ELFAA

European Low Fares Airline Association

Liberalisation of European Air Transport:

The Benefits of Low Fares Airlines to Consumers, Airports, Regions and the Environment

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Table of contents

Table of figures

Executive Summary

The European Low Fares Airline Association (ELFAA) was officially launched in January 2004 out of a growing realisation that the particular views and interests of low fares airlines (LFAs), the fastest growing and most competitive sector in European air transport, and their customers were not being represented by traditional airline associations or reflected in recent EU air transport policy. ELFAA currently has 11 airline members from 10 European countries carrying almost 60 million passengers per annum or roughly 16% of intra-European scheduled passengers in 2004, with total low fares services in Europe accounting for approximately 24%. The low fares sector has been growing at an average of over 35% per annum over the past 5 years and will continue to grow strongly as the demand for low fares services increases. The total share of low fares traffic in Europe is expected to reach over 40% by 2010. Our current members are: Air Berlin (Germany), Air Polonia (Poland), Flybe (UK), Hapag-Lloyd Express (Germany), Ryanair (Ireland), Sverige Flyg (Sweden), Sky Europe (Slovakia), Sterling (Denmark), Transavia/Basiqair (The Netherlands), Volareweb (Italy), and Wizz Air (Hungary).

The EU's successful liberalisation of the air transport industry ushered in a period of unprecedented growth in air transport and introduced many new entrants and business models into the market. Following the success of Southwest Airlines in the US, the low fares model has been the major driver of the successful liberalisation process in Europe.

Liberalisation and the advent of low fares air travel have forced the traditional flag carrier airlines to compete for the first time. Competition has led to lower air fares and better services across the board. As a result air traffic has exploded, having been stifled for years due to the lack of competition and high fares. Liberalisation has also led to increased competition between airports bringing lower costs and more efficient services. This has greatly improved direct connections between the European regions, leading to increased inward investment, tourism and related employment. The low fares business model is also more efficient and offers a more "environmentally friendly" alternative not only to traditional airlines, who generally use less efficient aircraft and operational models, but also to other more polluting forms of transport, such as motor cars and coaches.

However, the highly political nature of the flag carrier airlines and their strong hold on industry representation has meant that EU policy to date has generally not reflected these significant changes in the industry.

The presence of strong low fare competition in European air transport continues to be crucial at a time when the traditional network carriers are consolidating and as a result continue to withdraw direct services from regional airports and continue to charge higher fares. A lack of understanding by decision-makers of the full ramifications of changes which have been taking place in the industry will lead to the continuation of ill-informed and incoherent policies which undermine the low fares model, leading to less competition, higher fares for consumers, and less services to the regions and major city routes, all of which will seriously undermine European integration and economic development.

It is unfortunate that the European Commission has not carried out a comprehensive study on the benefits of liberalisation, the development of the low fares airline sector and the positive impact which this has on regional economies. As the representative industry body for the low fares sector, ELFAA endeavours in this report to fill the current gap in understanding of the low fares model and the wide-ranging benefits it brings. The report also seeks to break some of the “low cost myths” that have emerged due to a lack of understanding as well as negative lobbying and the absence of the LFAs from the policy making process.

As a progressive industry organisation, we look forward to working with policy makers and other industry groups to ensure that the benefits of liberalisation are promoted through informed policy making that fosters competition, lower fares and greater choice for consumers and European businesses.

Wolfgang Kurth
President of ELFAA
and CEO of Hapag-Lloyd Express

1 Liberalisation in Brief

Prior to the liberalisation process of European air transport between 1987 and 1997, the industry was highly regulated and inflexible, with no real competition between national carriers and fares that were set through bilateral agreements between states. A web of bilateral air service agreements shaped the industry, with specified routes and airports, agreed aircraft types, fares and frequencies, and designated carriers. In effect, capacity on the majority of routes was artificially restricted, fares were offensively high and entry into markets by non-flag carrier airlines was virtually impossible. Various European regions left outside agreed route networks due to decisions taken at national level had either no possibility of attracting air services or had to rely on connecting services through the emerging network hubs of the flag carriers. In short, the average consumer could not afford to travel and European integration suffered.

Deregulation in Europe was preceded by early liberalisation between Ireland and UK in the mid-1980's, which created the conditions for the emergence of the first European low fares airline, Ryanair. Ryanair was permitted to enter certain routes between Ireland and the UK, bringing competition to the duopoly that had existed for years between the national airlines, Aer Lingus and British Airways.

The liberalisation of European air transport was achieved in four stages:

i) In 1987, under the first package of liberalisation measures, fare restrictions were reduced. Carriers were also given additional flexibility for cooperation within the limits of existing air service agreements.

ii) In 1990 the so-called second package of liberalisation measures allowed all European airlines to carry passengers to and from their home countries to other EU Member States (3rd and 4th freedoms). Also 5th freedom flights, i.e. intra-European flights with stop-over in a third country and the right to pick-up and drop-off passengers during the stopover, were allowed to a greater extent. Fare and capacity restrictions were further abolished.

iii) In 1993 the third package of measures, including the common licensing of carriers and freedom of access to the market, was introduced. All carriers holding a community license were allowed to serve any international route within the European Union. Finally, carriers were given almost full freedom to set fares.

iv) In 1997, as part of the third liberalisation package, all carriers holding a community license were given the right of cabotage, i.e. the right to operate domestic routes within the whole of the EU.

As a result of the creation of the single market for air transport, European carriers obtained practically unlimited freedom to choose their routes, capacity, schedules and fares. Interference from national governments in these decisions was reduced to a minimum. Commercial considerations became the primary incentive for airlines to open/close a new route, to add/reduce capacity and to increase/lower fares.

Liberalisation of the European air transport market has been hugely successful in increasing competition and consumer choice and lowering fares across the board. Low fares airlines have also achieved all of the objectives set out by the European Commission for liberalisation.

2 Emergence of Low Fares Airlines

The national airlines were not particularly enthusiastic about the new competitive environment. Obviously the shift from a highly regulated market, with strong government protectionism, towards an open market and a need to compete was not welcomed by them. Their initial reaction was to consolidate their position in their own national market, by buying out smaller competitors, and making limited in-roads into other national markets. The real opportunities now being presented by liberalisation were however seized upon by a new generation of airlines applying the low fares model – with Ryanair and easyJet being the most noticeable examples.

Following early liberalisation between Ireland and the UK, Ryanair emerged as a new entrant in a market that had been dominated by Aer Lingus and British Airways. Ryanair initially introduced services between Ireland and UK destinations, including London. Once the third liberalisation package was introduced in 1993 Ryanair was able to start services between the UK and continental Europe. EasyJet launched flights between London and Scotland in 1995 and commenced its first connections between the UK and continental Europe in 1996. These two most established European LFAs are also currently the largest, carrying over 50 million passengers a year between them.

At present around 60 new entrant and charter/regional airlines apply the low fares model to varying degrees in Europe offering consumers efficient direct services to many, often previously unserved, destinations around Europe. LFAs currently account for around 24% of the scheduled intra-European air traffic and the market share of LFAs continues to grow strongly. ELFAA members themselves serve over 900 routes connecting over 200 cities. They currently operate a total fleet of 249 aircraft and will carry almost 60 million passengers in 2004. Although the United Kingdom is by far the most developed market for low fares services, with several low fares airlines having established operational bases there and with the low fare share of scheduled traffic at the airports approaching 50% in 2004[1], this success has been replicated in other markets as consumers are opting for low fares services in continually increasing numbers. Consumers in the new EU Member States are also now benefiting as the same liberalized rules in the field of air transport became applicable in their territories on 1 May 2004.

2.1 Following the US Example

The low cost/low fares airline business model is not, however, a European invention. The idea was originally developed and successfully implemented in the United States following deregulation of the air transport market there in the late 1970s. A

[1] UK Civil Aviation Authority, Regional Aviation. The Impact of Low Cost Airlines, Presentation given at the 10th World Route Development Forum, October 2004.

US regional air carrier, Southwest Airlines, relaunched itself as the original low fares airline, offering low fares services from its hub at Love Field, a secondary airport in Dallas, Texas. Today it carries over 65 million passengers a year and is the most profitable US airline.

Southwest's remarkable growth was achieved through low costs and high efficiency in every aspect of its business. For example, Southwest operates from uncongested secondary and regional airports where charges are lower, delays rare and turnaround of aircraft can be achieved much more quickly than at a congested hub airport. Southwest Airlines perfected the "25 minute turnaround", i.e. the time it takes to land an aircraft, disembark passengers, refuel if necessary, board the next flight and take off. This led to much improved aircraft efficiency. Southwest operates a single aircraft type, the Boeing 737, which allows all pilots, cabin crew, and engineers, to operate on any aircraft in the fleet, thereby reducing training and maintenance costs as well as the cost of aircraft financing. The ability to earn revenue is increased beyond that of traditional carriers due to a higher seat density as there is no business class and only limited catering, which requires less storage space. This, combined with high load factors (i.e., average number of seats sold per flight), significantly lowers the average per-seat cost. Southwest's pricing structure is very simple and tickets are primarily sold directly, i.e. via the internet and through call centres, hence minimising distribution costs. The following figure gives a breakdown of the various efficiencies that lead to the low fares and high volumes necessary for the success of low fares airlines.

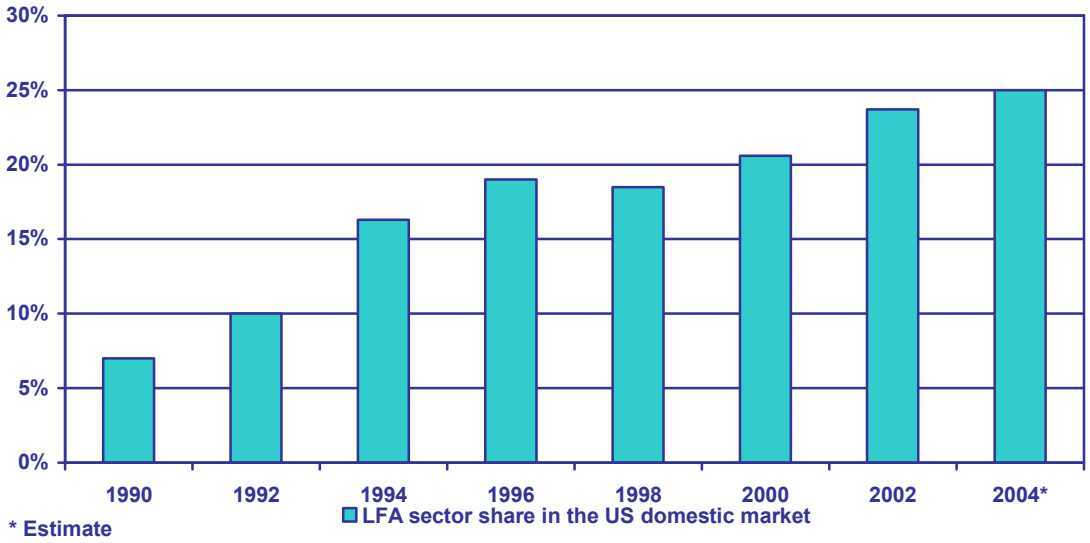
Figure 1 Low-cost model advantages

LFAs	Traditional airlines	LFA advantages
Operate from mostly secondary, underutilised, regional airports	Operate from mostly primary international hub airports	Lower airport charges, faster turnaround times, less air traffic control-related delays
Fast turnarounds (25 min.)	Slow turnarounds due to use of congested hub airports	Better fleet utilisation
Direct point-to-point flights, no transfers, short-haul routes	Mix of long, medium and short haul routes with transfers ("connecting flights")	Lower complexity, higher capacity utilisation
Standardised fleet (only one aircraft type), higher seating density	Various aircraft types, low seating density	Cheaper aircraft financing; Lower maintenance and training costs; Simpler swapping around of flight and maintenance staff; Higher capacity utilisation
Distribution primarily through direct channels (internet, call centres)	Most tickets sold via travel agencies (high GDS costs, travel agent commissions, etc.)	Lower distribution costs, lower complexity
No "frills", extras paid for (e.g. catering, excess baggage)	Entertainment programmes, express check-in, VIP lounges, paper tickets, business class, "free" catering	Lower ancillary costs, less complexity; Additional revenues
Highly incentivised work force (variable proportion of salary up to 40%)	High basic salaries (variable proportion less than 10 %)	High employee productivity

The savings achieved through these lower costs and greater efficiencies are passed on to consumers in the form of lower fares. As demand for air transport is highly price sensitive, reduced fares result in higher passenger numbers, which in turn lead to further efficiencies and therefore lower costs. Southwest and other low fares airlines which followed suit in the US and eventually in Europe and Asia are therefore volume, and not price, driven. More than 20 years of experience has proven that this philosophy reflects consumers' expectations and LFAs have grown rapidly as a result.

Low fares airlines have been the fastest growing segment of the air transport market in the US. Total US air traffic has increased significantly since liberalisation as traditional airlines have been forced to restructure and offer lower fares to compete in the market. Figure 2 below shows that the LFA share of the US market has increased from just 7% in 1990 to approximately 25% in 2004. The 1993 US Department for Transportation study on the "Southwest Effect" found that "[the] average prices for markets Southwest does not participate in for distances of 0 - 250 miles and 251 - 500 miles, are $109.92 and $130.32, respectively. In Southwest markets of similar distances, the average prices charged by all carriers are $56.29 and $57.61, respectively".[2] Thus, competition from Southwest has led to a 50% reduction in prices on routes where it is present.

Figure 2 Share of the low fares airline sector in the US domestic market[3]



The development of the low fares sector in Europe following EU liberalisation is essentially a replication of the development of Southwest and other low fares airlines in the US. The benefits of LFAs and particularly Southwest, have been widely recognised and the traditional network carriers are still struggling to replicate Southwest's success. Similarly in Europe Ryanair, the original European low fares

[2] The airline deregulation evolution continues. The Southwest Effect, Department for Transportation, May 1993.
[3] Harumi Ito, Darin Lee, Low Cost Carrier Growth in the U.S. Airline Industry: Past, Present, and Future, April 9, 2003 and own research.

airline, has been followed first by easyJet, with a slightly different variation of the low fares model, and subsequently by several other new entrants as well as charter and regional carriers. Recently, low fares airlines have enjoyed success in the new EU Member States with the emergence of ELFAA members Air Polonia, Wizz Air and Sky Europe. The low fares model has also been adopted in Asia with such new entrants as Air Asia and Tiger Airways.

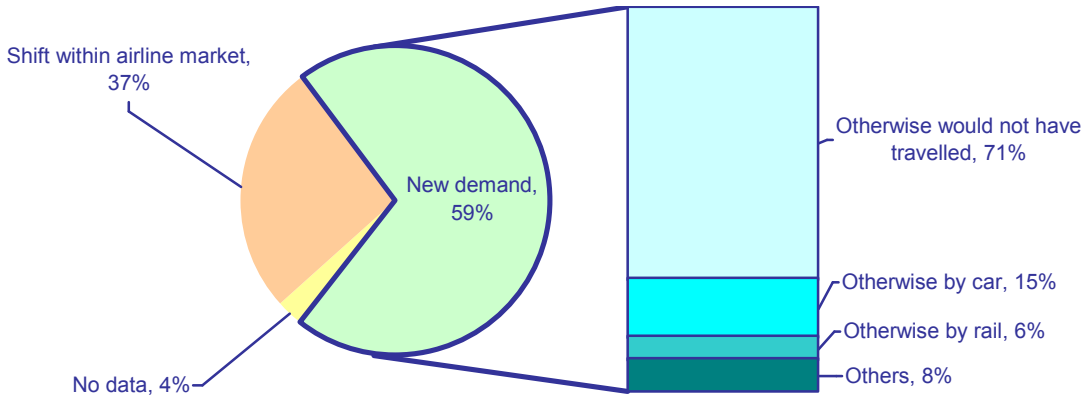
2.2 Breaking the "Low-Cost Myths"

Despite the huge benefits of liberalisation in Europe and the resulting competition and lower fares to consumers LFAs have brought, the low fares sector continues to be plagued by a number of myths that colour the perception of this sector leading to misinformed and damaging policies in the area of air transport.

i) Myth number 1: LFAs poach passengers from the traditional airlines, thereby undermining these airlines.

This is not true, the vast majority of low fares passengers are new passengers, who either would not have travelled at all in the absence of low fares services or would have taken another, less efficient, higher cost mode of transport. The figure below indicates the breakdown of low fares passengers.

Figure 3 Share of new demand in the LFAs' traffic and breakdown of the new demand [4]



Indeed, passenger numbers for traditional airlines have generally increased as they have been forced to reduce their fares and improve service due to competition. Figures 6 and 7 below demonstrate this effect on one international and one domestic route in Europe.

LFAs can also regenerate demand for air travel. Following the tragic events of 9/11 the travelling public was reluctant to travel by air. The sudden dramatic loss of demand for air travel caused traditional airlines to reduce capacity and services and

[4] Source: NFO Infratest, 2002; Monitor Group Analysis.

also increase fares both in Europe and the US. The LFAs however, responded to the situation by decreasing fares still further to the point at which passengers took to the air again. LFAs saw big increases to passenger numbers and increased services further as confidence in air travel was restored and demand returned – not only for low fares airline services but for all air services.

ii) Myth number 2: LFAs can only offer low fares because they receive subsidies from airports and regional authorities.

This is not true but this impression has unfortunately been strengthened by the European Commission's decision in the Charleroi case. Airport costs are just one of several efficiencies that contribute to LFAs' low cost base (see figure 1 above). LFAs require a lower level of service from airports and do not use all of the facilities, e.g. air bridges, business lounges, etc. They also use the facilities more efficiently, e.g. faster turnaround times. The airports themselves are generally located in more remote areas where the property values are lower and they also have more basic facilities, i.e. less gold plating than main city airports. All of this translates into lower costs to the airports which can then be passed on to the airlines in the form of lower airport charges.

LFAs have also successfully changed the way airports do business with airlines and have forced these airports to increase their efficiency and offer lower costs to airlines willing to deliver large passenger volumes to otherwise underserved airports. Low fares airlines are able to offer guaranteed passenger volumes, which is a huge benefit to such airports as it increases both their aeronautical and non-aeronautical revenues. LFAs also offer valuable marketing services to the airport and regions by promoting them as attractive destinations. In exchange, these airports offer long term, low cost arrangements in order to incentivise the airlines to grow their traffic.

A recent study by the Boston Consulting Group has recognised the huge potential for regional airports that are willing to increase their efficiency and lower their costs in order to attract LFAs.[5] Airports, such as Stansted, Liverpool, Frankfurt Hahn, and many other underutilised secondary and regional airports, have been very successful in taking advantage of the large passenger volumes delivered by LFAs. It is often the case that airports which once were not able to cover their fixed costs have subsequently seen tremendous growth in commercial revenues as a consequence of the large volumes of passengers generated, which has transformed the financial status of the airports from loss-making to profit-making. This again follows the US model where Southwest Airlines has transformed such airports into thriving and profitable hubs. The "low cost airport" business model will be discussed further below in Section 3.2.

[5] The Boston Consulting Group, Airports – Dawn of a New Era. Preparing for one of the industry's biggest shake-ups, April 2004.

iii) Myth number 3: LFAs do not treat their employees well.

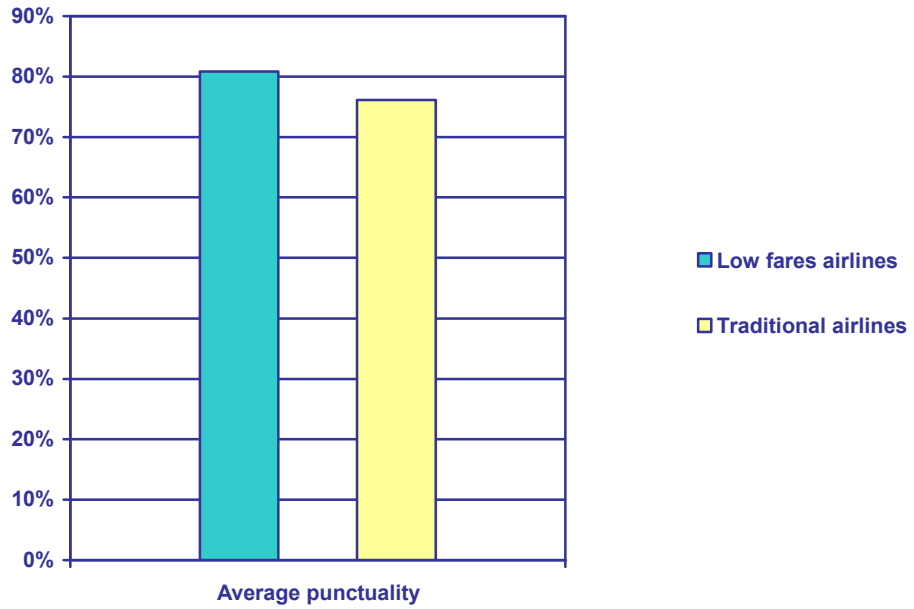
This is not true. LFAs rely heavily on the high productivity of their staff and incentivise their employees to work efficiently (see figure 4 below). Traditional flag carrier airlines have huge numbers of staff, more for political reasons than commercial. For example, airlines like BA, Lufthansa and Aer Lingus, among others, have reduced staff numbers dramatically since 9/11 but are generally carrying the same number if not more passengers. LFA employees are generally incentivised based on the number of flights flown and are often compensated through commissions for on-board sales. Employees may also benefit from share option schemes and other benefits. The overall package is similar to if not better than traditional airlines. In addition, numerous jobs have been created as a result of low fares airlines that simply would not have existed without them.

Figure 4 Average employee productivity at ELFAA members and at selected national airlines

iv) Myth number 4: LFAs do not have good customer service.

This is not true. LFAs are the leaders in the key customer service areas. They have the highest levels of punctuality and the lowest number of cancellations, denied boardings, lost bags, and customer complaints. This is due to higher efficiency, simple operations and operating from less congested airports. In fact, the LFAs were the first to publish customer service statistics. This has forced the traditional airlines to publish their statistics also and to compete on customer service. LFAs therefore not only offer passengers a lower price but also a punctual and reliable service.

Figure 5 Average punctuality at LFAs and at traditional airlines [6]



The LFAs have changed the perception of air travel from being something that only the wealthy could afford to being a kind of commodity – just another form of transport, such as the bus or the train. Old myths that passengers expect to receive a "free" meal on board and would not travel to regional and secondary airports have been broken, with an increasing number of consumers choosing the low fares option. LFAs are very transparent in what they do and do not offer to customers because bookings are made via the internet or through call centres, where this information is readily available, enabling passengers to make an informed choice.

v) Myth number 5: LFAs cut corners on safety.

This is not true. LFAs are regulated by the same stringent safety standards as all European airlines. Indeed, LFAs are particularly conscious of safety, perhaps because of this incorrect perception and the fact that a serious safety incident could potentially have a greater impact on their business than on a traditional airline.

vi) Myth number 6: LFAs are less environmentally friendly than traditional airlines.

This is not true. In fact, LFAs generally operate newer, more energy efficient, less polluting aircraft than do the traditional airlines. LFAs mostly operate to less congested airports thereby reducing noise and congestion in major urban areas. LFAs also have more efficient aircraft configuration and higher load factors (i.e., average number of passengers per flight) which allows the airlines to achieve lower energy use per passenger. The environmental aspects of the low fares airline business model will be discussed further below in Section 3.4.

[6] Source: UK CAA punctuality reports January - June 2004 on major airlines operating to/from the UK (Ryanair, SAS, FlyBE, Lufthansa, British Airways, KLM, easyJet, Aer Lingus, Air France, Iberia, BMI, Alitalia)

3 The Benefits of LFAs

LFAs have dramatically changed the European air transport market following liberalisation. The benefits in many areas are evident. The following sections outline the impact of low fares airlines on consumers, both in terms of consumer choice and lower fares; the dramatic growth of underserved regional and secondary airports; regional development/integration and increased tourism in formerly underserved areas; increased employment and the environmental benefits of more efficient operations.

3.1 Benefits for Consumers

Consumers have been the major beneficiaries of air transport liberalisation and the emergence of LFAs in terms of greater choice of service providers and destinations as well as reduced air fares in general for travel within Europe. The lower fares on offer have dramatically increased the numbers of passengers who can now afford to travel by air and has also brought enormous cost savings to the travel budgets of many businesses across Europe.

3.1.1 Increased Consumer Choice

i) The number of airlines has increased dramatically since liberalisation removed the barriers for new entrants. Prior to liberalisation only national carriers and a small number of regional airlines were permitted to operate within Europe. According to the European Commission, the number of scheduled airlines in Europe increased from 77 in 1992 to 139 in 2000.[7] In the past four years the number of new entries has been even more impressive. Many of these newcomers are applying aspects of the low fares model. Indeed, many of the national carriers are either adopting aspects of the low fares model (e.g., Aer Lingus, which has relaunched itself as a low fares airline) or have set up low fare subsidiaries, such as SAS's Snowflake, KLM's Transavia/Basiqair, BA's 'go' (subsequently acquired by easyJet), Lufthansa's Germanwings and BMI's bmibaby. As a rough indication of the huge growth in the availability of low fare services, the number of seats offered by LFAs during a particular week in July 2000 was just 750,000 but for the same week in 2004, a staggering 7.5 million seats were on offer.[8]

   European consumers can now choose between a variety of airlines and are no longer bound to their respective national carriers. This forces both low fares and traditional airlines to compete on the basis of price, network, customer service, etc.

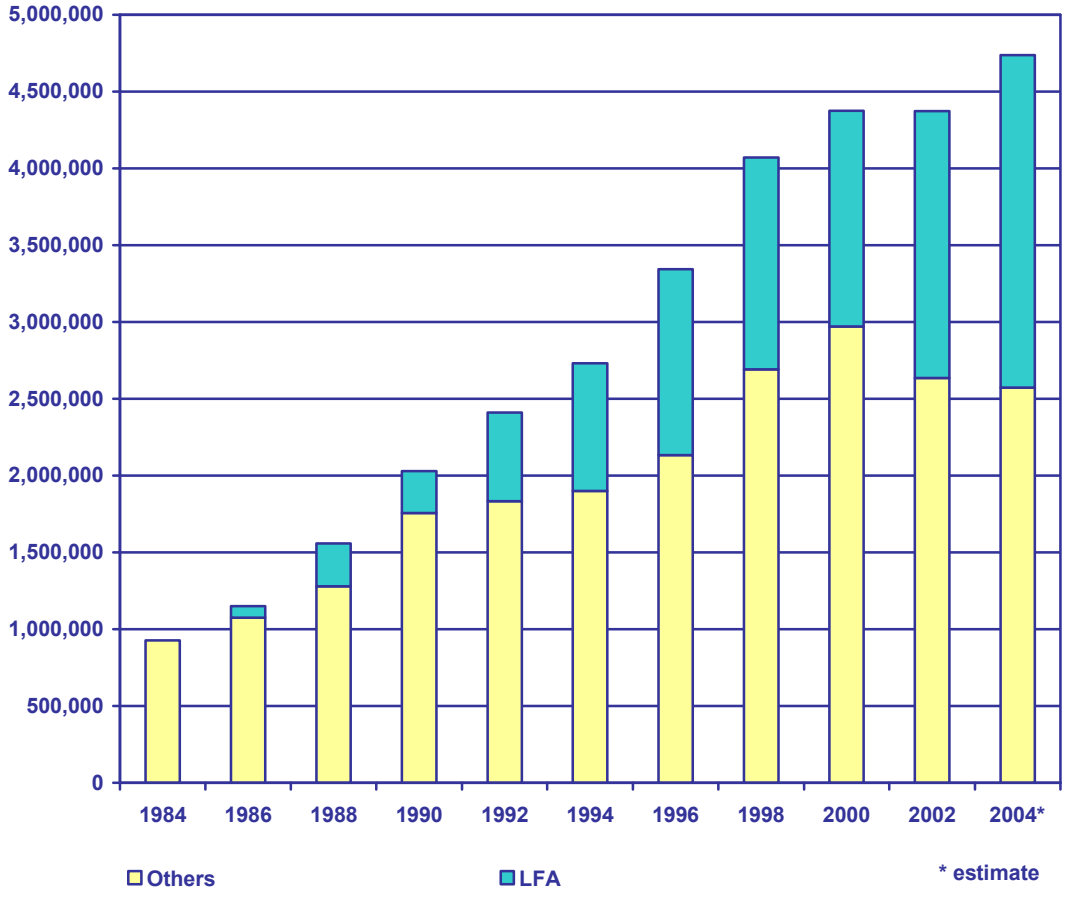
ii) Dense intra-European routes are now served by more airlines than before liberalisation. This gives consumers at both ends of the route a greater choice of schedules, frequencies and airports to fly from. Before liberalisation air

[7] Source: European Commission, DG TREN, http://www.europa.eu.int/comm/transport/air/rules/bilan_en.htm.
[8] Source: Airline Planning Group.

service agreements had artificially restricted traffic on many important routes. The number of frequencies and aircraft capacity were curbed leading to over-demand and high fares. In most cases only main airports for the areas were served. Deregulation created new business opportunities that have been exploited by the LFAs, who offer higher frequencies and lower fares on these trunk routes, usually to secondary airports in a close proximity to the main airport for the area. As a result, traffic overall has surged on many routes. The use of secondary airports by LFAs has also given consumers greater choice. For example, one of the busiest intra-European routes, Dublin-London is currently served out of all five London airports.

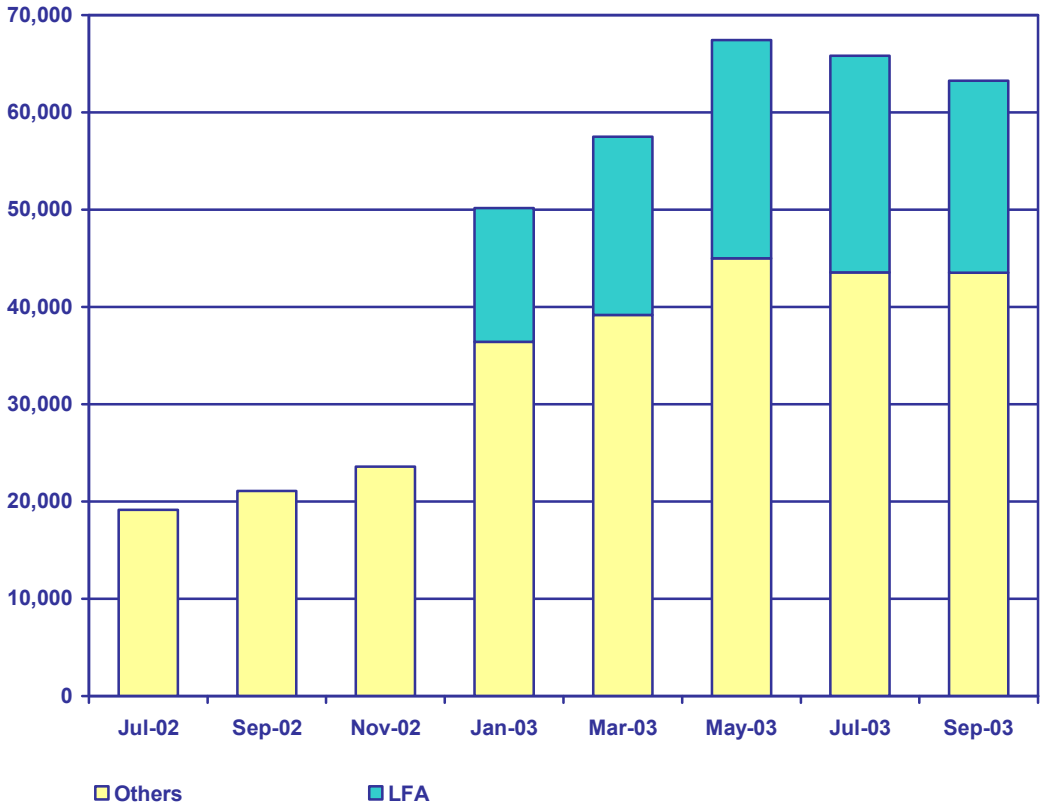
Below are just a few examples of traffic increase following an entry of a low fares airline on an important route. A similar pattern has been replicated on every route where an LFA is present.

Figure 6 Traffic increase on the Dublin – London route following the entry of an LFA [9]



[9] Source: Aer Rianta traffic numbers, UK CAA statistics.

Figure 7 Traffic increase on the Cologne – Hamburg route following the entry of an LFA[10]



iii) The number of direct routes served in Europe has also increased significantly as a result of the growth of LFAs, whose business model involves direct ("point-to-point") as opposed to connecting ("hub-and-spoke") services. Traditional airlines such as British Airways, Air France and Lufthansa have followed the "hub-and-spoke" model, similar to their US counterparts, and have abandoned many direct services opting instead to carry people through their major hubs. Many regional airports have suffered serious cutbacks in passenger volumes and the number of scheduled services from their airports as a result. For example, in the case of Strasbourg Airport, Air France terminated 10 direct services from the airport in the last 8 years.

LFAs, by contrast, offer direct services to these regional airports, thereby replacing the services abandoned by the network carriers, and have opened up whole new routes that previously had no direct service at all. According to the European Commission, there are currently 30% more air routes than in 1993.[11] This number is likely to be considerably understated as LFAs continue to rapidly open new routes. ELFAA members have developed several completely new routes where traffic has grown year on year. Figures 8 – 10 below demonstrate passenger growth on three such London originating routes.

[10] Source: Hapag-Lloyd Express' own research.
[11] Source: http://europa.eu.int/comm/transport/air/rules/bilan_en.htm (October 2004).

These examples demonstrate the huge demand for air services to and from these previously unserved destinations. These low fares services contribute substantially to tourism and employment in the local economies, as will be discussed further below.

Figure 8 Traffic figures on the London – Biarritz route following the entry of an LFA

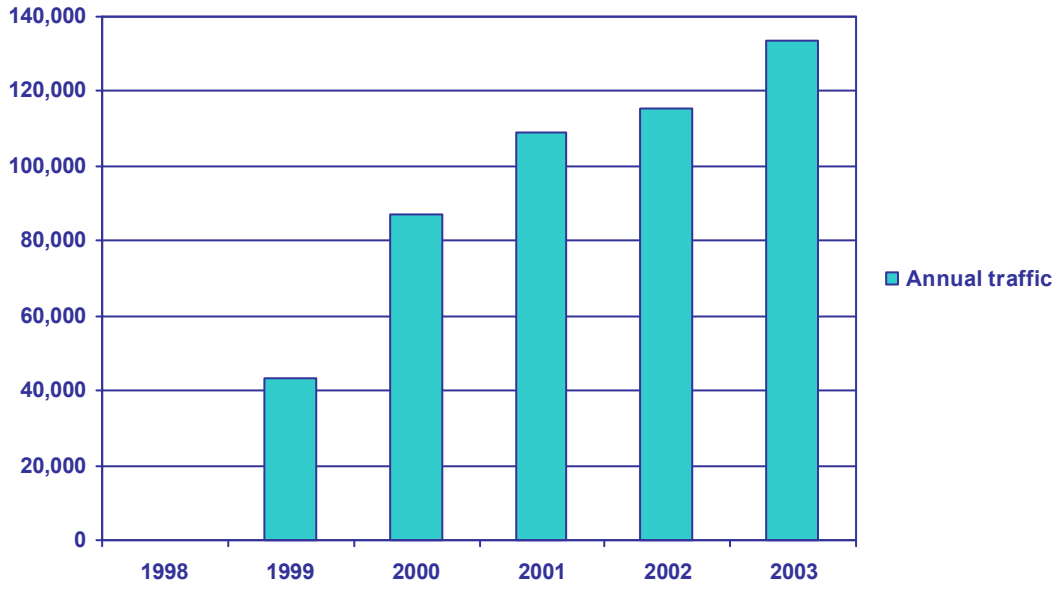


Figure 9 Traffic figures on the London – Dinard route following the entry of an LFA

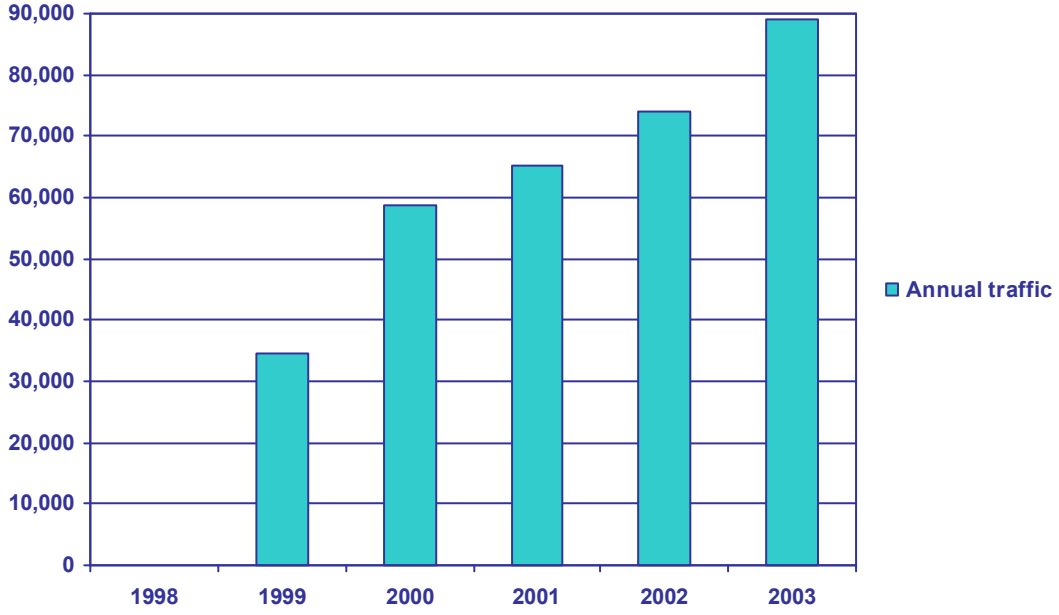
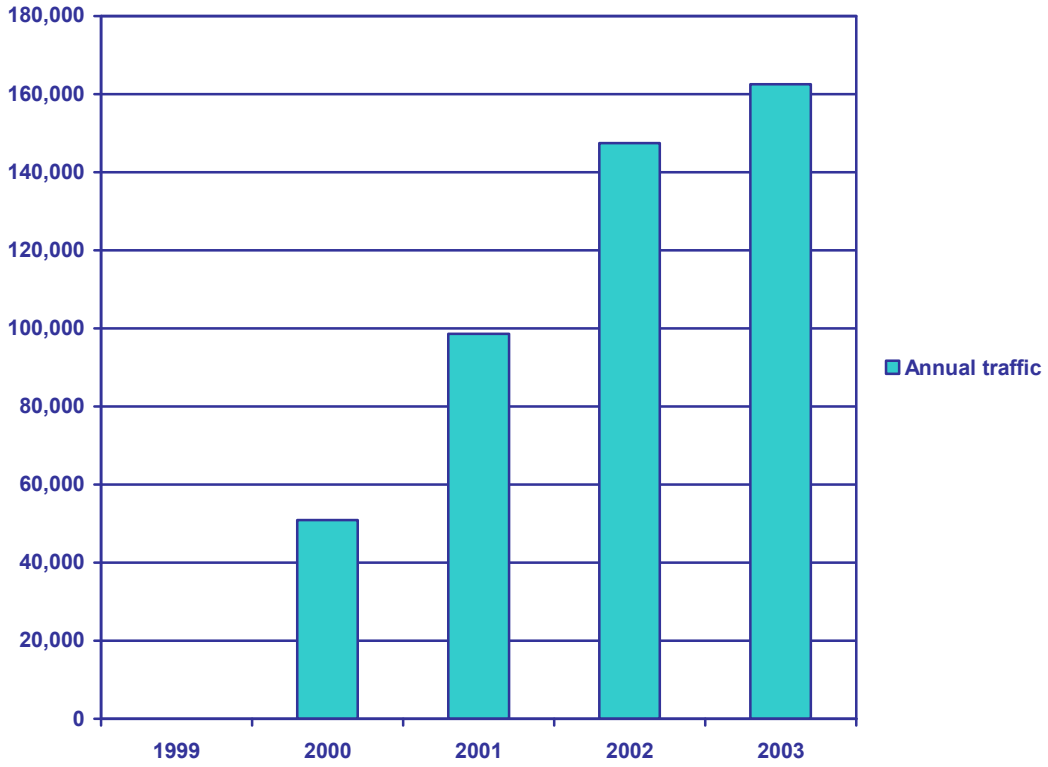


Figure 10 Traffic figures on the London – Alghero route following the entry of an LFA



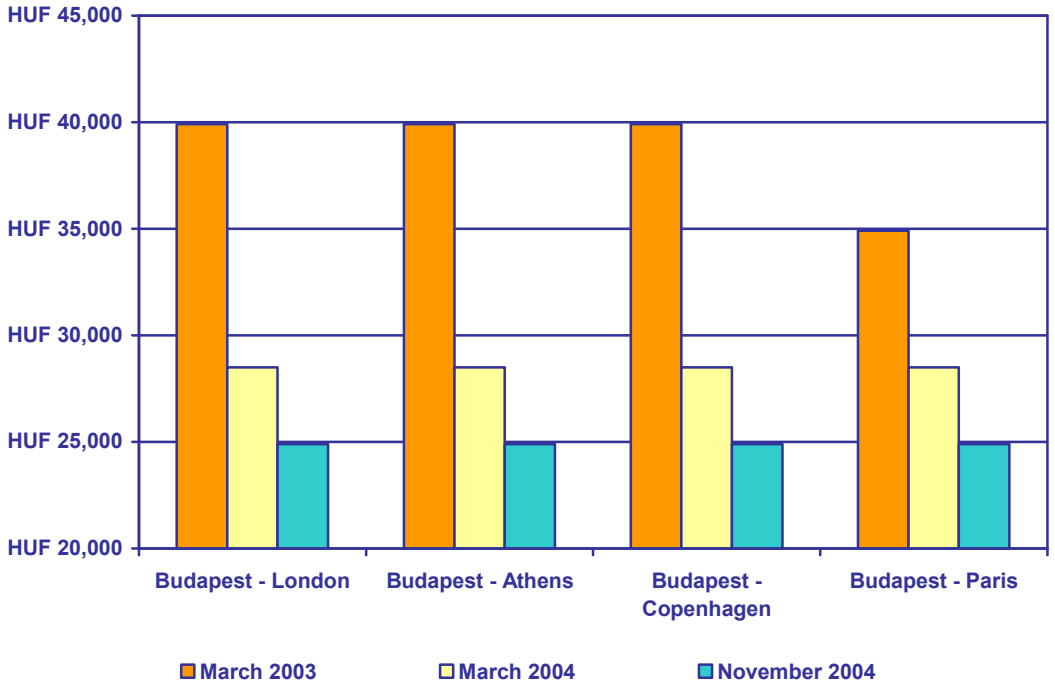
3.1.2 Lower Fares

Increased competition and the growth of LFAs in Europe have led to a dramatic drop in airfares. The low cost base achieved by LFAs has allowed them to sell tickets at prices which were unimagined prior to liberalisation. Strong competitive pressure from LFAs on major trunk routes has also forced the traditional airlines to lower their fares in order to compete to retain their market share. For example, Lufthansa reduced its restricted economy class €143 return fare on the Cologne – Hamburg route to an unrestricted €92 (a 36% reduction and a waiver of restrictions) when Hapag-Lloyd Express, an ELFAA member, entered the route in January 2003.[12]

Further examples of a traditional airline being forced to lower its fares following the entry of a low fares airline can be observed on several routes to/from Budapest. Figure 11 below illustrates the reaction of Malev Hungarian Airlines to such entries on routes where there was previously no low fares competition.

[12] Source: GDS Amadeus.

Figure 11 Lowest available restricted economy fares at Malev Hungarian Airlines before and after the entries of low fares airlines[13]



However, this only applies to routes where low fares competition is present. Where routes continue to be dominated by one or two traditional airlines without any competitive pressure, the fares generally continue to remain at a high level The European Commission observed in 1999 that "the level of fares decreases when the market structure passes from monopoly towards duopoly or routes with more than two carriers".[14]

Competitive pressure from LFAs has also forced many of the traditional airlines to remove abusive fare restrictions, such as the famous Saturday night rule – which required passengers to include a Saturday night in their itinerary in order to avail of "discounted fares"; and "one-way" pricing – which forced passengers to pay a business class fare if they wished to travel one way. Comparative advertising by LFAs highlighting the extent to which consumers were being overcharged as a result of these restrictions has also put pressure on these airlines to revise their anti-consumer practices.

With the facility of being able to book on-line at their convenience, consumers are opting for the simple, transparent fare structures offered by low fares airlines. Combined with very low fares, this transparency in the pricing structure has attracted a completely new segment of consumers flying with the low fares airlines. Various passenger surveys indicate that a large portion of people flying with low fares airlines have never flown before or would not have travelled by air had it not been for

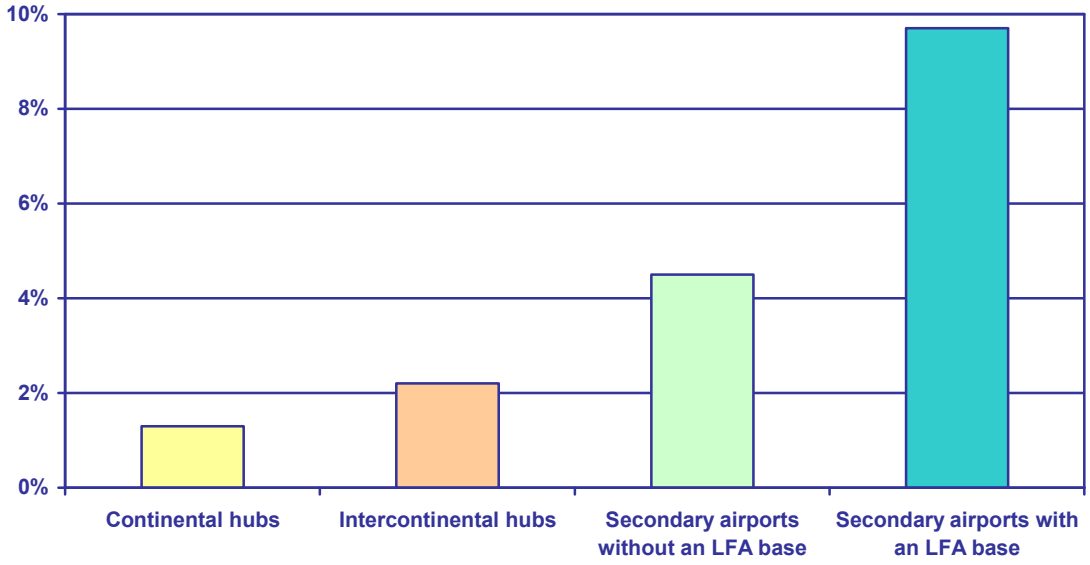
[13] Source: Wizz Air's own research.
[14] European Commission, The European airline industry: from single market to world-wide challenges, 20 May 1999.

low fares. Thus, LFAs have tapped into a growing demand for air services based on offering low fare, point-to-point services. Figure 3 above shows that this newly created demand accounts for approximately 59% of total low fares traffic.

3.2 Benefits to Airports

Airports have also been major beneficiaries of liberalisation of air transport and the resulting emergence of LFAs. Competition and lower air fares have led to phenomenal growth at numerous airports, but particularly at the previously underserved regional and secondary airports which began to receive low fares services following liberalisation. Figure 12 below illustrates the growth rate of secondary airports that have LFAs bases compared to traditional hub airports.

Figure 12 Growth rate of European airports 2002/2003[15]



3.2.1 Emergence of Low Cost Airports

As there are generally no slot constraints at the regional and secondary airports, airlines have a relatively high level of freedom of choice over which airports they could operate services into. The decision is therefore often based on the cost of operating into any one airport compared to another. Airports consequently have been forced to change the way they conduct their business as they now find themselves having to compete with each other for business from the new entrant airlines. Liberalisation in air transport has therefore de facto led to liberalisation of the airport sector. Airports are no longer able to dictate the price and conditions to airlines of operating at their airports. For many years when the state owned both airports and airlines, airports were able to simply pass on their inefficiencies to the state owned airlines who in turn passed these on to the consumer in the form of

[15] Source: ITA Daten 2002/3, Analysen ADL Aviation Center; Arthur D. Little.

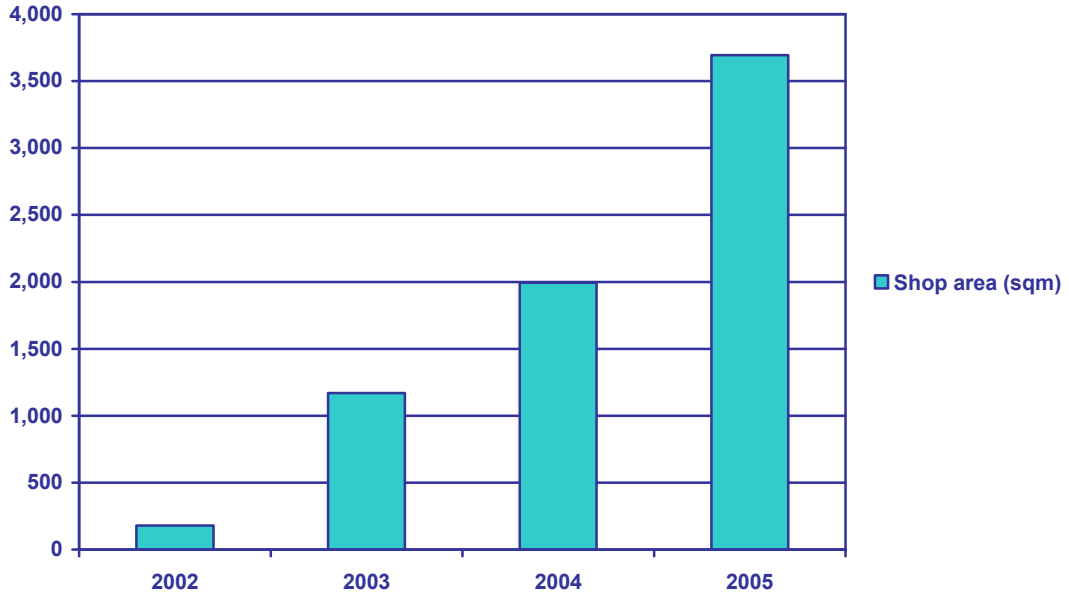
higher air fares. This is no longer the case as LFAs are now negotiating lower costs from underutilised airports (and forcing airports to become more efficient) in exchange for guaranteeing long term passenger and new route growth.

Underutilised airports have certain fixed costs, i.e. the costs they have to bear irrespective of whether the passenger throughput is 20 thousand or 2 million, and they therefore have an interest in maximising their passenger volumes in order to cover these costs. Greater passenger numbers lead to increases in both aeronautical and non-aeronautical (i.e. commercial) revenues and, ultimately, higher profitability. The main difference now between traditional and low cost airports is that the latter no longer consider aeronautical charges to be their main source of income. Instead, they concentrate on the non-aeronautical or commercial side of the business realising that tremendous opportunities now exist for them to significantly increase revenues and profitability in this area. Indeed, at Love Field in the US, home to the original low fares airline, Southwest Airlines, non-aeronautical revenues are three times higher than aeronautical.[16]

Non-aeronautical revenues can be sourced from four main areas:

i) Large numbers of passengers attract businesses to the airport. Car rentals, shops, banks, post offices, restaurants, bars, etc., consider it viable to locate themselves at an airport with high passenger volumes. The airport collects rental and concession fees from these businesses, which tend to increase proportionally with the increase in passenger numbers.

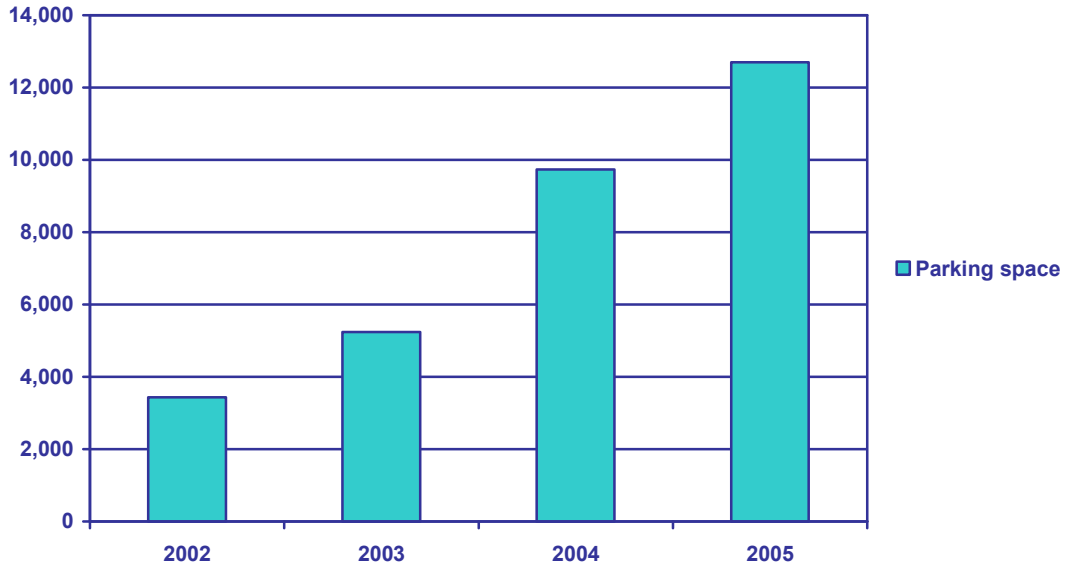
Figure 13 Development of terminal shopping area at Frankfurt Hahn airport[17]



[16] The Boston Consulting Group, Airports – Dawn of a New Era. Preparing for one of the industry's biggest shake-ups, April 2004, page 29.
[17] Source: Frankfurt Hahn airport, September 2004.

ii) Car parking is another important source of revenue. The car parking charges at low cost airports, which usually have an abundance of space available, are usually significantly lower than those at major airports where car parking capacity is often constrained. Higher passenger numbers have led to increased demand for parking facilities (as seen in Figure 14 below) and higher parking revenues.

Figure 14 Development of parking space at Frankfurt Hahn airport[18]



iii) As low cost airports are often located some distance from the main city centres they serve, the need to offer a regular surface transportation service often arises. Airports either organise the shuttle transport in-house, or contract it out and receive a concession from the operator. Either way, the transport of passengers to and from city centres is a significant revenue source for low cost airports.

iv) Airports with high passenger throughput are also a great advertising medium. Airlines, hotels and other tourist attractions in the region, car rentals, neighbouring regions and cities all find it very effective to advertise at such airports. They realise that airline passengers are the best target of travel and tourism advertising, and are therefore willing to spend considerable amounts to advertise at these airports. Low cost airports pay great attention to creating as much advertising space as possible, to enable them to secure substantial additional revenues.

The profile of low cost airports is also greatly enhanced through concerted marketing efforts of the LFAs serving them. Many airports have entered into joint marketing

[18] Source: Frankfurt Hahn airport, September 2004.

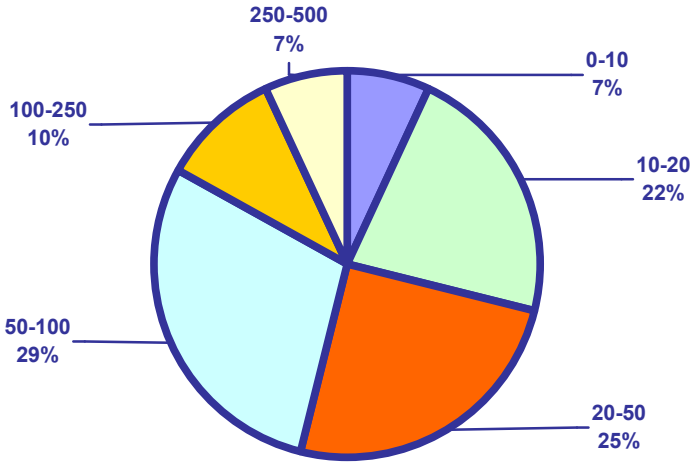
arrangements with the airlines in order to maximise the awareness of the travelling public that their airport is either a viable alternative to the local "primary" airport or is located in an attractive tourist/business destination.

3.2.2 Traffic Growth at Low Cost Airports

The low cost airport model was originally very successful in the UK, which gained advantage from early liberalisation between Ireland and the UK and where the majority of growth in the low fares sector still comes from. Airports like London Stansted, Glasgow Prestwick and Liverpool have made the transition from loss-making secondary airports to being major international airports serving large metropolitan areas. Other airports have also made the transition and are competing to offer low cost, efficient facilities to the growing number of LFAs. Low fares services gave many secondary airports the international recognition which most of them previously lacked.

The model has been replicated across Europe with secondary airports increasingly providing a competitive alternative to the congested, expensive hub airports. Catchment areas of airports in Bergamo, Stansted, Hahn, Girona etc. have been significantly extended and now also include neighbouring large cities, like Milan, London, Frankfurt and Barcelona. Figure 15 below shows the catchment area of Cologne Bonn Airport based on the information provided by the Hapag-Lloyd Express' passengers traveling to Venice. The figure demonstrates that low fares can attract passengers from as far as over 250km.

Figure 15 Catchment area of the Cologne Bonn Airport for low fares passengers traveling to Venice (km)[19]



[19] Source: Hapag-Lloyd Express' own research.

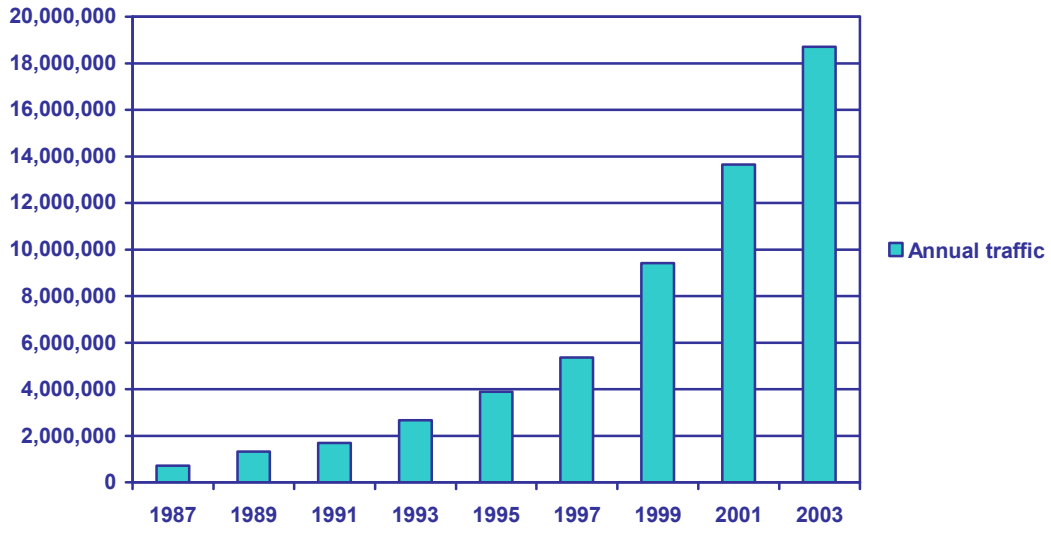
Figure 16 below indicates the emergence of secondary airports used by ELFAA members in major European cities.

Figure 16 Use of secondary airports in major European cities by ELFAA members

City	Primary airport(s)	Secondary airport(s)
Amsterdam	Schiphol	Rotterdam
Barcelona	Aeroport del Prat	Girona, Reus
Berlin	Tegel	Schönefeld
Brussels	Zaventem	Charleroi
Copenhagen	Kastrup	Malmö
Cracow	Balice	Katowice
Düsseldorf	Düsseldorf International	Cologne/Bonn, Weeze
Frankfurt	Main	Hahn
Glasgow	Abbotsinch	Prestwick
Hamburg	Hamburg Airport	Lübeck
London	Heathrow, Gatwick	Stansted, Luton
Milan	Malpensa	Bergamo
Paris	Charles de Gaulle, Orly	Beauvais
Rome	Fiumicino	Ciampino
Stockholm	Arlanda	Skavsta, Västerås
Vienna	Vienna International	Bratislava

Figures 17 to 21 indicate traffic growth at some of the low cost airports following the entry of low cost airlines.

Figure 17 Traffic growth at London Stansted airport following the entry of LFAs in 1991 [20]



[20] Source: CAA statistics and http://www.baa.com/doc/712eb95974cdf46c802566b9004bfd2f_frame.html.

Figure 18 Traffic growth at Liverpool airport following the entry of LFAs in 1996 [21]

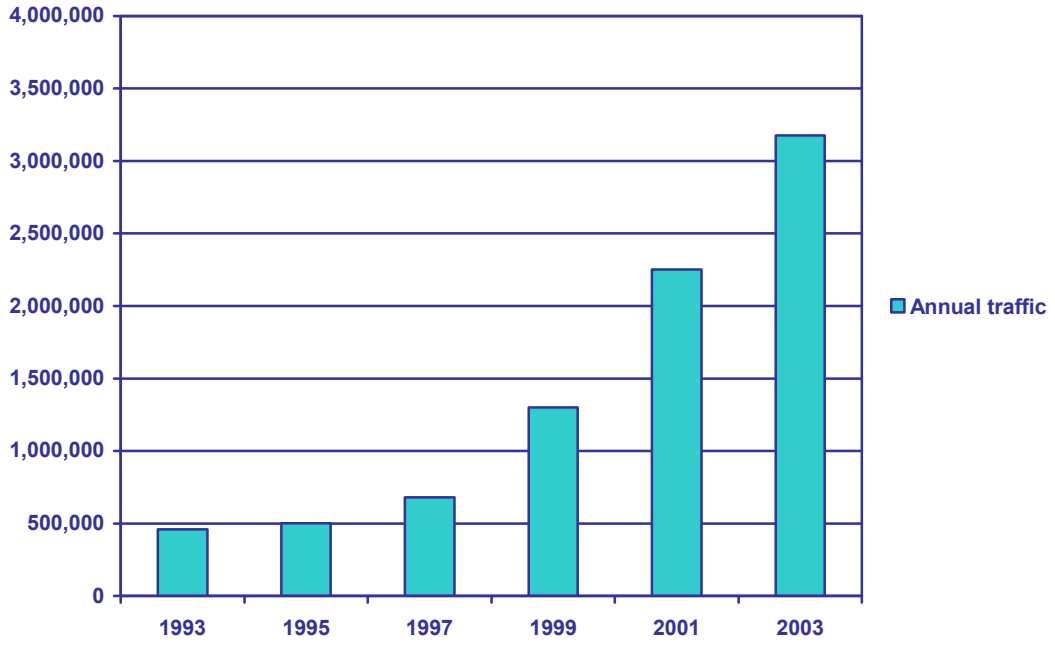
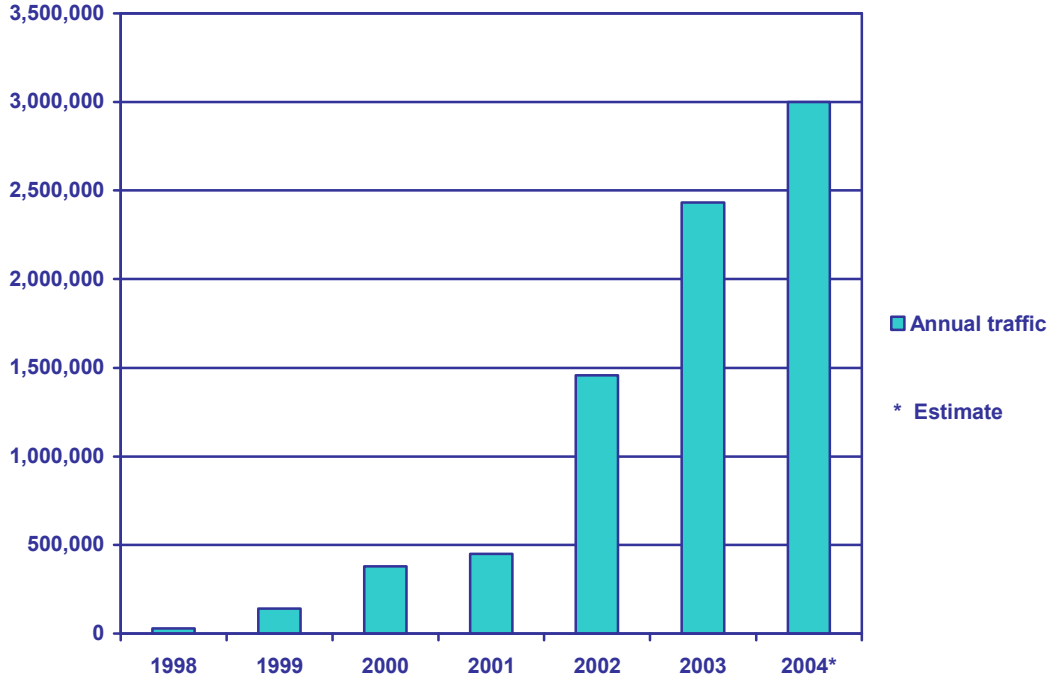
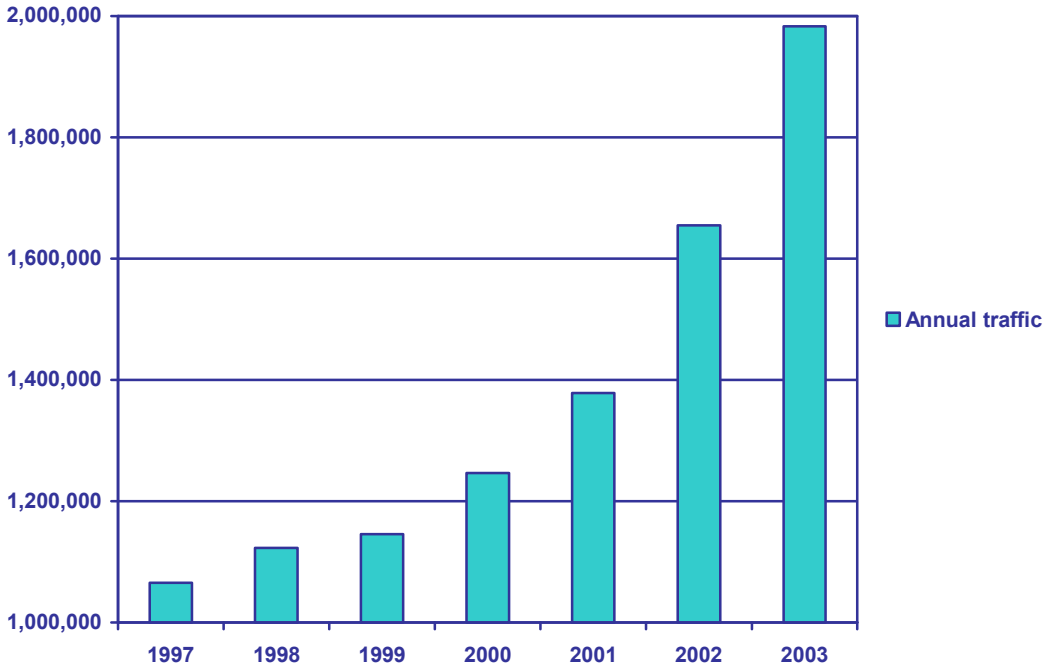


Figure 19 Traffic growth at Frankfurt Hahn airport following the entry of LFAs in 1999 [22]



[21] Source: CAA statistics.
[22] Source: http://www.hahn-airport.de/default.aspx?menu=press_basic_infos&cc=en.

Figure 20 Traffic growth at Pisa airport following the entry of LFAs in 1998 [23]



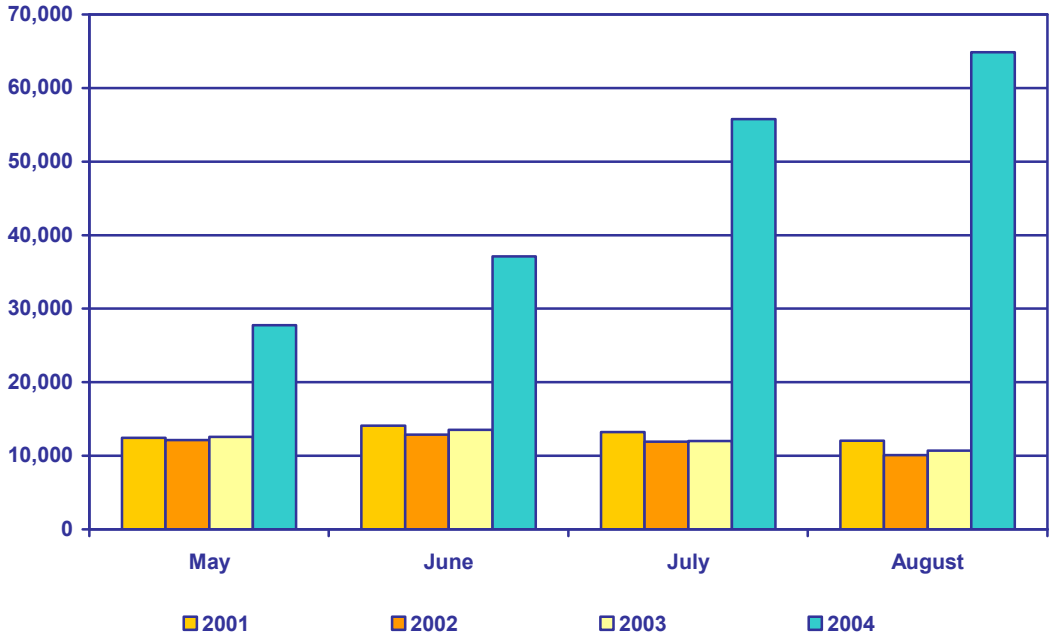
It is firmly established in the industry that the enterprise value (EV) of an airport is closely linked to passenger volumes. This is true for both major hub airports and the emerging low cost airports. For example, Copenhagen Airport saw its value increase from €525 million in 1994 to €956 million in 2002 on the back of an increase in passenger numbers from 14.1 million to 18.7 million.[24] Thus, a 32% increase in passenger numbers was accompanied by an 82% increase in the EV of the airport. Similarly, Glasgow Prestwick Airport, a major Ryanair base, saw its EV increase from just €2.9 million in 1992 to €48 million when it was resold in 2001. During that period, passenger numbers increased from just 10,000 to 1.3 million (the vast majority of this increase was Ryanair traffic).

Strong traffic growth and the resulting increases in revenues have also enabled numerous low cost airports to refurbish their existing infrastructure or develop new, low cost facilities, and build additional car parks or commercial outlets to increase their revenue streams still further.

A very illustrative example of traffic growth at an airport, delivered by low fares airlines, is Katowice Airport in Poland. Following Poland's accession to the European Union on 1 May 2004, two new low fares airlines, ELFAA members Wizz Air and Air Polonia, took advantage of the newly liberalised markets and launched services to several European destinations. As a result, traffic grew dramatically compared to similar periods in previous years.

[23] Source: CAA statistics and http://www.pisa-airport.com/sat/cda/aree/index.php?idArea=12&idSection=37.
[24] Source: Credit Suisse First Boston.

Figure 21 Scheduled traffic growth at Katowice airport [25]



The developments in the EU and the new accession countries again mirror the situation in the US post deregulation where Southwest Airlines and other LFAs operate from uncongested regional and secondary airports allowing them to compete with the more dominant carriers without having to struggle to obtain sufficient slots at the congested hub airports. Airports like Chicago Midway, Baltimore International and Oakland in Northern California enabled LFAs to provide competition to the network carriers like American Airlines, Continental, Delta and US Airways and also led to competition between the airports. For example, Southwest has been able to provide strong competition to the likes of American Airlines on the Chicago to Las Vegas route without having to deal with American's dominance at Chicago O'Hare Airport, where it would have been virtually impossible to have obtained sufficient slots in order to be a viable competitor. In addition, Midway has become a viable alternative to Chicago O'Hare, thus creating competition between the airports.

3.3 Benefits to the Regions

3.3.1 Regional Development/Integration

Low fares services between European regions and major international destinations as well as directly between regions play a vital social and economic role. Year round services increase tourism and encourage the location of businesses near low cost airports.

[25] Source: MPL Katowice Marketing Department.

Airports are a driving force in regional economies. The hub-and-spoke network model adopted by traditional airlines, which involves pulling direct services and reducing capacity at regional and secondary airports, placed the viability of many such airports at risk. The ability of these airports to attract long term traffic growth from LFAs has rejuvenated the airports and also the regions. There have been countless studies carried out highlighting the benefits of LFAs to regional airports and regions.[26] These studies emphasize the increases in tourism, employment and influx of businesses to the region as a result of increased passenger numbers and destinations offered from the airport. Airports like Brussels Charleroi, Frankfurt Hahn and many others are located in underdeveloped regions and the growth of the airport has facilitated regional regeneration.

The European Union's Committee of the Regions recently observed that

> *"[t]he availability of regional air services, and in particular low-cost air services, operating from regional airports improves access to the global economy. This, coupled with the lower labour costs and facilities costs associated with the more remote regions, can encourage the business community to locate new economic investment within the region. Existing businesses in the region could develop their market share by being able to reach other parts of the Member State, the EU and the rest of the world".*[27]

A recent study prepared for the Chamber of Commerce and Industry of Carcassonne-Limoux-Castelnaudary in December 2003 showed that the 253,000 low fares passengers who visited the region during one year generated €8.4 million of direct income for the region. The indirect monetary flow, including all tourist expenses and real estate investment, reached €135 million. The so-called "induced flow", i.e. increased spending generated by those affected by direct and indirect monetary flow, amounted to €272.4 million.[28]

The study on the impact of low fares air services at Cologne Bonn airport on the regional economy estimated taxes paid to federal state and to local authorities as a result of the presence of the LFAs at €91 million in 2002. Cost and productivity advantages for companies in the region were assessed at €147.6 million. Finally, average incoming passenger's expenditure in the region amounted to €285.42 per trip.[29] The effect of air services is similar in all of the regional destinations served by low fares airlines. Incoming tourists stay in local hotels, eat out locally, use local car rentals, visit tourist attractions, hence they trigger formation of new tourism-related businesses and increased employment.

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[26] For instance: SQW Limited and NFO WorldGroup, Impact of Ryanair on the Ayrshire Tourism Economy, 2002-2003: Economic Impact Study, September 2003; GCW Consulting, Ryanair Service at Strasbourg. An Economic Partnership for Developing the Airport and the Region, September 2003; Ract Madoux – Groupe Second Axe, Rapport d'etude: Impact socio-economique de la compagnie aerienne Ryanair dans la region et alentours de Carcassonne, December 2003; Institut für Verkehrswissenschaft and der Universität zu Köln, Die regionalwirtschaftlichen Auswirkungen des Low cost-Marktes im Raum Köln/Bonn, 2004.

[27] Committee of the Regions, Own-initiative opinion on Low-cost airlines and territorial development, 17 June 2004.

[28] Ract Madoux – Groupe Second Axe, Rapport d'etude: Impact socio-economique de la compagnie aerienne Ryanair dans la region et alentours de Carcassonne, December 2003.

[29] Institut für Verkehrswissenschaft and der Universität zu Köln, Die regionalwirtschaftlichen Auswirkungen des Low cost-Marktes im Raum Köln/Bonn, 2004.

The Assembly of European Regions summarised the above processes:

> *"The cooperation between low-cost carriers and regions is successful by contributing enormously to European integration and regional development. […] Regions are experiencing increased economic growth in sectors such as tourism and witness the development of small and medium-sized enterprises in a wide range of commercial sectors".*[30]

3.3.2 Tourism

The emergence of low fares airlines has revolutionised European tourism. Prior to liberalisation, few ordinary consumers could afford to travel by air and many regions and cities lacked any air access or could only be reached by connecting through a hub airport, such as Charles de Gaulle, Heathrow or Frankfurt Main making the journey time consuming as well as expensive. This meant that potential tourists either did not travel to these regions at all or travelled via a less efficient, more time consuming mode of transport, such as ferries, trains, cars and busses. Even on major tourist routes, the service offered was usually highly seasonal, with limited capacity and high fares. Related services in these destinations, such as hotels and restaurants, were, as a result, also highly seasonal and therefore had to charge higher prices in the peak season in order to recover losses in the off peak.

The benefits of LFAs to European tourism can be grouped into three categories:

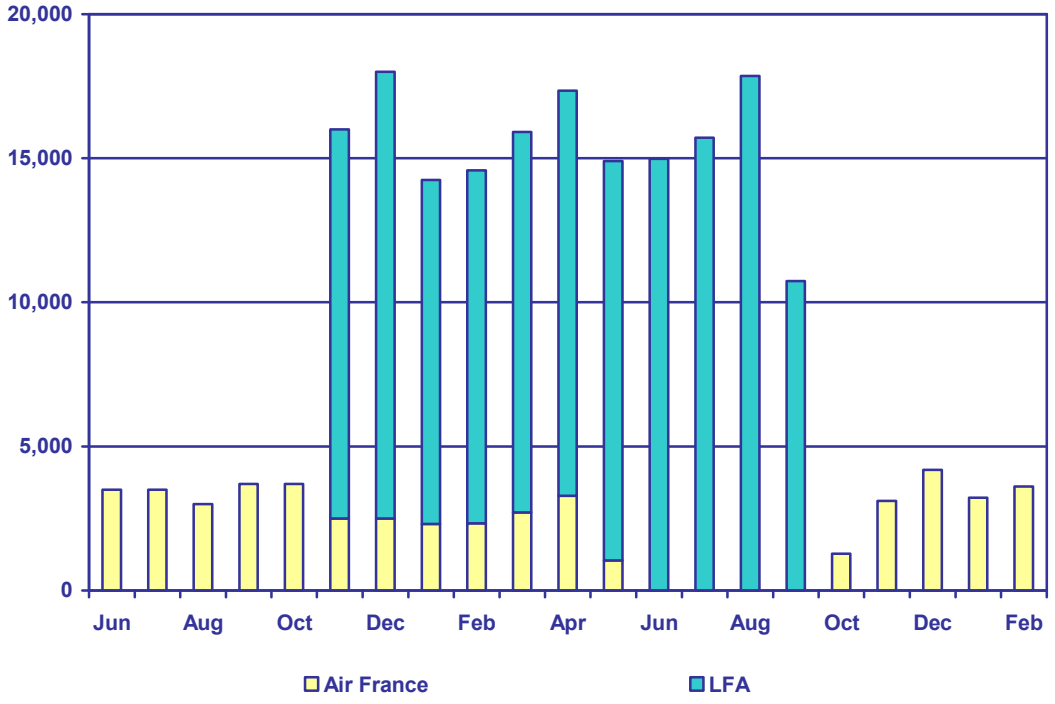
i) LFAs have greatly increased the number of new tourist destinations accessible by air. As explained in more detail above, many low fares airlines opt for the use of regional and secondary airports, hence they help spread traffic across a larger number of airports and regions. For example, those wishing to travel from the British Midlands to Western France find that they are no longer forced to travel via London or Paris to get to their final destination, as they now have a choice of direct links between UK provincial cities and the French regions. This has greatly facilitated inter-regional tourism as passengers travelling on holidays or visiting friends and family in the regions are generally reluctant to travel by air if it involves the more complex task of connecting through a congested hub airport. Low fares airlines also offer a broad range of connections between regions and major hubs.

   Peripheral towns and regions with little or no international recognition have often been developed as part of the LFAs' networks. Low fares airlines have undertaken concerted marketing campaigns to increase the "brand awareness"

[30] EU Transport Report, 10 May 2004, volume 2, no.17.

of many towns and regions. For example, the city of Strasbourg in Eastern France was previously considered essentially a business destination, given that it is the location of many European and other international institutions. However, London-Strasbourg route proved to be a very popular tourist destination among English travellers when Ryanair began offering low fare services on this route and highlighted the inherent attractions of the city and the region. Figure 22 below shows the impact of low fares on traffic on a route previously dominated by a flag carrier.

Figure 22 Traffic volumes at London – Strasbourg route between June 2002 and February 2004



Pisa is an example of a city whose air traffic was severely impacted when Alitalia terminated several direct routes to the airport and concentrated instead on connecting services through its hubs in Rome and Milan. Tourists were forced to travel by coach to Pisa and would spend very little time in the city. This meant that the local hotels and restaurants were unable to attract these tourists to use their facilities and the tourist industry suffered. Pisa Airport now has several LFAs offering services to the airport and the region (including 3 ELFAA members) and traditional airlines are also reconsidering their strategy with respect to this airport given the success of the low fares airlines in developing services there.

The following is a non-exhaustive list of other towns and regions, which were unserved or under-served prior to liberalisation, and have been popularised by the low fares services of ELFAA members.

Figure 23 Examples of tourism destinations discovered for international air travel by low fares airlines

Country	New international tourism destinations
Austria	Graz, Linz, Klagenfurt
Belgium	Charleroi
Denmark	Esjberg
Finland	Tampere
France	Bergerac, Rodez, Limogez, Carcassonne, Pau, La Rochelle, Nimes, St. Etienne, Tours, Poitiers, Dinard,
Germany	Karlsrhue-Baden, Altenburg, Hahn, Tempelhof, Münster (Osnabrück), Erfurt
Ireland	Knock, Derry, Kerry
Italy	Bari, Pescara, Ancona, Brindisi, Palermo, Alghero, Trieste
Norway	Haugesund
Poland	Gdańsk, Poznań
Slovakia	Košice
Spain	Bilbao, Girona, Jerez, Murcia, Santander, Valladolid, Zaragoza
Sweden	Malmo, Nyköping
United Kingdom	Blackpool, Bournemouth, Newquay

ii) As noted above, another positive change made possible by LFAs to European tourism has been a more even traffic distribution throughout the year. While charter airlines generally concentrate on Mediterranean destinations during summer months and on ski destinations during winter, LFAs offer year round flights to all of the destinations they serve. Hence, they help to spread the traffic in the most popular tourism destinations giving a more secure and steady income to hotels, restaurants, car rentals and other tourism-related businesses.

iii) LFAs have also popularised mid-week holiday travel to the regions. The lowest fares are offered during off-peak travel times (generally between Monday and Thursday) which incentivises customers, particularly price sensitive groups (such as students travelling on field trips etc.), to fly outside the weekend peaks. More evenly distributed holiday traffic throughout the week helps to avoid congestion at the airports and also allows hotels, restaurants, etc., in tourist destinations to maintain higher booking rates during weekdays.

3.3.3 Employment

The emergence of low fares airlines has boosted employment in many sectors of the economy, with European regions being the major beneficiaries. There are three main types of employment generated by low fares airlines – within airlines themselves, at airports and in regional businesses (including tourism related industries).

i) ELFAA members and other emerging LFAs in Europe have generated thousands of jobs within their own airlines, including pilots, cabin crew,

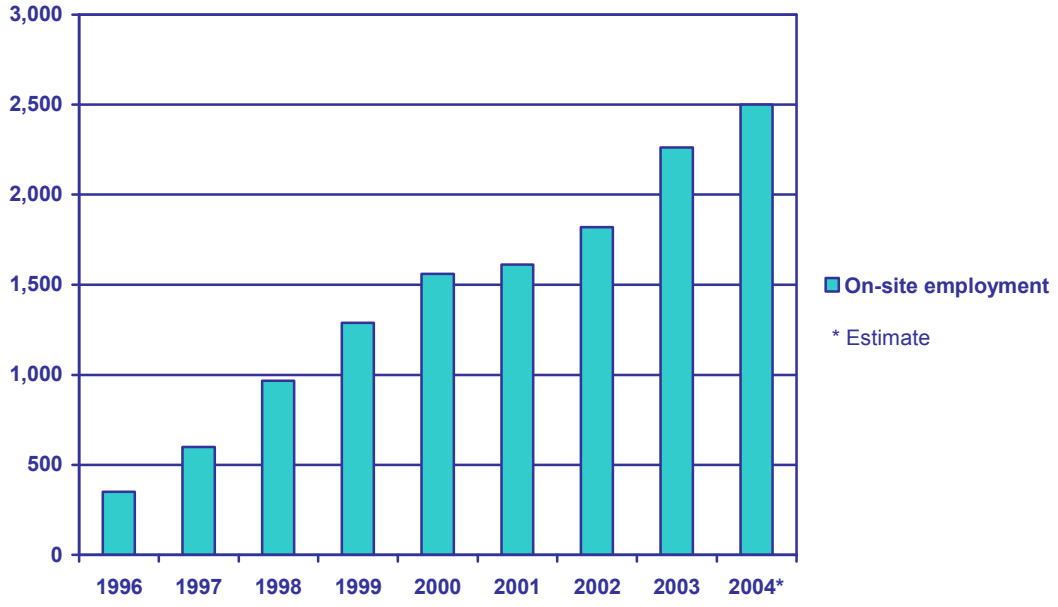
engineers and administrative staff. Although LFAs generally achieve much higher productivity from their staff, i.e., they employ proportionally less people than traditional airlines, LFAs still create c.a. 166 jobs per every 1 million passengers.[31] ELFAA members in total employ approximately 10,000 people.

ii) Employment at airports can be divided into employment directly related to the operation of the airport (administrative, security, handling, etc.) and employment related to ancillary activities, such as shops, restaurants and other commercial activities located at the airports. Direct employment at airports is closely related to the passenger throughput. Increasing traffic requires more staff in almost every field of airports' activity.

Indirect employment at airports also depends heavily on passenger throughput as the higher the passenger throughput at the airport, the more shops, restaurants, banks, car rentals, etc. will locate there. For instance, Frankfurt Hahn airport reported the increase in the number of businesses on-site from 30 in 1996 to 107 in 2003.[32]

Figure 24 below presents the increase in employee numbers at Frankfurt Hahn airport, which has experienced unprecedented traffic growth thanks to the presence of low fares airlines. Also the impact of just three low fares airlines present at the Cologne/Bonn airport in 2003 on direct and indirect employment was estimated at 1,766 jobs.[33]

Figure 24 Increase in employment at Frankfurt Hahn airport [34]



[31] ELFAA members' average productivity rate – c.a. 6,000 passengers per 1 employee.
[32] Source: http://www.hahn-airport.de/default.aspx?menu=press_basic_infos&cc=en.
[33] Die regionalwirtschaftlichen Auswirkungen des Low-cost Marktes im Raum Köln/Bonn", IfV Universität Köln, 2004.
[34] Source: http://www.hahn-airport.de/default.aspx?menu=press_basic_infos&cc=en.

iii) Regional employment generated by low fares air services is associated with the growth of the tourism industry and with new businesses locating in regions for the reasons explained above. Additionally, increased purchasing power of employees at airports, in the tourism industry and in new businesses locating in the regions creates the need for more and better services in all other sectors and, in effect, triggers a virtuous cycle for employment in the regions.

A study prepared for Airports Council International (ACI) in January 2004 reveals that on average 950 on-site jobs are created at airports and 1,100 regionally for every 1 million passengers.[35] Therefore, ELFAA members, who will carry almost 60 million passengers this year, generate roughly 57,000 jobs directly at airports and 66,000 indirect jobs or a total of over 120,000 jobs in the European regions.

3.4 Environment

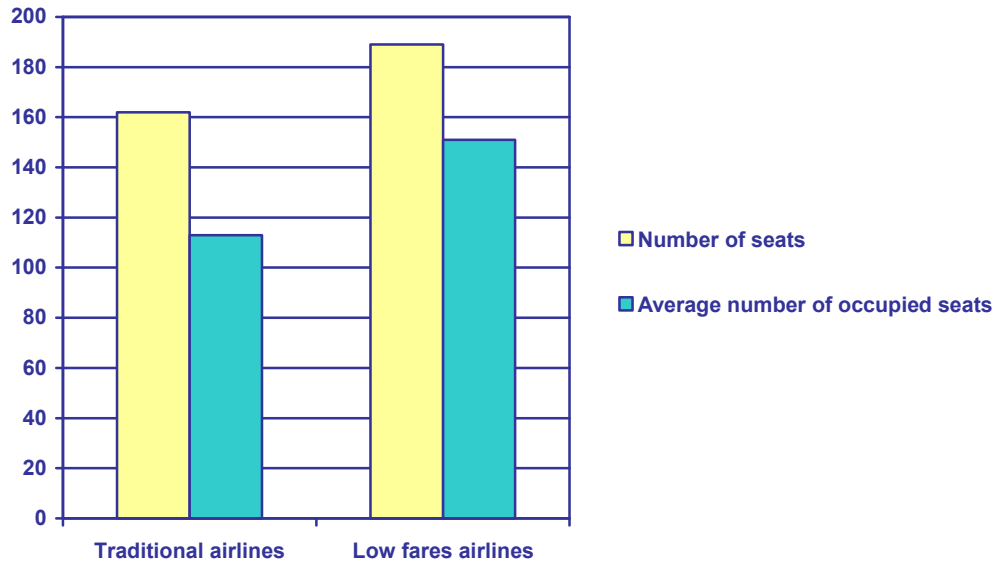
Low fares airlines contribute to the development of sustainable tourism and environmentally efficient travel throughout Europe. As noted in Section 2.2 above, the myth that LFAs are more damaging to the environment is untrue. LFAs are actually minimizing environmental impacts given the more efficient nature of their operations and the fact that they generally operate much newer fleets. The most popular aircraft type among ELFAA members is the New Generation Boeing 737. Airbus A-319 and A-320 are also extensively used. These newer generation aircraft are the most technologically advanced and energy efficient aircraft in the industry. The use of these aircraft minimizes fuel burn and noise emissions.

The following are the main factors contributing to lower environmental impacts of LFA's.

i) *More efficient seat configuration and lower fuel consumption.* For example, the Boeing 737-800 in service with a traditional airline will generally only have 162 seats on this aircraft due to business class seating and on-board catering, whereas an LFA can configure this aircraft to accommodate up to 189 seats, or 17% more. Together with the fact that low fares airlines normally achieve on average at least a 10% higher load factor than traditional airlines, i.e. 80% as opposed to 70%, this efficient aircraft configuration decreases the average energy use per passenger in the low fares airline sector by approximately 25% compared to traditional airlines.

[35] York Aviation, The social and economic impact of airports in Europe, January 2004.

Figure 25 Differences in aircraft configurations and load factors – example of Boeing 737-800



ii) *Decreased noise emissions.* The modern fleet used by ELFAA members exceeds all current noise limitations. Moreover, low fares airlines operate to less congested airports, which are generally located in less densely populated areas with lower levels of aviation activity compared to the main hubs. Hence, the noise nuisance generated by LFAs is minimised. LFAs also generally avoid night operations, which further reduces overall noise nuisance.

iii) *Direct services lead to less connecting flights.* Because LFAs operate direct flights, passengers only have to take one flight as opposed to having to connect through congested hub airports, i.e., using 2 or more flights. The fact that LFAs operate to regional secondary and underutilized airports also helps to avoid congestion on the access roads around main hubs with the frequent traffic queues which tend to result and allows for more equal traffic distribution. Busy airports can lead to 'holding patterns' where aircraft have to circle for minutes in the air before they are allowed to land leading to extra fuel burn and emissions.

iv) *Reduced waste.* The lack of "frills" offered on low fares services significantly reduces the amount of waste normally generated by traditional airlines. LFAs do not usually hand out newspapers and do not offer "free" meals and drinks, all of which generate huge amounts of waste on traditional airlines.

4 Threats to the Future Success of Liberalisation

Despite the enormous success of liberalisation and the numerous benefits brought by LFAs to consumers, the airports and regions, the low fares model is under threat due to a lack of understanding by policy makers of the model and the tendency of

Member States to protect their national airlines. There is also a general trend towards re-regulating the airline industry through legislation and policies that reduce efficiency and increase costs to airlines and therefore undermine the competitiveness of the industry. The following are examples of issues that ELFAA has been lobbying policy makers on in order to protect the competitiveness of the industry.

4.1 Examples of Policies that Threaten the Competitiveness of the Industry

4.1.1 Regulation 261/2004 on Compensation and Assistance for Denied Boarding, Cancellations and Long Delays

The EU has passed legislation which purports to protect passengers by imposing penal fines and assistance requirements on airlines in cases where passengers are denied boarding (because of overbooking) or for cancellations and long delays of flights. LFAs generally do not engage in overbooking (because their fares are non-refundable) but this legislation will in any event not prevent this practice as traditional airlines, who offer flexible fares for business passengers, will continue to profit from this practice. Moreover, the legislation will also not prevent delays and cancellations as the vast majority of these are due to causes such as weather, air traffic control delays and security issues, all of which are completely beyond the control of the airlines. As airlines will be made to pay for assistance to passengers for these delays and cancellations, the only effect of this legislation will be to force up the cost of travelling by air for consumers and make certain routes unviable, thereby reducing consumer choice.

The legislation is particularly unfair to low fares airlines because these penalties have no relationship to the amount of the fare paid by the customer. Thus, a passenger who paid less than €50 for their fare on a low fares airline could conceivably receive a minimum of €250 in compensation for a cancelled flight, in addition to compensation for their hotel (if the cancellation requires them to stay an additional night), meals, phone calls, faxes, etc. The total “compensation” due to passengers would most likely vastly exceed the amount of the fare paid to an LFA.

The Regulation is also anti-competitive as it only applies to air transport and not to other competing forms of transportation such as ferries, coaches and trains.

ELFAA has been forced to challenge this legislation in the courts given the damage it will inflict on the low fares model and the industry in general. The UK High Court has referred the case to the European Court of Justice to determine the legality of this legislation.

4.1.2 Misapplication of the State Aid Rules

The state aid rules in the EU were designed to ensure that Member States do not grant unfair advantages to their national companies that distort the single market and place competitors from other Member States at a competitive disadvantage.

The airline industry is replete with state aid as inefficient national airports and airlines have been heavily supported by their respective governments. Airlines like Sabena, Alitalia and Olympic Airways each received billions of euro from their governments (ultimately financed by taxpayers) even after liberalisation, which has placed new entrants at a serious competitive disadvantage. The so-called "one time/last time" rule, which applied following liberalisation to allow state-owned airlines to restructure themselves in order to compete in the liberalised market, has been widely abused and national governments continue to support their national airlines.

However, a more concerning development is the trend towards national airlines and airports using the state aid rules to prevent competition from low fares airlines operating at regional and secondary airports. As discussed above, the low cost airport business strategy has been a remarkable success and has been crucial to the success of the low fares business model. LFAs have negotiated low costs at formerly underutilised airports in the UK and on the Continent in exchange for delivering large traffic volumes that increase the profitability and value of these airports. Decisions from the European Commission in the Charleroi case and from local courts demonstrate a lack of understanding for the huge changes in the competitive environment of airports, again a process largely driven by the LFAs.

The Commission announced following the Charleroi decision that it would adopt guidelines on airport financing and on the limits of what airports can offer to airlines in order to attract air services. If these guidelines place restrictions on publicly owned airports that do not apply to their privately owned counterparts, public airports will be at a severe competitive disadvantage and traffic growth to the European regions will suffer as a result. ELFAA, along with the Committee of the Regions, regional organisations such as the Assembly of European Regions (AER), and regional airports have called on the European Commission to allow regional airports the flexibility to compete for traffic from the LFAs.

4.1.3 Industry Consolidation

The European airline industry is currently undergoing considerable consolidation with traditional network airlines entering into "code-sharing" and "network" agreements, which reduce competition and typically lead to higher prices for consumers. More recently, the merger of two major national airlines, Air France and KLM, has shown that a reduction in competition leads to higher prices. Air France/KLM has announced two price increases since their merger, despite the fact that passenger numbers have increased. Fares in competitive markets, by contrast, continue to decline.

As the network carriers become more and more dominant at their major hub airports, the ability of airlines to compete with these emerging "mega carriers" will depend on their ability to operate from the emerging low cost airports. As noted above, the low fares model of using these airports has forced the network carriers to reduce their fares on routes where they compete with LFAs. However, decisions such as in the Charleroi case and policies like the Passenger Compensation Regulation will render LFAs less competitive and result in higher prices for consumers.

The Commission needs to ensure that airline mergers and cooperation agreements do not lead to a reduction in competition and the inevitable increase in fares. Restrictions imposed by the Commission in these cases have largely been ineffective in preventing these mega carriers from reducing competition and increasing their prices.

4.1.4 Cost and Inefficiency of Air Traffic Control Services

The European Commission has been a strong proponent of rationalising air traffic control services in Europe under the Single European Skies initiative and ELFAA is supportive of these efforts. European air traffic control services are highly inefficient due to the fact that each Member State has control over its own airspace and airspace is therefore highly fragmented. Air traffic control costs are also a major component of airline costs (currently approximately 15% for LFAs) and these costs continue to increase year on year as airfares continue to fall.

Although the Commission has made considerable progress in introducing legislation to rationalise European air traffic control, there is still enormous inefficiency and high costs in the provision of these services that has to be tackled in order to ensure the continued growth of European air transport.

ELFAA has obtained observer status within Eurocontrol, the body overseeing ATC charges in Europe, and is lobbying for greater efficiency and lower costs in the provision of ATC services.

4.1.5 Environmental regulations

ELFAA strongly supports the concept of environmentally sustainable transport and as explained in Section 3.4 above, the efficiency of the low fares model and the use of modern aircraft significantly reduce the environmental impact in terms of emissions, noise nuisance and the amount of waste generated. European travellers can now travel directly between European regions and cities and at a fraction of the cost and time taken by more traditional transport modes like rail, car, bus or ferry. As discussed above, it is a common misconception that airlines are more polluting than these forms of transport.

However, these misconceptions are being used by certain interest groups in order to impose environmental legislation, e.g. aircraft emission charges, that will limit the growth of air transport services. Air transport is already the most heavily regulated sector and has to compete with rail and ferry services that are still supported by their national governments. Legislation based on factually inaccurate conceptions of the air transport will undermine growth of air transport and will also negatively impact on

regional integration and development as air transport is the only feasible option in many cases for travellers to reach their destinations.

4.2 Necessity for Regulatory Impact Assessment for all Legislation

The European Commission and most regulatory bodies are required to undertake a regulatory impact assessment (RIA) prior to proposing legislation that will affect a particular industry or industries. Regulation of air transport has considerable knock-on effects on numerous other industries and on regional development generally. However, it is often the case that such assessments are either not carried out or do not adequately reflect the current realities in a particular market. This was certainly the case with the passenger compensation legislation discussed above and it has led to a situation where serious damage will be done to the air transport industry and LFAs will be placed at a competitive disadvantage if the legislation is not overturned.

In order to ensure that the benefits outlined in this report are not lost through uninformed legislation, it is necessary that a thorough RIA is carried out prior to any proposed legislation being tabled. It is also necessary that all parties affected by such legislation are consulted as part of the RIA and continue to have an input into the legislation to ensure that it is fair and balanced and actually achieves its specified goal.

5 Conclusions

The success of liberalisation in European air transport industry has largely been due to the ability of new entrants to challenge the traditional way of running an airline and pursue new business models which offer strong competition to the traditional network airlines. The low fares model in Europe has brought huge benefits to consumers, in terms of lower fares and greater choice and has benefited regional and secondary airports by delivering large passenger volumes to these underutilised airports. European integration and development have also benefited from the increase in employment at the airports and the wider community, and increased tourism and new businesses locating in the regions. The low fares model also limits the impact on the environment by efficiently using modern, fuel efficient aircraft and uncongested airports thereby promoting sustainable development.

However, in order to protect and promote these benefits, EU and national policymakers need to understand the low fares model and ensure that legislation does not undermine this successful model and the overall competitiveness of the industry. National governments must stop supporting their national airlines at the expense of more efficient operators and the interests of consumers. Policies and legislation must promote competition and should be supported by an RIA following extensive industry consultation.

The members of ELFAA look forward to working with the EU institutions and Member States in order to ensure that the benefits brought by liberalisation are promoted in future policy in order to ensure continued competition, consumer choice and lower fares.