The Case for Fair Competition in Europe's Aviation

Why action is needed to safeguard our aviation's future

ECA Piloting Safety
European Cockpit Association

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A Call to Action!

Nico Voorbach
ECA President

As an active airline pilot for a European carrier, I naturally want Europe's aviation industry to have a promising future. A future that allows us to connect people, to strengthen Europe's economy, and to provide quality employment for the millions of Europeans who work in and for aviation, every day.

But as my fellow-pilots from across Europe, I am greatly concerned that this future might simply not happen – unless we take decisive action.

Because unfair commercial pressure from some market players, who play by a different set of rules, is changing the landscape of the European aviation business. 'Social dumping', 'bogus self employment' and 'flags of convenience' are the new buzz words among certain business leaders. And heavily state-sponsored airlines from the Middle East and Asia are rolling out a massive artificial growth scheme to push their European competitors out of the market.

Such unfair competition threatens the very nature of aviation in our region. And of our pilot profession. It risks turning into a race to the bottom – unless we as pilots, together with our airlines and Europe's decision-makers stand up to turn the tide.

This ECA publication shows that stopping unfair competition is not only necessary and urgent, but also feasible. It is a call upon the EU decision-makers to share our vision of a successful and competitive EU aviation industry. And an urgent call to take the necessary political and legislative steps. Together the EU Institutions, the airlines and Europe's professional pilots can, must and will make a difference!

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Introduction

Safe, fast and affordable air travel is a common desire of any passenger. To achieve this, the legislator set the ground for the airlines to compete freely with each other. Nonetheless, while 'competition' has become the name of the game, "unfair" is the term that has started to creep in – to the detriment of the industry, its employees and the long-term future of the sector.

'Unfair competition' takes many faces. More and more airlines are seeking competitive advantage through market-distorting business practices, such as social dumping and 'forum shopping'. They try to benefit from light regulation and favourable taxation regimes in countries that serve them as a 'flag of convenience'.

This, in turn, puts pressure on other companies to use similar practices to safeguard their market share. In addition, heavily subsidized or state-owned foreign carriers are not hiding their appetite for expanding their network and increasing connectivity through their regional hubs. This competition is on the point of turning into a 'race to the bottom' for the entire aviation industry.

To reverse this trend action is needed. National and European decision-makers, as well as industry and employee leaders must join forces to ensure competition takes place on a level playing field. Only then will Europe's aviation continue to spur growth, generate employment and connect people and regions.

ACTION IS NEEDED!

» **Europe must better coordinate and strengthen its social regulations across Europe to address the unintended consequences of liberalisation.**

» **Abusive business models, subsidy-hunting, and regulatory 'forum shopping' must be eradicated.**

» **A level playing field with 3rd country airlines is a precondition for the industry to survive.**

Liberalisation & deregulation

The roots of competition in the European air transport market can be traced back to the launch of deregulation and liberalisation of air transport in the early 90s.

The process brought a significant change in the airlines' business environment. Flag carriers shifted from state-owned, quasi monopolists to business entities required to make profit in a competitive environment. At the same time, restrictions on market entry, capacity, frequency and pricing had been lifted.

While this deregulation increased competition in the aviation market, regulators did not foresee sufficiently robust rules on how to safeguard against anti-competitive behaviour. Neither did they foresee that such a market opening would affect aviation employees' collective and individual rights, as well as their working conditions.

While carriers were looking to adapt to the new business opportunities, some were quick to identify the loopholes created by the fragmented legal framework in Europe and the absence of common European rules on labour, social rights and taxation.

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New 'business' models

Against this background, complex, opaque, 'innovative' business models and flexible contractual arrangements to employ air crew emerged in the industry's race to cut costs in response to growing competition. The ground for such practices had become fertile, allowing inventive operators to cherry pick among different national regulatory regimes and uneven oversight, leaving ample space for interpretation and making uniform rule enforcement a real challenge.

These business models are taking all forms and shapes. Such is the case of airlines arbitrarily relocating their business to **'flags of convenience'** countries.

The aim is to avoid corporate tax and social contributions for their employees, and/or to benefit from lenient employment legislation and lax regulatory safety oversight by the authorities that offer their 'flag'. This model follows the footsteps of the maritime industry, where flags of convenience led to the disappearance of a European (and American) maritime industry and the employment and tax income it used to generate in Europe.

The most striking recent example in aviation is **Norwegian Air Shuttle**. This airline decided to move its long-haul operations from Norway to Ireland in an attempt to circumvent Norway's higher social and labour standards. It set up a subsidiary 'Norwegian Air International', registered its aircraft in Ireland and recruited pilots through a contract agency in Singapore and nominally based them in Bangkok. This complex set-up is designed to exploit the loopholes in EU legislation and the lack of coordination between countries of the European Economic Area.

Another example is airlines that use **flexible employment set-ups** that are often on the edge of legality. These set-ups force employees into temporary contracts or (bogus) self-employment (e.g. obliging pilots to set up their own limited liability company that offers its services though agencies to the airline). Pushing pilots into such unstable (and potentially illegal) contractual relationships will ultimately also have negative repercussions for safety, as they become vulnerable to being pressured into prioritising their employers' commercial needs over safety considerations, and because having to worry about their uncertain employment status will distract them from their primary task: flying their passengers safely to their destination.

Many European countries have legislation prohibiting **bogus self-employment** but the rules often remain paper tigers. 'Self-employed' pilots are in reality obliged to work exclusively for one company and have no control over their remuneration, working time, holidays or places of work. While these criteria are often used to define whether someone is an employee or genuinely self-employed, the existing regulations have proven not to be efficiently enforced.

Pilots can also be employed on **zero-hour contracts** and be paid only for the hours in the sky. No paid annual leave, maternity leave, or sick pay are included. Another practice is gaining popularity, the so-called **'Pay to Fly'** (P2F) schemes, whereby newly graduated pilots have to pay their airline for gaining flying experience on an aircraft. It might seem odd but due to the high cost of initial training and qualifications on a certain aircraft type, young pilots find themselves deep in debt and are ready to take up any opportunities to gain flight experience or to clock essential flight hours. Although P2F is on the verge of what is legal, the model is spreading.

Oversight, enforcement & forum shopping

Such 'business' models can exist and thrive if oversight and enforcement efforts of authorities are failing. A telling example are the labour inspections across Europe.

These are virtually non-existent in aviation and across national borders, and are hampered by a shortage of trained staff and unclear divisions of responsibilities for the inspection of flight crews between national labour and transport departments.

Regulatory oversight is also a key tool to maintain **high safety standards**. The current system of oversight whereby each national authority is responsible for all carriers on their register is, however, not always effective. While on paper everything may look fine when national authorities are audited, the reality on the ground is often different: with limited resources, **one authority cannot effectively oversee** remote operations, particularly when airlines have a complex, trans-national set-up with multiple bases across Europe – like many companies nowadays have – or with virtual airlines, i.e. companies that do sell tickets but have no own aircrafts.

Serious concerns have been expressed, for example, regarding the ability of the relatively small **Irish Aviation Authority (IAA)** to perform increasingly complicated oversight on large and dislocated Irish registered operations, including Ryanair and its bases in 16 European countries, Norwegian Air International with crew bases in Bangkok and aircrew on Singaporean contracts, or Aer Lingus with operations in the UK, to name just a few.

Lack of effective oversight and uniform regulatory enforcement ultimately act as an invitation to lower compliance and to abuse loopholes. This puts those companies at a competitive disadvantage that do comply with the rules and are stringently overseen by their authorities. It also creates a dynamic for **regulatory forum shopping** and 'flags of convenience': companies will establish their Air Operator's Certificate (AOC) in the country – or countries – where they will be least 'bothered' and allowed to run their business as they wish. Regulatory forum shopping is the practice whereby a structure or setup of a company is designed in a way to ensure that the more commercially expedient or less stringent regulatory regime of a foreign country can be used instead of the one which would normally be expected to apply in the company's home country. 'Shopping' for this more convenient regulatory 'forum' will invariably mean that an organisation's setup is more complex and less transparent than necessary. It allows that many regulatory standards and tax/social security regimes are avoided and different ones – chosen by the company – are applied. It also means that when some or all of the tax regimes in the jurisdiction where the company conducts its business are circumvented, local enterprises and citizens are effectively forced to subsidise the forum shopping entity. The more complex the set-up of the company and the more it involves entities in different national jurisdictions, the more difficult it will be for national authorities to adequately oversee such a company.

Blank cheque to airports & airlines

In Europe competition rules are at the core of the internal market liberalisation and integration.

Despite some restrictions, certain airlines are seeking direct or indirect subsidies from airports (e.g. lower airport charges) or from local authorities (e.g. a fixed euro amount per passenger transported to their region). Depending on the circumstances, this can allow them to **unfairly cross-subsidise** their operations and ticket prices to the detriment of their non-subsidised competitors.

In early 2014, the European Commission published a revised set of rules for state aid to airlines and airports, introducing more flexibility on operating aid for small and regional airports during a ten-year transitional phase. In principle, the rules limit state aid in volume and time and intend to ensure that tax payers' money is not used to cover operating costs.

Yet, in reality both regional airports and public authorities are often keen to attract airlines through marketing support, rebates or incentive schemes with the objective of increasing the connectivity of their region and attracting tourists. Even if found to comply with the rules, such incentives have a potential to distort competition.

Shifting international hubs away from Europe

Distorting competition is an equally acute problem as regards foreign air carriers from outside Europe. Economically booming airlines from Asia and the Middle East are often state-sponsored or state-owned, with access to cheap infrastructure, capital and fuel, while being subject to non-transparent accounting standards.

The governments of these competitors have developed ambitious strategies to help their carriers to step up their expansion in Europe and to shift the connection on international flights to their region – thereby replacing European carriers from those routes. Most emblematic are the so-called **Middle East "big three"** – Emirates, Etihad and Qatar Airways. In 2013, they ordered the outstanding number of 355 wide-body aircraft, demonstrating their determination to massively increase capacity and to fuel further expansion across all continents.

Qatar Airways is 100% owned by the Qatar state via the Qatar Investment Authority; Etihad Airways is 100% owned by the government of Abu Dhabi; and Emirates is wholly-owned by the Government of Dubai. As their financial situation lacks transparency, there are **no guarantees that the governments are running their companies as 'private' entities**. From a simple financial perspective, as long as the oil and gas revenues remain in the region, these companies will enjoy a huge 'war chest' and access to 'cheap' money to finance their further expansion. In addition, weak social legislation in their countries offers them the competitive advantage of a precarious workforce that cannot count on the respect of the basic standards set by the International Labour Organisation (ILO).

Finally, the past and future expansion of Middle East carriers would not be possible without a significant state-sponsored development of modern **airport infrastructure**. Dubai Airport is now the world's busiest airport in terms of international passenger traffic.

A new terminal will be built at Abu Dhabi International Airport, and Qatar plans to open a new Hamad International Airport in Doha. Such massive investments in infrastructure are in stark contrast to the situation in Europe, where airport expansions and opening hours are constrained by multiple considerations, making Europe as a global hub less and less competitive.

Cheap aircraft: Subsidising Europe's competitors

Many carriers receive low-interest financing from export credit agencies, both in Europe and the US.

These agencies act as an intermediary between national governments and exporters, including aircraft exporters, by providing favourable financial conditions to third country airlines where aircraft are not produced (hence, US, French, German or British airlines can only partially benefit). As this financial tool is applied evenly, it does not rebalance the level playing field but subsidises the big buyers of aircraft.

De facto this means that Europe helps the already cash-rich foreign airlines to buy aircraft at discounted rates. And these aircraft will be deployed in an already saturated market to compete against Europe's airlines. Europe is helping foreign carriers to push Europe's own airlines out of the market!

For European carriers it is impossible to match the financial power of state-sponsored foreign carriers. But this is just one part of the picture. Non-EU carriers are **not bound to play by the same rules** and stringent European regulations notably on competition and state aid. There is also a clear lack of global common standards regarding passenger rights, environmental policies, and safety and security requirements.

These rules – albeit necessary – have a price tag for European airlines which their competitors are not subject to – and are an additional obstacle to compete on a global level playing field.

What's at stake for Europe's economy?

Some governments outside the EU took a deliberate decision to support their aviation industry – and to do so very heavily, as they consider it as a strategic sector and engine for national growth. This is an approach that the Europe's industry and decision-makers should study carefully.

In Europe, air transport supports **7.8 million jobs,** generates more than **475 billion euros** in revenue, contributes to tax income and social security systems, and is a stimulator for economic growth, tourism and geographic connectivity. The importance of this sector should be recognised by the EU, as well as the role of its employees – a key asset of any airline. The highly qualified and well-trained crews are responsible not only for carrying out the operations, but mainly for ensuring flight safety and the wellbeing of passengers.

Crucially, EU Members States have an important role to play to ensure a level playing field. They should ensure that strategic elements of their economy (e.g. airport infrastructure, airline ownership and market access) are not traded away when negotiating air transport agreements and cross-sector trading partnerships with foreign companies and governments. Such negotiations should be used to enhance Europe's airlines ability to compete internationally, rather than considering air transport as a bargaining chip to achieve other commercial or political interests.

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The Road to Fair Competition

To stem the trend towards unfair competition Europe's decision makers must take action.

This action should start with the recognition that the aviation sector and the high-skill employment it generates are a vital asset for Europe's economy and its social and geographical cohesion. To ensure a long-term sustainable future for Europe's aviation, based on fair competition on a level playing field, several concrete steps are necessary and urgent:

1. **Europe must better coordinate and strengthen its social regulations across Europe to address the unintended consequences of liberalisation. Reinforcing efforts to eradicate fake self-employment and social dumping practices must become a key priority in Europe.**

Effectively and consistently enforcing existing regulations at national level, introducing new legislation that requires aircrew members to be directly employed by the airline holding the Air Operator's Certificate and banning the use of zero-hour contracts are part of the solutions.

In addition, tax and social security rules and their coordinated enforcement across borders, including protection for those making protected disclosures ('whistleblowers'), should be reinforced.

Another important tool is the crew's 'home base' concept. Embedding this principle in the relevant employment and taxation legislation will help to stop the use of artificial or fictive airline bases. It could also allow to specify and clarify existing legislation concerning social rights and standards applicable to the air crew members in employment contracts.

2. Abusive business models, subsidy-hunting, and regulatory 'forum shopping' must be eradicated.

The most important rules in this area are laid down in the European Commission Regulation 1008/2008. In its current form it allows the use of virtual airlines, PO box companies, regulatory 'forum shopping' and 'flags of convenience'.

A possible and needed solution is the revision of this regulation and the strengthening of its definition of the 'Principle Place of Business' (PPB), which currently is far too permissive. An airline should only be registered in a Member State where the company has substantial flight operations and not only a management or administrative centre.

3. Ensuring a competitive level playing field with 3rd country carriers is a precondition for the industry to survive.

Europe and EU Member States must learn from third country governments and invest in quality airport infrastructure to guarantee a high level of service for passengers.

Fair competition is a particular challenge when airlines from foreign countries are subject to completely different regulatory, legal and social frameworks. As a truly global industry, it is therefore crucial for the EU Commission to continue dialogue with 3rd countries. This must include launching initiatives to foster fair competition and regulatory convergence at bilateral and global level.

Regretfully, certain third countries do not have effective competition rules in place, and have been reluctant to accept or even discuss 'fair competition' clauses in air transport agreements with EU Member States. As long as those clauses are not applied, and as long as foreign airlines do not abide by transparent financial and accountancy principles to ensure they are not state-supported, the traffic rights to the EU should be limited.

The above solutions will help to give an initial impetus to (re)establishing a level playing field in aviation. But they are a first step only. More actions will be needed in future, based on a long-term strategic vision for aviation as a key asset for Europe.

About ECA

The European Cockpit Association was created in 1991 and is the representative body of European pilots at the EU level. It represents over 38.000 European pilots from the national pilots' associations in 37 European states.

European Cockpit Association - AISBL
Rue du commerce 20-22, 1000 Brussels
www.eurocockpit.be

Visit www.eurocockpit.be for more information on (Un)fair Competition in aviation