



Resilience and Recovery through the Covid-19 crisis: state support to sustain the civil aviation sector

Proposal by Prospect

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State support to ensure the survival of the aviation sector through the COVID-19 crisis

1. The COVID-19 crisis has resulted in a reduction of air traffic by approximately 90%. This is set to be compounded by the UK's imposition of quarantine measures on anyone entering or returning to the UK from overseas, despite reservations expressed by the government's chief scientific adviser.¹
2. This has had a devastating impact on the whole aviation industry, which contributes £22 billion and 230,000 direct jobs to the UK economy.² It is the largest aviation network in Europe. In 2014 it was estimated to contribute £8.7bn a year in tax to the exchequer – a figure that will have increased substantially by the beginning of this year. It is also one of the UK's highest productivity sectors, with the average air transport services employee generating £84,000 in GVA annually, over 60 per cent higher than the whole economy average.³
3. As the government has recognised, aviation also has a critical role to play in supporting regional growth and rebalancing. The UK's local and regional airports serve as "hubs for growth within and beyond the region in which they are situated", providing quality employment opportunities and vital connectivity.⁴ Those with long-haul networks such as Bristol, Belfast international, Manchester, Newcastle, Glasgow and Edinburgh provide their surrounding regions with invaluable access to global markets.
4. Until this crisis the UK aviation sector was growing in line with the needs of a growing economy. It has important work to do to make this growth more sustainable and compatible with the government's net zero target, but last year the Committee on Climate Change envisaged that this could be consistent with demand growth of 25 per cent above current levels over the next thirty years,⁵ and the industry has put forward a "road map" for decarbonisation that, if achieved, would enable a 70 per cent growth in passengers while reducing net carbon emissions to zero.⁶ As we suggest below, one of the most significant negative impacts of the current crisis is that it is setting back this vital work at a time when we could be accelerating it.
5. It is of course hard to predict what the lasting impact of the current crisis will be on demand and costs in the aviation sector over the medium term. But there can be no doubt that, if the UK economy as a whole is to recover and return to growth over the months and years ahead, it will need an aviation sector that is able to respond to growing levels of demand for air transport, even if the exact levels and pathways may not match those forecast a few months ago. That said, there is no indication that UK citizens' appetite for leisure travel will diminish in the medium-to-long term – sated in recent years by government and EU policy enabling ever-lower ticket prices. How far this demand

¹ <https://www.ft.com/content/a37950d6-d876-4215-a859-9b0a9dc3627b>

² https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/769696/aviation-2050-print.pdf

³ <https://airlinesuk.org/wp-content/uploads/2015/03/Oxford-Economics-2014.pdf>

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/769696/aviation-2050-print.pdf

⁵ <https://www.theccc.org.uk/publication/letter-international-aviation-and-shipping/>

⁶ https://www.sustainableaviation.co.uk/wp-content/uploads/2020/02/SustainableAviation_CarbonReport_20200203.pdf

translates into aircraft movements and passenger numbers will be dependant to a significant degree on government policy decisions on the future of the industry.

6. Throughout the crisis, Prospect has been calling on the government to take a strategic approach to support for aviation. This should not be based on simply ‘bailing-out’ airlines. A strategic approach is required which recognises the pivotal role of aviation in the UK economy and in the delivery of government ambitions for trade, regional development and rebalancing, and the environment. Aviation also contributes good quality employment, with considerable investment in capital and skills through a complex and diverse supply chain. And, of course, aviation is an important part of the UK’s transport infrastructure. Finally, but often forgotten, UK aviation has a superb safety record. That, too, is at risk.

7. Prospect has already published two specific proposals aimed at ensuring that air traffic infrastructure and services survive:

- Renationalisation of NATS⁷
- Airports Capacity Retention Scheme⁸

8. Prospect’s objectives throughout the crisis to date have been to address the short-term impact on companies’ cashflow, assisting in identifying cost-savings while ensuring that measures do not limit the ability of key services – particularly safety-critical services – to recover. But measures are also required to secure the long-term viability of the industry.

9. In relation to NATS – the provider of critical national infrastructure – its funding model is in a state of flux. The EU is reviewing the Single European Sky Performance Scheme – and, thus, the revenue model for ANSPs – in the light of the COVID-19 crisis and there is uncertainty as to NATS’ position within the Single European Sky post-Brexit. But there will always be a continuing ICAO/Chicago Convention obligation on the UK to provide air navigation services. Against this background, a decision needs to be taken by the government as to the long-term governance and financing of NATS.

10. This is particularly important when it comes to the capital programme to renew and modernise airspace and the systems managing it. In response to the COVID-19 cash crisis, NATS has suspended its £670M programme – over 5y of RP3 - and there is every indication that the funding stream (increased charges to airlines) will never be reopened by the EC, certainly not at that level. Does the government still want this work to be completed? Will the airlines ever be willing to pay for it? What is the UK’s future place in the Single European Sky? Is it right that long-term capital programmes should be funded directly from revenues?

11. One way of securing NATS’ operations and programmes would be for the government to step in. Revenue and capital support could be delivered by the government as shareholder; increasing the state’s equity from its current 49%, as proposed by Prospect in May.⁷

Infrastructure investment and “building back better”

12. The Government has signalled its intentions to stimulate and support investment in essential infrastructure as a key plank in its economic recovery plan.⁹ Accelerating public and private investment in infrastructure offers a way of both supporting employment and incomes in the short-term while raising the UK economy’s productivity and growth potential in the medium and longer-term. It is also a key route to advancing environmental and regional economic objectives.

⁷ Attached and available at <https://library.prospect.org.uk/download/2020/00688>

⁸ Attached and available at <https://library.prospect.org.uk/download/2020/00689>

⁹ <https://www.businessgreen.com/news/4015986/reports-chancellor-preps-green-jobs-revolution>

13. Air transport infrastructure should be seen as an important part of this plan. The UK's airspace, air traffic management systems and airports are as much a part of its essential economic infrastructure as its roads and rail, energy and communications networks. Taking the opportunity to upgrade these capacities and accelerate moves toward greater sustainability would pay economic, social and environmental dividends for years and decades to come.

Specifically, we believe this entails:

- Treating NATS' capital programme, which would normally be funded from revenue, as a vital investment in improved efficiency and environmental sustainability. Rather than suspending these programmes, as has happened to help protect NATS' cash position, they should be expanded and accelerated, taking advantage of the temporary reduction in air traffic levels to lock in more efficient and environmentally sustainable systems of air traffic management. This will require expenditure on staff training as well as new technology but should be seen as an investment that will deliver significant public benefit in both the short and long term
- Prioritising support for local and regional airports that play such an important part in their surrounding economies. It is essential that the current crisis does not result in permanent damage to the capacity of smaller airports which would exacerbate the concentration of economic growth and opportunities in London and the South East. The government should treat support for smaller airports' fixed costs, advocated in our Airports Capacity Retention Scheme, as a vital investment in economic infrastructure and regional rebalancing. [Airports Capacity Retention Scheme/link]

Project Birch

14. We acknowledge the Government's position to date – that aviation companies should maximise the use of calls on shareholders, banking facilities and general government packages such as the CCFF. We recognise the value of the furlough scheme and its extension to the autumn; however, particularly with the additional demand-suppressant of quarantine affecting the crucial summer season, furlough alone will not be enough to ensure the survival of an industry with the capacity and resources to recover.

15. The Government has recently announced Project Birch, a bailout plan to save strategically important companies. It has said that, in exceptional circumstances, where a viable company has exhausted all options and its failure would disproportionately harm the economy, it may consider support as a 'last resort'. Although we do not believe that this amounts to 'strategic' support, we situate our current proposal within this declared intent.

Proposal

16. Birch *should* be strategic. But there are few details of how it will work. To date, the Government has stated that companies can - via the relevant Secretary of State for their sector - individually seek funding of last resort. In aviation, support would be explored through confidential talks with the DfT and the Treasury. We understand that companies would have to demonstrate that they have exhausted other avenues – including shareholders, banks and the CCFF. They will have to demonstrate that, were it not for the COVID-19 crisis, they would be viable organisations and that their failure would disproportionately impact the economy. Finally, we understand that the government is assessing companies for compatibility with the UK's climate change objectives, but it is not clear whether support is conditional on specific contributions.

17. Prospect believes that this company-by-company approach is *not* strategic. The DfT has told the aviation unions that it is 'open' to discussions sector wide, but nothing has been put in place. As the Birch process gets underway, it can be made more strategic if the criteria for access and the conditions for support are transparent. The Government cannot

be allowed to 'pick winners' without reference to a strategy and without visibility of how state support fits into wider policy objectives for aviation, the economy and the environment.

18. To support and inform a more strategic approach, there needs to be a government-led exercise to build consensus on reasonable planning assumptions around traffic and passenger numbers over the medium term. This may have to be scenario-based and regularly updated, but will be essential for assessing rationally the viability and business plans of operators and for ensuring that capabilities and capacity are there to meet future needs.

Eligibility

19. Companies should only be offered access to Birch if they:

- Demonstrate their importance to the resilience of the industry – infrastructure provider, pivotal position in the supply chain, likelihood of substitution by alternative providers, skills and training record (do they feed the labour supply of the industry or feed from it?)
- Have a high proportion of fixed costs (fixed costs need revenue protection as a priority)
- Demonstrate good COVID-19 behaviours to date:
 - employment (no opportunistic changes to terms and conditions, good treatment of staff on furlough, no premature redundancies, etc)
 - supply chain (paying bills, not invoking *force majeure* contractual clauses)
 - dividends
 - consumer protection
- Have a good record of corporate social responsibility – including tax status of ultimate owner, contracts with local/UK suppliers, environmental performance and effective industrial relations

Conditions

20. State support should have conditions attached:

- Safety
- Maintenance of lifeline services
- Regional development (including connectivity/transport integration)
- Guarantees to sustain UK supply chain ('trickle-down')
- Repayment schedule and method (capital grant, loan and/or equity, taxation)
- Retention and extension of capital programmes (eg direct government support for key capital programmes with carbon reduction objectives)
- Environmental targets and required measures
- Ethical employment practices – including commitments on training/skills, terms and conditions, limits on redundancies, union/workforce involvement
- Dividends and executive pay
- Consumer rights and service standards



By email: kelly.tolhurst_mp@dft.gov.uk

Kelly Tolhurst MP
Parliamentary Under Secretary of State
Department for Transport

AG 2.3.1

6 May 2020

Dear Minister

NATS Holdings and NATS Limited - ownership

I wrote to you on 18 March concerning the future of the NATS En-route Limited (NERL) RP3 Price Determination in the light of the Covid-19 crisis. Since then, the UK government supported an agreement at European level aimed at assisting airlines' cash-flow by providing for the deferral of En-route charges, with payment of 50% of those charges by Eurocontrol this summer and their eventual recovery from the airlines later next year.

While this agreement was welcome in covering some of what has been an almost complete loss of income for NERL, it will not solve NERL's chronic loss of income going forward. There exists a traffic risk sharing mechanism that allows for a level of minimum funding paid for by the airlines, that operates on a N+2 basis, where N is any given year. However, it is unlikely that the airlines will be in a position to pay for this, and it will meet significant resistance, given that the airlines will not have used the services of NERL for a significant part of this year. NATS cannot be expected to operate as a commercial entity knowing that it will run at a significant loss for two years with little prospect of recovering those losses.

With the exception of Italy, all other European ANSPs are state entities. They know that they can run a deficit budget with the security of government support. Notwithstanding the government's golden share, NATS does not have this security.

Prospect has sought a commitment from the DfT that the government will be the funder of last resort for NATS – providing cover for the revenue gap it is experiencing so that it can continue to manage UK sovereign airspace and operational air traffic services to airlines and airports. We have pursued this in our regular weekly meetings with officials since mid-March. We have not received the assurance we seek.

Although no-one believes the government would allow airspace simply to close down, the reality is that it would be perfectly rational for the NATS Board to decide to take a commercial decision to wind-up the business – if not immediately, then when the aviation sector's recovery trajectory is better known and before NATS becomes insolvent.

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There are suggestions that the ownership model is an obstacle to NATS securing the support available to other large companies through the CCFF. Even if these obstacles are overcome, the CCFF will not provide a long-term, sustainable solution for NATS, especially if the lost revenues this year are not recovered through the Eurocontrol and traffic risk sharing mechanisms.

The only shareholders NATS can call on are the Airline Group and Heathrow Airport – neither are in a position to prioritise further investment in NATS.

The lack of access to emergency funding and the worsening medium-term revenue position brings into question NATS' ownership model.

NATS is key national infrastructure and direct government support is essential if the aviation industry is to be in a position to recover from the current crisis. If NATS is forced to restructure to survive in the short-term, there is a major risk that it will cut capacity to the extent that it is a hindrance to the recovery of the industry and the wider economy.

NATS' strategic position in the economy – and its safety-critical role – as well as the UK's responsibilities as an ICAO signatory state suggest an alternative ownership and governance model similar to Network Rail. The government could achieve this quickly by purchasing the Airline Group and HAL's shareholdings (perhaps providing them with a welcome cash injection at the same time). The NATS employees' holding should remain.

I hope you will look on this proposal favourably. I should point out that Prospect is not being opportunistic here – we dropped our policy to renationalise NATS some time ago and have actively supported the PPP's development and success over the years. But we see no other way of preventing the collapse of the company.

I look forward to your response.

Yours sincerely

A handwritten signature in black ink that reads "Steve Jary". The signature is written in a cursive style with a horizontal line underneath the name.

Steve Jary
National Secretary
Aviation, Defence & Security



Air Traffic Services in airports through the Covid-19 crisis: proposal for a Capacity Retention Scheme

Submission by Prospect

22 April 2020

www.prospect.org.uk

Towards an Airport Capacity Retention Scheme:

Proposal on emergency funding for the continued provision of Air Traffic Services at UK airports

1. The COVID 19 crisis has resulted in a reduction of air traffic by approximately 90%. This has had a devastating impact on the whole aviation industry, which contributes £22 billion and 230,000 jobs to the UK economy¹. It is the largest aviation network in Europe.
2. Underpinning the whole industry, and fundamental to its operation, are the airports throughout the country which allow aircraft to take off and land and facilitate the movement of passengers and cargo to global markets. Heathrow is one of the world's great 'hub' airports linking UK plc with the rest of the world. Many regional airports provide a lifeline to rural communities and support regional economies.
3. Airports are a key part of UK infrastructure. They should be considered as important as the road, rail and water networks. Although the airports are liberalised and run in a competitive market, in these times of national emergency a strategic UK overview is needed to ensure that these crucial elements of infrastructure survive, to support the reopening of the economy and allow previous levels of connectivity to return.
4. The aviation industry is considerably more than just the airlines, despite them being the focus of attention. If aircraft have nowhere to land, they are superfluous.
5. Airports by their very nature are fixed infrastructure assets which require certain elements to operate, eg fire and rescue services, air traffic control, security, airfield operations etc. They are required irrespective of traffic levels. These services are very difficult to flex with different traffic levels because of their specialist nature and the requirement for them to operate whenever the airport is open, whether there is one aircraft movement or one thousand.
6. But airports operate in a largely unregulated market on a business model which relies heavily on revenues from retail and car parking. Hard data is limited because of commercial confidentiality, but an international study found that 'non-aeronautical' revenues typically account for two-thirds of airports' income - retail (28%), car parking (22%) and property rental (15%)². Many smaller airports have seen landing fees driven down by competition for airline customers to the point that they are a small proportion of income. Only larger airports are able to levy decent charges for aircraft parking. But, whatever the mix, the bulk of airport income is driven by passenger numbers. This model is arguably unsustainable in the longer term as, even with a recovery in aircraft movements post Covid-19, it is highly likely that passenger numbers will be reduced as a result of long-term social distancing.
7. This business model is certainly not sustainable in the short-term. Just like airlines, airport operating companies have suffered a massive drop in income and are experiencing severe cashflow difficulties. This is having a knock-on effect on essential airport services, of which air traffic control is a crucial element. Air traffic control services are either provided for 'in house' as a department of the airport or contracted out by the airport operating company to a third party 'Air Navigation Service Provider (ANSP)'.

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/769696/aviation-2050-print.pdf

² https://aci.aero/Media/40668803-c552-4df1-a6aa-896de03ce933/mZG4Hg/Publications/Preview%20Editions%20and%20TOC/2015%20ACI%20Airport%20Economics%20Report_Preview_FINAL_WEB.pdf

8. As a result of the airports' cashflow problems, air traffic services are coming under significant pressure. But they are a fixed cost providing a specialist role. The costs are fixed insofar as an airport has to have an air traffic service covering all the hours it is 'open' and the core components of the service do not vary significantly with the volume of aircraft movements and certainly not with the number of passengers. For this reason, where the service is contracted-out on commercial terms, the contracts are fixed-price. Airport operating companies are now seeking to reduce their payments for this service. This presents huge risks as air traffic staff would have to be cut. This could hamper continued service provision (for cargo, humanitarian and repatriation flights) and puts at risk the industry's ability to return to previous levels of service. Air Traffic Controllers and ATC Engineers take a long time to train and need to maintain currency at their unit; the supply cannot simply be switched back on again. But it is not clear how a 'recovery' pool of labour will be funded and maintained. It would be a major strategic failure if the industry starts to recover, only to find the airports can no longer provide the capacity due to air traffic services not being able to cope, all because of what is hopefully a short-term cashflow crisis.

9. Much of the public and political attention on aviation during the Covid-19 crisis has been on airlines. Putting aside the rights and wrongs of supporting airline companies *per se*, it will not be enough to expect support for airlines to 'trickle down' through the supply chain. The revenue model is based on movements and passenger numbers, not the availability of infrastructure and capacity.

Proposal

10. In order to ensure continuity of service, provide relief to UK airports with respect to their fixed costs and to ensure that services can be maintained at a level to allow the industry to recover, it is proposed that short term financial assistance for the provision of air traffic services at UK airports is facilitated by the UK Government.

11. This could replicate and follow the principles of the agreed Eurocontrol initiative that has been instigated for the distribution of en-route charges to European ANSPs, including NATS En-route Ltd (NERL).

12. For the financial year 20/21 the UK Government would advance the cost of air traffic service provision at UK airports requiring such assistance, either through the airport itself, or direct to the ANSP.

13. This cost would be the amount required for immediate service provision continuity, together with ongoing costs needed to maintain staff for recovery, minus any furloughing rebates and discounting other costs such as profits, unessential overheads and development costs.

14. If the recovery of the industry is slow or partial, this support should continue to be underwritten by the government pending a better understanding of the likely restructuring of the industry. In the event that there is a full recovery the government would be expected to seek partial or full recovery. The costs could be repaid in a number of different ways over future years to be determined.

15. Mechanisms to repay these costs could include:

- a. the airport repays the costs over a number of years, in line with the trajectory of recovery;
- b. the costs could be recovered from an element of Air Passenger Duty;
- c. the costs could be a surcharge, post Brexit, to UK en-route charges, spread over a number of years.

16. This proposal would ensure adequate funding for the continuation of air traffic services at UK airports throughout this crisis, help protect airports from financial collapse and thus allow the infrastructure to be in place to aid the economic recovery.