



IATA COMMENTS

On the European Commission's Staff Working Document regarding COMMERCIAL SLOT ALLOCATION MECHANISMS

Foreword

The International Air Transport Association (IATA) hereby submits its comments on the European Commission's paper on Commercial Slot Allocation Mechanisms.

One of the main activities of IATA is to run the Scheduling Conferences at which airports, airlines and slot coordinators from around the world gather to obtain and refine the slot portfolios that are necessary to keep international air transport networks running smoothly. IATA also issues the World Scheduling Guidelines, a set of rules used for slot allocation purposes world-wide that are often revised.

IATA fully supports the position jointly expressed by AEA, ACI Europe, IACA, EUACA in their letter of 19th October 2004. IATA agrees that the current consultation paper cannot be the basis of a sound policy discussion for the following reasons:

- it tries to solve the wrong problem: the true problem is lack of capacity at Europe's airports;
- it is too one-sided: its definition of efficient use of airport capacity looks at maximizing passenger throughput at an individual airport, ignoring the effects on air transport networks, inside and outside Europe; and
- it steers away from the economic impact analysis carried out by the Commission's own consultants.

Any debate about critical aviation issues must be placed in the wider context of the "better lawmaking" called for in the Lisbon Agenda, and be part of an overall air transport policy. Failing that, the European Commission is in danger of formulating policy on false premises, which could potentially have disruptive consequences for the airline industry, airports, European Governments, and passengers from around the world.

The real problem is that airport capacity lags demand for air transport

The European Commission's consultation paper focuses on a series of alleged 'fundamental flaws' in the current slot allocation system. It is based on an outdated view of the Scheduling Procedures. It sees the present system as one that is static and gives incumbent airlines the right to keep underused slots, which in turn makes it difficult for new entrants to compete successfully with them. It concludes that the solution should be a radical reform of the way in which landing and take off slots are allocated.

Congestion is indeed a problem at many European airports. The root of the problem is not a flawed slot allocation mechanism, but insufficient airport capacity. Passengers and airlines suffer as a consequence. Congestion generates delays, fuel waste, and pollution. It helps no one.

On the other hand, adding airport capacity is deeply unpopular. While additional runways alone cannot solve the congestion problem at some airports, it is possible at others, even in today's environment. Witness Spain, where there will be 50% more slots at Madrid Barajas, and 40% more slots at Barcelona thanks to bold airport expansion programmes.

Demand for slots at specific airports is not a function of slot scarcity. Establishing a correlation between congestion and demand for slots misses the point. The main driver is passenger demand for transport to, from, or through a particular place. The provision of airport services is hardly competitive. Only a few cities have the luxury of having several airports, and even then they are not always perfect substitutes for each other. To quote NERA, the Commission's own consultants:

The lower average proportionate slot holdings of the major carriers operating at airport with little or no excess demand represents the carriers desired holding. It follows that the holding is determined by underlying passenger demand, which is typically lower at these airports than at those in the slot constrained groups. None of the airports in the unconstrained group are operated as a hub and the carriers typically offer less developed networks¹.

Moreover, capacity could be added at selected EU airports without building new runways. Miami airport, for instance, offers twice the capacity of Brussels airport – yet both have a similar runway pattern. Zurich airport had to reduce its capacity at certain hours by imposing stricter flight separation patterns. Amsterdam Schipol has artificially reduced its capacity through environmental constraints, and it could handle many more flights than it actually does. None of these issues have anything to do with slot allocation rules.

Any slot allocation mechanism that is contemplated in isolation from economic considerations, such as the demand for air transport to/from a given airport, or the level of landing charges, will not solve congestion problems. It will only re-distribute a scarce resource at higher cost.

In short, IATA does not believe that the Commission can solve or even reduce congestion at Europe's airports simply by changing the way slots are allocated.

Stated policy aims

The Commission sets out four policy objectives. With these new policies, the Commission seeks to ensure:

- Efficient use of airport capacity;
- Slot mobility;
- Effective competition at EU airports;
- Compatibility with world-wide procedures.

In IATA's opinion:

- The Commission should consider a broader definition of 'efficiency' when it comes to analysing use of airport capacity;
- Slot mobility, as defined by the Commission, should not in itself be a policy objective;
- There is effective competition in the EU's airline industry already;
- The Commission's policy would be incompatible with world-wide procedures.

¹ NERA, Study to Assess the Effects of Different Slot Allocation Schemes, p. 42. NERA Economic Consultants. London, January 2004 (emphasis added)

“Efficient use of airport capacity”, and how to define it.

The European Commission states its concern with ‘inefficiencies’ in the using of existing airport capacity. This is a different problem from congestion. It is possible to imagine an uncongested airport that is used inefficiently or a congested airport that is used efficiently. The two are different issues.

IATA and its member airlines also note that the view taken by the European Commission is one-sided. The consultation paper takes the view that ‘efficient use of airport capacity’ is the same as the ‘maximum throughput of passengers per slot’. Put simply, ‘use bigger planes to carry more passengers’. This is not a sound definition of efficient airport capacity because it does not take networks into account. The development of sound policy demands a network definition of efficient airport capacity.

Airlines operate networks. Even the simplest ‘point-to-point’ operation by a no-frills carrier needs two slots, one at each end, and they need to be coordinated. If carrier A’s Geneva to Barcelona flight is scheduled to take-off at 13:00, the airline must secure another slot to land at Barcelona at 14:25. Otherwise, the operation will not be optimal. (The plane might have to fly above its most fuel-efficient cruising speed, or fly a holding pattern until it is cleared to land). For airlines operating networks (as IATA members typically do) the issue becomes much more complex. It is not two slots that need to be coordinated, but all of them, network-wide. A network airline needs to ensure that it has the right slots at the departure airport to maximize fleet utilization and connectivity, and the right landing slots at each destination, to ensure optimum fleet use.

Compatibility with world-wide procedures

Slot allocation rules are not a European issue. They have global implications because airlines run a global business. Their aircraft fly in and out of different jurisdictions every day. IATA member airlines also link up their networks through multilateral interlining, a system that connects some 4,000 airports world-wide and allows passengers to fly on multiple airlines and complex routings seamlessly on a single ticket. At the very least, this requires rules that are globally compatible. Unilateral action only undermines this finely-tuned system, and eventually hurts the consumer.

In March 2003, over 180 States gathered at ICAO’s 5th Worldwide Air Transport Conference (ATConf/5). The European Commission was present. Among other things, the Conference recommended that :

(...) Any slot allocation system should be fair, non-discriminatory and transparent, and should take into account the interests of all stakeholders. It should also be globally compatible, aimed at maximizing effective use of airport capacity, simple, practicable and economically sustainable;(...)

The ICAO Council later circulated these conclusions by State Letter SC 5/1-03/781 dated 25 July 2003.

IATA Scheduling Guidelines meet the requirements set out by ATConf/5. The market mechanisms that the European Commission is considering do not. At the very least, they would not be globally compatible. The fact that they might be used “for slots for intra-EU services only” makes no difference. And, most certainly, they do not appear simple nor, as we will demonstrate, will they be economically sustainable for airlines and their passengers.

Effective competition at EU airports

Competition in the European airline sector is strong and it is certainly effective.

AEA data for geographical Europe show that average passenger yields per revenue passenger kilometer fell by 41 per cent in real terms between 1993 and 2003.

Competition from no-frills carriers in recent years has spread rapidly across Europe. While it is difficult to place a reliable figure on their combined market share, it may be estimated in the order of 20% in Europe, but up to 40% in selected markets.

No-frills carriers in particular have chosen for the most part to operate out of secondary airports because they are cheaper, not because slots are available. EasyJet, for instance, has decided to move its services from Zurich² to Basel, not because it is difficult to get slots in Zurich but for reasons of cost.

Following the collapse of Swissair and Sabena, more slots are available today at Zurich, Geneva, and Brussels airports. Swiss International Air Lines operates approximately 50 % of the flights that Swissair and Crossair used to operate together. Approximately 40 % fewer intercontinental services are operated today out of Zurich airport, compared to 2001. Yet, very few carriers have moved to take advantage of this extra capacity. The same applies to Brussels.

Slot mobility

The fourth stated aim of these policies is to ensure 'slot mobility'.

IATA disagrees that 'slot mobility' in the sense understood by the Commission should be a policy aim. We refer to our comments on airline networks and the complexity associated with managing the slots needed to run an efficient operation across a network or networks. The concept of 'grandfathered' rights, which lies at the core of the Worldwide Scheduling Guidelines, is an essential element of a successful network operation. It is not designed to reduce competition, but to ensure the long-term stability needed to minimize disruption to a very delicate 'clockwork' machinery. It also benefits consumers – passengers and shippers alike – and therefore makes sense from a financial point of view as well as from a regulatory perspective.

Airlines are capital-intensive businesses. They need to calculate long-term returns with a certain degree of certainty. "Slot mobility" potentially runs counter to this need for long-term planning. We are not convinced that the benefits, if any could be persuasively demonstrated, associated with slot mobility would outweigh the clearly negative consequences they would bring to passengers and shippers, as well as to airlines.

² easyJet will no longer operate flights from Zurich after 31 October 2004. Flights to Basel are available from Berlin, Liverpool, London Luton, and London Stansted throughout the published schedule. (Source : www.easyjet.com)

Market mechanisms

Independent of its position on the Commission's policy objectives, IATA believes the market mechanisms it is considering will not work.

First of all, IATA questions to what extent the economic study carried out by NERA can be used as a basis for policy discussions.

- NERA's analysis of the reasons of congestion does not examine passenger demand at specific airports nor does it consider other economic factors such as the level of airport charges.
- There is little analysis of the effects of the proposed mechanisms on passenger flows and network structures across Europe, and generally the overall economic impact on the airline industry. Our preliminary calculations point to hundreds of millions of euros of extra cost for airlines, without a clear offsetting benefit.
- NERA's study and the Commission's consultation paper differ significantly, in that the Commission's proposals introduce many new elements that NERA did not consider in their models.

Auctions

Slot auctions are unlikely to allocate scarce capacity at European airports in an economically effective manner.

Economics argue against slot auctions. In a 1993 paper³, NERA argued convincingly that airport slots are not like radio frequencies or mobile telephone channels. An airport slot is not a homogenous commodity.

- Slots at different times are not a good substitute for each other;
- As argued above, slots have substantial interdependencies, so that a change in one slot has knock-on effects at destination airports, and throughout the network;
- Slots have substantial demand complementarities such that even if a time is available, the apron space or terminal capacity to handle extra passengers at that time may not be.

NERA concluded that 'There is no market price for airport services at a busy airport'⁴.

Higher posted prices

Higher posted prices run contrary to internationally agreed policies.

- Airport charges, according to the ICAO Policy Manual, should be based on "the full cost of providing the airport and its essential ancillary services, including appropriate amounts for cost of capital and depreciation of assets, as well as the cost of maintenance and operation and management and administration expenses, but allowing for all aeronautical revenues plus contributions from non-aeronautical revenues accruing from the operation of the airport to its operators."⁵

³ Ian Jones et al (1993), *The Economics of Airport Slots*, NERA, London.

⁴ Ian Jones et al. *op.cit.* page 9

⁵ See ICAO, *S Policies on Charges for Airports and Air Navigation Charges*, International Civil Aviation Organization Doc. 9062, Sixth Edition, 2001.

- Under Article 15 of the Chicago Convention on International Civil Aviation, “uniform conditions shall apply to the use of airport and air navigation facilities in a Contracting State by aircraft of all other Contracting States”.

Moreover, in its most recent study NERA might be underestimating the level of price charges needed to alter demand. In the 1993 paper quoted earlier, NERA estimated that prices at London Heathrow would have to rise by 100% and those at Gatwick 50% in order to clear the market. An earlier study⁶ by the UK Civil Aviation Authority suggested charges would have to rise 150% at London airports. In other words, congestion pricing would provide a perverse economic incentive *not* to invest in capacity expansion.

“Forced redistribution”

IATA is deeply concerned by the notion of ‘forced redistribution’ introduced in the European Commission’s consultation paper. We know of no other industry in which the Commission is seeking to confiscate fundamental assets from incumbents. An airline would find it difficult to invest in its fleet, or indeed ensure reliable medium term operations, if a lottery could suddenly put an end to its ability to do business on the route(s) for which it had planned to use its investment.

IATA strongly disagrees with the Commission’s statements that “There is no legal requirement for allocated slot to be used at a 100%”, or that “Scarce capacity is not always used to the full”. This is yet another misperception of how the industry operates. Scarce capacity is fully used and there should not be a legal requirement for slots to be operated at 100%. Any incentive, regulatory or economic, to try to fully use allocated slots whatever the circumstances could have perverse side-effects, for example on safety. Most cancellations occur for reasons of weather, maintenance or another safety-related concern, not for economic reasons, and they are counted against the 20% tolerance contained in the existing rules.

The confiscation mechanism would not contribute to reach the stated policy targets. For example, a slot could be taken away from an airline that operates a wide-body aircraft, in line with the Commission’s policy wishes, and redistributed to a carrier that uses narrow-body aircraft, thereby reducing an airport’s passenger throughput.

“Secondary trading”

IATA submits that the mechanism currently contemplated by the European Commission as ‘secondary trading’:

- is hardly a market mechanism;
- is not a secondary trading mechanism;
- is not the secondary trading mechanism assessed by NERA;
- displays deep distrust of market economics;
- allows for heavy-handed administrative intervention;
- is vague and leaves much room for interpretation;
- is self-defeating, in that it raises entry barriers (new entrants would need to pay for slots that are allocated for free today)
- might trigger litigation.

⁶ CAA (1989) Traffic distribution policy for the London area and strategic options for the long term, a Consultation Paper. CAA, London.

In the light of the description of secondary trading in the consultation paper, it is questionable whether one is dealing with a true market mechanism. Everything in the consultation paper describes an administrative system highly geared towards intervention by public authorities.

It questions, for instance, "whether the number of slots held at one airport by one air carrier [or an alliance] should be limited". Yet, the size of slot holdings by a particular airline at a particular airport (its home base, for instance) may simply be a natural consequence of market dynamics, and of regulatory constraints to cross-border integration. It is for Competition Law and competition authorities to determine if that leads to an abuse, on a case-by-case basis. Capping slot holdings would only distort market dynamics.

The mechanism under consideration seems to be more of a 'secondary slot auction' than trading. It is not the mechanism that NERA considered⁷. Airlines would not enter into a bilateral contract with another airline, but hand a slot to the coordinator who would then proceed to sell it to the highest bidder. In a truly market-based bilateral trading scheme, airlines may choose their trading partners. In the 'secondary auction scheme' contemplated in the paper, they are barred from doing so.

IATA further opposes third parties (*i.e.* non-airlines) entering the secondary trading market. It is likely to be incompatible with the 'use-it-or-lose-it' rule, whereby slot holders must show an 80% slot use during a scheduling season or hand slots back. It would add an (unnecessary) intermediary to the transaction who might seek rents out of a speculative position, thereby increasing costs without adding value.

The Commission repeats its view that 'slot trading is illegal in the European Union'. It follows, according to the Commission, that there is a "lack of economic incentives for carriers to make available unused slots or slots at commercially less attractive times to those carriers ready to offer competitive services." IATA disagrees with both statements. The UK High Court⁸ pronounced a particular slot swap that involved monetary compensation to be in keeping with Regulation 95/93 and to the best of IATA's knowledge, none of the EU's member States rules such practices to be illegal⁹. Where the practice is accepted (and takes place) carriers do not lack an economic incentive to make slots available.

Slot allocation and the Lisbon agenda

Four years ago, the European Council pledged to turn Europe into the "most dynamic knowledge-based economy in the world' by 2010". It admits that, almost half way through the process, there is a mixed picture, and that efforts need to be stepped up. One of the elements of this demanding agenda was 'better lawmaking'. Better lawmaking is geared to increase productivity and competitiveness. The Council of the European Union recently concluded that:

Better regulation at both European and national levels will enhance competitiveness and productivity. The European Council welcomes the recent four-Presidency initiative on better

⁷ "Under the category of secondary trading, we have examined the potential impact of trading based on bilateral negotiations between airlines". Study to Assess the Effects of Different Slot Allocation Schemes, p. 76. NERA Economic Consultants. London, January 2004.

⁸ R v Airport Coordination Limited ex parte The States of Guernsey Transport Board (QBD, Kay J, 25:03:99).

⁹ The new slot allocation Regulation keeps the same language as Regulation 95/93, *i.e.* 'slots may be freely exchanged'. The Council did not accept any changes to the language that would have restricted current practices.

regulation and calls on the Council to pursue a programme of actions to drive this forward over the coming year¹⁰

The present proposals on slot allocation should be vetted against this background. The stated political aim is to foster competitiveness through better, not more, regulation. IATA submits that the Commission's current proposals fail that test. Demand for air transport and GDP growth go hand in hand. Should the EU's policy facilitate this growth in demand or curb it? Should it now add another layer of complex, unnecessary, and counter-productive regulations on an overburdened industry?

Importantly, the Lisbon process contemplates self-regulation as a plausible alternative to EU regulation of an industry. In this area, industry self-regulation has worked and continues to do so. Contrary to the Commission's outdated and mis-perceived view of the IATA Scheduling Guidelines, they are reviewed regularly, and are improved.

Revised slot allocation rules came into force in the EU last April after a lengthy and difficult debate. They already cover some of the policy issues contemplated in the Commission's paper (by addressing late returns of slots, for instance). Not even six months later, the European Commission is proposing radical new ways of allocating take-off and landing slots in the European Union's airports, which would make the EU the odd man out on the international aviation scene. IATA believes a number of recent amendments to Regulation 95/93 still have to be tested, and might deliver some of the objectives pursued. It would be wise to give them time.

Conclusion

The European Commission's proposals on slot allocation through market mechanisms try to solve what are essentially congestion-related problems without tackling the politically sensitive issue of increasing airport capacity. As such, they are bound to fail.

A change in slot allocation mechanisms has the potential to radically alter the way air transport functions. The European Commission is underestimating (in fact, not estimating at all) the potential impact on European and intercontinental air transport networks. It does not consider changes to traffic patterns, additional cost and complexity, etc. It analyses the issue from the point of view of a single airport – not from the perspective of the overall air transport network. Sound policy requires better, more thorough analysis.

The proposed market mechanisms differ significantly from those modeled by NERA. Therefore, it is inaccurate to say that the proposals are backed by an economic impact analysis. Adoption of any of these market mechanisms would produce hardly any benefits, but would generate disruptive and unintended side-effects.

Such a revolution in air transport regulation should not go forward unless all proposals are based on a solid understanding of the *status quo*, and all possible consequences have been analysed in detail. This is not yet the case.

November 2004

¹⁰ Conclusions of the Council of the European Union held in Brussels on 25-26 March 2004.