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AIRLINE COMPETITION

-- Note by Switzerland --

18-19 June 2014

This note is submitted by Switzerland to the Competition Committee FOR DISCUSSION under Item IX of the agenda at its forthcoming meeting to be held on 18-19 June 2014.

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1. Introduction

1. Aviation is an important sector for the Swiss economy. As export-oriented country, tourist destination and headquarter of multinationals and NGOs, Switzerland attaches a great importance to its connections around the world. The three national airports in Zurich, Geneva and Basel-Mulhouse are the backbones of the international connections of the Swiss civil air traffic. In addition Switzerland has 11 regional airports and 16 airfields. Zurich remains the largest airport, as hub of the home based carrier, Swiss International Air Lines Ltd (SWISS). In recent years Geneva Airport has registered a slight increase, which is partly attributable to the growing range of destinations offered by low-cost carriers.

2. As far as national airports are concerned, scheduled and charter traffic accounts for 435,147 movements in 2012.¹ With regional airports and airfields, the number reaches 455,422 movements. Scheduled and charter-flight movements at the three national airports more than doubled between 1970 and 2012. Air traffic accounts for about 45 million of passengers, an increase of more than 28 percent between 2000 and 2012.

3. The challenges of the Swiss aviation are numerous: evolution of the competition between airlines with market entry of new kind of competitors, competition between hubs, national and environmental restrictions are part of the issues that Switzerland faces.

2. Evolution of the Swiss airline sector

2.1 From a national carrier to another

4. The former national carrier of Switzerland, Swissair, was well-known around the world for its safety and quality. Since the foundation of the company in 1931 the Swiss Federal Council was highly involved in the management of Swissair in order to guarantee the best possible connections around the world as part of a political and economic strategy. Accordance of exclusive traffic rights, so called "monopoly of Swissair" and State control on prices were among its prerogatives. These anticompetitive practices gave Swissair generous income by charging consumers and enterprises monopolistic prices.

5. The restructuration of the international aviation market had negative consequences on Swissair. It was not prepared to face the deregulation that took place during the 70's in the US aviation market which impacted Switzerland during the 90's. Furthermore the Swiss people's rejection of the accession to the European Economic Area (EEA) in 1992 implied the suspension of the discussions regarding the bilateral Agreement on civil aviation between Switzerland and Europe. These developments negatively impacted the access of Swissair to the internal market.

6. During the economic recovery of the 90's Swissair set up an expansion strategy ("hunter strategy") by acquiring market shares of other carriers. In 1998 the deregulation of the internal Swiss market took place with the end of the monopoly of Swissair and the Confederation opted out of its support to the national airline.

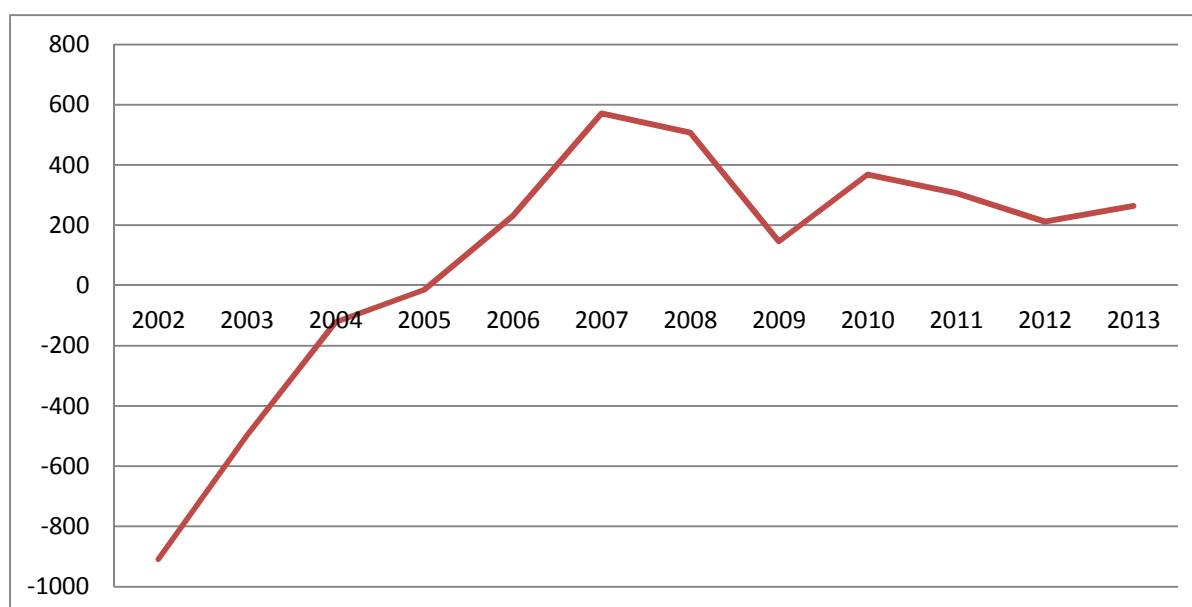
7. The crisis of the Swiss aviation ended with the fall of the Swissair group. The failure of the expansion strategy of Swissair, the end of the protected tariff system and the consequences of the 11th of September 2001 led to the paralysation of the fleet. In March 2002 the airline bankrupted despite the massive intervention of the Federal government.

¹ Federal Statistical Office (FSO) and Federal Office of Civil Aviation (FOCA), 2013, *Mobility and Transport: Swiss civil aviation 2012*.

2.2 From independence to takeover

8. The Swiss government got highly involved in the creation of a new international airline in April 2002 through injection of public funds. It wanted to guarantee worldwide connections to the country. Its participation should be temporary. The beginnings of the new airline were difficult with important operating losses (see Figure 1) and dismissal of employees. In order to ensure its existence SWISS and the Swiss government looked favourably at the offer of Lufthansa to participate in the airline in 2005. The same year and for the first time SWISS did not have to announce new stabilizing measures. In this context, the public opinion, who has kept in mind the bankruptcy of Swissair, saw the takeover like a rescue of the new airline and not like its death.

Figure 1 SWISS operating result (EBIT), mio. CHF



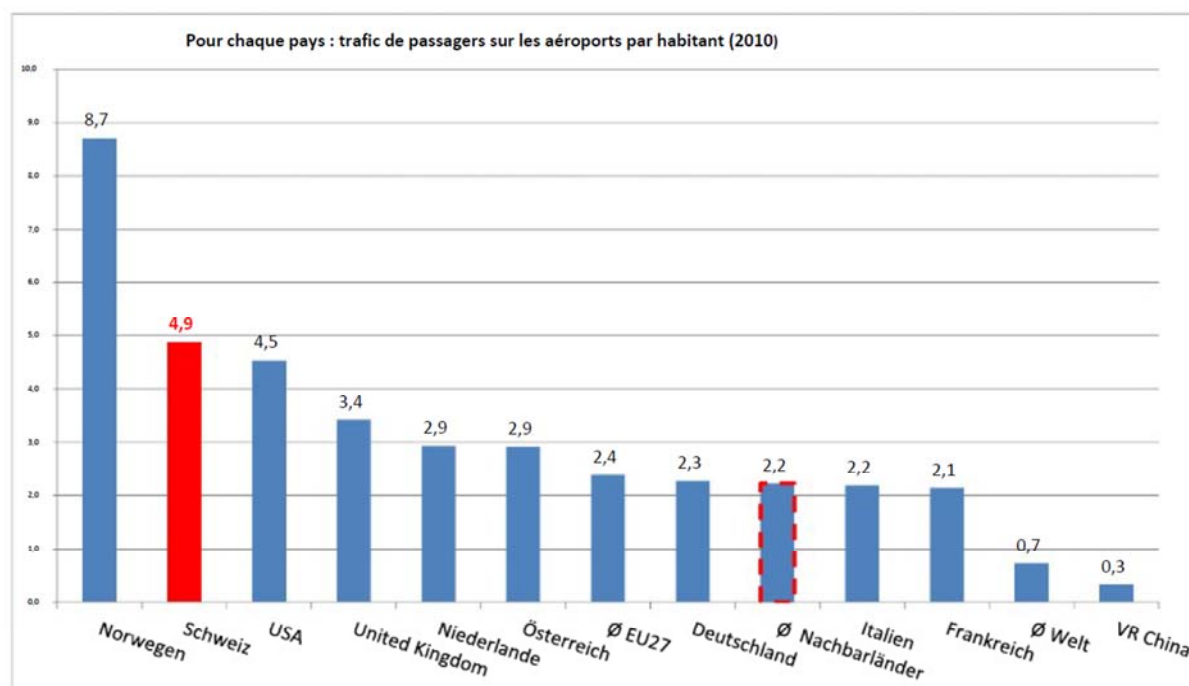
Source: SECO; SWISS, Financial reports.

9. The takeover procedure was analysed by the European Commission (EC) and not by the Swiss Competition Commission. As a matter of fact, according to the bilateral Agreement between the European Community and the Swiss Confederation on Air Transport (ATA), the EC has exceptionally full jurisdiction to assess potential competition concerns in Switzerland. In 2005 the EC received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 by which the undertaking Deutsche Lufthansa took over SWISS. After the positive decision of the EC the takeover was completed in July 2007. SWISS joined the Star Alliance and became a member of Lufthansa's Miles and More frequent flyer program in April 2006. In the Lufthansa group SWISS kept a certain part of independence, with headquarter in Basel and hub in Zurich.

3. Competitive issues

10. The deregulation in 1998 gave opportunity for new carriers to enter the Swiss market. In comparison with other countries Switzerland has a high passenger demand (number of air travels per capita) (see Figure 2). In 2012 Switzerland has 8 carriers with scheduled traffic and 70 other companies with commercial traffic.

Figure 2 Airport passenger traffic per capita, 2010



Source: Intraplan, 2012, *Monitoring de la compétitivité du transport aérien suisse*, p. 6.

3.1 Low-cost carrier EasyJet

11. SWISS does not have a monopoly but still remains the most important company in Switzerland. The second most important carrier after SWISS is the low-cost airline EasyJet Switzerland (EasyJet). In 2012 the scheduled traffic movements in Switzerland is 160,277 for SWISS, 42,488 for EasyJet and 33,825 for Lufthansa.² EasyJet established an important base on the airport of Geneva, the second largest national airport located in the French part of the country. After the decision of Swissair at that time to concentrate its fleet in Zurich, Geneva airport turned toward foreign airlines. The attractiveness of the airport is high for business flights as Geneva accounts for numerous headquarters of multinationals and NGOs.

12. The pressure of EasyJet led SWISS to develop new services but also to stop serving certain unprofitable connections. After SWISS neglected the airport of Geneva for the benefit of Zurich during the 90's, it announced in 2012 extensive changes to its organisational and market-development activities in Geneva.³ With 39.5 percent of market shares, EasyJet benefits from a strong position in Geneva and an important competitor for SWISS (15.3 percent market shares) that wants to reinforce its connections point-to-point in Western Europe, same segment as the low-cost carrier.

3.2 Gulf's carriers

13. Like other airlines in Europe, SWISS faces an increased competitive pressure from Gulf's carriers like Emirates, Etihad and Qatar Airways. This is above all the case for the long-haul routes to Asia, Africa and Australia. After the fears in the context of the takeover to lose the hub of Zurich in favour of German

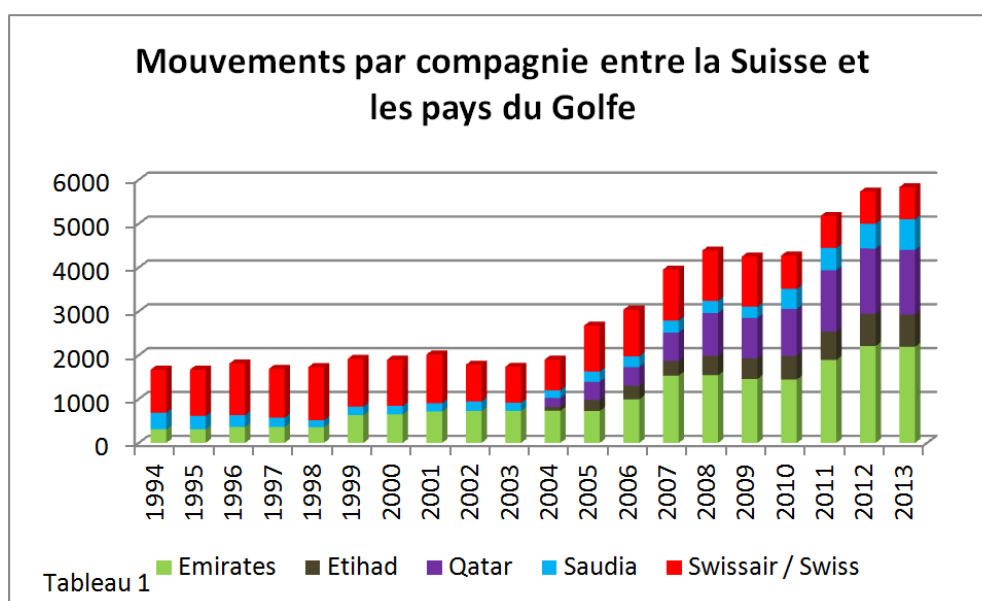
² Federal Statistical Office (FSO) and Federal Office of Civil Aviation (FOCA), 2013, *Mobility and Transport: Swiss civil aviation 2012*.

³ <https://www.swiss.com/corporate/en/media/newsroom/press-releases/pressrelease-20121112>

hubs, SWISS sees its position threatened by the Gulf's carriers that set cheaper offers in order to redirect the passengers to their Gulf's hubs. Unlike SWISS that is worried about the arrival in Zurich of these strong competitors, the airport of Zurich is delighted about it. After Singapore Airlines, Emirates is the second carrier to fly from and to Zurich with an A380 that increases the attractiveness of the airport.

14. From the three national airports SWISS serves 84 destinations in 40 countries. Until 2001 the connections between Switzerland and the Gulf were distributed among SWISS and Saudia/Emirates (see Figure 3). After the bankruptcy of Swissair, new Gulf's airlines appeared and absorbed the increasing demand. SWISS kept one frequency to these destinations. Furthermore Switzerland concluded bilateral agreements with Gulf countries like Qatar and United Arab Emirates.

Figure 3 Movements per airline between Switzerland and the Gulf's countries



Source: FOCA.

15. Among its 28 long-haul routes, SWISS can run 5 of them profitably with local passengers only. The others are dependent of connecting passengers who are more and more absorbed by Gulf's carriers. From a political point of view the lost of the hub of Zurich in favour of the Gulf would have negative impacts for Switzerland even if the effect is difficult to quantify. The attractiveness of the country could suffer. Therefore fears involved by these new competitors are real. Some denounce a case of unfair competition. The Gulf's carriers could benefit from better framework conditions at home and therefore could have interesting offers in terms of prices that European carriers could not follow. It is true that the framework conditions are not the same in Switzerland and in Gulf's countries. However the critics of unfair competition are difficult to prove. Some examples:

- The relating countries have lower labour costs but these are not specific to aviation sector and the working conditions cannot be seen as "unfair competition".
- The fuel price of the airports in these countries is lower than in Europe but stays in the lower middle class. They benefit from lower fuel cost per passenger/km because their carriers have a recent fleet.

- The airport fees are low in international comparison. The aeronautical sector benefit from revenues of commercial activities (single till), which is not the case in Switzerland and Europe.
- The countries do not know any restriction regarding environment and opening hours and some do not have any income tax.

16. Therefore in general the carriers benefit from framework conditions that foster their developments compared with European conditions. However the situation of competition has to be put in perspective. The volume of passengers of the Gulf's carriers in Zurich represents 3 percent of the total volume. The competition of European carriers is certainly a more important challenge for SWISS.

3.3 Importance of the infrastructure

17. Discussion to reinforce the attractiveness of Switzerland is on the table. Some ask for better conditions in the airport of Zurich because it has many restrictions that do not exist elsewhere (lack of capacities, slot scarcity as barrier to entry, operating hours with night rest between 23 and 6 o'clock, expensive fees). As illustration, last December SWISS and other users of the airport of Zurich appealed against the FOCA's approbation of the aeronautical fees of the airport. But Zurich is representative of the situation in Switzerland. In this field the conditions in Geneva and Basel are more competitive in comparison with the European airports even if both also have low reserve capacities. Another proposal suggests that the State finances the safety and security costs (fire) that are now paid by the users of air transport.

4. Conclusion

18. After an important government's intervention in Swissair and then SWISS, Switzerland faces now a period of strong competition all over the world. From a political and economic point of view, a strong position in air traffic is important for Switzerland. The competition between airlines has positive impacts on consumers through lower prices, wider supply, and new destinations. These offers also strengthen the site of Switzerland as important provider of services whether through SWISS or another airline.

19. The challenges of the Swiss aviation do not restrict themselves to the competition of Gulf's carriers. Polluting and noise emissions are important topics and impose constraints to air traffic. The lack of capacities in Swiss airports is also an issue that discriminate economic development of air transport. The higher costs for firms in Switzerland have to be compensated through innovative services and higher productivity. The Swiss aviation sector has to adapt its model to the new competitive situation and improve the quality of its offer, often underlined as example.⁴ The competitiveness of Swiss airlines is high, with high level of productivity and strong profitability in comparison with foreign competitors. The dream of an independent national airline is out of time. Since the Swiss Government has decided not to hold any longer any participation in its airlines, Switzerland lost a large part of political and economic control on the Swiss aviation. However it has the role to develop framework conditions in order to foster investments, innovation and new services.

⁴ Intraplan, 2012, *Monitoring de la compétitivité du transport aérien suisse*.

Digression

The Swiss Competition Commission (COMCO) recently finished an inquiry regarding a horizontal cartel on prices in the air freight sector. During the period 2000 to 2005 several carriers agreed on certain elements of prices in the air freight transport. The COMCO pronounced sanctions against 11 carriers for a total amount of about 11 million CHF.⁵ The inquiry was characterized by a high degree of complexity because of the existence of numerous bilateral agreements in air transport with third States. The one concluded with the EU is of particular importance. The COMCO had to apply the Cartel Act but also the European competition rules as they are part of the agreement. The European Commission and the US Department of Justice also opened inquiries and sanctioned the behaviour of several carriers.

The decision of the COMCO has been appealed and is pending at the Swiss Federal Administrative Court. The conclusions of the enquiry are not published yet.

⁵ Korean Air Lines Co. Ltd., Atlas Air Worldwide Holdings, Inc. (Polar Air Cargo Worldwide, Inc.), AMR Corporation (American Airlines), United Continental Holdings, Inc., SAS AB (Scandinavian Airlines), Japan Airlines Co., Ltd., Singapore Airlines Limited, Cathay Pacific Airways Limited, Cargolux Airlines International S. A., British Airways Plc. et Air France-KLM SA.