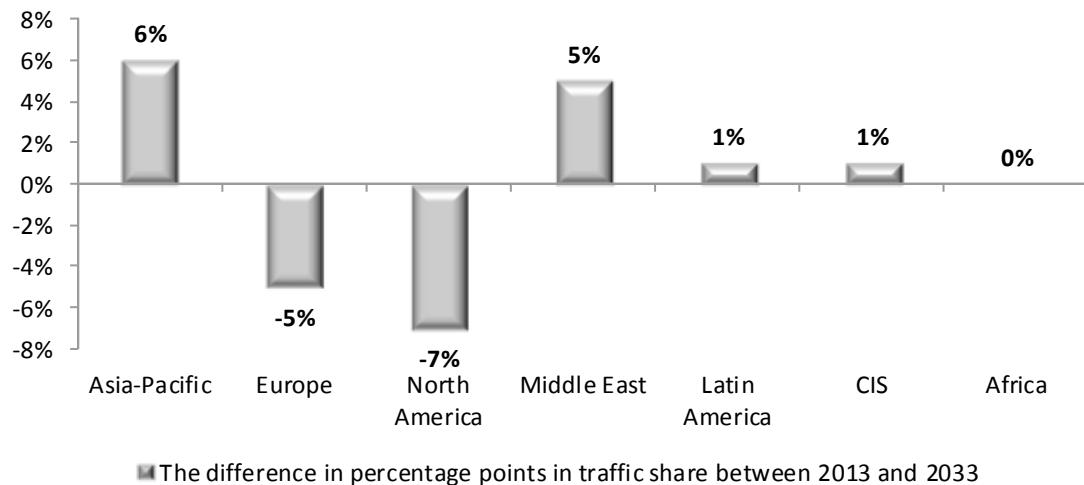
Source: Presentation of J. Leahy, Flying on demand, based on Global Market Forecast 2014-2033, Airbus.

Airbus forecasts that while the European's market share will drop by 5 percentage points the Middle-Eastern carriers and airlines from Asia-Pacific region will increase their market participation by 5 and 6 percentage points respectively (See figure 7).

¹⁵³ Eurocontrol, Challenges of Growth, Task 4: European Air Traffic in 2035.

¹⁵⁴ Airbus, Global Market Forecast 2014-2033

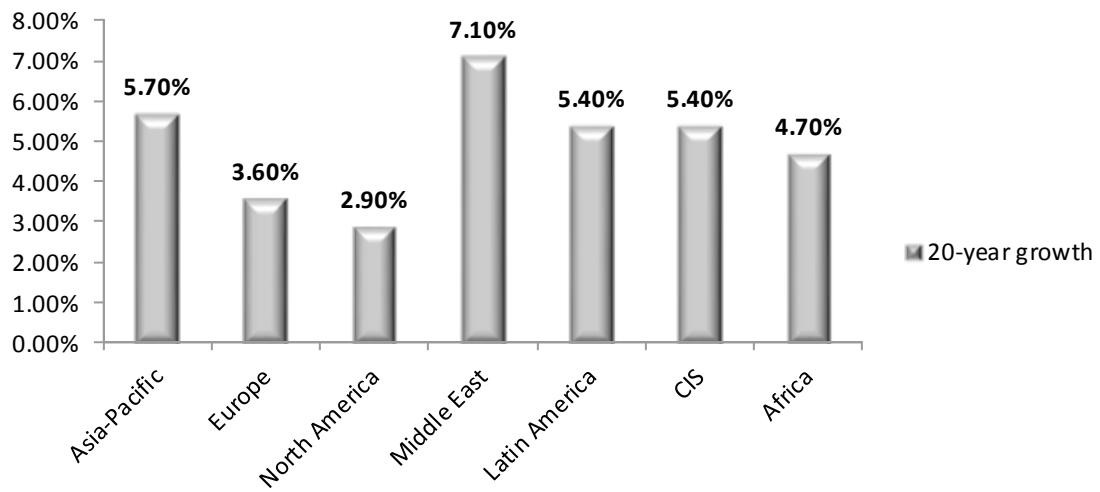
Figure 7 - The change in market share between 2013 and 2033 by airline domicile.



Source: Presentation of J. Leahy, *Flying on demand, based on Global Market Forecast 2014-2033, Airbus*.

Airbus predicts also that Europe over the next 20 years will record second lowest yearly traffic growth in the World. The highest growth will be at the same time realised by Middle Eastern carriers (see Figure 8).

Figure 8 - The yearly growth by airline domicile between 2013 and 2033.



Source: Presentation of J. Leahy, *Flying on demand, based on Global Market Forecast 2014-2033, Airbus*.

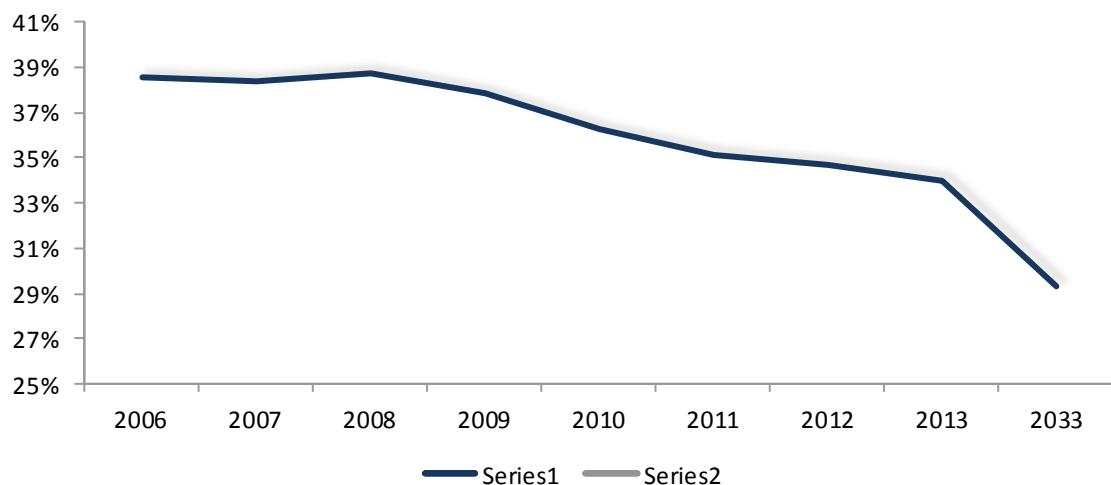
It is not surprising though that Eurocontrol predicts that “in terms of air traffic growth, Europe will be in the slow lane, with the Middle East and China (Asia/Pacific) growing much more rapidly”¹⁵⁵.

Boeing for example forecasts that the share of European traffic¹⁵⁶ will drop from 34% in 2013 to 29% in 2033 (see Figure 9).

¹⁵⁵

Eurocontrol, Challenges of Growth, Task 4: European Air Traffic in 2035, p. 9

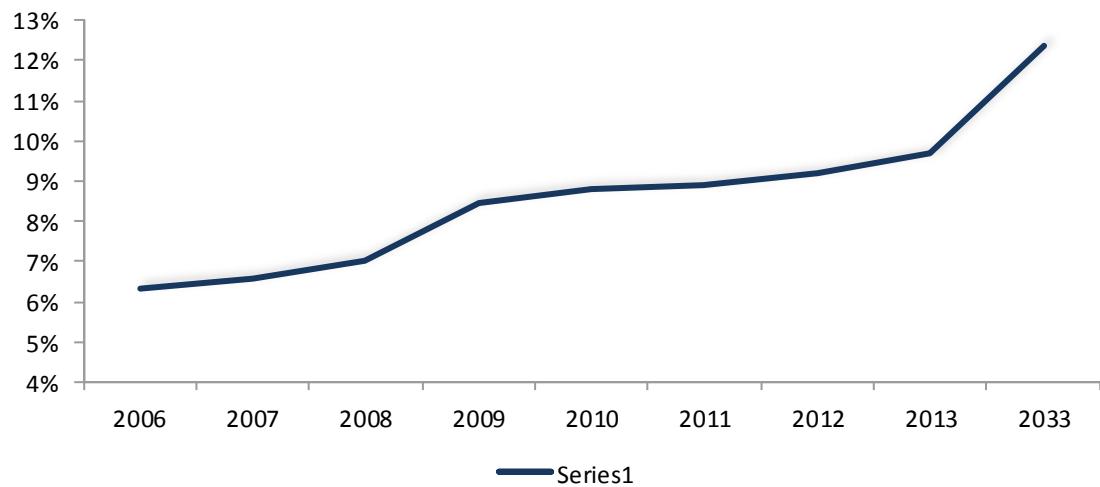
Figure 9 - The global share of European traffic (including intra-European operations)



Source: Boeing Current Market Outlook 2014-2033

At the same time the share of Middle Eastern traffic¹⁵⁷ is predicted to increase by 2 percentage points from 10% in 2013 to 12% in 2033 (see Figure 10).

Figure 10 - The global share of Middle Eastern traffic (including intra-Middle-Eastern operations)



Source: Boeing Current Market Outlook 2014-2033.

As in case of the whole market the forecasts for the major extra-European direct traffic flows are also declining. Traffic between Europe and North America is going to lose its global share from 7% in 2013 to 5% in 2033. At the same time, the share of the air traffic flows between Europe and the Asia-Pacific is only going to be maintained at the same level.

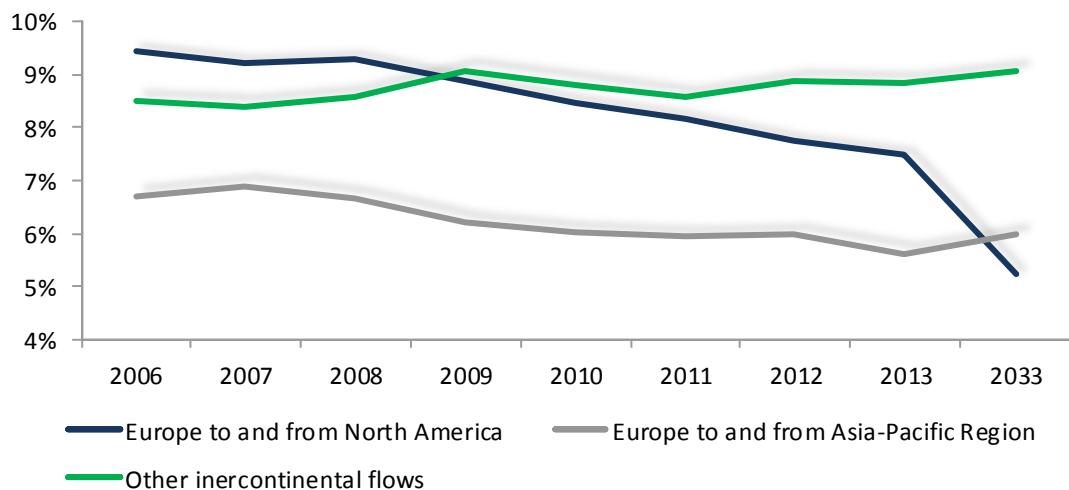
¹⁵⁶

Intra-European flows and major extra-European flows (All carriers – irrespective of their origin)

¹⁵⁷

Intra-Middle-Eastern flows of and major extra-Middle-Eastern flows (All carriers – irrespective of their origin)

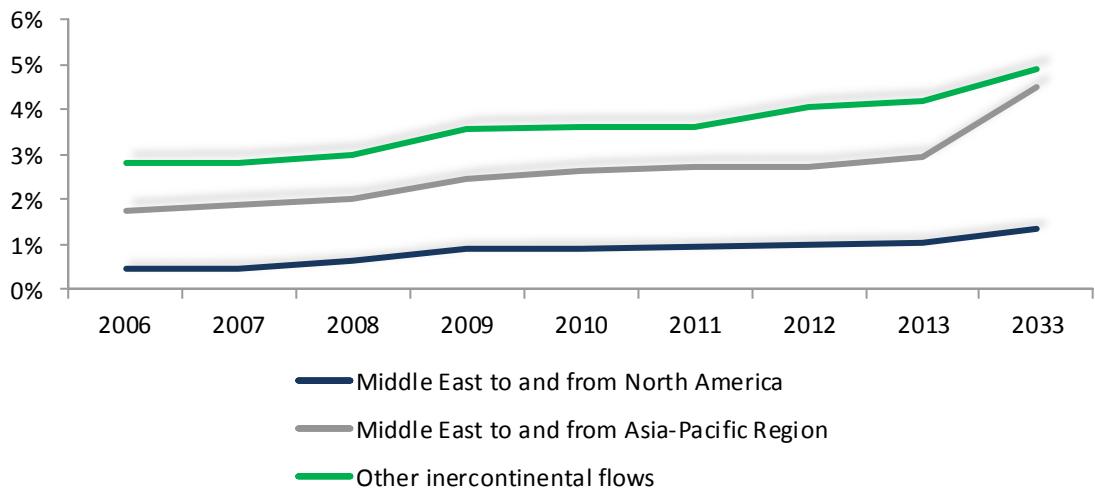
Figure 11 - The global share of major intercontinental traffic flows from Europe



Source: Boeing Current Market Outlook 2014-2033.

According to Boeing's forecast the flow between Middle East and Asia is going to increase its global market share by half over the forthcoming 20 years.

Figure 12 - The global share of major intercontinental traffic flows from Middle East



Source: Boeing Current Market Outlook 2014-2033.