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signed by Mr Jordi AYET PUIGARNAU, Director

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to: Mr Javier SOLANA, Secretary-General/High Representative

Subject: **COMMISSION STAFF WORKING DOCUMENT**
Proposal for a Regulation of the European Parliament and of the Council
on common rules for the operation of air services in the European
Community - Impact assessment - Summary

Delegations will find attached Commission document SEC(2006) 976.

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.7.2006
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COMMISSION STAFF WORKING DOCUMENT

Proposal for a regulation of the European Parliament and of the Council on common rules for the operation of air services in the European Community

**IMPACT ASSESSMENT
SUMMARY**

{COM(2006) 396 final}
{SEC(2006) 943}

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1. CONTEXT AND REASONS FOR ACTION

On 23 July 1992 the final stage in the liberalisation of air transport in the Community was reached with the adoption of the three Council Regulations - No 2407/92, 2408/92 and 2409/92 - known as the "third package". This followed up the "first package", adopted in December 1987, and the "second package" of June 1990.

More than ten years after the entry into force the third package has largely played its role, allowing unprecedented expansion of air transport in Europe at affordable fares. Despite this success, most of the Community's airlines continue to suffer from overcapacity and from the excessive fragmentation of the market. In addition, passengers do not reap the full benefits of the internal market because of a lack of price transparency or because of discriminatory practices on the basis of the place of residence.

The inconsistent application of the third package across the Member States and the lingering restrictions on intra-Community air services distort the level-playing field of the airlines and limit competition in some parts of the internal market.

The problems arising from an inconsistent application of the third package regulations are expected to subsist if the legislation is not changed:

- Without a more stringent and homogeneous application of procedures for granting and revoking operating licences, we will continue to assist to a high failure rate among market entrants that risks to leave their passengers stranded. No action would also leave unchanged the present competitive imbalances for air carriers between Member States (absence of a level-playing field). Furthermore, given the often precarious financial situation of many new airlines, employment in the airline sector will remain unstable.
- Although only a limited number of airlines make use of leasing agreements of third country aircraft, under present legislation it can be expected that this number will increase while the safety supervision in these instances is not always fully assured.
- In a context of more liberal external aviation relations – in the wake of the “open skies” ruling – the present legislation in combination with surviving provisions from old bilateral agreements between Member States creates additional hurdles by divergent practices between Member States, especially with regard to code-sharing with third country carriers and price setting on 6th freedom routes. This will limit the economic benefits that citizens can reap from the liberalisation of external relations as the price and the choice of connections with third countries will depend on their place of departure in the European Union.
- Some Member States resort more easily to public service obligations (PSO) than others. At the same time, the number of PSOs and their restrictive nature has increased significantly over the years. This tendency increases the risk for travelling citizens to be confronted with monopolies and thus higher fares and reduced supply. At the same time, in cases where PSOs are necessary, present rules do not always attract a sufficient number of competitors in the tender procedure.

- As concerns air fares, price transparency is expected to remain insufficient given the possible confusion with respect to the inclusion or not of all taxes and charges in air fares and discriminatory practices towards residents from different Member States.

2. CONSULTATION OF INTERESTED PARTIES

The preparation of the proposal has been preceded by a public consultation exercise in order to gather as many comments and suggestions as possible from the individuals and bodies concerned. This exercise respected the minimum standards for consultation of interested parties as defined in the Communication from the Commission of 11 December 2002 (COM(2002) 704 final).

An open internet-based consultation took place between 17 March and 30 September 2003. Despite having taken place three years ago, the contributions to the consultation process remain presently valid as their context has not fundamentally changed. The consultation paper, the contributions and the summary of the contributions are available on the Commission's "Your voice in Europe" website:

http://europa.eu.int/yourvoice/index_en.htm,

and more particularly on the following internet address:

http://europa.eu.int/comm/transport/air/rules/package_3_en.htm.

The Commission received 56 contributions from national authorities, international organisations and organisations representing airlines, airports, tourism operators and the air sector's employees and workers.

On 26 February 2004 a consultation meeting with stakeholders was held in Brussels. Delegations from 11 Member States and from 11 organisations representing the above-mentioned stakeholders were present.

The consultations confirmed that the present legal framework does not require a profound revision, but that it needs a number of adjustments and precisions in order to address the identified short-comings.

All of the respondents agree with the Commission as to the positive effects of the third package on the liberalisation of air transport. The majority consider the current regulations to be satisfactory, subject to a few adjustments combined with an effort to harmonise which could be made by adding more detail in the texts or drafting guidelines. Some of them, especially among the carriers, consider a revision to be unnecessary or at any rate not urgent. However, there is support for the modernisation and simplification of the texts and the suppression of provisions that were needed in 1992 but that are outdated today.

All the comments expressed during the consultation process have been carefully examined in the preparation of the proposed revision. The results from the consultation have been fed into the impact assessment.

3. OBJECTIVES

The general objectives of the revision of the third package are to increase market efficiency, to improve the safety of air services and to improve passenger protection.

Therefore, measures have been examined that:

- Ensure the sound overall financial health of the Community air carriers;
- Avoid competition distortions;
- Avoid social dumping;
- Enhance price competition and price transparency; and
- Avoid discrimination of EU carriers on the basis of nationality.

4. POLICY OPTIONS

The nature of the stated problem – non-homogeneous and inefficient application of the legislation – does not require a profound revision of the options taken when the third package on the internal aviation market was adopted.

For these reasons, the revision of the third package operates a series of adjustments in order to address the identified problems. In the impact study, we mainly focussed on the comparison between a ‘no change’ option and a ‘change’ option:

- (1) A ‘no change’ option, which is leaving unaltered the present three regulations composing the third package of the internal aviation market (a consolidation of the text without changing the content would also correspond to this option);
- (2) A ‘change’ option, which includes a series of changes to the third package in order to ensure the homogenous and effective application of its rules.

One alternative option would have been the setting-up of a Community authority to grant licences or to supervise the granting process. It would have offered the advantage of guaranteeing that the operating licences are issued and monitored in exactly the same way for all Community air carriers. However, during the public consultation, the national authorities were virtually unanimous in regarding this development as unnecessary or premature. Therefore, this idea is not further studied in the impact assessment.

The Commission assessed in depth the economic, social and environmental implications of measures that concern the following areas:

- (1) Requirements for the operating licence:
 - (a) Stricter requirements as to the information to be provided by air carriers

- (b) Stricter conditions for submission and approval of financial accounts
 - (c) More regular review of the air carriers meeting the requirements of the operating licence, especially for start-ups
 - (d) Introduction of a clearer procedure for revocation of an operating licence
 - (e) Enhancement of Commission powers for revocation of an operating licence
- (2) Stricter requirements for leasing agreements, especially for wet-leasing (leasing with crew)
- (3) The link between the internal aviation market and air services to third countries
- (a) Access to intra-Community routes by non-Community carriers only through agreements to which the Community is a contracting party
 - (b) Free code-sharing and fare setting on routes to third countries
- (4) Public service obligations (PSO):
- (a) Clearer legislation, better description of the conditions attached to PSOs
 - (b) Longer concession periods: four years instead of three (five years in the case of ultra-peripheral regions)
 - (c) Improvement of the Commission's information on the context of PSO impositions
- (5) Traffic distribution between airports:
- (a) Clear definition of the concept of conurbation and abandonment of the notion of airport system
 - (b) Enhancement of Commission powers in this matter: prior approval for traffic distribution rules
- (6) Fares transparency:
- (a) Transparency of fares information
 - (b) Provisions for ensuring non-discriminatory fares with respect to place of residence
 - (c) Leave price setting to market forces subject to general competition rules

5. Social, Economic and Environmental impact of the proposed measures

Our analysis looked into the impact of the ‘change’ option, in comparison with the base case, in particular along the following lines

- Overall impact on the European economy
- Social impact
- Environmental impact

This section gives a synthetic overview of the main findings.

Overall economic impact

The measures are expected to increase competition and reduce market distortions, although the ensuing market consolidation needs to be followed carefully along competition rules in order to avoid abuses on some routes.

Air carriers benefit from the creation of a level-playing field although the operating costs might be slightly increased by the stricter requirements concerning the operating licence.

Consumers enjoy higher safety levels and reduced air carrier bankruptcy risk. Overall, the increased competition and greater price transparency should lead to lower fares and more services offered.

The ‘change’ option increases some administrative costs of the national authorities, e.g. for the monitoring of the operating licences, but decreases others, e.g. for public service obligations.

Social impact

The ‘change’ option has two main effects on employment.

The stricter supervision of the air carriers’ financial conditions and the stricter requirements concerning wet-leasing will render employment more stable and less precarious in the sector.

As some of the proposed measures might lead to higher traffic levels, employment in the sector might increase, but the magnitude of this increase is probably limited.

Environmental impact

The environmental impact of the ‘change’ option is limited and is mainly linked to the possible increase of traffic compared to the no-change option.

A small reduction in the environmental impact may arise from the avoidance of public service obligations on short routes that are served by efficient rail services.

The revision of the third package pursues no environmental objectives. It must be recalled that the environmental impact is already being addressed by distinct

Commission initiatives¹ in the framework of the Sustainable Development Strategy and the European Climate Change Programme.

6. COMPARING THE OPTIONS

The impact of the ‘change’ option on the specific objectives is summarized in the following table.

Specific objectives	Impact of change option on specific objective	Comments
Ensure the sound overall financial health of the Community air carriers, reduce the bankruptcy risk	++	Stricter monitoring of the operating licence
Avoid social dumping	+	Stricter conditions for wet-lease
Avoid competition distortions	++	Homogenous application of rules regarding operating licence, PSO, traffic distribution, 6 th freedom flights
Enhance price competition and price transparency	++	Non-discrimination on the basis of the place of residence and publication of all inclusive fares and rates
Avoid discrimination of EU carriers on the basis of nationality	++	The ‘change’ option removes still existing restrictions on the internal market (mainly access to third country routes)

The ‘change option’ appears to present a balanced approach that offers clear economic and social advantages over the ‘no change’ option. It reinforces the internal market by accelerating market consolidation and thereby creating a competitive environment for European air carriers capable of taking on their international competitors. It contributes to the objectives of the Lisbon strategy.

It presents clear advantages for passengers by enhancing the market forces that lead to lower fares, better services offered and higher safety levels.

The negative but very limited environmental impact of the proposed measures can be compensated by other measures taken in order to reduce the environmental impact of aviation.

Therefore, the Commission makes a proposal according to the described ‘change’ option.

¹ “Reducing the Climate Change Impact of Aviation”, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, COM(2005) 459 of 27 September 2005.