

Section 9

CONCLUSIONS

September 2004



CIVIL AVIATION SECURITY FINANCING STUDY	9
Conclusions and recommendations	

9 Conclusions

9.1 Structure of European aviation security

There are two basic models for the provision of aviation related security activities within Europe:

- **Centralised Model** – the main security activities are primarily the responsibility of the State via a government body (CAA, Ministry of Transport, police force, etc). This is broadly the current situation in 11 States (Austria, Finland, Germany, Iceland, Italy, Luxembourg, Norway, Portugal, Spain, Sweden and Switzerland).
- **Decentralised model** – the main security activities are provided by the airport authorities under the supervision of the relevant authority (normally the CAA). These activities could either be provided by the airport directly or outsourced to a third party. This is the current situation in 7 States (Belgium, Denmark, France, Greece, Ireland, Netherlands and the UK).

From the results of the analysis in this study, a number of conclusions can be drawn.

9.2 State and airport revenue versus expenditure

- The States and airports generated an estimated €1.2bn from security taxes and charges across the 18 States in 2002.
- There is a significant difference in the average revenue profile for States and airports under the models, with the centralised model generating 63% more revenue per passenger than the decentralised model (€1.07 to €1.74).
- In the decentralised model, those airports that do not levy specific security related charges drive the majority of this difference. A number of the airports that do not levy charges are subject to economic regulation. As such, the costs of security are factored into their allowable charges and are therefore recovered.
- The States and airports incurred an estimated expenditure of €2.0bn on security related activities across the 18 States in 2002 leading to an operating deficit of €0.8bn.
- The total State and airport costs per passenger under the two models are almost identical with €2.22 per passenger in the centralised model compared with €2.24 under the decentralised model.
- The net State and airport position under the two models reflects the differences in income with the centralised model having a deficit of €318m (-€0.63 per passenger) while the decentralised model has a much larger net deficit of 467m (-€1.23 per passenger).
- When the large regulated airports are excluded from the analysis (on the basis that the regulatory structure allows them to recover their costs), the deficit reduces to around €147m under the decentralised model.
- When the 18 States are combined, the operating deficit for States and airports is €786m. Again, the airports in the decentralised model that do not levy specific charges but are subject to economic regulation (BAA and Copenhagen) drive a significant

proportion of the deficit. When these airports are excluded, the estimated deficit for all of the States and airports reduces to around €397m which equates to a deficit of €0.46 per passenger.

9.3 Competition issues conclusions

- The total revenue generated from State taxes and charges was relatively consistent with total burden on the passenger of under €2.00 in 11 of the 15 States levying security related taxes or airport charges.
- Neither the authorities nor the airports in three States (Denmark, Finland and Norway) were levying any security related taxes or airport charges in 2002.
- By contrast, 4 States (Austria, Italy, Germany and the Netherlands) had estimated passenger burdens ranging from €2.18 to €3.13.
- There was no clear distinction in the levels of revenue generated per passenger under either of the models with 5 of the decentralised model States charging passengers a total of less than €2.00 compared to 6 States in the centralised model. The 4 highest charging States were all in the centralised model.
- Passengers in the 4 highest charging States were paying considerably more in specific security related State taxes and airport charges than passengers in the other States.
- The actual passenger charges related to security may also be contained in general aeronautical charges at a number of airports, including those large regulated airports in Denmark and the UK. This lack of transparent application of security charges distorts the overall understanding of the revenues actually generated to fund security at airports across Europe.
- The expenditure per passenger on security related activities provided by the stakeholders was less than €2.50 in 13 States; another 2 States had expenditure just over €2.50 (France and the Netherlands); a further 2 States (Germany and Switzerland) recorded average expenditure of around €4.00 per passenger; Luxembourg was the outlier with a total expenditure of €8.87.
- Germany, Austria, Italy and the Netherlands had some of the highest levels of expenditure to match the high levels of revenues.
- No clear conclusions can be drawn as to whether either of the models produces lower overall levels of expenditure. In 2002, the full requirements of Regulation (EC) No 2320/2002 had not yet been fully complied with in a number of States.
- What does emerge is that the 4 States with the highest levels of expenditure were all in the centralised model (with average cost above €2.50 per passenger).
- At the operating level, it is clear that the specific State aviation security taxes and airport security charges do not fully meet the costs of aviation security in 14 of the 18 States. Apart from Luxembourg with the largest per passenger operating deficit of €8.62, 4 other States had deficits between €1.01 and €2.36 (Denmark, Greece, Switzerland and the UK).

CIVIL AVIATION SECURITY FINANCING STUDY	9
Conclusions and recommendations	

- A further 9 States had deficits of less than €1.00 per passenger (Belgium, France, Germany, the Netherlands, Norway, Portugal, Finland, Italy and Spain).
- The remaining 4 States posted small operating surpluses in 2002, ranging between €0.04 and €0.12 for Austria, Ireland and Sweden. Iceland posted the largest surplus with €0.59 per passenger.
- Some level of funding from the general taxpayer was found to be required in 6 States with the largest funding from general sources in Luxembourg at €8.62 per passenger. The remaining 5 States (Belgium, Germany, Portugal, the Netherlands and Switzerland) ranged from €0.02 to €0.49 per passenger.
- The balance of funding between the passenger and the general taxpayer in each State is therefore weighted heavily towards funding by the passenger. In 12 of the 13 States with operating deficits (with the exception of Luxembourg), the airports fund the major proportion of the deficit. The issue of how much security related revenue is raised from general aeronautical charges distorts this issue as a number of airports do not levy specific security charges but have raised their general charges in 2003 specifically to meet increased security costs.
- In some States passengers have more of taxes and/or charges burden than in other States and the reported levels of expenditure is more in some States than in others. Some States generate net surpluses and deficits under each of the models but there is no clear evidence that passengers are significantly advantaged or disadvantaged under either of the models or in any of the States.
- When the proportional share of combined 2002 State and airport revenues, expenditure and traffic was compared to see if any relationships existed for the 18 States, there would appear to be good correlation in 9 of the States.
- Exceptions include Germany and France that have revenue and expenditure variations. Germany had 25% of revenue from 15% of the traffic and France generated 19% of total revenue from 13% of total traffic. In terms of State expenditure, Germany accounted for 20% of combined State and airport expenditures from 15% of traffic. The share of expenditure against share of traffic in the France was a much better correlation (16% versus 13% respectively).
- The UK accounts for 20% of total traffic but only reported generating 7% of total security revenues. This reinforces the view that aviation security activities are funded through general aeronautical charges via the regulatory framework price caps at the larger airports. The share of the UK's expenditure correlates closely with traffic share. A similar picture emerged in Denmark.
- Overall there is a good fit between the relative proportions of security revenue generation, expenditure and traffic for the 18 States. Whilst there are variances in revenues and/or expenditure versus traffic share in a number of the 18 States, the overall relationships would appear to suggest that share of total revenues and costs should relate to traffic share for the majority of the States.
- Passenger elasticity of demand would imply that an increase in passenger security costs through additional State taxation and airport charges is likely to have a dampening effect on passenger demand. In 2002, combined State and airport income from passenger related aviation security taxes and charges for the 18 States increased

by an estimated 24% over the previous year to €1.2bn. However, total estimated traffic declined by around 1.6%, which would indicate at a macro level that passenger elasticity of demand would not appear to be overly sensitive to increased security costs.

- Lower traffic in 2002 would have been driven by a number of variables including global economic downturn, threats of terrorism and war in Afghanistan. However, the additional State taxes and airport charges increases may have had a contributory effect on the overall decrease. In the Netherlands, traffic grew 4% year-on-year when there was an 89% increase in State and airport revenues through increased levies on passengers. A contrasting position is evident in Belgium, where traffic declined by 23% when levies increased by 8%.
- It is always very difficult to isolate the impact of one variable where multi-variants combine to produce an outcome. However, given the financial pressures on airlines and airports during 2002, any increases in security costs would have had a negative impact on airport and airline profitability. Further analysis of this aspect is outside the scope of this study.
- From comparing the security taxes and airport related charges versus the average fares for economy and business class travel at a sample of European and long-haul routes, the following conclusions can be drawn:
 - The impact of security taxes and charges on the sample of long-haul routes represents less than 1% of the average economy class fare for 12 of the 13 routes analysed and less than 0.5% of the business class average fare for all routes analysed.
 - For intra-European travel, the combination of security taxes and airport charges represents between 1% and 2% of the average fare.
 - For domestic routes, security levies represent between 3% and 6% of the cost of the sample of routes, which is significantly higher than those averaged by intra-European routes.
 - Due to the nature of the no frills business model (low-fare and short sectors), the proportion of security taxes and charges paid by passengers could be significantly higher than for any of the other route samples analysed. However, this may depend on the originating point of travel (State and/or airport). For example, an easyJet passenger would have been charged 1.2% of the average fare when departing from London-Luton airport, but this could have risen to as much as 13% when departing from Amsterdam Schiphol.
- Although there is no evidence that security taxes and airport charges represent a deterrent to air travel demand, these could represent a significant proportional cost for passengers particularly when travelling on domestic routes and/or no-frills carriers.

9.4 Carrier security revenue versus expenditure

- The security operating results for the carriers in the study were mixed. The respondents represent around 48% of total passengers carried in the 18 States. Whilst many carriers were able to introduce security related surcharges after September 2001, many were not because of competitive pressures. Those carriers able to introduce surcharges generated an estimated €633m in 2002.

CIVIL AVIATION SECURITY FINANCING STUDY	9
Conclusions and recommendations	

- A number of carriers, especially the full service network carriers, generated considerable surcharge revenues in 2002 leading to a security operating surplus of around €62m or €0.30 per passenger for those carriers levying security charges.
- When all responding carriers are included in the analysis, the result is a net deficit of €44m or €0.19 per passenger.
- Responding carriers in 6 of the States reported security operating surpluses whilst those in 6 other States reported operating deficits. Deficits were generally as a result of not levying a security surcharge.
- Information on costs related to cockpit door modifications and increases in insurance premiums drove most of the increased costs for carriers in 2002. When the impact of these items is estimated across the 18 States, the deficit could be as much as €1.0bn in 2002.
- However, the expenditure on cockpit door modification was mostly completed in 2002 according to the carrier responses, and these costs of circa €330m are considered to be non-recurring.
- For a selection of carriers, the reported aviation security operating position was compared with available financial results to examine the relationship between carrier profitability and the levying of surcharges:
 - It would appear that carriers posting operating losses in 2002 were to some extent impacted by their negative position from the financing of additional security costs.
 - On the other hand, it would also appear that those carriers posting operating profits during the same period also recorded a surplus from surcharge revenues financing security related expenditure in 2002.