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Torsten Steinrücken\* and Sebastian Jaenichen\*\*

# Towards the Conformity of Infrastructure Policy with European Laws

## The Case of Government Aid for Ryanair

*The court cases over contracts with Ryanair seem to imply that there is a contradiction between the wishes of local government authorities to purchase infrastructural services which improve the local business environment and European competition laws. The following article examines whether the financial support Ryanair receives should in fact be considered unfair and illegal against the background of the more general problem of reduced-price access to public facilities for private business.*

The airline Ryanair, which was founded in 1985, contributes with its innovative business model to a market which is becoming increasingly competitive. It achieves this in part by receiving support from the public budget and presenting itself as an affordable airline due to the cost advantages which possibly stem from this financial aid. This raises interesting questions regarding competition and regulatory policy. Ryanair recognised that in industrial locations on the outskirts of densely populated areas and in places with few inhabitants there is a willingness to pay for a connection to national and international airport networks.<sup>1</sup> This has brought with it a reduction in the prices of the necessary facilities (landing rights, airport tariffs etc.)<sup>2</sup> From an economist's point of view, the question arises – especially within the EU<sup>3</sup> – as to whether such support from the public budget leaves its competitors at an unfair disadvantage and because of this whether such payments should be banned.

Recently there have been two controversial cases concerning state aid which supposedly favours the airline Ryanair. One of them involved the purported subsidising of Ryanair's air-traffic activities at the Belgium regional airport Charleroi. In a more recent action in June 2003, a French administrative court ruled that the payments from the Chamber of Industry and Commerce in Strasbourg be cancelled due

to their unfair effects upon competition. As a result, Ryanair cancelled its flight connections to and from Strasbourg and moved them to the German regional airport at Baden-Baden.<sup>4</sup> This article will discuss the question as to whether the financial support that Ryanair receives from some local government authorities should be considered unfair and illegal in the light of European competition laws. It also looks at the more general problem of apparent reduced-priced access to public facilities for private businesses.

### Distortion of Competition?

Ryanair's business model is based to a large extent upon attaining financial support from regions with smaller airports in exchange for inclusion within Ryanair's flight network and its established ties with the international air community. This is one of the reasons for the relatively affordable ticket prices.<sup>5</sup> Until now,

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<sup>1</sup> Ryanair's behaviour reminds one of the Schumpeterian entrepreneur, who brings the "silk stockings within the reach of factory girls". See J. A. Schumpeter: *Capitalism, Socialism and Democracy*, New York 1942, third edition (1950), pp. 67-68.

<sup>2</sup> Beside the support mentioned, municipalities grant further utilities such as financing the training of employees, offering lower tariffs for ground services and rooms, and subsidising marketing projects. Cf. *Official Journal of the European Communities* C 18/3, 25.01.2003.

<sup>3</sup> *Ibid.*

<sup>4</sup> *Frankfurter Allgemeine Zeitung*, 19.09.2003, p. 19.

<sup>5</sup> The restriction to one aircraft (Boeing 737), the exclusive possibility of flight booking via internet or call centre and the required payment for food on board are further reasons for Ryanair's low ticket prices compared to other airlines. Ryanair itself advertises these cost advantages as follows: "[...] Low Fares and friendly, efficient service – that's our way. And how do we do it? Superb cost management. Landing in airports that don't rip you off [...]" See [www.ryanair.com](http://www.ryanair.com).

this business idea has been faced with two lawsuits, which we shall discuss below.

The European Commission, in response to a request of 24 October 2001, decided on 11 December 2002 to institute a legal enquiry into state aid concerning benefits received by Ryanair from the Belgium region Waals Geweest.<sup>6</sup> The criticised agreement between Ryanair and Waals Geweest contains not only a 50 per cent reduction in landing fees, but also the promise to compensate Ryanair for any change in taxes for ground services or operating hours of the airport Charleroi. This promise can be considered a shifting of risks towards the government authority. In exchange for these concessions Ryanair agreed to adhere to a minimum number of flight connections to and from Charleroi over a period of 15 years. This increases the certainty of airport revenues during this period and ensures the ties to the international air community.<sup>7</sup> With its latest decision the European Commission has ruled that a part of the grants received by Ryanair from Brussel's South Charleroi Airport have to be repaid. According to this decision a share of 25 to 30 per cent of the government aid does not qualify as conform to European competition law.<sup>8</sup>

Ryanair has signed contractual agreements similar to the Charleroi case with a considerable number of further European airports. Objecting to payments granted by the Chamber of Industry and Commerce in Strasbourg, the Air France subsidiary Britair has recently made a complaint against the airline. Britair is not pursuing the honourable interest of social welfare, though. Its reason for rebelling against Ryanair's business practice is unequivocally based on its own profit goals.<sup>9</sup> If the court rules in Britair's favour, Ryanair will then be faced with repayments of up to millions of euros. This would diminish Ryanair's current competitive advantage and lead to a rise in its ticket prices. This

obviously provides benefits for the suing competitor. With its decision of 24 July 2003, the French Administrative Court ruled that public payments favouring Ryanair contradict European competition law. Apart from direct payments similar to those granted in the Charleroi case which lead to a subsidy per seat amounting to €12.57, Ryanair had successfully insisted on further locational contributions. Among these various infrastructural services which Ryanair receives are services such as a scheduled traffic connection between the airport and the city of Strasbourg and a regular bus service to the German city of Baden-Baden. Furthermore, Strasbourg agreed to provide a bus service to a skiing area in winter. Much to the regret of the subsidising Chamber of Commerce and Industry,<sup>10</sup> the French Court ruled in its decision that the marketing contract unfairly favours Ryanair and does not promote tourism in the region of Strasbourg to an extent which justifiably defends the price paid by the Chamber. Due to this judicial ruling, the Chamber of Commerce and Industry will have to stop the payments to Ryanair.<sup>11</sup> The French Court will for the time being be looking at the case to find out whether the public aid granted does indeed leave Ryanair's competitors at an unfair disadvantage.

### European State Aid Control: Goals and criteria

According to Articles 81-89 EEC, competition within the EU should develop freely and without state intervention.<sup>12</sup> There is therefore a need for legitimating state aid activities which have to meet the criterion of appropriateness. How can cases of state aid which may be rejected by the European Commission be identified? The criteria of Article 87 have to be met in order for aid to be judged illegal. Each of the following questions must be affirmed individually to declare the granted aid as being provided illegally.

- (1) Is the aid granted by any kind of state unit and does it favour private business?

<sup>6</sup> European Commission, press release IP/02/1854, 11.12.2002.

<sup>7</sup> Cf. OJ 18/3, op. cit., p. 7: "Ryanair verbindt zich ertoe om gedurende een periode van 15 jaar ten minste twee, en ten hoogste vier vliegtuigen, te stationeren in Charleroi. Deze vliegtuigen dienen aanwezig te zijn op de luchthaven tussen 23.00 uur 's avonds en 6.00 uur 's morgens, en dat gedurende ten minste 300 dagen per jaar. Ieder vliegtuig dient ten minste drie retourvluchten per dag vanuit Charleroi uit te voeren (in totaal dus zes vluchten)".

<sup>8</sup> For more details see European Commission: press release IP/04/157, 03.02.2004.

<sup>9</sup> Since Air France is a public enterprise, the examination of competition premises should lead to another interesting question: to what extent state activity within this market itself distorts competition. Although this gives rise to interesting questions, the underlying problem will not be discussed further in this article. For a similar problem in the German hospital market cf. Björn Kuchinke, Jens Schubert: Beihilfen und Krankenhäuser, in: *Wirtschaft und Wettbewerb*, 2002, No. 7/8, pp. 710-719.

<sup>10</sup> Cf. Chambre de Commerce et d'Industrie de Strasbourg et du Bas-Rhin, Communiqué, 26.08.2003. "La Chambre regrette que les circonstances actuelles contraignent la Compagnie Ryanair à choisir un autre aéroport que celui de Strasbourg pour assurer la continuité de la desserte. [...] L'arrivée de Ryanair a permis à l'Aéroport de mobiliser tous ses moyens, rendus disponibles par la crise du transport aérien, afin de retrouver une croissance positive de son trafic : avec + 4 % d'augmentation de ses passagers de janvier à juin 2003, Strasbourg est le seul Aéroport à réaliser une telle performance parmi les 10 grands aéroports français."

<sup>11</sup> The Superior Administration Court of Nancy dismissed a petition by Ryanair for permission for the continuation of subsidies received from the Chamber of commerce and industry in Strasbourg. Cf. *Frankfurter Allgemeine Zeitung*, 19.09.2003, p.19.

<sup>12</sup> See Wolfgang Kilian: *Wettbewerbsrecht*, Munich 1996, p. 86; Thomas Oppermann: *Europarecht*, 2. ed., Munich 1999, margin number 1030.

- (2) Is the grant paid directly out of a public budget or by use of intermediate agents?
- (3) Does the private business or the industry receive advantageous grants without an adequate return on these grants?
- (4) Do private enterprises or industries have unequal access to the grants?
- (5) Does it affect the trade between member states?

These five criteria have to be applied cumulatively, i.e. if one of them is not fulfilled, the measure under examination cannot be subjected to the general state aid prohibition. It is normally assumed that the third criterion is already fulfilled if the first one is. The literature usually recognises unequal treatment of private business by the state on the basis of unusual market return (exaggerated payments). We shall discuss this criterion under the separate point (3) of the criterion list. We shall first examine the agreements between Ryanair and the airports of Strasbourg and Charleroi on the basis of the legal standard provided by Article 87 paragraph 1 EEC. Subsequently we shall discuss the relevance of the lawsuit made against Ryanair and its contracting parties on the basis of general economic criteria.

### **European Competition Rules and Grants for Ryanair**

Attempting to answer the first two questions is problematic. Even if the payments favour a private enterprise such as Ryanair, it is still uncertain whether the grants burden the public budget. In this case, grants were not given directly through the public budget but by the local Chamber of Commerce and Industry, which finances itself mainly through contributions from local enterprises. This causes problems regarding the application of Article 87 paragraph 1 EEC. In practice, the state will always have ways of arranging the intended advantage through intermediaries so that the visible part of the transfer appears to be a private payment. Even if serious problems in identifying a distortion of competition are already recognisable here, in the further discussion this problem will generally be regarded as solvable. We shall draw attention to the question as to whether financial support from the state to private enterprises can be classified as lessening the intensity and fairness of competition. We shall therefore limit ourselves to discussing and answering the questions raised by the criteria (3) and (4), since it can be assumed that the competition impairment regarding trade between member states (5) results if there are positive findings in (3) and (4).

From an economist's point of view, financial support to private enterprises granted by state institutions should be rejected if it distorts competition between private business activities. Ryanair's rival Britair has brought forward a complaint of such a distortion of competition, i.e. a promotion favouring one enterprise over its competitors through any activity undertaken by national institutions. But is this really due to selective and preferential treatment of Ryanair? If so, what kind of criteria lead to the certain recognition of selective favours? Is it that only one enterprise (Ryanair) out of a group of competing enterprises receives public payments, and that only this enterprise and none of its competitors could have achieved the benefit of the subsidy? In the cases regarding grants received by Ryanair, this appears more than doubtful for various reasons.

Firstly, it can be objected that the payments do not fall under the classical definition of a subsidy. In economic theory, subsidies are generally defined as monetary payments without a direct return (adequate compensation). In the second case examined in this paper (Strasbourg), Ryanair committed itself to carrying at least 370 000 passengers between Strasbourg and London in return for €1.4 million per annum. A clear arrangement can similarly be observed in the Charleroi case.<sup>13</sup> From a juridical point of view, this contractual agreement can be understood as the purchase of a communication service which upgrades the infrastructural bundle of the region. The aid granted cannot therefore be considered to be payment without compensation. The strongest defensible doubt is as to whether the value of the compensation which Ryanair provides is appropriate or not.<sup>14</sup>

Furthermore, Ryanair appears to be the only airline which benefits from such public payments. However, in this case no facts have emerged to determine that Ryanair has exclusively received the offer regarding the various locations and that competitors have been discriminated against during the submission process. This also seems fairly unlikely. It is to be assumed, however, that Ryanair acted as a Schumpeterian entrepreneur by recognising the demand and willingness to pay of some municipalities in less populated areas. Ryanair became the first airline to base a whole business idea on fully exploiting this market opportunity.

<sup>13</sup> See footnote 7.

<sup>14</sup> It seems worth mentioning that the question whether the quid pro quo in the exchange between state-owned airports and Ryanair are comparable to those a market process would bring about, has no clear answer. Such an exchange relation can only lead to results different to those a free market creates if – assuming equal negotiation skills – any party possesses some kind of monopolistic market power.

This does not mean that Ryanair's strategy was impossible for its rivals (Easyjet, German BA, Britair etc.) to imitate. It can also be speculated that Ryanair acquired a first mover advantage, making it more difficult for any other newcomer to the market. Britair surely could have received this financial support, since it is rather unlikely that a French industrial location would prefer an Irish airline to an Air France subsidiary (such as Britair).

The theory as to why Ryanair has received such preferential treatment can be rejected not only due to the airline's foreign provenance but also to the natural interest of rational locations to acquire the desired infrastructural service at the lowest possible price. If another airline provided the same flight connections at a lower (subsidy-)price, it might be more difficult to understand why Ryanair was given the grants. This argument can also be applied to cases in which it is much more difficult to put a figure on the quid pro quos, in which the compensation for public payments received (e.g. financial bonuses for opening or maintaining an enterprise at the location) consists in the generation of technological externalities.<sup>15</sup> Apparently a natural productivity advantage accounts for the fact that Ryanair achieved its aims and now satisfies the demand of many locations for scheduled air services. As the following statement of a manager at the German airport of Cologne shows, locations consider carefully which airlines they choose to offer advantageous conditions to: "We are negotiating with Easyjet [...] Negotiations with Ryanair have been cancelled. The Irish market leader is so aggressive in its pricing that in the long run Ryanair will take over all the other competitors [...] That is not in the interest of Cologne airport."<sup>16</sup>

Judging the case on the underlying criteria of the European Competition Law, the agreement cannot be characterised as illegal state aid. Although Ryanair had an advantage due to the benefits of public payments, it is not fair to say that other airlines had been unfairly discriminated against during the process of the public purchasing of infrastructural services.

### **Jurisdictional Competition and Local Infrastructure Supply**

Industrial locations create bundles of infrastructural facilities which they make available to location seekers. Decisions about the composition of these bun-

dles are usually their own. They decide, for example, whether to open a trade area to finance cultural attractions or to improve their traffic infrastructure. Offering the compound bundle, they compete with the bundles of other locations. Locations seekers make use of the location offers as though these were a production input. Infrastructural facilities can therefore be interpreted as inputs which more or less directly contribute to the production process. This evidently leads to a more or less direct support of different undertakings through the specific local infrastructure. Businesses value the infrastructure available at the location differently. This fact determines the spatial allocation of mobile production factors. Locations obviously try to interfere with the process of location choice by combining infrastructural facilities, maximising the number of enterprises in the region. The competition between locations can be interpreted in this sense as a search process which leads to the discovery of the ideal bundle that enterprises favour over all other bundles after consideration of price (tax price) and quality (firm specific utility).

### **The Purchase of Infrastructural Services**

As we have previously argued, payments from some municipalities to Ryanair should be seen as the purchase of infrastructural services which improve the local business environment. Access to the national and international air community leads to a reduction in transport costs, which positively affects the settlement of new enterprises. Moreover, incentives to draw business activities from rural into urban areas and agglomerations are reduced.<sup>17</sup> Additionally, the opportunity to use air transportation services increases productivity in the rural area. Bergman/Sun<sup>18</sup> show in an empirical study that improved access to air services promotes labour productivity. It is notable that a 1% increase in access to scheduled air services promotes labour productivity in a rural area by 0.123%.<sup>19</sup> The "lighthouse effect" of the air traffic integration of a region via scheduled air services can also be regarded as a positive contribution to regional economic develop-

<sup>17</sup> For the relationship between transportation costs and migration away from rural areas see E. Helpman: The size of regions, in: David Pines, Efraim Sadka, Itzhak Zilcha (eds.): Topics in Public Economics, New York 1998, Cambridge University Press, pp. 33-54.

<sup>18</sup> Cf. Edward M. Bergman, Daoshan Sun: Infrastructure and Manufacturing Productivity: Regional Accessibility and Development Level Effects, in: D. F. Batten, C. Karlson (eds.): Infrastructure and the Complexity of Economic Development, Berlin 1996. They write (p. 26): "Relative access to nearby scheduled air service helps promote labour productivity (0.123% productivity bonus per 1% increase in access to scheduled air service) in rural manufacturing, while similar access to rail service penalizes productivity -0.116% per 1% increase in access to daily rail service."

<sup>19</sup> Ibid.

<sup>15</sup> Cf. Torsten Steinrücken, Sebastian Jaenichen: Wofür bezahlen Standorte? Subventionswirkungen im Wettbewerb der Regionen, in: List Forum für Wirtschafts- und Finanzpolitik, Vol. 4, Band 28, 2002, pp. 313-326.

<sup>16</sup> Handelsblatt 22.10.2003, p.14, our translation.

ment. Locations communicate their quality to potential investors by financing infrastructural services out of future revenues. This is the same argument which industrial economists use to explain advertisement expenditures on product markets.<sup>20</sup>

### The Practice of Infrastructure Purchases

We should concede that the advantages for any region of connecting to the national and international air community are difficult to measure.<sup>21</sup> Municipalities overcome this problem however through temporary limited contracts.<sup>22</sup> Only if the positive effects expected by a location actually come into effect does it try to extend the contractual agreement with the airline. Since the payments in most cases burden the public budget at the local level (presuming fiscal equivalence), it is highly misleading to suppose that locations in the long run grant more advantages than the real value of the benefit that derives from the air service evaluated by the locations (taxpayers). In our opinion, the purchase of an infrastructural service produces positive externalities for a region. The beneficial effects of scheduled air services are distributed more or less equally throughout the anonymous mass of a region's population. Ticket prices therefore do not always reflect people's real willingness to pay. Lowering the ticket price through regional payments can therefore be considered an internalization of (positive) external effects.<sup>23</sup> The beneficial effects of a regional air service connection can even favour those who do not directly use the flights for themselves. Some people's willingness to pay for air services can be aggregated in theory through the formation of clubs. These clubs pass grants to the air services supplier.<sup>24</sup> Though in most cases the airports pay for the support Ryanair receives, they will reduce their products in price to the observed extent if taxpayers, local interest groups (e.g. in the case Ryanair/Strasbourg the local Cham-

ber of Commerce and Industry) or non-governmental organisations pay for the desired infrastructure. Since in many cases the regional access to air services cannot be achieved without state intervention, the state authorities or other organisations would have to reduce the market price by subsidising until the optimal quantity of air services was realised.

The argument that the payments received by Ryanair were illegal state aid could be countered more effectively if the allocation process were less secretive. Hence it should be considered granting the allocation of payments in order to achieve better infrastructural standards (i.e. flight connections) through an official call for tenders. A transparent allocation process would result in a fair market price and the question as to whether the performance of the grant receiver were less than could be expected if different airlines competed for public support could evidently be denied. In a recent ruling, even the European Court has recently demanded that the allocation of public services should take place in a transparent and objective way.<sup>25</sup> Especially in fulfilling public obligations in the field of traffic services, the European Court demands that subsidies should be allocated within a clear and objective framework. The European Court considers various traffic services such as local or regional bus and railway connections as belonging to such public obligations.<sup>26</sup> Direct flight connections naturally merit the same treatment as buses or railways. The demand for an official call for tenders should not lead to condemning the payments received by Ryanair as illegal, because it cannot be demanded that a business, when launching an innovative idea, generates potential distortion of competition. Thus it is absurd to expect Ryanair to show altruistic consideration for its competitors and the whole competition process. Nor can Ryanair be forced to reveal its innovative business idea including the expected profits to its competitors by seeking public support through open tenders. This argument, which implies the acceptance of the innovator's rent Ryanair has gained until the present, can of course be utilised only to defend the support already granted. Through the revelation of

<sup>20</sup> Cf. Torsten Steinrücken, Sebastian Jaenichen: Heterogene Standortqualitäten und Signalstrategien: Ansiedlungsprämien, Werbung und kommunale Leuchtturmpolitik, in: Zeitschrift für Wirtschaftspolitik, 2003, No. 3.

<sup>21</sup> On this problem cf. Werner W. Pommerehne: Präferenzen für öffentliche Güter: Ansätze zu ihrer Erfassung, Tübingen 1987.

<sup>22</sup> The contract between Ryanair and Waals Geweest was for a period of 3 years and in the case of Ryanair and Charleroi for a period of 4 years.

<sup>23</sup> Concerning the effects of such an internalisation on social welfare, Pigou already pointed out in 1929 that, "In general industrialists are interested, not in the social, but only in the private, net product of their operations. [...] When there is a divergence between these two sorts of marginal net products, self interest will not, therefore, tend to make the national dividend a maximum; and, consequently, certain specific acts of interference with normal economic processes may be expected, not to diminish, but to increase the dividend." Arthur C. Pigou: *The Economics of Welfare*, London 1929, p. 174.

<sup>24</sup> To give an example of this, imagine a car driver who never uses trams, buses or the underground but has a willingness to pay for these local transportation services. This willingness to pay stems from the natural interest of a car driver, who desires that many people use such local transportation services in order to bring down his congestion costs.

<sup>25</sup> See European Court of Justice: C-280/00 *Altmark Trans GmbH v Regierungspräsidium Magdeburg*, 24.7.2003, quoted in: *Wirtschaft und Wettbewerb*, 2003, No. 9, pp. 993-1004.

<sup>26</sup> *Ibid.*, p. 993.

the business model and the increasing sensitivity for effects on competition, this argument loses strength. It is however a problem of the locations (airports) and not of those receiving the grants (Ryanair) if the latter contradict the standards set by European competition rules. A transparency-promoting call for tenders which exactly defines the desired infrastructural services could reduce the subsidy, since several airlines would compete for public support.

### Summary

With regard to the criteria of Article 87 paragraph 1 EEC, the examination of the financial aid granted by certain municipalities leads us to deny the alleged illegality of these payments. This is not a case of distorted competition.<sup>27</sup> Even if it is only Ryanair that benefits from this kind of public spending in Europe, it cannot fully be claimed that these payments are selectively granted. Rather, one can assume that an implicit com-

petition process has revealed certain cost advantages of Ryanair and therefore we should consider the result of this process as if Ryanair has offered the best return for public financial support. Furthermore, it was Ryanair that recognised municipalities' willingness to pay and their willingness to reduce the price of local airport tariffs if real compensation was promised by the airline. In judging the payments in favour of Ryanair, and the agreements between the airline and several municipalities, it is not this which should be criticised, but rather the unclear procedure and the lack of any official call for tenders. This would lead to "[...] compliance with uniform rules on competition between carriers" as demanded by the European Commission in its latest decision on that case.<sup>28</sup> A location's purchase of infrastructural services should not be impeded by regulatory supervision such as European state aid control. The decision by the European Commission aimed to increase transparency regarding the general terms of the tender in order to guarantee a workable price competition between airlines.

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<sup>27</sup> Soltész argues in a different way. Cf. Ulrich Soltész: "Billigflieger" im Konflikt mit dem Gemeinschaftsrecht?, in: *Wirtschaft und Wettbewerb*, 2003, No. 10, p. 1039. "Die über die Flughäfen gewährten Beihilfen verzerren den Wettbewerb zulasten derjenigen Konkurrenten, die nicht von vergleichbar günstigen Konditionen profitieren können."

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<sup>28</sup> Cf. European Commission: press release IP/04/157, 03.02.2004, op. cit.