ECA Submission

to the

U.S. Consultation on Gulf Carriers Subsidy Claims

(Dockets: DOT-OST-2015-0082, DOS-2015-0016, DOC-2015-0001)

Executive Summary:

- The state-sponsored rapid expansion of Persian Gulf carriers has harmed the competitiveness of Europe's aviation, will continue to do so, and will soon have the same detrimental effect on U.S. carriers and jobs, if not contained.
- Their massive capacity dumping, at a scale well beyond market growth, has the potential to threaten the survival of Europe's – and the U.S.' – aviation industry, with significant negative repercussions for employment, growth and economic activity, tax and social security income and connectivity.
- The Gulf's success is based on the combination of at least two anti-competitive strategies: one consists in dumping capacity on the market, 'inundating' it and destroying competitors, subsequently absorbing capacity to eventually be able to set prices and control the market ('sponge effect' - push-inundate-absorb). The other involves acquiring equity in EU airlines to circumvent the EU rules on market access ('Trojan Horse' strategy) and to expand their network both within Europe and beyond (e.g. notably towards the US, incl. through Fifth Freedom rights).
- Recent developments at ICAO (ATRP) and the EU-Gulf Cooperation Council reveal the Gulf's unwillingness to engage in any discussion on fair competition.
- ECA therefore recommends to the U.S. to take this threat seriously, to act quickly by seeking urgent consultations with the Gulf States and – in the meantime – by freezing traffic rights and seat capacities of these airlines to/from the U.S.

The European Cockpit Association (ECA) is the representative body of European pilots at European Union level. It represents over 38,000 pilots from the National Pilot Associations in 37 European States and it is a recognised social partner in the EU sectoral social dialogue for Civil Aviation.

Same Threat on both sides of the Atlantic

ECA fully shares and supports the conclusions of the analysis on the competition impacts stemming from state-sponsored and -subsidised Persian Gulf carriers, as conducted by numerous stakeholders both at EU and U.S. level. They illustrate how the state aids granted to the Persian Gulf[1] carriers are incompatible with the rules of

[1] «Persian Gulf carriers» or «Gulf carriers» refer to Emirates, Etihad Airways and Qatar Airways.

a liberalised market, incl. EU internal market and EU Treaty rules, are not in full compliance with the provisions of existing Air Services Agreements[2], and have significant negative economic, employment and connectivity repercussions both in Europe and in the U.S., as well as in other regions, such as Asia-Pacific.

In this submission ECA focuses mainly on the European experience with regard to the exceedingly fast expansion of the Persian Gulf carriers. In Europe, air transport provides 7.8 million jobs[3], generates more than €475 billion in revenue, contributes to tax income and social security systems, and is an important stimulator for economic growth, international trade, tourism and geographic connectivity. As such, aviation has an important strategic role both in economic and employment terms and in terms of geo-political / geo-economic considerations.

ECA has been engaged in a continuous dialogue with the EU Institutions and national authorities in Europe regarding the risk of this strategic sector losing its international competitiveness due to the 'non-market driven' rapid growth of the state-sponsored/-subsidised Gulf carriers. The findings of the 'White Paper' study, carried out by three major U.S. airlines, provided further facts and substance to the arguments ECA has been supporting for a few years now, as did recent submissions by EU carriers.

From a European pilots' perspective, these facts show that European and U.S. employment are at stake. **Aviation jobs are at risk of being cut and/or replaced by non-European employees – who are often not protected by basic workers' rights** –, be it in the cockpit or the cabin, be it in related services like catering, maintenance etc., be it in terms of jobs lost in other sectors that are related to and dependent on a thriving local European / American aviation.

From a U.S. perspective, it is particularly important to note that the expansion of the Persian Gulf carriers to and from the U.S. market has started only recently. By contrast, Europe's carriers have been experiencing significant capacity expansion by the Gulf carriers for many years already. The detrimental impact of this 'capacity dumping' on the European market is very likely to be experienced by U.S. carriers in the near future, if no action is taken.

Unlevel Playing Field: a part of the Gulf Carriers' business model

The heart of the problem is that the expansion model of the Persian Gulf airlines is rather peculiar if not unique, being massively dependent on their governments' policies: the governments of the UAE and Qatar have developed ambitious and comprehensive strategies to help their carriers to expand in Europe, in the U.S. and beyond. They consider their respective airline not only as an economic/commercial activity by itself, but as a strategic tool to ensure and enhance the long-term economic – and possibly geo-strategic – future of their states.

[2] Many individual European States (e.g. Germany, France, Netherlands and UK) /UAE Air Services Agreements contain articles with reference to "fair and equal opportunities". Also the EU-UAE Agreement provides protection from subsidies (art. 6 – compatibility with competition rules).
[3] Source: http://aviationbenefits.org/media/13940/ATAG_AviationBenefits2014_Europe.pdf

State Ownership and Control is the issue: Qatar Airways is 100% owned by Qatar State via the Qatar Investment Authority; Etihad Airways is 100% owned by the government of Abu Dhabi; and Emirates is wholly-owned by the government of Dubai. As their **financial situation lacks transparency**, there are no guarantees that the governments are running their companies as 'private' entities, and evidence points that there is a clear absence of any profit requirement. Furthermore, the interconnected vertical and horizontal integration of the different components of the aviation sector in each of the three Gulf countries, de facto confers monopoly advantages that would be illegal in the EU. Put differently, from a simple financial perspective, as long as the oil and gas revenues remain in the region, and as long as the state remains heavily involved at all levels, these companies will continue to enjoy a huge 'war chest' and **access to cheap fuel, cheap capital and direct political support to finance and promote their further global expansion**.

In addition, weak or no social legislation in their countries offers the Persian Gulf carriers the **competitive advantage of a workforce that cannot count on the respect of the basic standards set by the International Labour Organisation** (ILO). Trade unions are very restricted or not allowed in these countries, collective bargaining is inexistent, female employees' basic (human) rights are often disregarded (e.g. female cabin crew), and no protection against dismissal is available. Good safety rules and procedures on paper are not enough, **the emergence of a solid safety culture among air crew – based on 'Just Culture' principles – is and remains challenging**, due to the simple fact that any crew member can be dismissed at any moment and for any reason.

Finally, the past and future expansion of Persian Gulf carriers would not be possible without a significant **state-sponsored development of modern airport infrastructure, aimed at attracting and diverting as much air traffic as possible** and at accommodating the arrival of the over 600 wide-body aircraft that are on order. Dubai airport for example is now the world's busiest airport in terms of international passenger traffic and it is growing. A new terminal will be built at Abu Dhabi International Airport, and Qatar plans to open another International Airport in Doha. Such massive investments in infrastructure are in stark contrast to the situation in Europe, where airport expansions and opening hours are constrained by multiple considerations, making Europe as a global hub less and less competitive.

All these elements – which are not available to European and U.S. carriers – confer to the Persian Gulf carriers a significant competitive advantage, which distorts the level playing field with Europe's and the U.S.' airline industries.

Capacity Dumping & 'Sponge Effect'

Contrary to what some may argue, **Gulf carriers do not put efforts in opening new markets**, thus offering consumers more choice. On the contrary, their business model mainly targets existing routes: **they shift passengers' traffic and connection on international flights from Europe to their own region ("share shift") thereby replacing EU carriers from those routes, however without stimulating additional demand**. Any major traffic gains by Persian Gulf carriers in the Gulf-EU market have actually come at the expense of the EU airlines. As evidenced in submissions from EU carriers, **numerous flight connections had to**

be stopped due to the Gulf airlines' having diverted traffic towards and via their hubs, in particular destinations to South-East Asia-Pacific and to Africa.

Against this background and considering the Gulf carriers' aggressive expansion plans and their huge order book for long-haul wide-body aircrafts, **the additional capacity they bring into the market will continue to exceed the market growth** in the foreseeable future. Crucially, this substantial 'capacity dumping' will continue to harm EU carriers, which cannot (and should not) rely on state coffers to sustain a prolonged **capacity-driven price dumping, erosion of yields and serving routes at a loss**, as their counterparts from the Gulf have the means to do. Job losses in Europe, decline in economic activity, tax and social security income will ensue, as will the loss of **direct connectivity for European consumers**, who instead will have to travel to Asia or Africa via a connecting flight through one of the Gulf hubs.

What can be observed is that **the Persian Gulf carriers' strategy is based on an anticipated 'sponge effect' (push-inundate-absorb)**. They thereby push their capacity into the market at an artificially high rate, inundate the market and destroy their competitors, and then release the pressure to ultimately absorb and reduce the capacity again, which is now largely controlled by them, allowing them to dictate the price and control the market. This is a perfectly 'rational' behavior, known in other sectors, and is the reason why regulators around the globe introduced legislation against such uncompetitive practices.

This scenario is likely to be rapidly replicated in the US. While the EU is 'ahead' of the U.S. in terms of exposure to the Gulf carriers and damage done, it is very probable that the damage done to U.S. airlines due to the subsidized Gulf carriers' operations will increase rapidly. Indeed, the Gulf carriers are reported to have expansion plans going beyond Europe and focusing on increasing their presence in the U.S. market.

This is why numerous EU and U.S. stakeholders – both airlines and airline employees – are seriously concerned about the rapid expansion and ambitious plans of the Gulf carriers and their state owners. And this is why the European Commission, EU Member States and the U.S. government should be too.

The 'Trojan Horse' effect

The expansion of the Persian Gulf carriers in Europe is exploiting other channels, too. One of them consists in **acquiring equity in EU airlines, using them to expand their network and market reach, both within Europe and outside**: Benefitting from the EU's relatively liberal Ownership & Control rules, Etihad is buying ownership stakes in other European airlines/groups: 49% of Alitalia, 29% of Air Berlin, 49% of Air Serbia, 33.3% of Darwin Airline, and 4.99% in Aer Lingus – and Qatar purchased 9.99% of IAG (British Airways, Iberia, etc.), although some observers reckon that this share in IAG may de facto be substantially higher.

Buying equity stake in a weak, financially challenged airline is actually at odds with normal practices in a market economy, whereby an airline in financial difficulties would rather have to be restructured and downsized. If however, financial and profit considerations can come second and penetrating a market – and overcoming market access barriers ('Trojan Horse' strategy) – is instead the aim, then buying large shares in several loss-making European carriers has a certain logic.

One of the problems in this respect is that, in addition to a transfer of ownership, Europe is witnessing the potential **transfer of the effective control of these European airlines to the Gulf companies**, a qualitative element that is obviously more difficult to establish, prove and oversee. This risk is particularly prevalent in the case of Darwin Airline, Air Berlin and Alitalia.

Indications for ***de facto* effective control**, can be seen in the following examples:

- After Etihad invested in Air Berlin, almost all long-haul destinations flown by Air Berlin to Asia (e.g. Berlin-Bangkok) and Africa were cancelled. These connections have all been taken over by Etihad Airways through Abu Dhabi.
- NIKI Airlines, which is an Austrian low-cost airline and a subsidiary of Air Berlin, has 3 bases and 23 aircrafts in Austria. There are 14 flights per week between the UAE and Austria. Due to the resulting fierce competition, Austrian Airlines are stopping flying to Abu Dhabi and Doha.

While the European Commission applies very strict rules on state aid and unfair commercial practices, including in the aviation sector, there are obviously still gaps to be filled in the EU legislation. **Adequately tracking down and preventing *de facto* effective control by a third country airline** is one example. Another is that if there is evidence that third country governments subsidise their airlines doing business in the EU or investing in European airlines with the main aim of deviating passenger traffic to their regions, such actions must be stopped and sanctioned. **To be effective and prevent that such sanctions simply result in the Gulf carriers shifting towards the US market, the U.S. should take a similar approach.**

'Job Shift' to the Gulf

As mentioned above, **ECA is particularly concerned about the impact of the Gulf carriers' expansion models on the employment in Europe's civil aviation** sector, including for airline pilots, cabin crew and other aviation staff.

The loss of market share – due to the ongoing 'capacity dumping' and resulting 'share shift' – will inevitably translate into the elimination of flight connections and ultimately to the reduction of the fleet, thus reducing not only consumer choice but also and especially jobs in Europe, both directly in the aviation sector and indirectly in related/dependent sectors.

According to US airlines, the estimation for US market is approximately **800 net jobs lost by the US carriers for every lost or foregone international wide-body flight** connection. Depending on aircraft type and destination, these numbers are similar for European carriers.

Losing jobs in Europe and shifting them to the Gulf carriers – including future growth which will generate Middle-Eastern jobs as opposed to European ones – also means **less tax income and less social security contributions in Europe**. It also means **replacing European quality employment by jobs in the Middle East where basic**

social and employee protections and rights do not exist or are not enforced. This is clearly not in line with the new EU Commission's "Agenda for Jobs, Growth, Fairness and Democratic Change".

International Developments

Lastly, ECA would like to draw the attention of the U.S. government to the **current threat to the competitiveness of the aviation industry** due to developments that - in the long run - may have repercussions on the U.S. market.

We refer in particular to the so-called EU-GCC (Gulf Cooperation Council) dialogue on aviation, as well as to the proposals put forward by ICAO (Air Transport regulatory Panel, ATRP) related to a worldwide Multilateral Air Services Agreement. **In both processes, the Gulf countries are determined not to discuss the issue of fair competition and even less willing to negotiate provisions in that area**.

In the specific case of the **EU-GCC dialogue**, the Gulf countries seem to be interested in attending these dialogue meetings. However, they seem to have as primary objective to 'encourage' the individual EU Member States to negotiate market-opening on a bilateral basis. The conclusion (or further expansion) of such **bilateral agreements** with individual European States is **instrumental to their further expansion** on and within the EU market, as well as **for using the EU market as a stepping stone to the lucrative U.S. market**.

In the medium and long term a major risk would be to see the U.S. market heavily impacted by those bilateral agreements between the European countries and the Gulf countries. In fact, it is already the case that the Gulf carriers exploit the above-mentioned agreements to **increasingly compete on Fifth Freedom routes between the United States and Europe** (e.g. via the UK or Italy). For example, Emirates currently operates such a Fifth Freedom passenger-carrying flight from Milan to New York, and the U.S. airlines demonstrated the commercial damage that they attribute to Emirates services. In case Gulf carriers further expand such Fifth Freedom operations to the U.S. this would most likely harm both EU and U.S carriers operating on those same transatlantic routes.

Conclusion

To conclude, ECA calls upon the U.S. government, as it has repeatedly called upon the European Commission and the Member States, to take seriously the threat posed by subsidies and state sponsorship to the Gulf carriers, and to take the necessary steps to level the playing field. This could include consultations with the Gulf States' governments and in the meantime a restriction ('freeze') of traffic rights and seat capacities of these airlines to/from the U.S.

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