WORKING PAPER

INTERNATIONAL CIVIL AVIATION ORGANIZATION

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ASSEMBLY — 35TH SESSION

ECONOMIC COMMISSION

Agenda Item 28: Regulation and organization of airports and air navigation services

ECONOMIC PERFORMANCE OF ATM

(Presented by the International Transport Workers' Federation)

SUMMARY

This paper reviews the economic impact of the current downturn on the performance of air traffic service providers. It describes ongoing structural changes taking place in the industry and the impact of these on ANS provision. It recommends that ICAO review the charging formula contained in ICAO Doc 9082.

Action by the Assembly is in paragraph 5.

1. INTRODUCTION

1.1 The aviation community is still struggling with the combined effects of the deepest-ever cyclical downturn in the industry, exacerbated by a series of external shocks including the September 11 events, a second gulf war, and the outbreak of SARS. These economic shocks have affected all components of the aviation chain to varying degrees. The airlines have suffered most, but air traffic services providers have also been plunged into crisis, especially where these activities have been commercialised by States.

1.2 The severity of the recent economic crisis is not only resulting in traditional remedial measures such as cost and capacity cuts, but is leading to a fundamental structural change in the industry which will impact long term on the economic performance and efficiency of the air navigation services.

1.3 The International Transport Workers' Federation believes that two factors in particular will need to be addressed by States to ensure that ANS providers are economically fit to meet their future performance requirements. Firstly, States will need to respond to the permanent changes now underway in

[1] English, French and Spanish versions provided by the International Transport Workers' Federation.

the airline sector, and secondly, States will need to introduce mechanisms to ensure that ANS providers have sufficient financial resilience to better respond to the cyclical nature of the industry.

1.4 Aviation markets are going through structural change as evidenced by the emergence and continuing growth of low cost airline operators. This is leading to a significant change in the mix of traffic flying internationally. Whilst recent traffic figures point towards a slow recovery towards pre-9/11 levels, the amount of revenue being collected by ANS providers is static or still falling. As a result, and in the absence of financial reserves, many ANS providers are seeking to increase their charges at a time when the industry can least afford it. In turn low-cost carriers are lobbying governments to reduce ANS charges. This Working Paper proposes solutions to ensure that a sound economic regulatory framework underpins performance targets for safety, efficiency and regularity.

2. THE CURRENT CHARGING FORMULA

2.1 The charging framework for ANS providers is set out in ICAO Doc 9082: "ICAO's Policies on Charges for Airports and Air Navigation Services". This states, in paragraph 45, that the charges for en-route services should be a single charge per flight based on the distance flown within a defined area and the aircraft weight.

2.2 This formula was established at a time when governments accepted that they had some responsibility for providing ANS infrastructure. In many states that is no longer the case. As with the rest of the aviation industry, the ANS "market" has changed with the growth of autonomous organisations. Many of these organisations are commercialised Air Navigation Service providers.

2.3 The ITF believes that the weight for distance formula no longer accurately reflects the cost of providing ATC services. The formula is based on an erroneous assumption that the size of the aircraft and distance flown has a bearing on the cost of providing services. In fact, the cost per mile of delivering services declines as the distance flown increases. This is borne out by the fact that the US standard for classification of air traffic facilities recognises that the workload for air traffic controllers, and therefore the cost of providing the service, is greatest during the transitional phase of flight.

2.4 There is also no direct relationship between aircraft size and service cost. Under the current charging formula, operators of smaller aircraft are in effect being subsidised by carriers operating with larger aircraft. The cost of providing air traffic services, particularly personnel costs, is directly related to the volume of airspace controlled (sectors), as well as the number and variety of aircraft types at any point transitioning the airspace. In this regard, an aircraft that remains within one sector of airspace for several hundred miles does not require substantially greater resources than an aircraft that briefly traverses the sector.

2.5 The structural change underway in the industry is leading to a shift towards greater use of smaller aircraft and a decline in the market share of large aeroplanes. In part this is a consequence of the growth of low cost carriers operating point-to-point services, and in part a consequence of an ongoing downturn in the proportion of long-range operations traditionally served by larger aeroplanes. For example, in the United Kingdom, the ANS provider, NATS, can point to a steady growth in traffic over recent months but revenue has remained below the pre September 11th levels. This steep decline in revenue is caused by a reduction of traffic over the Atlantic Ocean and a change in the type of aircraft being flown by airlines operating into and out of the United Kingdom.

2.6 It could be argued that the aircraft size criterion is intended to ensure that charges bear some relationship to the number of passengers transported. However, it is far from clear whether the current formula provides the best means of ensuring value to the passenger. The change in the mix or aircraft types in the market is one of the factors that are causing providers to increase ATS charges to recover lost revenues. At the same time passenger numbers are staying low. This means that the proportion of ticket price attributable to ATC is increasing. Airlines have to either increase the ticket price or make savings elsewhere.

3. WHO SHOULD CONTRIBUTE TO THE COSTS OF PROVIDING AIR NAVIGATION SERVICES?

3.1 ICAO Doc 9082 states at paragraph 36 that "The Council considers that as a general principle, where air navigation services are provided for international use, the providers may require the users to pay their share of the related costs." The current approach in many countries is that the charges mechanism attempts to recover all of the costs associated with ANS provision. Public funding for air navigation is reducing or has disappeared in many ICAO states, despite the fact that the aviation industry, including general aviation, contributes millions of dollars in taxes and duties very little of which comes into the provision of ANS infrastructure. At a global tripartite meeting of governments, employers and workers convened by the International Labour Organization in 2002, where the workers' group pointed out that 'the economic impact of September 11th was exacerbated by earlier and still ongoing efforts to move civil aviation into a solely market driven service." The economic crises of this industry should be seen as a wake up call that the changes in the industry over the last decade have made the industry more fragile.

3.2 It is not just the ITF that believes there is a problem. In a brochure called the *Corporatisation Report* published by CANSO in August 1999 it was argued that 'It should not be expected that an autonomous air navigation services authority in a State with a minimal traffic and hence minimal revenue generating capacity would be profitable."

3.3 This was written in the context of countries with relatively small aviation industries. However the ongoing crisis means that many providers in countries with large and developed aviation markets are now facing similar crises and are seeking to reduce costs because they cannot make a profit.

3.4 In the final report of the ILO tripartite meeting held in January 2002 (TMICA/2002/11), it was recognised 'that the existence of a vibrant civil aviation industry is in the public interest." The same paragraph goes on to say 'The availability of and access to air transportation can serve as a powerful engine for national economic growth benefiting the public as a whole whether or not the individual is a consumer of air transport." The paragraph concluded, 'Therefore the interests of public safety and security dictate that governments play an active role in the protection and maintenance of a civil aviation infrastructure." This was a statement agreed by governments as well as workers and employers. It is our contention that the current charging guidelines do not recognise such an approach.

3.5 In many countries aviation is unique in that it is the only transport mode that receives no subsidy or public funding. Increasingly it is expected that airlines should cover all of the costs of the ANS infrastructure. This is in marked contrast to the approach towards road or rail signalling and traffic management. This lack of public support is in turn increasing the pressure on providers to reduce costs and in many cases this brings pressure to reduce staff and a potentially adverse effect on performance targets for safety, efficiency and regularity. Many in this industry are concerned that this approach is having an impact on safety. If a government sees a need to improve rail services or a need to reduce traffic jams it will build

new roads or provide support for railways. In the case of aviation it "grants the freedom to borrow money outside of government debt."

3.6 The problem with such an approach is most marked at times of crisis. Traditionally, the public nature of ATS provision has meant that governments have acted to guarantee the minimum funding needed to maintain system-wide and integrated provision, and reliability at times where income does not meet operational or investment needs.

3.7 The association that represents commercialised providers, CANSO, argues that the solution to this problem is to release ATS providers to operate as commercial agencies with a capacity to extract profits from the service provided, and to raise capital from the private finance sector. This approach, however, is contrary to the principles contained in ICAO Doc 9082, which presupposes that service users will only be charged for the service actually provided on a transparent and cost-only basis.

3.8 The ITF believes that the public sector functions of national ATS systems need to be recognised. These systems provide safety and services not only for the users, i.e. the airlines, but also for citizens more widely in the same way that, for instance, traffic lights protect pedestrians as well as automobile drivers. Nevertheless, quite apart from any other considerations of public policy, private finance from the banking sector is universally more costly than funds secured by States, while commercialisation presupposes that some element of the income generated will leave the system in the form of dividends or returns to the shareholders.

3.9 Given that the State is the ultimate guarantor of the integrity and operational performance and reliability of the national ATS system, we would also question whether, through commercialisation, risk has actually been transferred. We believe the evidence shows that commercialisation or privatisation can bring economic instability, does not guarantee a higher level of economic efficiency and in a number of cases has lead to a decline in performance and reliability.

3.10 States - given the economically critical roles played by civil aviation - will continue in effect to be the bottom-line guarantor of their national infrastructure, including their air traffic services. Nevertheless, this does not mean that State funding should somehow be provided in an unstructured way. One mechanism for managing the business cycle that is an integral feature of the air transport industry would be for States to permit the establishment of Reserve funds, dedicated to financing operational and investment costs, at those points in the business cycle where income from charges declines while costs remain fixed or rise. Such contingency funding could be established on the basis of estimated costs of the service over the entire business cycle. This would be more efficient, in our view, than relying on private capital. It would also mean an end to the routine rebating of charges at times of high traffic volumes. It would, however, require some revision to the current ICAO policies as outlined in Doc 9082.

4. CHARGING AS A PERFORMANCE ISSUE

4.1 The issue of user charges should also be an element in the review of performance. ICAO, in a paper to the 11th ANS conference, noted that the trends in the world economy, in corporatisation of ATM and towards a more structured ATM regulatory environment by States as well as by ICAO, are placing increasing pressure on accountability, not only for service provision, but also for business and safety cases when making implementation decisions. Decisions on efficient routing and environmentally friendly routings are being undermined because of the charges being levied. It follows that if an airline is being asked to route

through expensive airspace to avoid congestion then it is more likely to disagree, whereas those flying through airspace who do not levy charges and use taxes, or a mixture of both, will accept the change.

4.2 IATA in its working paper has also called for a review of the efficiency and effectiveness of ANS. In a paper to the 11th ANS conference (ANS11WP/50) they noted "that when evaluating efficiency of an air traffic services (ATS) provider, the costs associated with providing the service and the resulting benefit to the airspace user must be considered." The ITF does not disagree with that statement, but we suggest that it is not just the airlines interests that should be taken into account. There must be wider consideration of the public interests. A review of the current guidance on charges would help that approach.

4.3 IATA also noted in the same paper "safety is paramount but efficiency and regularity are crucial to the development of a sustainable, efficient and cost effective air transport system". Again, the ITF does not take issue with that statement. However, we believe that governments should also play a part in such an approach. We believe that it is time to return to the original vision of ICAO that airlines should share in the costs of provision of ANS services, but that the fundamental role of the State needs to be recognised.

5. ACTION BY THE ASSEMBLY

5.1 The Assembly is invited to conclude that:

a) As part of the review of guidance material suggested by the secretariat in A35-WP/10, ICAO undertakes a review of the current charging formula to see how it might be revised to meet the new climate.

b) Such a review should include consultation with all stakeholders including the representative bodies for ATS employees, the ITF, IFATCA and IFATSEA.

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