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COMMUNICATION FROM THE COMMISSION

THE WAY FORWARD FOR CIVIL AVIATION IN EUROPE

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I. CIVIL AVIATION IN EUROPE : A BRIEF REVIEW OF LEGISLATIVE AND ECONOMIC DEVELOPMENTS

1. Efforts to create a Civil Aviation policy took off in 1974 when the European Court of Justice ruled that the general rules of the Treaty of Rome apply to air transport.
2. In 1978 a Memorandum listing priorities was drawn up and the first, very cautious legislative step was taken in 1983 in the form of a Directive for Interregional Air Services¹. A second, more detailed Memorandum followed in 1984². In 1985 the European Court of Justice decided on the action brought forward by the European Parliament against the Council³. In 1986, the European Court-of-Justice in an important case ("Nouvelles Frontières") reiterated the urgency of establishing an appropriate Community framework for Europe's civil aviation system⁴. The political breakthrough towards launching the process which gradually replaced the traditional bilateral way of organising intra-European air transport was achieved in 1987 with the adoption of two Council Directives : one on air fares, and the other on capacity control and access to routes. Furthermore the Council adopted a political commitment to carry on this process towards the realisation of a complete Single Aviation Market in this sector⁵.
3. In 1989 the Council of Transport Ministers declared that liberalisation of air services, harmonisation of standards and a common policy on external aviation relations must be regarded as integral parts of the common air transport policy. The practical legislative process continued in 1990 with the so-called Second Package⁶ followed in 1991 by a Regulation on air freight; and finally in 1992 the decisions on the Third Package were adopted⁷. This development of the air transport policy was accompanied by a gradual but full implementation of the competition rules in this area.

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^{1/} O.J. No. L 237 of 26.8.1983

^{2/} COM(84) 72 final

^{3/} O.J. C144 of 13.6.1985

^{4/} ECJ cases No. 209-213/84, ECR p. 1425

^{5/} O.J. L 374 of 31.12.1987

^{6/} O.J. L 217 of 11.8.1990

^{7/} O.J. L 240 of 24.8.1992

The process of harmonising rules on technical standards, and on safeguarding fair competition such as computer reservation systems, slot allocation and safety requirements moved forward in parallel. As regards the external dimension, the Commission presented a Communication and proposals in 1990 and 1992.

4. Politically speaking, the legislative evolution from a rigid regulatory framework based on a bilateral approach towards a fully developed genuine Community market was based on commitments entered into only in 1987 with the Single Act.
5. Economically speaking, the succeeding legislative steps which have led to the creation of the Single Aviation Market were launched against the background of a general economic situation for the aviation industry, both world-wide and in Europe, which was different from that of today. During the late Eighties the industry experienced a period of strong growth and satisfactory profitability. In 1988 air carriers reporting their results to International Civil Aviation Organisation (ICAO) averaged a profit margin of 3.0 %. Accordingly, aircraft manufacturers' orderbooks and delivery cycles achieved unprecedented levels.
6. Europe was no exception to this general development. Between 1987 and 1991 the number of seats offered on scheduled intra-Community routes increased by approximately 50 %. Between 1988 and 1990 more than 100 new intra-Community routes were opened.

Table 1

Annual capacity increase on scheduled intra-Community services (seats offered)

1988	11.6 %
1989	14.5 %
1990	9.7 %
1991	9.2 %
1992	7.8 %
1993	3.5 %

Source : ABC data-base
ITA (Institut du Transport Aérien)

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7. In the aftermath of the Gulf-crisis, capacity growth slowed down significantly as a consequence of heavy losses. Most Community air carriers gave priority to consolidation instead of market expansion.
- As a consequence, the new freedoms of the Third Aviation Package (fifth-freedom, cabotage) have so far been little used if compared with the overall capacity operated by Community air carriers. Accordingly, only 20 of the 50 busiest intra-Community routes were operated by more than 2 Community air carriers (July 1993). Nevertheless, the significant increase of fifth-freedom operations in 1993 indicates the additional economic potential created by the abolition of remaining restrictions to this type of air transport operation, and this is likely to be exploited more fully as the economy recovers.

Table 2

Fifth freedom operations in Europe

	<u>Routes offered</u> (per week)	<u>Seats offered</u> (per week)	<u>Change (%)</u>
1991 (July)	16	24.456	
1992 (July)	21	23.278	- 4.8 %
1993 (July)	33	38.428	+ 65.1 %

Geographical scope : European Union plus Norway and Sweden

Source : ABC data-base

8. Likewise, relatively few cabotage operations have been started since the Third Package entered into force (12 routes in July 1993). It appears that the overall economic situation as well as the remaining restrictions (valid until 1 April 1997) have contributed to this slow development so far. Additionally, some air carriers are using cross-border shareholdings as their prime vehicle for developing new markets. TAT and Deutsche BA represent the most prominent examples of this way of making use of new commercial opportunities.
9. The growth in aircraft orders in the late Eighties, combined with a significant slowing down in traffic growth, has resulted in an overcapacity situation. Load factors decreased sharply. It is not surprising that this overcapacity has put considerable pressure on yields. However, price competition has almost exclusively concentrated on promotional fares. The percentage of seats sold at promotional fares has increased significantly. At the same time normal air fares remained relatively high in Europe if compared with other regions.

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Table 3

Intra-European scheduled air traffic

	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
passengers travelling at				
- full fare	39 %	37 %	33 %	29 %
- promotional fare	61 %	63 %	67 %	71 %
- load factor	62.5%	56.8%	56.8%	58.0%

Source : AEA

10. Overcapacity has led to declining average yields. This has put considerable pressure on the financial situation of most major air carriers. However, another important element of the current situation is the variation in developments as between individual air carriers. This can, first, be seen by comparisons between air carriers belonging to the Association of European Airlines (AEA, usually called "flag-carriers") and independent air carriers organised in the "Association des Compagnies Aériennes de la Communauté Européennes" - ACE). During the period from 1989 to 1992 independent air carriers which provide more than 50% of the intra-European air traffic were able to generate a positive operating margin which never dipped below 3 % whereas most AEA-carriers experienced in 1993 the fourth consecutive year of operating losses. This may be based on various factors like higher flexibility, better adaptation to shifts in demand higher operating efficiency (towards leisure travel) and - last but not least - less exposure to the highly competitive North-Atlantic market where European carriers are faced with strong competition from U.S.-carriers making full use of the benefits offered by their huge home market. Similarly, differences also exist among so-called "flag-carriers", although during the recent four years profit making companies represented the exception to the rule.

A major part of the European airline industry has yet to fulfil the task to restore an economic equilibrium. Between 1990 and 1992 AEA-carriers accumulated losses of 3,5 billion ECU. Preliminary results for 1993 indicate a less homogeneous situation with significant improvements in a number of instances but also with a further deterioration of the situation in cases where a major cost-saving effort was launched relatively late. On average 1993 was another year with significant losses for a major part of the European airline industry.

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II. UNDERLYING REASONS FOR ECONOMIC IMBALANCES IN THE EUROPEAN AIRLINE INDUSTRY AND POLITICAL CONSEQUENCES : THE COMMISSION'S VIEW

11. It follows from the foregoing that the present economic and financial situation does not allow for simple and uniform explanations of current strains nor for simple and generally valid solutions. It is obvious that a multitude of factors has played a role in an industry which has, with the exception of the period following the Gulf-crisis, always encountered above average growth rates if compared with other sectors of the economy. Against this background of a unique combination of above average growth and chronically poor profitability the "Comité des Sages" had been asked to undertake an economic analysis and to present proposals for supportive policy action.

The Commission has carefully analysed its report titled "Expanding Horizons" as well as various other sources of information to develop its own analysis on the reasons for the present situation as well as policy conclusions. On this basis it has identified the following key reasons for the existing situation.

Overcapacity

12. As seen from the introductory part today's problems result to a considerable extent from declining yields caused by a gap between a very dynamic capacity development which dates back to decisions taken during the late Eighties and the development in recent years of market demand for air services. This overcapacity problem is - apart from the specific situation caused by the Gulf-war - largely based on the combined effect of overoptimistic expectations at the level of individual airline's managements and the business cycle. In this respect the airline industry is not unique. All sectors of the European economy have to cope with amplitudes in business activities caused by macroeconomic fluctuations.
13. At company level adaptation to a changing market situation is, at first, a normal permanent management task. The question is whether specific features of the aviation business make it particularly difficult to find a proper answer and an efficient strategy at management level. The following elements may suggest the existence of such particularities :
- The lead-time for adding capacity (new aircraft) is - normally - very long. Therefore, carriers are forced to look well in advance of (unknown) future market developments for production slots in order to be able to participate in anticipated growth. This creates a great margin of error in relation to capacity planning, in particular with a view to the fact that business cycles of the airline industry tend to encounter bigger amplitudes than many other industries.

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- The (normally) high share of financial costs not depending on the level of output implies a temptation to seek improvements to the cash-flow situation by means of marginal pricing policies which then contribute to keeping excess capacity in the market, thus further undermining the possibility to improve yields.
- Generous bankruptcy law terms established by U.S.-law ("Chapter 11") and state aid practices in other parts of the world have worked against the reduction of overcapacity.
- The high commercial value of slots at busy airports implies a tendency towards a business strategy strongly oriented towards occupying, as many slots as possible to anticipate future growth .
- Because of regulatory restrictions in international aviation on access to markets based on bilateral agreements it is very difficult to shift capacity quickly from weak markets to markets with stronger growth. This is particularly valid for the major European air carriers generating the overwhelming part of their revenues on these non-Community markets. At the same time exposure to overcapacity in other regions (U.S) has been very strong.

Lack of productivitiy and efficiency in Europe

14. Pressure on airline yields, caused by overcapacity does, in itself, not sufficiently explain current strains on the financial performance of the airline industry. It may be compensated improved efficiency or higher load factors. The level of productivity and overall operating efficiency is, therefore, a crucial element. Contrary to overcapacity, which is a world-wide phenomena, it appears that specific European weaknesses exist in respect of the efficiency of the air transport system. The Civil aviation industry presents the same symptons as other sectors in Europe, as identified in the White Paper on "Growth, Competitiveness, Employment". This significant lack of productivity leads to a major cost disadvantage, applying both to the internal costs of airlines and costs beyond direct management control, such as user charges. Reinforcing the ability of a Europe-based aviation industry to participate in a profitable way in future growth requires considerable efforts from air carriers and their shareholders and employees; from Member States; from international aviation organisations; and from the European Union with a view to improve cost effectiveness. Most major air carriers have launched far-reaching and painful restructuring efforts in order to meet this challenge caused by a lack of efficiency. Further efforts are required in areas beyond direct management control:

- Available statistical information suggest that physical productivity of European air carriers is more than 20% below levels achieved by U.S.-carriers (1992).

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- A similar problem exists in the area of infrastructure costs. For example, airport charges to be paid in Europe for the use of medium-size aircraft (B-737) are, at average, three times higher than in the United States.
- Extra-burden also results from a relatively high level of ATC-charges and from congestion induced delays and waste of fuel.

Too high costs

15. As a result of the efficiency gap in various areas, operating costs of European air carriers are, at average, about 40 % above those of their counterparts in the United States. There are various reasons for this problem. Tackling such efficiency problems is, of course, predominantly a task of airline managements. However, it is necessary to recognise that a significant part of an airline's operating costs are determined in areas beyond direct control of managements. This is particularly valid in relation to charges for the use of air transport infrastructure which count, at average, for app. 25% of the overall operating costs of a scheduled air carrier. The Commission believes that public decisions on air transport infrastructure capacity and quality, as well as on rules concerning the use of such infrastructure will in future have to be based on a clear recognition of their impact on the overall efficiency of the civil aviation system.

The Political Conclusion : Phasing-out costly fragmentation

16. It follows from the foregoing that present financial problems of a major part of the European airline industry result from the combined effect of overcapacity and a lack of operating efficiency within and beyond control of airline managements. Relief from overcapacity caused by a downward business cycle will, though slowly, be brought about by market developments. The application of the Third Package provisions and relevant competition rules as well as action in the area of external relations, will support these developments. A more direct intervention such as a scrapping scheme is difficult to justify for the following reasons :

- The industry has, in the meantime, already returned to significant growth rates. Load factors are improving. This will in itself considerably help to phase-out overcapacity.
- There are increasingly signs that this process is already well under way: Leasing rates for popular aircraft have re-started to recover from a drastic decline. IATA expects return to a balanced capacity situation already during 1995/96.
- Policy intervention on capacities in the market is at least as difficult to finetune as management decisions on capacities and prices. This implies a considerable risk of creating policy-induced market distortions.

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17. On the contrary, structural problems in the area of infrastructure costs will remain. There is even the danger that some relief in the area of the overcapacity problem will work against tackling at political level these structural problems with the determination they deserve. The Commission is firmly convinced that the European aviation industry will reachieve sustainable growth and profitability only if, in addition to the management task of restructuring carriers which need to be supported by enforcing the Third Package provisions, public authorities work towards a quick solution to the extra-burden caused by an inadequate diversity of standards, allocation of responsibilities and other rigidities. This fragmentation is the result of the history of civil aviation but ill-adapted to the requirements of the Single European Aviation market and the impact of increased global competition.
18. The Commission is of the opinion that efficiency gains which Europe's civil aviation industry so urgently need necessitate a series of initiatives aimed at turning the Single Aviation Market into economic reality. Air carriers established in (high wage) industrialised parts of the world need the advantages of a large home-market without internal barriers if they are to compete successfully with their counterparts from other parts of the world. Failure to increase efficiency at home and to speak with one voice to our trading partners will further weaken our global competitiveness.
19. Eliminating the fragmentation of the market, however, is not simply a matter of shifting administrative and political responsibilities from local, regional and national authorities to EU institutions. Further, the closest cooperation between all relevant authorities must be ensured. Community law includes the principle of subsidiarity which applies alongside the prerogative for sovereignty over the air space, as established in the basic law for international civil aviation.

These principles include the right of Member States of the European Union to delegate responsibilities and to establish and to develop further the framework for close coordination of policy initiatives, in close cooperation with existing organisations.

The European Commission will

- *regard efficiency improvements and cost-saving measures in the civil aviation system of Europe as political priority for the sector during the years to come.*
- *seek efficiency improvements primarily by eliminating fragmentation of the European civil aviation systems, so as to generate the full economic benefit of a genuine Single Aviation Market.*
- *assume its responsibilities in this area in close cooperation with Member States, interested parties and specialised international organisations.*

Keeping the balance : A political task

20. A number of aeropolitical issues touch directly upon the relationship between the interests of air carriers and others, such as the environment, the interests of employees in safeguarding and creating jobs and working conditions, and the interest of national authorities in the role of air carriers as public service providers in the widest sense. In addition, the interests of air transport users and, above all, safety requirements must be given careful consideration.
21. Politically speaking, the balance between different interests is a crucial issue. It is not surprising that the "Comité des Sages" looked at such problems primarily from the perspective of generating immediate support for air carriers. This is an important aspect. But political assessment cannot stop here.
22. There is a need to ensure a proper balance of interests. The Commission is convinced that, in the end, a competitive, financially healthy airline industry will best serve the interests of airline employees and users and generate the financial means to do more for the protection of the environment. Equally, airport authorities have in the long run a substantial interest in the economic strength of airport users.
23. More generally, the task of safeguarding a proper balance between different interests requires a clear definition of the relative importance of different policy objectives. In this context, an assessment of the role of the air transport system for the economic and social well-being of the European society must complement the analysis oriented towards sector-specific requirements.
24. There is general agreement that air transport should provide services at reasonable costs where people and business need them. The basic discussion has always been whether this is best achieved by an interventionist policy or by competition. The European Union has opted for a middle-of-the-road-approach by gradually phasing-in the liberalisation of intra-European flights, and supplementing the new regime with safeguards for situations where the market alone may not be sufficient. This approach recognises that a number of specific features of the air transport system may occasionally require policy intervention either to address unbalanced situations inside the system or directly to serve other policy objectives (e.g. public services, environment etc.).
25. The European Commission is of the opinion that present financial difficulties of the airline industry should not be used as an excuse to avoid the permanent policy task to review the balance between different objectives and different policy goals. It furthermore believes that major conflicts of interest do not really exist in the long run. A coherent policy approach focusing on the air transport system as a whole and not only at individual parts, is required. This approach, however, cannot ignore the current short-term problems of the airline industry, nor the airline industry's own responsibilities in relation to commercially sound decision-making.

III. WHAT IS NEEDED : A CONCERTED ACTION PROGRAMME FOR CIVIL AVIATION IN EUROPE

26. As set out above the European Commission is convinced that remedying policy action is required in order to address structural weaknesses of the European civil aviation system. In particular, the Commission is of the opinion that public authorities at all levels should actively support restructuring efforts undertaken by the airline industry.

This requires as a matter of priority first, the removal of impediments to the full economic effect of the Single Aviation Market which still exist and secondly, major efforts to produce a significant improvement in the quality and the capacity of the air transport infrastructure.

27. In this context the Commission recalls its recent "White Paper on Growth, Competitiveness and Employment". This document outlines the economic policy priorities for the years to come. The European Council has endorsed these guidelines with strong emphasis on making the Single Market fully effective and on improving infrastructure in Europe.

The European Commission will

- *attach priority to making the internal market fully effective and to significant improvements in infrastructure as key elements for making Europe's civil aviation industry more competitive, thus enabling it to safeguard existing jobs and to create new employment.*

A. The Single Aviation Market : From a Legal Framework to Economic Reality

28. With the Third Package measures and a number of related rules (competition rules, slots, CRSs, etc) a clear-cut legal framework for a genuinely European air transport system has been established. However, the Single Market is an economic process, not merely a legal act. Reaping the full positive economic benefit of a much bigger home market requires the full implementation of existing rules, to enable the airline industry to adapt quickly to the requirements of the new regulatory framework.

Implementation of Third Aviation Package

29. The recommendations of the report "Expanding Horizons" on this issue largely follow the established practice of Member States and the European Commission. The Commission's forthcoming report on the implementation of the Third Package will confirm that relatively few implementation problems have occurred.
30. Public debate has so far largely ignored the fact that the Third Aviation Package contains specific safeguard clauses for situations of economic difficulty. Council Regulation N° 2409/92 allows for intervention against so-called downward spirals on air fares⁸. Council Regulation N° 2408/92 includes the possibility of a temporary capacity freeze when the situation is fundamentally unbalanced⁹. The use of both safeguard clauses has, as a rule, to be initiated by Member States concerned before the European Commission can intervene. So far, no Member State has requested use of these safeguard clauses.

The European Commission

- *will continue its policy of ensuring fulfilment of Single Market requirements through full implementation of the Third Package rules. Its decisions in relation to the use of safeguard clauses will take into account the economic situation at that point.*

Application of competition rules

31. The report calls on the Commission to take into account the new Single Market environment and present overcapacity when applying Articles 85 and 86 of the EEC-Treaty. With the exception of predatory practices (where vigorous action is recommended) most of the recommendations call for flexibility when assessing different forms of inter-airline cooperation.

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⁸See Art. 6 of Council Regulation N° 2409/92 (O.J. N° L240 of 24.08.92)

⁹See Art. 10 of Council Regulation N° 2408/92 (O.J. N° L240 of 24.08.92)

32. The European Commission is carefully examining the recommendations made by the "Comité des Sages" in relation to competition rules in close cooperation with interested parties. It shares the opinion of the Comité that cost-saving forms of airline cooperation may play an important role in the restructuring process of the industry. Cooperation agreements may help to serve air transport markets in a commercially meaningful way. In addition, examination of such cases takes into account the significantly increased accessibility of air transport markets in the Single Market environment.
33. The Commission will consider carefully any individual agreements notified to it which have the objective to reduce overcapacity on individual routes. The Commission agrees with the "Comité des Sages" that no such agreements should be approved which aim to restrict the commercial freedom of other air carriers to enter the market, or to increase capacity as allowed by the Third Package provisions.

The European Commission

- *intends to use speedy and efficient procedures notably for establishing informal contacts prior to formal notification of cooperation agreements between air carriers while maintaining and fully applying existing block exemptions*
- *will examine the possibility of establishing guidelines for the application of Art. 85 and 86 of the EEC-Treaty for different types of interairline cooperation. Such guidelines would aim for encouraging efficiency increasing forms of cooperation with clear benefits for air transport users*
- *will consider reviewing the procedural requirements established by the Council Regulation No. 3975/87 with a view to reducing the administrative burden*

34. The recommendations of the "Comité des Sages" on tariff consultations are particularly sensitive. At present, IATA consultations enjoy preferential treatment in the form of a block exemption. However, this exemption is linked to a number of conditions to ensure that its specific purpose is served and that discussions will not create a price cartel. Tariff consultations are permitted only for the purpose of facilitating interlining which is essential for maintaining the high degree of flexibility of Europe's air transport systems and should not be used primarily for other purposes.

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35. The "Comité des Sages" has asked that the block exemption be applied flexibly. Keeping the balance between safeguarding the interlining system and avoiding a price cartel has always been a delicate and difficult task. Economically difficult times bring a temptation to shift this balance in favour of the interests of the airline industry. Against this background the recommendation to apply the block exemption in a "flexible manner" is not surprising.
36. However, the Commission considers that tariff consultations already enjoy an exceptional regulatory treatment. This is unique and requires close monitoring to avoid abuse. A major difficulty arises because tariff consultations are sometimes treated by air carriers as though they were de facto binding. But under no circumstances can de facto binding arrangements be covered by the existing block exemption.
37. Where cost increases are common to all air carriers, similar tariff increases across the board may arise. In such situations they may not necessarily be based on de facto binding arrangements. However, where cost developments are not uniform to the industry the Commission would not expect to see similar price movements in different markets.
38. The Commission recalls that the Court of Justice has made it clear that the Commission cannot, by using less formal means, modify the legal effect of the block exemption. This can be done only by means of a formal change in the Regulation itself. The Commission is always ready to consider applications for individual exemptions outside the scope of the existing block exemption as it has done at the time of the Gulf-crisis which led to serious difficulties in the airline industry.

The European Commission will

- *maintain the existing block exemption on tariff consultations and continue to monitor closely the impact of such consultations on the market*
- *take into consideration the general economic environment and in particular cost developments when examining price movements in the market*

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Slot allocation

39. In some instances providing access to intra-European routes is not exclusively a matter of enforcing the Third Package and related competition rules. At congested airports, objective capacity constraints constitute a potentially important obstacle to the use of the economic opportunities created by the Single Aviation Market. Council Regulation No. 95/93 on common rules for the allocation of slots aims at ensuring non-discriminatory decision-making in this area¹⁰.
40. The Commission shares the opinion of the "Comité des Sages" that problems caused by a lack of slots should preferably be dealt with increasing physical capacity or by improving operational conditions. However, for various reasons this option is not always open to the extent necessitated by the traffic developments. Close monitoring of the effectiveness of the existing Regulation is, therefore, necessary.

The European Commission will

- *closely monitor the effectiveness of Regulation No. 95/93 on the allocation of slots and take an initiative even before the latest review date (1 January 1996) if necessitated by developments in the market.*

State aids

41. The report of the "Comité des Sages" acknowledges the potentially distortive effect of state aids as well as the useful role that financial support, if granted under strict and clear conditions, can play in restructuring the industry by making it more competitive. The carefully worded recommendations aim at striking a proper balance between these two aspects, by suggesting a number of conditions for the Commission's approach to such operations.

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¹⁰/ O.J. L 14 of 22.1.1993

42. Most of the recommendations made by the "Comité des Sages" are very close to the Commission's decisions in a number of recent aid cases. The Commission's work on up-dated guidelines on state aids is well-advanced. The new guidelines for the application of Articles 92/93 of the EEC-Treaty to the airline industry will be published in the Official Journal immediately after they are adopted by the Commission.

The European Commission

- *is of the opinion that financial State support for restructuring air carriers can be accepted only if it does not distort or threaten to distort competition. It will decide on updated guidelines for the application of Art. 92/93 as soon as consultations with Member States and interested parties have been finished.*

Time-table : *Consultation paper on new guidelines available to interested parties in June 1994*

External aviation relations : From debates to action

43. The need to consider external aviation relations, together with liberalisation and harmonisation, as an integral part of the European air transport policy has been accepted since the Council conclusions of 1989. In February 1990 the Commission made a first proposal to the Council on aviation relations between the Community and third countries. This proposal pointed out that the gradual development of the internal market requires to be able to act also externally as an entity. In October 1992 the Commission revised this proposal, in order to take better account of the special characteristics of the aviation sector and of the need to establish appropriate procedures for a transitional period. As to now, the Council of Ministers has not been able to reach agreement on this proposal. The only decision taken so far was to establish an Aviation Group as the framework for the technical preparation of negotiations.
44. The Community has already negotiated with third countries in the past. In June 1992 an aviation agreement was concluded between the Community and Norway and Sweden extending the scope of Community legislation in the air transport area to these two Scandinavian countries. This agreement is now supplemented by the entry into force of the European Economic Area agreement, which has extended the geographical application scope of the Community's aviation legislation further to Austria, Iceland and Finland.

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45. However, as the report of the "Comité des Sages" rightly points out, the lack of overall progress is increasingly preoccupying given the importance of external relations for the economic well-being of the European aviation industry. It is obvious that network optimization within the whole territory covered by the Single Market and cross border cooperations involving equity are essential prerequisites for developing a genuine and competitive European aviation industry. The Community interest in this area involves much more than the simple cumulation of national interests as currently perceived.
46. The failure to combine the Single Aviation Market and its potential for network optimisation with the development of a common external policy with adequate and efficient procedures, is one of the most important barriers to the achievement of the full economic potential of a large home market. Discussion of legal issues has perhaps drawn attention away from the economic rationale of urgently developing a common approach in this area. Demolishing internal restrictions while maintaining a diversity of rules in relation on access to and from non-European aviation markets means that the contents of individual bilateral agreements instead of the relative competitive position of individual undertakings determine to a significant extent the conditions for European airline restructuring. This limits, even undermines, the process of improving the global competitiveness of the European aviation industry.
47. Beyond such generally valid principles, and irrespective of the Commission's legal position, which remains unchanged, consideration of practical steps in this area cannot escape from defining priority areas for making progress. In this context, the Commission believes that measures aimed at supporting directly the Single Aviation Market deserve urgent action. In relation to geographical priorities the Commission believes that the proximity to the existing Single Market and the economic importance of the bilateral relationship concerned should determine the sequence of common action in this field. Therefore, common initiatives should start with progressively integrating European neighbours into the application scope of Community legislation and with actively preparing a joint position vis-à-vis the United States.

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The European Commission will

- *take the necessary initiatives to enforce the entitlement of Community air carriers to serve third country destinations from other Member States than the State of registration*
- *work towards replacing nationality clauses in bilateral air services agreements concluded by EU Member States by a Community clause and take the necessary action*
- *present proposals in respect of aviation relations with other European States in order to bring commitments entered into with the cooperation agreements progressively into practice. Priority will belong to aviation relations with Central European States which have concluded so-called "Europe-Agreements" with the European Union*

Time-table : Proposal for mandate to be tabled in July 1994

- *continue - in close cooperation with Member States via the Aviation Group - exploratory talks, with the United States in particular with a view to identify areas where common European action could help to improve the competitive position of Europe's economies*
- *continue the preparatory work for administrative procedures for use in relation with external aviation policy decisions and attach, in this context, priority to developing criteria for the allocation of traffic rights obtained at Community level.*

Time-table : Discussion paper available before the end of 1994

Harmonisation : Increasing efficiency and improving cost consciousness

48. Harmonisation of standards is - a priori - an essential prerequisite for a genuine Single Aviation Market since it ensures the phasing-out of distortions caused by different standards and rules. However, with a view to the cost implications of harmonised standards and the mixed experience with the implementation standards the report of the "Comité des Sages" has questioned the traditional approach in this area.
49. The Commission recognizing fully the need to avoid regulating when it is not strictly justified for safety reasons, but is convinced that harmonisation efforts should be continued to ease the completion of the internal aviation market and to prepare for its enlargement to all European countries. This nevertheless must take due account of concerns expressed by the aviation industry.
50. Many criticisms address the lack of efficiency of the mechanisms used today for regulatory harmonisation, as well as the necessity better to monitor the way in which common regulations are applied throughout Europe, outside the European Union. The Commission intends to address this consequence of the fragmentation of the European aviation system in the spirit of cooperation stressed at the beginning of this document. The way forward would appear to lie in the creation of a Single Safety Regulatory Authority through the exercise of the regulatory competencies of the States and the Community within an organisation based on a multilateral Treaty and to delegate to this authority the task of monitoring the way national administrations apply the joint rules. The Commission intends to work actively towards this goal and will use meanwhile its legal powers and obligations to ensure such a unity in the European Union based, in particular, on the work and the input of the JAA.
51. On the question of the economic consequences of such harmonisation, the Commission agrees on the need to evaluate in each case the cost of the regulations proposed for integration into Community law. Accordingly it will develop the appropriate economic evaluations before presenting new measures to the Council and the European Parliament for adoption. It will also encourage the JAA to evaluate its own proposals in advance.
52. Cost implications drive not only from the regulations themselves, but also from the way they are implemented by national administrations. This is clearly visible the case in the area of airworthiness certification where joint action has demonstrated huge benefits for the aircraft manufacturing industry. The Commission intends to stimulate increased cooperation along these lines and to work with Member States to establish the most appropriate structure to handle certification in an efficient way.

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The European Commission will

- *work towards a Single Regulatory Authority on Air Safety*

Time-table : Consultation paper available in October 1994

- *conduct a study to analyse the most efficient way to conduct airworthiness certification*

Time-table : Launch of study in June 1994

- *attach a cost-benefit analysis to future proposals for harmonisation measures*

B. Air Transport Infrastructure in Europe : Speeding-up improvements

53. The report "Expanding Horizons" identified the relatively high level of en-route and airport charges as a major obstacle to improving the competitiveness of Europe's aviation industry. It has, therefore, called for significant efforts to improve ATC and airport infrastructure. In addition, it has asked for more appropriate rules for the use of such infrastructure and decision-making inside relevant bodies in order to promote efficiency improvements.
54. The main thrust of these recommendations meets a long-standing concern of the Commission. In a number of areas preparatory work on new initiatives is already well-advanced. In this context new provisions of the Maastricht Treaty on the creation of Trans European Networks (TEN) have significantly improved the political and the legal framework for new initiatives.
55. Airports and Air Traffic Management (ATM) are components of the Trans-European Network as recently proposed by the Commission¹¹, as is the global navigation satellite system (GNSS). ATM and GNSS are also explicitly mentioned in the Commission White Paper on "Growth, competitiveness and employment". Several Airport projects are also mentioned in the priority list established by the Christophersen Group working on the implementation of this initiative.

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¹¹see COM(94) 106 of 29 March 1994

56. In the field of Air Traffic Management, the Commission intends to use the momentum created by these initiatives to provide significant funding to support implementation of EATCHIP¹². This includes the standardisation activities described in the Work Programme, the infrastructure investments mentioned in the Convergence and Integration Programme and the research and development efforts needed for the future European Air Traffic Management Systems. To this end funding will be secured from different budgetary sources such as the transport network fund, the fourth R+D framework programme and the cohesion fund as well as the cooperation funds to assist the extension of EATCHIP to Central and Eastern European countries as well as to the Republics of the Former Soviet Union.
57. Morevoer, beyond the question of improving the efficiency of Air Traffic Control, Europe also needs a common policy for a more efficient use of air space through an increased use of flow management technics as well as the formulation of more clear priorities between different categories of airspace users in order to optimize the use of existing capacities. There is also a crucial lack of a common decision-making body for adoption of standards and rationalisation/planning of investments on RTD activities. This is another consequence of the fragmentation of the European Aviation system and the most appropriate solution lies in a gradual transfer of the necessary competences to an organisation created by an international treaty in order to have an effective power of decision and the capacity to bind its members. The Commission intends to address this subject in the course of the ECAC ministerial meeting of 10 June.
58. Finally, it is now universally agreed that satellite technologies will play an essential role for navigation purposes and might, together with improved telecommunications tools, will make a significant contribution to future European Air Traffic Management systems. Therefore, the Commission thus proposes a European strategy based on two complementary actions. The implementation of a European complement to the GPS/GLONASS existing system using the INMARSAT III satellite in order to participate in the first generation GNSS (GNSS 1); the development of the European technology necessary to contribute to the next generation GNSS (GNSS 2).

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¹² European Air Traffic Control and Integration Programme, developed by Eurocontrol on behalf of the European Civil Aviation Conference (ECAC).

The European Commission will

- *continue and accelerate the work on TEN-programmes for Air Traffic Management to provide a basis for the use of infrastructure funds.*
- *contribute actively to the preparatory work for the creation of the political and institutional framework required for the implementation of a Single Air Traffic Management System in Europe.*

Time-table : *Launch of study on the basis of the conclusions of the MATSE4 Ministerial meeting on 10 June 1994 in August 1994*

- *make a significant contribution from Community funds for the preparation of a satellite based air navigation system.*

59. With entering into force of the Maastricht-Treaty airports are now fully incorporated into the common transport policy. The Trans-European airport network is an integral part of the future trans-European network, to the development of which it is expected to contribute significantly by the 2010. Additionally, regional policy instruments offer opportunities to contribute from Community funds to improvements and extensions of airport capacities especially in less developed peripheral regions of Europe.

The European Commission will

- *promote the enhancement and development of airport capacity to meet existing and future demand as well as the interconnection of the airport network with other networks*
- *work, as an initial step of implementing the Trans-European Airport Network program, towards a European contribution to the development of new airport capacity notably at Milan, Berlin and Athens*
- *where asked use regional policy instruments for the improvement of airports located in peripheral regions.*

60. In addition to physical improvements rules for the use of air transport infrastructure are equally important. Airports provide a number of services and facilities, of which some by their nature constitute a monopoly (e.g. use of runways). It is essential that the charges for those services and facilitation are non-discriminatory and transparent, as well as cost-related . In addition, adequate user participation could contribute to transparency and cost-consciousness in relation to investments and operational conditions. The Commission believes that an in-depth examination on possibilities in relation to the charging principles and other rules concerning the provision of these services and facilities is required.

The European Commission

- *will present a consultation paper on how best to ensure non-discriminatory, transparent and cost effective provision of airport services and adequate user participation in decision-makings*

Time-table : Early 1995

61. The way in which the provision of a number of other services is provided at the airport will in future require new organisation. Ground-handling services (both land-side and air-side) are the most prominent example. The majority of the Comité-des-Sages advocates the liberalisation of such services.
62. The Commission's services have been analysing this area. Reactions to a consultation paper indicate that users and independent service providers favour - in varying degrees - opening-up these services to competition. The reactions, however, also indicate that such opening-up whether total or partial requires careful examination because the supply of groundhandling services is subject to certain constraints .
63. The matter is further complicated by the requirement to ensure careful transition to the new regulatory framework. Technical safety and security requirements will have to be considered as well as economic and social aspects. At certain airports, a considerable amount of revenue is generated by the ground-handling business. Sudden changes to the regulatory environment may provoke disruptions in the form of operational constraints and a compensatory increase in other fees.
64. The European Commission believes that there is a genuine need to introduce a market-oriented approach for the provision of ground-handling services at Community airports. This new approach should be a balanced approach and take due account of the interests of all stakeholders : air carriers, airports, ground-handlers, consumers and employees.

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The framework should, therefore, provide for the opening-up the market to competition. It should, however, also provide for safeguards so as not to jeopardize safety and security requirements as well as take account of what is technically feasible. At the same time it should ensure stability and safeguard against unfair practices. It should also ensure the non-discriminatory and transparent provision of services and selection of groundhandlers.

65. On the basis of these principles

The European Commission will

- *take an initiative aimed at opening-up ground-handling markets at Community airports.*

Time-table : October/ November 1994

IV. SAFEGUARDING A FAIR BALANCE BETWEEN DIFFERENT INTERESTS

66. For the reasons outlined in Chapter II, it is essential to assess the balance of interests in relation to the recommendations of the Comité des Sages. This applies particularly in relation to social issues, environmental aspects and, last but not least, the interests of tax payers. This political task is complicated by the fact that the priorities Member States attach to such areas may differ inside the European Union. In that context, the principle of subsidiarity requires careful consideration before launching initiatives.

Financial issues

67. On taxation issues the Commission regards it as - a priori - difficult to support calls for a specific treatment of this industry. This applies in both directions : sector-specific relief should be avoided, as should the imposition of specific air travel-related burden. Apart from this general principle, however, there may be specific particular aspects that require careful examination before taking decisions:

- The present zero-rating for Value Added Tax (VAT) for intra-EU air travel expires at the end of 1996. The Commission's preparation of decisions for the period thereafter will have to take into account the economic impact of new taxes as well as problems eventually resulting from different rates.

- Further work on the introduction of the CO2-Energy tax need to evaluate carefully its impact on both, the improvement of the environment if the tax is applied to the airline industry, and the economics of related businesses.

- Sector-specific harmonisation efforts in the area of direct taxation in order to facilitate aircraft purchases (corporate taxes) is difficult to justify.

68. The capacity of air carriers to finance investments is, like the issue of taxation, a question to be analysed in a broader context. In particular, it is appropriate to examine further the ability of the airline industry to raise the capital required for future investments. In this area further in-depth analysis of the present situation is required before the launch of any policy initiatives.

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The European Commission will

- *carefully consider economic implications for the aviation industry when preparing initiatives on taxation*
- *undertake an economic study comparing the access of the aviation industry to innovative financial instruments (e.g. tax-lease, accelerated depreciation, securitisation) in different parts of the world with a view to proposing new initiatives in case the existence of serious problems in this area for the European aviation industry is confirmed.*

Time-table : Economic study to be launched June/July 1994

Environment

69. On environmental issues the report calls for abstaining from introducing unilaterally stricter European standards on NOX and noise emissions. The Commission can understand the concerns of the European airline industry in this respect. Indeed, it appears questionable to introduce more stringent operational measures during economically very difficult times if such measures are likely to have a clear negative financial impact.
70. A further question, however, is whether international organisations (ICAO) can effectively respond to developments in industrialised regions. Given the fundamentally different interests of developing nations in this area, it is doubtful whether leaving the issue entirely to world-wide organisations would best serve the long-term interests of Europe's aviation industry and related businesses, or of airport users, of the population living in the vicinity of airports and finally, of the general interest in protecting the environment.

The European Commission will

- *further assess initiatives on gaseous and noise emissions in air transport in relation to scope and timing*
- *evaluate the practical feasibility of supplementary measures, including noise monitoring at airports, to improve the environmental compatibility of air transport*
- *intensify its dialogue with important trading partners and, in particular, other industrialised regions on environmental aspects of civil aviation*
- *assess the practical feasibility of a methodology for a cost-benefit analysis of environmental measures*
- *work towards a stronger European role on such issues in ICAO.*

Time-table : *Consultation paper to be issued by mid 1995*

Social Issues

71. The social implications of restructuring civil aviation merit careful consideration. At first, the Commission agrees with the "Comité des Sages" in relation to its basic conviction that restoring competitiveness by means of major restructuring is the key safeguarding existing jobs and creating jobs in the future. Equally, the Commission believes in the need to increase labour flexibility and labour mobility. As already outlined in the "White Paper on Competitiveness, Growth and Employment", more flexible labour market structures can significantly facilitate job creation. This applies generally and not only for the aviation industry.
72. It is clear that training and related measures have an important role to play in ensuring the adaptability of the existing work force and are an important element for the competitiveness of the industry.
73. It is also clear that airline companies themselves as well as public authorities have to assume their responsibilities in relation to the structural changes which are necessary including in the area of training.

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74. As far as the Community is concerned, the content of Objective 4 actions under the European Social Fund within the Community Support Frameworks as well as actions under the new Community Initiative ADAPT will be of relevance. Both of these horizontal policy instruments pursue the objective of facilitating the adaptation of workers to industrial change. The possible contribution of these instruments will be discussed in partnership in the context of drawing up the relevant Community Support Frameworks and Operational Programmes. In relation to measures to be taken at national level the draft guidelines on state aids will indicate a flexible approach on aids clearly serving the purpose of facilitating employees' adaptation to airline restructuring.
75. Concerns have been expressed in relation to "flag of convenience" approaches in civil aviation. In this context it is worthwhile to note that existing Community legislation already contains important provisions against such practices well-known in the maritime transport sector. In particular, the Council Regulation No. 2407/92 on operating licences for Community air carriers has established criteria in relation to effective control in an air carrier, financial and economic fitness. Similarly, requirements on the use of leased aircraft constitute an effective safeguard. On the basis of the experience made so far the Commission does not believe in the necessity and in the effectiveness of requirements going beyond these safeguards. A different question is the issue of working conditions for cockpit crews and maintenance staff. This is an important element for safeguarding and reinforcing a high safety level in Europe. The work in this area should not be compromised because of current financial strains.
76. Concerns have also been expressed in relation to a general tendency to delocate aviation-related activities to low-wage third countries. The Commission is of the opinion that underlying technological features of air transport differ significantly from many other industries in relation to a number of elements which determine the potential for job creation. Air transport is a high technology growth industry which requires sophisticated training of most of the aviation workforce. This limits the scope for delocating at large scale such activities.

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The European Commission will

- *analyse in close cooperation with Member States policy options as to how to help aviation employees adapt to a new environment*
- *look sympathetically at aids intended to serve directly the purpose of assisting airline employees' adaptation*
- *carefully monitor the location of aviation activities with a view to identify as early as possible structural changes*
- *continue its work on harmonised working conditions with a view to establish European standards for flight crews and maintenance staff oriented towards safety requirements.*

V. CONCLUSIONS

77. The European Commission

- invites the European Parliament, the Economic and Social Committee and the Council of Ministers to endorse the policy priorities outlined in this communication and to cooperate closely with a view to bringing about as soon as possible the proposed measures to increase the efficiency of the European Civil aviation system.

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