Introduction

Cornwall Airport Limited (CAL) is the operating company for Newquay Cornwall Airport (NQY); it is a wholly owned subsidiary of Cornwall Council (CC), which is also the owner of the Airport.

This response from CAL/CC to the European Commission’s (hereinafter called the “Commission”) consultation of proposed changes to the draft ‘EU Guidelines on State Aid to Airports and Airlines’ published on 3 July 2013, adopts a generic approach to addressing our concerns about the principal proposals contained within the document, but in doing so seeks to illustrate these by reference to the implications they may have for NQY and where appropriate other peer regional airports in the UK and Ireland.

Put simply the proposed regulations will either force the closure of NQY or severely restrict its growth towards sustainable operations, contrary to the intention of the Commission’s proposals to make all airports commercially sustainable.

Whilst CAL/CC support the need for the Commission to review the State Aid Guidelines from 2005, as it made a commitment to do at the time, our overriding impression is that the Commission have taken no account of the change in economic climate and passenger volumes since the earlier guidelines were published, nor the many other significant pressures that small and medium-sized regional airports have developed since that time.

These include:
- Consolidation within the airline sector,
- Additional safety and security related operating costs, and
- The difficulty of securing access to investment capital, as both public authorities and private investors seek to reduce borrowing and exposure to risk.

The Guidelines seem narrow in their perspective, at the heart of which are legal precepts and economic theory that do not acknowledge or recognise the challenges facing these airports and the potential impact of the Commission’s revised interpretation of Treaty provisions and intentions. Perhaps the best evidence for this is that the Commission has not updated the work undertaken by Cranfield University et al in 2002\(^1\), which it sponsored, to establish whether the findings of the report remained valid or whether conditions had changed (for the better or worse) for regional airports in the intervening decade. The Cranfield analysis provided in-depth objective conclusions that many in the industry recognised, even though there were aspects that could have been investigated more thoroughly.

It is our view that the consideration of updating the evidence base should have been undertaken in advance of the publication of the Guidelines which would have given the guidance a much greater legitimacy on which it has based its proposals.

It could be interpreted from the Guidelines that the Commission has a pre-determined path that it intends to follow in eliminating Aid given to Airports which is highly likely if implemented to lead to the closure of a significant number of small regional airports. It is hoped that the Commission will listen to airports responses and their local and regional stakeholders in securing a fully functional single market by allowing remote and peripheral regions air access.

\(^1\) Cranfield University (2002): Study on Competition Between Airports and the Application of State Aid Rules; for EU
There are also contradictory messages from within different parts of the Commission. Measures exist to boost economic activity in the EU (Cornwall has been given a further Convergence programme 2014-2020 which recognises the Cornwall GDP/head is less 75% of the EU average) whilst others seem to seek to undermine the ability of remote and peripheral regions with small airports to compete in a European and wider global context. Measures are now proposed, which will restrict regional connectivity and airports ability to participate in crucial trading markets, we regard the measures the Commission are now putting forward as ill-timed and inconsistent. At worst they are fundamentally flawed, do not recognise specific characteristics of individual airports and serve only to shift the balance away from a competitively functioning internal market towards one which heavily favours larger airports and will fundamentally damage regional and peripheral interests.

The draft guidelines are much stricter than the current 2005 guidelines in several respects, and therefore alter this balance and we feel intervenes too strongly. The stricter approach to state aid contained in the new Guidelines does not allow sufficient flexibility for remote regions to address clear market failure. This diminishes the freedom of local and regional authorities to financially support airports and airlines to provide essential connectivity required to address geography, topography, population density and economic inequity.

In particular the provisions that affect NQY are:

- An airport which passes a 200,000 per annum passenger ceiling will no longer be eligible for operational aid;
- The levels of aid intensity allowed for capital investment associated with development projects; and
- Start-up aid is even more limited than hitherto,

These will all serve to ensure that small regional airports face an even greater task to reach long-term commercial sustainability and CAL/CC and its partners cannot support them. By its own acknowledgement the Commission recognise that airports that have a passenger throughput below 1 million passengers per annum will struggle to cover their operating costs\(^2\). How did it then come to the conclusion that airports with just over 200,000 passengers should be expected to?

We therefore urge the commission to review and change these parameters to ensure ongoing vital operations at airports like NQY.

The remainder of this response reflects upon these core issues in greater detail, in the context of background information on NQY in the sections which follow and accompanying appendices, but also with cross reference to the position faced by peer airports of NQY in the UK and Ireland where appropriate and illuminating.

\(^2\) Paragraph 5, Page 4: Draft EU Guidelines on State Aid to Airports & Airlines (July 2013)
Newquay Cornwall Airport – Current Position and Future Prospects

The number of passengers passing through NQY has fallen from just over 400,000 in 2008/09, shortly after CC took over the ownership and control of the airfield from the UK Ministry of Defence, to 170,000 last year. This has primarily been associated with:

- The failure of Air Southwest, which ceased trading in September 2011, at which time it, represented 61% of NQY’s route network and 45% of its passengers.
- The withdrawal of high volume (passenger) services operated by Ryanair as a consequence of rising Air Passenger Duty (APD) in the UK, which heavily penalises domestic travel,
- And to a lesser extent the failure of BMI Baby in September 2012 - when this airline also ceased trading further exacerbated the reduction in passenger numbers at NQY.

Despite this period of falling passenger numbers CAL has been able to reduce the operating subsidy it receives from CC to operate the airport from the high point of £3.3m in 2010-11 to closer to £3.0m last year, through a combination of cost controls and the creation of new income streams generated by diversification of business activities on the Airport. A further downward trend of the required PSOA funding was forecast for future years but the recent announcement from Flybe, NQY’s largest operator that it has sold its landing slots at London Gatwick (LGW), these were sold as a consequence of the pricing policy employed at LGW and crippling rises in UK APD taxes. This will add significant financial pressures on CAL/CC as the LGW service was its principal source of aeronautical revenue that will now be significantly reduced as a consequence of a new market entrant on the London service and the ‘incentives’ required to ensure a service to London is maintained.

Forecast Passenger Volumes

The Airport has recently commissioned RDC Aviation to produce a passenger forecasts for the Airport to 2030. The Airport Master Plan is reaching its five-year review cycle so the passenger forecast is an essential component of that review.

The forecast has been developed using a combination of short-term assumptions from discussions with airlines, current market trends, and in the long-term a projection of demand in the South West based on GDP and population growth. RDC do not foresee passenger volumes exceeding 500,000 per year by 2030 in their central case; their most optimistic passenger forecast projects 600,000 passengers by 2030. Consequently, even with a favourable economic outlook the Airport will still be some way from the ‘magic’ figure of 1mppa at which operating revenues should cover operating costs within 10-year transition period the Commission has proposed.

The composition of route demand at NQY shows that 155,000 passengers are currently flying on three routes that are critical to economic-socio fabric of the economy in Cornwall and the Isles of Scilly:

- 97,000 passengers between London and NQY;
- 24,000 between NQY and the Isles of Scilly and
- A further 35,000 passengers are flying between NQY and Manchester, which is also an important business/leisure route.

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3 RDC Aviation: Newquay Cornwall Airport Market Assessment & Forecasts. May 2013
Taken together these three core routes equate to over 75% of the Commission’s proposed threshold under which operational aid would remain allowable. Changes to London services consequent upon the sale of Flybe’s slot portfolio to LGW and its potential replacement with a leisure service from LGW and a premium business route to another London Airport could result in passenger numbers from NQY to London growing to circa 145,000⁴, which would take NQY over the threshold. If the 200,000 ceiling remains, NQY would have no choice but to restrict growth to below the threshold and discourage airlines from operating more services to the Airport or close because CC could no longer support its loss-making operation.

Essentially, therefore, the Commission’s measures in themselves a market intervention, that could if the “restricted growth” option is taken by NQY introduces further market failure, because there would be no possibility of reaching commercial sustainability.

**Economic Impact of the Airport on Cornwall**

It is a well established fact, that the aviation Industry plays a significant role in the economic well being of countries across Europe and makes a substantial contribution to regional economies, both through local direct, indirect and induced effects but also through wider catalytic effects associated with the improved connectivity that air services provide. There is a growing literature in relation to the latter that as highlighted in Appendix B.

The publication of the Oxera report⁵ commissioned by the Airport Operators Association (AOA), demonstrates the importance of aviation to the UK economy; it is one of the UK’s leading industries, supporting over 230,000 jobs and contributing £18 billion to the economy. The South West of England, hosts the largest aerospace cluster in the European Union, which in overall gross terms supports 59,000 FTE jobs and has a value of £3.2bn. It also prides itself as the home to 14 of the 15 largest aerospace companies in the world⁶

At a local level, the economic and socio benefits that the Airport brings to the economy of Cornwall (and the Isles of Scilly) are significant.

A report by Capita Consulting completed in September 2011⁷ found that the Airport:

- Supports 370 FTE jobs in Cornwall of which 290 were directly related to the Airport and generates £20m in GVA.
- Within the wider region the equivalent figures are 430 FTE jobs and £23m in GVA.
- Over 80,000 trips were made to/from the Airport for leisure purposes (i.e. tourism in Cornwall) generating £27m of directly related expenditure in the Cornish economy, which in turn supports 880 direct jobs and £17.3m of GVA.
- Increase GDP to the tune of £5.9m increase as a result of the efficiencies the airport facilitates as a result of the easier access to customers and suppliers it provides for Cornish based companies.

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⁴ Cornwall Airport Limited: London Capacity Analysis.
⁵ Oxera Report; ‘What is the Contribution of Aviation to the UK Economy’ November 2009
⁷ Capita Consulting: Economic Impact Assessment - September 2011
Aviation’s ability to connect markets is essential for all kinds of businesses, from SMEs through to multinational companies, allowing them to maximise the productivity of their work force by reducing travel times. A study by the Universities of the West of England and Bath, estimates that every additional 100 minutes of travel time reduces productivity by 6%; peripheral areas such as Cornwall and the Isles of Scilly, the impacts on productivity will be far more negative than cities and regions located closer to London and the European Heartland. The only realistic way over coming this fundamental geographical constraint and this is why air connectivity is so economically valuable to these regions and any policy that constrains it so damaging.

On a smaller scale, but of even greater significance in terms of economic and social integration is the important role NQY provides as a base for a vital life line connection to the Isles of Scilly (IoS). During winter 2012/13 the only other point of air access/egress to the IoS was via Lands End Airport (LEQ), which was closed for 3 months due to water-logging. Throughout this period, NQY provided the only way of travelling to and from the islands as there is no boat service which operates between November - March. Without NQY the Islands would have been cut off from commercial travel creating a major break down in the socio-economic needs of its community.

There is clear evidence from passenger and business surveys that businesses in Cornwall value the Airport highly. It’s connectivity is important to a large number whose decision to base themselves in Cornwall is in part due to the fact that there is an airport which will serve their longer distance connectivity needs. A number of businesses have indicated that if there were not an operational airport providing passenger connectivity they may well have to relocate out of Cornwall and others have indicated they would have to reflect carefully on plans to expand or reinvest in Cornwall.

Whilst it is difficult to quantify the potential effect of the closure of the Airport on inward investment, there is no doubt it would have significant adverse effect on the ability of the area to attract new investment. As one consultee stated:

“It would send a message which says that Cornwall is closed for business”.

We do not think that NQY is unique amongst small regional airports in providing a crucial under-pinning to the ability of serving remote and peripheral areas to remain connected and participate in national, European and the wider global economies. Cornwall shares much in common geographically and demographically with Northern Ireland (City of Derry Airport) the West of Ireland (Donegal, Sligo, Shannon, Kerry and Knock airports), the Highlands and Islands of Scotland and many parts of Scandinavia and the Baltic region. In other words, the problems the Commission’s proposals create for Cornwall are likely to be replicated in many other parts of Europe. It would be more appropriate if the core terms of the Guidelines on airport thresholds and start-up aids were to be amended to allow greater flexibility for funding small airports across the EU.

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8 UWE/University of Bath report ‘Meeting the Productivity Challenge’, 2006
9 Capita Consulting: Economic Impact Assessment - September 2011, Page 70.
Airport Costs and Revenues

Costs

Airports suffer from very high fixed costs, which are primarily determined by the regulatory authorities oversee aviation operations and aviation security - true variable cost represents a much smaller proportion of the overall cost of running the Airport.

The Civil Aviation Authority (CAA) has estimated that 82.5% of airports costs are ‘fixed’ - apart from capital costs the biggest component is regulatory compliance related\textsuperscript{10}.

By way of illustration NQY supports a full service Air Traffic Management System (this is required by its operating License) and Category 6 fire cover. The cost of these two functions represents 31% of the Airport’s total operating budget and are required irrespective of whether 200,000 passengers or 2,000,000 passengers pass through NQY – in other words they are independent of traffic volumes. Large airports have the ability to spread these fixed costs over a much greater number of passengers than NQY is able to, which means its cost per passenger ratio is inevitably higher.

Even after every effort has been made to reduce costs and improve efficiency as far as possible, there is a fixed point after which costs cannot be cut any further without impacting on fundamental safety and security requirements or wider operational integrity. This is certainly true of NQY. As passengers have declined since 2008 he Airport has taken a significant number of steps to reduce its operating cost base to the lowest level possible whilst concurrently diversifying its revenue generating activities. Between 2010-11 and 2012-13 the annual cost of operating the Airport has been reduced by 11.1%, which equates to £0.7m in nominal terms or £1.1m per annum (14.3%) if the GDP Deflator\textsuperscript{11}, is taken into account (see Figure 1).

Figure 1: Operating Costs

\textsuperscript{10} Graham Newton [2013]: Airport Profitability, Airport World (volume 8, Issue).

\textsuperscript{11} GDP Deflator (Implicit Price Index) data taken from \url{www.tradingeconomics.com} - ONS Sourced
With fixed costs essentially inviolable, over 85% of the cost reductions have come from staffing reductions that make up 60% of NQY’s operating costs, with the result that NQY now has costs that are lower than many peer airports in the UK (e.g. Durham Tees Valley, Blackpool & Humberside)\(^{12}\).

As illustrated above the Airport has made some significant steps in reducing its cost base but what is apparent is that whilst costs are fixed, the business is suffering from low levels of income following the reduction in passenger numbers and a lack of alternative revenue streams.

**Revenue**

With operational efficiencies having been delivered, the fundamental problem now faced by NQY is lower income levels as passenger numbers decline and the need to find alternative sources of revenue that are not dependent on the vagaries of the passenger market, which at small airports can be subject to major shocks not in the control of the operating company. It was in recognition of this, that a decision was made in 2010 to proactively develop non-aeronautical revenues from property and other ancillary channels to supplement, but not replace, those from passenger services. Between 2010-11 and 2012-13 the latter declined 26%, while property revenue increased by 31% as properties acquired from the RAF at the time of Transition were re-furbished (made possible by assistance from Convergence ERDF Funding) and let and aeronautical charges, principally from non-passenger flights, increased by 12% as a result of activities directly related with companies based at the airport in those now newly refurbished hangars (e.g. AgustaWestland).

Even so, the financial gap remains wide, and will not be filled for the foreseeable future.

**Spin-Off Activity from the Aerohub Enterprise Zone @ Newquay Cornwall Airport.**

In 2011 NQY was granted Enterprise Zone (EZ) status following a successful application to the UK Government on the grounds that it has the potential to be a truly transformational opportunity for the Cornish economy because of the unique characteristics of the site. The resultant development project (the Aerohub @ Newquay Cornwall Airport), is the UK’s only aerospace focused Enterprise Zone on an operational civilian airport; it is one of the largest development opportunities in the West of England with an unparalleled aviation environment and an attractive package of financial incentives. It is anticipated Aerohub will be a catalyst for new jobs and private sector investment underpinned by the development of an aerospace learning centre/academy which will develop, enhance and adapt local skills in particular engineering.

The EZ has started off in positively and has already created 175 new jobs on the Airport with employment forecast to grow to over 400 by 2015. Several new occupiers have arrived since the EZ was created:

2. Gateguards – (aerospace and advanced Engineering – 6 new jobs (14 existing).)
3. Ainscough Wind Energy (renewable energy manufacturer, 20 new jobs (60 current employees).
5. Bloodhound SSC (automotive/engineering, 6 new jobs).

\(^{12}\) CRI Statistics 2011

Future Plans include two new hangars that once completed and occupied will provide over 150 aerospace jobs at average salaries around twice the Cornwall average, a third hangar for future and a new hotel operator. The overall target is to deliver 38,725sqm of floor space, providing 437 safeguarded and new jobs by 2015. None of this would be possible without the support of external funding and the commitment of CC as owner, because CAL would not be able to borrow money to finance the development as a company it is dependent on deficit funding to avoid running at a substantial loss. But equally, without the operational airport to provide the platform, it is highly unlikely the investment (and their associated wider economic benefits) would have been attracted to Cornwall.

Other small airports in the UK are also attempting the same diversification based on the space and uncongested airspace they can offer compared with larger airports. It would be unfortunate if the Guidelines were to run counter to the future delivery of projects that have been so strongly supported by the EU ERDF Convergence Programme.

NQY was recognised in the Convergence Programme as a transformational infrastructure project for Cornwall, and as we have described above and in Appendix A it has been fulfilling this role well. We are concerned; however, that another part of the Commission is now inadvertently may undermine all that hard work.

Political Support

The UK National Government and the Commission has recognised the importance of NQY by the award of the Enterprise Zone status, and the recognition in both of the last two Structural Fund Programmes, that the Airport represents a transformational project for Cornwall. The substantive economic benefits to Cornwall that investment of public resources in NQY and the air connections and specialist infrastructure it provides, offers significant economic potential for a Cornwall that is still struggling to rise above 75% of the average GDP threshold in Europe.

Cornwall Council and the LEP have committed to on-going support for the Airport; recent surveys indicate that 80% of local residents in Cornwall agree with this approach and assign the airport the highest priority in terms of infrastructure spend. This lends significant political legitimacy to continuing public sector financial support for the airport, a pattern we are aware is replicated for most small regional airports in the UK. The Airport’s partners recognise that developing the facility to a point where it is commercially self-sustaining is a long-term project, one which is likely to last well beyond the seven year period allowed for in the draft Guidelines. This is reflected in the fact EZs have a 25-year life. The transitional proposals made by the Commission, therefore seem wholly unrealistic and need to be reviewed. If investment that has been made in regional airports to date it can’t simply be wasted. Airports serving peripheral areas of the EU such as Cornwall should not be closed primarily as a consequence of the Commission’s actions with regard to these Guidelines.

Comments on Proposals Covering Specific Types of Aid

Operating Aid to Airports

The threshold of passenger numbers greater than 200,000 above which operating aid will not be permitted following the transition period (where the amount of aid decreases by ten percentage points per annum) does not seem to be based on evidence – indeed it seems to run contrary to the findings of the Cranfield Study analysis, which even though dated are referenced extensively in the draft document. The perception which we have, as do other small regional airports in the UK, is that it is a relatively arbitrary number selected by the
Commission in the face of significant pressure from the large airports who responded to the 2011 consultation on the operation of the old guidelines. In doing so, it has ignored the very obvious self-interest that larger airports have in eroding the competition it faces from competing smaller airports in their extended catchment areas, even where this is deleterious to the interests of passengers or the economy of the wider region. In Newquay’s case many passengers from Cornwall are forced to travel over three hours to Bristol or London to catch flights, which with the right support could be provided from NQY.

It is also worth noting, that there are a number of Airports in the UK that are owned by private sector companies who operate at a loss without public subsidy whose passenger numbers are far in excess of the threshold. Robin Hood Airport Doncaster Sheffield in 2011 had an annual passenger throughput of over 800,000 but lost posted an operating loss in excess of £3m\(^{13}\). It has been supported financially by land sales (which for some airports are not possible or appropriate), and by a parent company that is willing to take a very long-term approach to realising a return on its investment. This is very unusual.

The 200,000 passenger threshold therefore needs to be raised to a level, which can support passenger growth, thus economic prosperity to a region. We propose that the threshold is raised to 700,000 passengers per annum and the transition period is expanded substantially – to 2025 or even 2030. Moreover, those airports that then remain unprofitable after the transition period has expired should then be invited to work with the Commission to achieve a pragmatic way forward.

In short, the application of the new guidelines should not force the closure of any airports in the future that would otherwise be able to operate. They are too important economically for that.

**Start Up Aid to Airlines**

We note the proposed regime to govern start-up aid to airlines:

- Only for airports with less than 3 mppa
- Aid limited to only the first 24 months of the route’s operation
- Aid intensity limited to only 50% of the start-up costs.

As with the other forms of aid, we believe that the proposals for start-up aid are unlikely to be sufficiently flexible to allow publicly owned airports like NQY to develop its route network to ensure the best possible connectivity and economic benefit for the region. We are not clear what was wrong with the start-up aid rules in the 2005 Guidelines and wonder why the Commission could not allow on or other set of rules to be applied on each route, but not both, to maximise flexibility to meet different carriers and service needs?

RDC Aviation, as specialist consultancy in the field, is employed by the Airport to support analysis of its route development strategy. A recent project which has been undertaken in analysing an Airlines costs which would be associated with a proposed new route which potentially would bring up to 70,000 new passengers clearly demonstrates that the airine would not recover the costs it incurs on the route start up until the forth year of operation. So in this case we would want wish to operate under the old rules rather than the new ones that would undermine the business case for this route. Why can’t the guidelines provide more flexibility, while not allowing the aid intensity to exceed 50% of the start-up costs.

One other small point you would draw to your attention is that it is not totally clear whether there will be a ban on start-up aid after 10 years following entry into force of the guidelines.

\(^{13}\) CRI Statistics 2011
Figure 2 annex II suggests this is the case, but it is not supported by the relevant point in the text of the draft guidelines.

**Investment Aid to Airports**

We note that the Commission has defined specific maximum investment aid intensities according to the size of the airport, as measured by the number of passengers per annum (ppa). In NQY case the Airport would fall in the less than 1mppa bracket.

We have discussed previously in this response the need for a greater role for democratically elected politicians, responsible to the electorate, who are in the best and most legitimate position to decide on the benefits an airport brings to their local areas and regions.

NQY therefore proposes the alternative aid intensities below. Such intensities still limit aid to ensure compatibility with the Treaty (Art.107.3c TFEU) but are more realistic in terms of allowing public support, particularly as regards the infrastructure costs of smaller airports - NQY.

<table>
<thead>
<tr>
<th>Size of Airport</th>
<th>Max. Investment aid Intensity</th>
<th>Max. Investment Aid Intensity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avg. passengers per annum</td>
<td><strong>Commission proposal</strong></td>
<td><strong>NQY proposal</strong></td>
</tr>
<tr>
<td>&lt;1 million</td>
<td>Up to 75%</td>
<td>Up to 90%</td>
</tr>
</tbody>
</table>

In order for the EZ to succeed at NQY further investment into infrastructure is going to be required in order to facilitate economic growth. Realistically in the short to medium term there is going to be no private sector support so financial backing will have to be sought from the public purse.

**Conclusions**

We believe that it is highly likely that if the Guidelines are published in their current form there will be a large number of airports, supported by their public owners or local/regional development agencies (including NQY) that will be seeking to make applications that aid is justifiable on Services of General Economic Interest (SGEI) grounds. There is no evidence that the Commission have taken into account this possibility and the workload and resource implications associated in turning around the resultant case load expeditiously. This in turn will potentially result in many airports being unable to attract investment to respond to opportunities that could improve their long-term commercial prospects, and create significant uncertainty in an industry that has the potential to be a major facilitator of economic recovery across the European Union.

In our response we have sought to provide clear evidence of the substantial beneficial impact that Newquay Cornwall Airport has on the economy Cornwall, as many other small regional airports have on their local and regional catchment areas. Without the facility to secure access to carefully targeted aid in the future, the opportunity costs arising from the failure to maintain beneficial investment will certainly have a significant detrimental impact on the these economies.
We also believe that it is extremely unlikely that many regional airports of NQY size (i.e. less than 1mppa), will be able to become profitable within the transition window defined by the draft Guidelines. Even after recent positive steps such as those CAL has undertaken to reduce operating costs and increasing revenues have been implemented sustainability is some way off. There are a large number of fixed costs that simply cannot be reduced. Restructuring the balance of revenues from reliance on solely passenger based income, requires a much longer period than seven years before a material impact will be felt on airport budgets. In the current difficult economic circumstances that challenge will be even greater. We would therefore urge the Commission to review their proposals in this regard and as a minimum allow up to 2025, or certainly a minimum of ten years for airports of less than 1mppa to reach operational breakeven.

Where geography, population density and levels of economic activity mean this is simply not sustainable, and there is:

(a) no alternative airport available within 90 minutes drive time – Exeter is that time from NQY and 3 hours imposes far too a level of inconvenience and user costs on economically marginal communities in remote and peripheral areas, or
(b) where air links remain essential for the economic and social integrity of those communities (as in the Isles of Scilly, the Highlands and Islands of Scotland and the West Coast of Ireland),

then greater latitude in terms of thresholds for on-going subsidy should be allowed (our recommendation would be 700,000 passengers), or the Commission should explicitly recognise that many such airports will seek to justify aid on SGEI grounds and that this is likely to remain a feature of their financing in perpetuity.

In terms of start-up aid for airlines, this remains an essential part of the risk sharing that smaller regional airports need to engage in to attract (and in some cases retain or replace existing services) as well as attract new ones. The ability to do so will be a fundamental component of their strategy for achieving long term commercial sustainability, and their ability to persuade airlines to consider starting routes to what are inherently perceived as less proven and therefore higher risk markets. The rational for the Commission’s changes to the rules on the length and intensity of start-up aid is not clear – it has presented no supporting evidence; we see no reason why it could not leave open the option to comply either with the 2005 guidelines in this area where these better suit the negotiations between airline and airport, or, where shorter but more intensive support is needed, allow the current proposals to be adopted. This would not add greatly to the complexity of implementation but would provide useful flexibility to the relevant parties. It would be a good example of where the Commission could explicitly demonstrate it has listened and is not tied to ‘a one size fits all approach’ which is the regional sector of the industry’s greatest concern.

In conclusion, we would like to emphasise to the Commission that the proposed changes to State Aid guidelines for airports and airlines set out in its draft document for consultation will have a significant negative impact on the financial viability of smaller regional airports such as NQY. This would be severely detrimental to the socio-economic fabric of a peripheral region like Cornwall, and would run contrary to the Commission’s underlying intent with regard to State Aid. It is not clear, what agenda the Commission seems willing to champion. It seems that there are too many small regional airports in Europe and the aim is that a significant number will need to close. This closure policy certainly runs contrary to the recognition in the EU transport White Paper that major airports are facing capacity problems (closing small airports will simply exacerbate this or require additional runways to be built, so that air passengers from the regions can make long surface journeys to larger airports frequently 2-3 hours or more away while existing infrastructure is under-utilised.
Economically the logic is questionable; it is environmentally clearly sub-optimal; socially divisive because it puts remote and peripheral regions at a significant disadvantage in terms of access and connectivity; it reduces passenger choice; and ironically it both undermines competition and works against the core treaty objectives of securing better integration the single market.

The only explanation put forward by the Commission appears to be a concern about competition between airports. The reality is, competition in the aviation industry is primarily focused at an airline level, or between major hubs or airport systems. The idea that individually, or even collectively, small airports of less than 1mppa, if in receipt of modest sums of state aid, will have a material influence on the functioning on those critical competitive markets is purely theoretical rather than having any sound evidence to support it.

As such the Guidelines have become a “hammer to crack a nut”, and need to be re-thought, with the emphasis being on encouraging the development of small regional airports and air connectivity in a way focussed at driving towards sustainability.

We hope, therefore, the Commission will reflect carefully on the evidence we have put forward, will undertake a rapid updating of the Cranfield University study on regional airports, and with that reassurance recognise the balance and pragmatism contained within the proposed amendments we have advocated above.
Appendix A: Background Information on Cornwall

Newquay Cornwall Airport (NQY) serves one of the most peripheral areas of the United Kingdom and is a critical component of the inter-regional transport infrastructure serving the economy of Cornwall. The region suffers from poor road and rail access, which means that journey times to London and most other large UK cities take 5 hours or longer by surface modes, make it very difficult to spend any material time conducting business activity in these key economic centres and return home the same day. There are no high speed rail connections, nor are their likely to be in the foreseeable future.

The population of the County is 532,500\(^\text{14}\), although the Airport’s 1 hr catchment area reaches the outskirts of Plymouth boosting the total potential catchment population closer to 750-800,000. And although Cornwall’s population is expected to grow to 633,200 by 2030\(^\text{15}\) with a propensity to fly currently less than one, even if this was to double or triple in the next 20 years it will still be difficult for NQY to achieve passenger throughputs anywhere near close to 1mppa at which Cranfield University airports are likely to generate sufficient revenues to cover their costs.

NQY currently runs at a financial loss. Deficit funding for the Airport is provided via a Public Service Obligation Agreement (PSOA) from CC to CAL. At the end of the 2012-13 financial year this amounted to £3.071m based on 173,000 passengers. During this financial year (2013/14) 185,000 passengers used the Airport.

Core employment on the site is as follows:

<table>
<thead>
<tr>
<th>Employer</th>
<th>Current as at July 2013(^\text{16})</th>
</tr>
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<tbody>
<tr>
<td>CAL</td>
<td>160</td>
</tr>
<tr>
<td>BIH</td>
<td>25</td>
</tr>
<tr>
<td>AW</td>
<td>40</td>
</tr>
<tr>
<td>Sky bus</td>
<td>14</td>
</tr>
<tr>
<td>CAAT</td>
<td>15</td>
</tr>
<tr>
<td>Others</td>
<td>20 (175 new jobs - see below)</td>
</tr>
<tr>
<td>Total Direct</td>
<td>274</td>
</tr>
</tbody>
</table>

Significant investment from Cornwall Council and ERDF has supported development and secured 175 new jobs in addition to above thus far. In the context of a County with a per capita GDP at 72% of the European average (2010 figures) this is clearly very important, not just in terms of boosting local economic activity but also job creation.

Cornwall’s GDP defines it as a ‘Less Developed Area’ in the European context (i.e. it has a GDP of less than 75% of the EU average). Productivity is regarded as the key to raising output and earnings in this kind of area, and the Airport is one of the bright spots for Cornwall by stimulating catalytic benefits from improved connectivity (see Appendix B) as well as direct, indirect and induced jobs locally and in the wider regional economy (see above).

\(^{14}\) Census 2011
\(^{16}\) There is a slight deviation from the 290 jobs reported in the Capita Consulting Economic Impact Assessment Report
Appendix B: How Does Aviation Connectivity Contribute to the Performance of Regional Economies?

i. Evaluations of airport’s economic impacts typically tend to be locally/regionally focused and deal with direct, indirect and induced impacts (e.g. jobs, GVA and tourism spend), which can be more easily measured and therefore are more tangible. In a local context these can be important – but they are not the whole story. There is now a strong and growing body of evidence supporting the proposition that aviation connectivity contributes to the growth not just of local economies in the immediate vicinity of an airport, but also more broadly to regional and national economies through a range of catalytic impacts. This proposition has become one of the focal points of the in-depth analysis that is underpinning aviation debate currently taking place in the UK. That work can undoubtedly be applied more broadly and is therefore summarized below.

ii. Conceptually, the catalytic impacts of aviation relate to its ability to enable other sectors of an economy to trade and operate more productively; this is achieved in three main ways:

- Through **reallocation of resources to more productive uses facilitating increased international trade in goods, services and tourism.** The merits of shifting more resources into aviation and tourism depend on the productivity of those sectors relative to the rest of the economy.\(^{17}\)

- By **increasing capital intensity.** Improved connectivity and trade should have the effect of boosting inward and/or domestic investment, raising output per person.

- By **encouraging innovation.** Investment in new or more sophisticated technologies, knowledge sharing and participation in new markets may encourage new ways of working and improve cost efficiency, raising domestic productivity.

iii. The most significant long-term impacts of aviation connectivity are not just the direct GVA and employment effects, but also its ability to facilitate economic growth through enhanced productivity in the wider economy. While connectivity is not a guarantee of a competitive economy, it is often a necessary condition that enables an economy to draw on a wider source of labour, skills and capital; to transport goods and services efficiently and reach distant markets; and encourage investment by foreign as well as domestic firms.\(^{18}\)

iv. Some good examples of this can be found within the regional economies of the more peripheral parts of the UK. In the Highlands of Scotland for example the importance of maintaining or improving air access from Inverness is a significant focus for local development agencies, not least because the whiskey industry, which is a mainstay of the regional economy, is highly internationalized and export orientated. The same applies in the energy sector for Aberdeen and the tourism sectors for Cornwall in the far South West of the UK and the West of Ireland.

v. There is now an extensive body of literature highlighting the contribution of aviation

\(^{17}\) Shifting more resources into export sectors could raise average productivity, although it may have an offsetting effect of raising the exchange rate (potentially disadvantaging other sectors, but raising real national disposable income through cheaper imports).

connectivity to the economy. In a report for DfT, Oxera identified that the main benefits of connectivity were transport user benefits, better place competitiveness and wider economic benefits. Transport users might benefit from more or better quality destinations, compared to a situation where a country or an airport is less well connected. Through better connectivity, the region around an airport can take advantage of the fact that it will be more attractive as a place to locate businesses.

vi. The wider economic benefits include agglomeration benefits, labour market effects, and imperfect competition effects. For example the increased size of an international product market available to a firm may help to increase its output and result in a greater demand for labour and consequently has its effect on the job market. Another potential wider economic benefit of increased connectivity is an increase in competition in both product and labour markets. The increase in competition could arise from widening the geographic size of the market. These factors have also been borne out with real world evidence.

vii. A study by Oxford Economic Forecasting showed that a good air transport network facilitates economic growth by improving efficiency, boosting investments and leads to more innovation. As they state:

“The improvement in productivity in firms outside the aviation sector comes through two main channels: through the effects on domestic firms of increased access to foreign markets, and increased foreign competition in the home market, and through the freer movement of investment capital and workers between countries.”

viii. In another study, carried out by INTERvistas for IATA, which provides a more wide-ranging international perspective, the analysis points to a 10% growth in connectivity boosting labour productivity levels by 0.07%. Indeed, many other studies also acknowledge that better connectivity leads to higher productivity in a region or country.

ix. Crucially, this higher productivity can lead to higher GDP, as evidence is found that ‘the catalytic impact on investment and productivity of the expansion of air services over the past decade has contributed an additional 4% to European GDP’. But just as importantly, implicit in this analysis, is that the loss of aviation connectivity can result in

x. The UK’s recently published Aviation Policy Framework summarizes the case well in paragraph 1.39:

“Excellent connectivity helps sustain clusters of specialised high-value industries in the UK such as the financial, legal, IT consultancy and business management sectors which are knowledge intensive and increasingly global in their operations.”

xi. But also:

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23 IATA (2007), ‘Aviation Economic Benefits’ IATA Economics briefing note no. 8, report provided by INTERvistas
“... businesses across a much wider range of industries – including chemical, oil, manufacturing and engineering, construction, retail, education, health, media, leisure, catering and transportation – use aviation to travel to service clients, to manage satellite operations and local offices, to source or sell business or manufacturing inputs and outputs and for overseas or multi-national companies based in the UK to reach global headquarters and other business partners.”

xii. This is why the issue of air access from the UK regions to London and the range of global destinations its airports (but particularly Heathrow) can provide, has become such a high profile issue in the current UK aviation debate and is so relevant to the European Commission’s proposals.

xiii. The strategic policy advice the CAA offered to the UK Government in its Insight Notes 1 and 2, prior to the publication of its Aviation Policy Framework earlier this year, is interesting in that it appears to recognise explicitly the need for UK cities and regions located at some distance from London’s major airports to have access to the capital’s hubs to facilitate onward travel to the wider world.

xiv. Given the priority the UK Government has given to re-balancing the economy, encouraging private-led investment and securing access to faster-growing emerging economies to increase export volumes, the absence of these important connections to the UK’s principal hub airport means that despite the valuable role that Amsterdam in particular is playing in serving many UK regional airports, they are less well connected than if they were also connected to Heathrow and/or Gatwick, and as a consequence many of their potential passengers are making extended surface journeys to larger airports to provide the enhanced level of connectivity they require. On this basis the CAA identified air access to London and its hub airport(s) as a nationally important issue.

26 CAA (2011): Insight Note 1 - Aviation Policy for the Consumer
27 CAA (2011): Insight Note 3 - Aviation Policy for the Future