



International Chamber of Commerce

*The world business organization*

## Policy statement

### State aid to airlines

Commission on Air Transport, 13 June 1995

#### Recommendations

In view of the changing aviation regulatory environment and the globalisation of the air transport industry, the ICC recommends:

1. That in principle state assistance to airlines, whether direct or indirect, should be deemed to distort the market and to be detrimental to airlines and users;
2. That where a government retains a share in an airline, it should act as any other shareholder and should not interfere in the day-to-day management of the company. Decisions on matters such as fleet replacement, route selection, and the like should be handled by airline managers aware of the commercial requirements of the market and not by government officials;
3. That notwithstanding the need for stricter criteria as suggested in these ICC recommendations, state assistance may be allocated to thin, regional routes under public service obligation rules similar to those provided for in the market access regulation for European Union carriers. Airlines receiving state aid to maintain services on such specific routes should, however, only be compensated after having been selected by public tender;
4. That where state assistance is provided, it should, except for circumstances noted in Recommendation 3, be strictly delimited in time and scope and be based on commercial and not on political considerations;
5. That where there are laws that compel regulators to adopt a neutral attitude as between public and private enterprises, state aid should be available only in very exceptional circumstances, and only on a transitional basis. Any state aid must be indispensable for the implementation of a genuine restructuring plan and not be granted to cover operational losses. The viability of such a restructuring plan must be considered in light of the restructuring plans adopted by companies active in the same sector (the aviation sector) without the benefit of state aids. With regard to the proportionality of the aid, the amount of aid must be restricted to what is indispensable for the implementation of the restructuring measures. Before granting approval for such state assistance programmes, the restructuring measures should be considered against comparable cases where airlines have taken their own actions to meet their financial needs. Specifically, the regulatory authorities should determine:
  - (a) what private carriers have done to meet past and current trading conditions and should demand why the state-owned carrier should not do the same;
  - (b) what savings the state-owned carrier can make by reducing its future investment programmes, its costs, and the excess capacity, if any, that it currently operates;
  - (c) whether the state-owned carrier has assets which can be sold without detriment to its core activity; and
  - (d) whether additional funds can be raised by measures such as the sale and lease back of aircraft.
6. That where state aid is exceptionally granted on a delimited basis, in whatever region, it should have the least possible impact on the airline's competitors. Consequently, any airline

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receiving government assistance:

- a)** should be prohibited from using that assistance to expand capacity and should, where feasible, effect a significant reduction in its capacity;
- b)** should be prohibited from using that assistance to buy or take over another carrier;
- c)** should bear the burden of proof in demonstrating that competitive interests of other airlines will not be negatively impacted.

7. That any state assistance should be assessed in the first instance by independent experts and monitored at a later stage of its implementation, preferably by independent auditors from the chartered accountants sector, to determine whether it adheres to the principles discussed in these recommendations. The results of the monitoring process should be transparent and should be made available to the public.

### Forms of state aid

In most countries, the aviation sector is characterised by government ownership and control of airlines. Outside of the United States, where all airlines are privately owned, partial or complete state ownership of airlines is the rule in Africa, the Middle East and Europe, and several important airlines in Asia have government shares ranging from 55-100 per cent. A recent survey of 150 airlines worldwide revealed that 70 had majority government ownership, 20 have minority government shareholdings, and only 60 had no government-held shares. In the European Union, five major EU carriers presently have government holdings ranging from 90-100 per cent.

Complete or partial state ownership has frequently involved state capital injections into airlines having financial difficulties. In 1994 alone, European governments injected more than \$ 7 billion in various forms of aid, direct or indirect, into their national airlines, and other European state-owned carriers have yet to submit their aid requests. States have frequently maintained that their position as an equity shareholder in their national airline constitutes reasonable grounds for investing capital in the carrier, since this is the normal reaction of a shareholder.

Several forms of state aid have been identified in international discussions, among them: (1) outright government subsidy; (2) soft loans made on less than normal commercial terms; (3) bond issues backed or facilitated by the government; (4) discounts on charges for airport services; (5) discounts on or exemptions from navigation and landing fees; (6) discounts on the price of, or privilege in the supply of fuel; (7) monopoly handling rights; (8) duty-free concessions at the airline's base airport granted without competitive bidding; (9) debt forgiveness, and (10) fiscal privileges.

### Justifications for state assistance to airlines

State involvement with airlines goes back many years and has been based on a number of considerations - economic, legal, military and psychological. Some countries consider that airlines are public utilities, and, as such, should be run by the government. In other countries, the principle of national sovereignty over airspace, written into Article 1 of the 1944 Chicago Convention, has been used as a justification for the creation of "national airlines" under government ownership and control.

Other reasons are linked to issues of national pride and prestige. Airlines in some countries are regarded as important symbols of the national identity, as "flag carriers" which carry the nation's emblem to distant destinations. By extension, these airlines have become instruments of government policy.

In other countries, economic reasons have been cited. Some countries are concerned about the impact on employment if the national airline were to fail. In other instances, airlines, particularly in

some developing countries, are said to require state support because they are infant industries and require protection. Some governments maintain that their national airline is an important source of revenue, particularly from tourism, and that state backing is necessary to preserve that revenue as a benefit for all citizens. This line of reasoning contends that if the national airline were to go private and to submit itself to the possibility of bankruptcy, the country in question could be deprived of its most important source of foreign exchange.

Other countries with a long tradition of government control of basic industry regard government ownership of and assistance to airlines as simply a natural extension of their economic philosophy. Many of these countries have little experience with, or interest in, private ownership and in submitting their airlines to the rigours of the competitive market.

In Europe, EU Commission officials cite legal reasons which preclude an absolute "one-time-last-time" rule on state aid or conditioning aid approval on privatisation. They note that Article 222 of the Treaty of Rome, the EU's constitution, is neutral with regard to property ownership. That means, the Commission says, that state-owned enterprises cannot be legally required to privatise. Furthermore, Articles 92 and 93 of the Treaty contain specific provisions concerning state aids which either are, or may be considered to be, compatible with the Common Market. Therefore, the Commission maintains that it cannot order that state ownership and assistance to airlines be discontinued in absolute terms; it is obligated, however, to determine whether such assistance "distorts or threatens to distort competition", in the words of Article 92 of the Treaty of Rome.

Clearly, the question of state ownership and state aid is a complex one, which requires careful analysis. Moreover, the term "state aid" is often loosely applied. It is, for example, necessary to distinguish between the state as shareholder and the state using its power, directly or indirectly, to subsidise or otherwise give economic assistance to national airlines.

Mindful of these complications, the ICC would like to set forth its own views, as the world business organisation, on the points at issue.

## The changing aviation environment

### **Liberalised markets and state aid**

At the outset, it is well to note that the aviation environment of the 1990s is markedly different from the period during which states began to exercise ownership and control over their airlines. The rigid regulation that prevailed in virtually all markets until the late 1970s has been gradually replaced by more competitive regulatory regimes, which have few limits on capacity, relatively free pricing, and more ease of market entry. In addition to the United States, where deregulation came into force in 1979, aviation markets have also been liberalised in Europe, Australia, New Zealand, the Indian sub-continent and elsewhere.

Before the late 1970s, when airlines were accorded protection by the regulatory system, state aids did not constitute a serious problem. But now that the rules of the game have changed, state aids are of substantially increased strategic importance, since they have the potential to severely distort competition. If state-backed carriers in liberalised markets - because of their recourse to state funds - are able to sustain losses that commercial companies cannot sustain, then there is no level playing field. If a liberalised market is to work properly, every participant must be subject to the same commercial pressures.



### **The globalisation of the industry**

Moreover, the concept of what constitutes a "market" in aviation terms has changed. It is no longer accurate to speak of markets in terms of limited geographic regions; because of cross-border equity stakes and a range of other alliances, the aviation market has become a global one. A recent survey revealed that 136 airlines worldwide have formed more than 280 alliances, spanning areas as diverse as joint sales and marketing, joint passenger and cargo flights, code-sharing, joint frequent flyer plans, management contracts, catering, and joint ventures in ground handling and maintenance. Some 177 of those alliances - around 62 per cent - have been entered into since January 1992.

The interdependence of airlines from different countries and regions has had several consequences: it has eroded the concept of the "national airline", and it has diminished the importance of national markets. It can no longer be claimed that competitive practices in one region have little impact on the airlines in other regions; issues such as state subsidy, market access, pricing and capacity have repercussions that extend far beyond national and regional borders.

### **Privatisation and its implications**

In addition, there has been an increasing tendency for states to relinquish control over their airlines by selling off all or part of them to private investors, many of whom are non-nationals. The list of airlines awaiting full or partial privatisation is extensive, and includes carriers from Europe, Latin America, the Caribbean and Africa.

Some countries privatise their airlines because of national budget constraints which make it difficult for the government to continue meeting the airline's requirements for fleet replacement and operating expenses; others can no longer afford to bail out carriers in financial difficulty; still others have become convinced that in liberalised and competitive markets, state ownership is no longer defensible. Whatever the reason, privatisation, where it occurs, has loosened the ties between governments and their airlines and allowed management the flexibility to make commercial decisions required by changing market conditions.

### **An assessment of arguments for state assistance to airlines**

In view of these developments, the arguments advanced in favour of state assistance are no longer persuasive:

1. The contention that an airline is a public utility requiring government financial assistance is a relic of the days when aviation was an infant industry and subsidised by the state as the only means of seeing airlines through to maturity. Aviation is now a mature industry and there is no need for such measures;
2. The contention that airlines are symbols of prestige and national identity has been overtaken by events - the creation of multinational airlines and the recognition that pride and prestige are of secondary importance to having airlines that are well-run and which provide an efficient service to users;
3. The contention that national sovereignty over airspace gives the state the right to subsidise its airlines is unfounded. There is no convincing link between the control of airspace and government subsidies to airlines;
4. The contention that airlines must receive government assistance in order to guarantee revenue from sectors such as tourism is not supported by the evidence. While tourism is an important generator of revenue, government subsidy to a national carrier is not the only



means of preserving such revenue. Privately-funded carriers can also serve to promote tourism. Moreover, some developing countries have already abandoned their national airline and have replaced it with a multinational carrier that represents several countries in the region. This is another means of adequately protecting revenues from tourism;

5. The contention that airlines needs state aid to restructure is subject to qualifications. While some airlines may require time to shed the burdens of past state direction and subsidy, the readjustment to a more market-orientated approach should not be unnecessarily prolonged. Moreover, state aid is not a necessary feature of restructuring. Restructuring is what all airlines, public and private, have to do to meet changing market conditions. Private airlines which have their own adjustment problems cannot call on the public purse when they have to restructure, which puts them at a competitive disadvantage. In fact, state aid can retard restructuring, since it shields managers from the hard decisions they must take to prosper in a new competitive environment;
6. The contention that state aid need not have a serious impact on competitors is dubious. State aid, direct or indirect, always has an impact on competition. Carriers using state assistance to ease one problem are then left freer to use more of their existing funds to gain a competitive advantage over their rivals;
7. The contention that flag carriers must not be allowed to go bankrupt is not acceptable. If airlines are going to operate in a competitive market, the possibility of failure must always be present. Moreover, if a liberalised market is to function properly, every carrier must be subject to the same commercial pressures.