

*Jakub Kociubiński**

A NEGATIVE SYNERGY – A REVIEW OF DIRECT SUBSIDIZATION MECHANISMS FOR SCHEDULED AIR SERVICES FOLLOWING THE COVID-19 PANDEMIC IN EU LAW AND PROSPECTS FOR IMPROVEMENT

Abstract: *Hardly any sector has been hit as hard by the COVID-19 pandemic as the air transport industry. As lockdown measures are lifted, a recovery phase begins that will shape the global economic landscape for the years to come. In this context this paper raises the question of whether the pre-existing EU instruments for subsidizing air operations – Start-up aid and the Public Service Obligation – none of which was designed with economic recovery in mind – can be adapted to the new circumstances after the current ad hoc measures under the Temporary Framework have dried up. The hypothesis which is taken as a starting point is that the existing state aid toolbox has built-in deficiencies which are hampering recovery efforts. This paper therefore attempts to determine whether alternatives can be sought within the confines of the EU state aid law, and if so what such alternatives might be.*

Keywords: airlines, airports, air transport, COVID-19, EU law, public service obligation, Start-up aid, state aid

INTRODUCTION

The current coronavirus outbreak has brought the aviation industry, and indeed the whole world, to an unprecedented standstill. Although this sector is generally considered susceptible to Black Swan events, the current crisis is much deeper than anything experienced previously; thus unlike earlier crises it is crippling to both airlines as well as airports. In view of the predicted long-term effects and currently-observed efforts to re-ignite economic growth across all sectors, COVID-19 should be perceived as a distinct phase of instability and uncertainty, and not as a relatively short transitional

* Associate professor (dr. habil.), Faculty of Law, Administration and Economics, University of Wrocław; e-mail: jakub.kociubinski@uw.edu.pl; ORCID: 0000-0002-4391-7439.

event between two stable periods.¹ Viewed in that wider canvas, the following industry-specific factors provide an additional context for this paper: The inherent economic interdependency between airports and airlines, as well as the existence throughout Europe of oversized and underused “ghost airports.”² Although the question of their financial viability and the use of public funds has been put forward many times before, this issue has become exacerbated by the current outbreak in the following ways: Firstly, if an economic downturn hits as predicted, state budgets may not be able to provide sufficient funds to continuously support every company in need. Secondly, it can be reasonably assumed that if cash-strapped airlines may be forced to reduce operations, the thinnest routes would be the first to lose service; and thirdly, for the same reason carriers will likely seek additional funding opportunities wherever they may be found. All this underscores the importance of rationalizing and improving the efficiency of government spending.

It is with all these factors in mind that this paper – by taking the perspective of the sector’s regulatory model, which involves financing airports through revenues generated by possibly subsidized air operations, raises the question of whether these subsidy instruments are appropriate to tackle the long-term, lingering effects of the COVID-19 downturn, i.e. extending beyond the current *ad hoc* relief efforts. There are only two instruments in European Union (EU) law which allow for the direct subsidization of air operations – Start-up aid and Public Service Obligations (PSOs). Neither of these were ever intended to support economic recovery. But because nothing else is available, by necessity these tools must be adapted to the new realities. Being *de facto* alternatives also makes them interrelated, i.e. changing one may affect both the way in which the other is applied as well as its scope. Even though these instruments may ultimately be supplemented by non-sector specific macroeconomic stimuli, the measures in question seem to remain relevant in the microeconomic perspective, both as the most readily available solutions and as a source of experiences for future lawmaking and policymaking.³ Consequently, the hypothesis which forms the basis for further discussion in this work may be formulated as follows: The pre-existing European legal framework for subsidizing air operations has built-in structural inefficiencies, resulting in wasteful spending and subsidy races and thus hampering future recovery efforts, to the particular detriment of regional airports. The analysis will begin by describing the existing temporary *ad hoc* aid measures, and then will then move to a review of the legal tools mentioned above, with a particular focus on their inefficiencies, and

¹ M. Babic, *Let’s Talk about the Interregnum: Gramsci and the Crisis of the Liberal World Order*, 96(3) International Affairs 767 (2020), p. 769.

² See European Commission, *Competition policy brief: New State Aid Rules for a Competitive Aviation Industry* (Issue 2, February 2014). See generally European Court of Auditors (ECA), *EU Funded Airport Infrastructures: Poor Value for Money*, Special Report no. 21 (2014).

³ Even more so considering that the recovery plan for Europe lacks a sector-specific focus, instead emphasizing the overall “green and digital” transformation. See Council of the EU press release, *EU Recovery Package: Council Adopts Recovery and Resilience Facility*, available at: <https://bit.ly/3COtOHs> (accessed 30 May 2021).

on how they negatively synergize with the sector's peculiarities in difficult economic realities, which are compounded by the pandemic. The paper will then explore possible alternatives; the nature of the challenges associated with amending start-up aid and PSOs; what improvements can be made in and to each of these instruments; and how feasible such improvements are. The analysis will conclude with *de lege ferenda* recommendations.

1. THE TEMPORARY FRAMEWORK AND BEYOND

Since the initial outbreak of COVID-19 – which resulted in unprecedented lockdowns circa March–April 2020, which in turn immediately led to negative economic impacts – many EU Member States have scrambled to adopt interim compensatory measures for the sectors affected. Initially, the European Commission's (EC, the Commission) reaction was disjointed, but subsequently it has coagulated into the *Temporary Framework to support the economy in the context of the coronavirus outbreak*, which is designed to be a faster and more flexible tool than the existing instruments, i.e. the so-called rescue and restructuring aid authorized under Art. 107(3)(c) Treaty of the Functioning of the European Union (TFEU), and the *Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty*, as well as state aid authorized directly under Art. 107(2)(b) TFEU.⁴

The Temporary Framework – which has become the main legal tool for providing urgent relief efforts to COVID-stricken airlines – is based on Art. 107(3)(b) TFEU, which offers high flexibility since it can be granted both to remedy the actual effects of a serious disturbance, i.e. to address urgent liquidity needs, as well as to prevent the worsening of a disturbance in the future.⁵ In other words, is not limited to compensation for cancellations of particular flights.⁶

⁴ Cf. Temporary Framework for State Aid measures to support the economy in the current COVID-19 outbreak. Originally adopted on 19.03.2020 and subsequently amended on 03.04.2020, on 08.05.2020, on 29.06.2020, on 13.11.2020 and on 28.01.2021. Consolidated version is available at: <https://bit.ly/37SqQ6E> (accessed 30 May 2021), para. 15 with Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, [2014] OJ C249/1; P. Nicolaides, *Application of Article 107(2)(b) TFEU to Covid-19 Measures: State Aid to Make Good the Damage Caused by an Exceptional Occurrence*, 11(5-6) Journal of European Competition Law & Practice 238 (2020). Following first flight bans, there was initially only a small number of cases utilizing Art. 107(2)(b) TFEU (notably see SA.57539 COVID-19 – Aid to Austrian Airlines [2020] OJ C346/1). But when it became apparent that the crisis would be longer, these were superseded by the Temporary Framework measures. De minimis aid will be omitted because costs in aviation are typically above its threshold.

⁵ See e.g. SA.57544 COVID-19: Aid to Brussels Airlines [2020] OJ C397/1, section 3.3.2; SA.57410 COVID – recapitalisation of Finnair [2020] OJ C310/1, section 3.3.2. Temporary Framework decisions are following the same assessment template; thus these provide a representative example.

⁶ Cf. Temporary Framework, *supra* note 4, para. 15bis, with e.g. Art.107(2)(b) TFEU decision SA.32163 Remediation of damage to airlines and airports caused by seismic activity in Iceland and the volcanic ash in April 2010 [2012] OJ C135/1, especially section 2.5.2.

Yet there is a fine line between the actual disturbance and the lingering effects of the economic downturn. As Andrea Biondi has put it, there is a concern that a framework devised to tackle an emergency could develop into the new normal.⁷ However, one cannot reasonably expect these lifelines to be prolonged indefinitely, especially after travel restrictions are lifted.⁸ Firstly, there is a moral hazard, encouraged by the guarantee of financial protection. Such a prolonged support could, for all intents and purposes, morph into morally hazardous and highly distortive operating aid which, for this very reason, is in principle considered to be incompatible with the Internal Market.⁹ Secondly, there exists the palpable possibility that fiscally-strapped states will not have sufficient funds during a downturn to subsidize every industry in need. This all is part of the wider problem of rethinking air transport post-COVID-19, but for the purpose of this discussion one can venture an educated guess that should a recession happen as predicted, carriers would be hard pressed to search for any subsidy opportunities.

From a state aid perspective, the situation with respect to airports is somewhat different: Facilities with an average traffic below 3 million passengers per annum may receive operating aid under Art. 107(3)(c) TFEU pursuant to the conditions set out in the *Guidelines on State aid to airports and airlines* (2014 Aviation Guidelines) for a transitional period, to end by 2024.¹⁰ Therefore, the Temporary Framework aid – aimed at helping to weather the storm – is of limited significance in the long run, especially for airports that were previously unprofitable. Because even if their financial situation worsened following the COVID-19 outbreak, the underlying causes of unprofitability had existed before the pandemic began.¹¹ Whilst urgent liquidity needs could be addressed using the Temporary Framework when the funding needed exceeds the adjustable limit for operating aid, and also assuming that under current circumstances the “grace” period for operating aid may be extended, the core problem of the lack of air traffic/insufficient demand goes beyond short- to medium-term survival, especially considering the EU’s policy focus on achieving airports’ economic self-sustainability.¹²

⁷ A. Biondi, *Governing the Interregnum: State Aid Rules and the COVID-19 Crisis*, 4(2) Market and Competition Law Review 6 (2020), p. 12.

⁸ Implicitly confirmed by the EC’s Overview of the State aid rules and public service obligations rules applicable to the air transport sector during the COVID-19 outbreak, available at: <https://bit.ly/2V-VChZ1> (accessed 30 May 2021). However, this is a preliminary working document, without a number, signature, or even date. Therefore, it cannot be relied upon except as a most rudimentary indication of the EC’s policy approach.

⁹ E.g. K. Bacon (ed.), *European Union Law of State Aid*, Oxford University Press, Oxford: 2017, p. 101.

¹⁰ Cf. Temporary Framework, *supra* note 4, para. 20 with Guidelines on State aid to airports and airlines [2014] OJ C99/3, paras. 112 and 118.

¹¹ Particularly, airports with the least amount of traffic were not significantly affected because their commercial revenues had been initially low in comparison with operating costs financed through operating aid. Thus, potentially profitable airports were most heavily affected. Cf. decisions SA.58212 Aid scheme for Polish airports [2020] OJ C421/1, traffic data, para. 13 and section 2.8; SA.58299 Aid to the Flemish airports [2020], OJ C421/1, traffic data, paras. 14, 18 and section 2.6.2.

¹² Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EU) 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the

For this reason, alternative direct funding mechanisms for airports' operations are also of negligible significance, and considering them as possible alternatives in a *de lege ferenda* context is a regulatory "dead end" and will be omitted in the subsequent discussion.¹³ All these problems are likely to be further compounded by the predicted lasting COVID-19-related impacts on demand for air travel, whereby airlines faced with the need to reduce capacity will be compelled in the first place to cut back their thinnest routes, not those serving major cities (there is also a need to retain slots at major airports).¹⁴ In other words, state aid-wise regional airports live on borrowed time, because the underlying issue is not COVID-related, and one cannot reasonably expect all direct lifelines to be prolonged *ad infinitum*.

In the author's opinion, all the interlinked factors outlined above seem to indicate a potentially perilous synergy. On one hand there is a need for a further stimulus to the economy. Given that such a policy has a clear economic dimension, it may also prove to be more politically acceptable to stimulate air traffic, rather than provide direct financial support for empty or near-empty airports. On the other hand, if the downturn were to prove more prolonged than envisioned, cash-strapped airlines will likely seek additional revenue sources.

The reason why these new economic developments synergize in a potentially detrimental way with the pre-existing legal tools for stimulating air traffic – Start-up aid and Public Service Obligations – is that these tools contribute to an environment conducive to wasteful subsidy races. Owing to the fact that many underused facilities struggle to attract any traffic, point-to-point carriers – being able to relatively easily switch between different airports – can credibly threaten to shift business away in the absence of subsidization or other preferential treatment.¹⁵ While the underlying problem of the economic and regulatory landscape of European aviation is well researched (and thus beyond the scope of this paper), it can be used as a point of departure for an analysis focused on which design features of these mechanisms referred to earlier are responsible for wasteful spending. Regardless of the fact that none of them were designed with

Functioning of the European Union – consolidated version [2016] OJ L327/19 stipulate that increases in the original budget of an existing aid scheme by up to 20% shall not be considered an alteration to existing aid (Art. 4).

¹³ Smallest airports with less than 200000 passengers per year, which since 2017 can be funded under GBER ([2017] OJ L156/1) even after the transition period is over. *See also* 2014 Aviation Guidelines, *supra* note 10, paras. 74-76 allowing for a PSO for the smallest airports. *See, inter alia*, Decisions SA.43964 SGEI compensation to Kalmar Öland Airport [2017], C51/1; SA.49331 SGEI compensation for Bornholm Airport [2018] C318/1.

¹⁴ The Commission temporarily lifted the "use-it-or-lose-it" rule ([2020] OJ L99/1), but one cannot reasonably expect this suspension to be prolonged *ad infinitum*.

¹⁵ *See e.g.* L. Budd, S. Ison (eds.), *Low Cost Carriers: Emergence, Expansion and Evolution*, Routledge, Abingdon: 2014, pp. 137 et seq.; J. Kociubiński, *Toxic Relationship? Competition Law Scrutiny of Airport–Airline Agreements – Possibilities and Challenges*, 41 *European Competition Law Review* 5 (2020); Z. Lei, A. Papatheodorou, E. Szivas, *The Effect on Low-Cost Carriers on Regional Airports' Revenue: Evidence from the UK*, in: S. Forsyth et al (eds.), *Airport Competition: The European Experience*, Routledge Abingdon: 2016, pp. 311-320; N. Postorino (ed.), *Regional Airports*, WIT, Southampton: 2011, and references cited therein.

economic recovery in mind, by necessity they must be adapted to the unprecedented economic situation; take into account how these problems may become exacerbated by post-COVID-19 austerity measures; and finally examine how (or rather whether) they can be remedied.

2. THE EXISTING SUBSIDY INSTRUMENTS

2.1. Start-up aid

The *ratio legis* of the Start-up aid stems from the fact that many regional airports struggle to attract an air traffic volume capable of generating sufficient revenue to cover operating costs.¹⁶ By providing Start-up aid to air carriers, the aim is overcome their initial reluctance about entering an untested market and mitigate the risk of incurring sunk costs in case of a failed entry. It should be viewed as an “over-the-counter” alternative to the prevalent practice of airports offering special deals to airlines (discounts, marketing contracts etc.) in exchange for the airline starting flights to/from that airport.¹⁷ Yet for an alternative mechanism to be attractive, it must offer an ease of use and effectiveness at least comparable to those means it seeks to replace. However, the less formalized and more flexible the procedure becomes, the greater is the risk of misuse. Conversely, the more formal safeguards against abuses, the less attractive offered alternatives become. This apparent contradiction between ease of use and level of safeguards has shaped the framework for Start-up aid.

Airlines departing from airports with fewer than 3 million passengers per year (or 3-5 million in undefined “duly substantiated exceptional cases”) can receive aid covering up to 50% of the airport charges for up to three years.¹⁸ It is assumed that over this period the subsidized route will reach maturity and ultimately profitability, and the argument thus assumes that airlines should be interested in continuing operations without additional subsidies.¹⁹ In this author’s opinion the “exceptional” nature of the COVID-19 outbreak and ensuing fallout and disruptions give Member States “more ammunition” to justify the subsidization of routes linking an airport with 3-5 million passenger per annum. This is important, because expanded eligibility would also cover larger, potentially more attractive markets. While there is no doubt that these larger markets have been hit equally hard by the COVID-19 outbreak, at the same time their commercial potential makes it easier for them to recover. Since there is a correlation between economic growth and air traffic, it can be reasonably assumed that regions with larger airports will also have more resources available to subsidize their air operations, leaving those airports/regions most in need at a disadvantage.

¹⁶ *Ibidem*.

¹⁷ 2014 Policy Brief, *supra* note 2, p. 2.

¹⁸ 2014 Aviation Guidelines, *supra* note 10, paras 142 (Elaborated in footnote 94 therein), 143 and 150.

¹⁹ *Ibidem*, paras 15, 141 and 147. Cf. R. Doganis, *Flying Off Course: Airline Economics and Marketing*, Routledge, Abingdon: 2010, pp. 203-226.

Since the aid in question can be authorized on the basis of Art. 107(3)(c) TFEU, compatibility conditions are based on common assessment principles, notably that a measure must contribute to a well-defined “objective of common interest.”²⁰ According to the *2014 Aviation Guidelines*, Start-up aid will be considered to fulfil this criterion if it “increases the mobility of Union citizens and the connectivity of the regions by opening new routes; or facilitates regional development of remote regions.”²¹ A claim can be made that by definition every new transport link fulfils these criteria, which appears to be *idem per idem*.²² This finds confirmation in the rather lenient assessments carried out by the Commission, which also provide insights on how the “ghost airports” referred to earlier affect the effectiveness of aid measures.²³ The necessity assessment in practically every Start-up aid decision – all adopted during the relatively good economic climate between 2014-2019 – has been limited to the laconic formula referring to the unlikelihood that new connections will result, without aid, in an increase in passenger traffic.²⁴ Insofar as an *ex ante* assessment allows, this assertion is correct, and thus sufficient to declare aid compatible with the internal market, but it omits the underlying issue of why no airline was willing to enter that market in the first place.

Consequently, in practice, meaningful assessments are restricted to purely quantitative formal criteria – intensity levels, length etc. – while the other qualitative criteria are *de facto* deemed automatically fulfilled, with the arguable exception of assessing whether there is already a parallel high-speed rail or alternative air routes from another airport in the same catchment area under comparable conditions.²⁵ However, even though the newer decisions lay greater emphasis on potential overlaps in airport catchment areas, the scrutiny remains rather superficial: The Aviation Guidelines define the catchment area in as a radius that is normally set at around 100 kilometres or around one-hour travelling time by land.²⁶ While this approach has the merits of ease of use, it still requires a degree of flexibility to avoid arbitrary constraints. In reality, an airport catch-

²⁰ See Bacon, *supra* note 9, p. 100. Aid can also be authorized under Art. 107(3)(a) TFEU, but due to restrictive conditions instances of this are very rare and will be omitted from further analysis.

²¹ 2014 Aviation Guidelines, *supra* note 10, para. 139.

²² *Ibidem*, paras 139-140; Commission decision SA.37121 Promotur (Canarias), [2013] OJ C348/1, para. 57.

²³ E.g. D. Ramos-Pérez, *State Aid to Airlines in Spain: An Assessment of Regional and Local Government Support from 1996 to 2014*, 49 Transport Policy 137 (2014), p. 147.

²⁴ Commission decision SA. 46709 Start-up aid for new routes from/to the airports in the Region of Calabria [2017] OJ C274/1, para 66, also see e.g. SA.40605 Start-up aid for flights from regional airports [2016] OJ C323/1, paras 52-54; SA.41815 Start-up aid for new routes from/to the airport of Comiso [2016] C220/1, para. 47, 50; SA.39466 Start-up aid to airlines operating in the United Kingdom, [2015] OJ C292/1, para 53; SA.57002 Start-up aid to new routes from Ancona airport [2020] OJ C228/1, para 61.

²⁵ See e.g. SA.39466 Start-up aid to airlines operating in the United Kingdom (*supra* note 24), section 3.2; SA.48345 Start-up aid scheme for routes from Tulcea Airport [2018] OJ C3/1, paras 13, 45-75; SA.41815 Start-up aid for new routes from/to the airport of Comiso (*supra* note 24), paras 35-45. Yet, it has never resulted in a negative decision.

²⁶ 2014 Aviation Guidelines, *supra* note 10, para. 12.

ment area is often difficult to define given the complex nature of passengers' choices of routes, types of destinations, passenger profile and so on.²⁷ Carrying out such a detailed assessment is simply impractical in cases involving few thin routes.²⁸ Therefore, in the EC's decisions the analysis is limited to *prima facie* available circumstances justifying a departure from the strict qualitative distance/time criteria. As a result, this has never been a decisive "limiting" factor, which illustrates the recurring dilemma between the degree of oversight and the ease of use.²⁹

Looking at the mechanism above through the lens of this article's hypothesis, one feature comes especially to the fore: Start-up aid does not include any mechanism ensuring the continuity of operations after the subsidy expires. The system is entirely based on economic incentives. Even assuming a route turns out to be somewhat profitable, it may still be economically rational to switch to another airport – for example if Start-up aid is offered there. In fact, this problem has surfaced earlier, especially considering that the average profitability of regional routes is unlikely to be high enough for these connections to be regarded by airlines as a high priority.³⁰ At the same time, one cannot blame the carriers involved for acting economically rationally, i.e. for exploiting opportunities presented by the regulatory framework.³¹ However, in the downturn following the COVID-19 outbreak, the incentive to switch between airports in search of new subsidies may be even greater for cash-strapped airlines. This poses a twofold risk: Local governments offering Start-up aid have no guarantee that the once-subsided routes will be retained to achieve intervention goals. Another concern is over a possible subsidies "arms race" to attract "footloose" carriers – privileging those with more resources and with a greater commercial base, which is something the EU state aid control system was originally designed to prevent.³²

2.2. The public service obligation

The problems described above can lead to the somewhat paradoxical conclusion that an alternative for retaining "footloose" carriers at regional airports is continuous subsidization. While such heavy-handed interference with the market mechanism is antithetical to the precepts of a fully liberalized market, this regulatory option – a Public Service Obligation – has always existed since the beginning of the European Economic

²⁷ See Postorino, *supra* note 15, pp. 79 et seq.

²⁸ Such detailed analyses are only carried out in the largest merger cases. See e.g. M.5440 Lufthansa/Austrian Airlines, section V.

²⁹ See e.g. SA.40605 Start-up aid for flights from regional airports [2016] C323/1, section 2.4.; SA.47746 Start-up aid to Maastricht-Aachen airport [2017] OJ C336/1, paras. 48-57.

³⁰ Ramos-Pérez, *supra* note 23, p. 147; R. Núñez-Sánchez, *Regional Public Support to Airlines and Airports: An Unsolved Puzzle*, 76 Transportation Research Part E: Logistics and Transportation Review 93 (2015), p. 107; X. Fageda, M. Gonzalez-Aregall, *Do All Transport Modes Impact on Industrial Employment? Empirical Evidence from the Spanish Regions*, 55 Transport Policy 70 (2017), p. 78.

³¹ Lawmakers must assume that companies are rational actors, which implies a systematic search for business opportunities. See generally R. Bork, *The Antitrust Paradox*, Free Press, Boston: 2005, p. 134.

³² Cf. Budd, Ison, *supra* note 15, p. 154 with Bacon, *supra* note 9, pp. 9-10.

Community.³³ In this context, it is also worth mentioning that PSO status has been imposed on several routes following the initial launching of those routes through Start-up aid (a separate question is why the PSO was not imposed right from the beginning).³⁴

Public Service Obligations in air transport are part of the wider, non-sector-specific concept of a Service of General Economic Interest (SGEI).³⁵ It provides a regulatory framework for the subsidization of scheduled air services that are both socially necessary and commercially unviable.³⁶ Unlike the above-described Start-up aid, it assumes routes will be permanently unprofitable. Although it was initially designed to ensure a minimum level “lifeline” service providing connections with the most remote and isolated places, such as islands or mountain areas, over the years it has transformed into a tool for regional development and as a transport alternative of convenience rather than of necessity.³⁷ The overall number of PSO routes throughout Europe is constantly on the rise, resulting in concerns whether they are indeed limited to clear-cut market failures.³⁸

The system works as follows: Member States may impose a Public Service Obligation in respect of scheduled air services on a route between its territory and that of another Member State which is considered vital for the economic and social development of the region which the airport serves.³⁹ Then, if within three months no airline has commenced or expressed a readiness to promptly commence operations on a PSO route, in accordance with the parameters set by the relevant public authority, the Member State can limit access to this route to only one competitively-selected carrier and can grant a financial compensation.⁴⁰ This so-called “public service compensation” is not caught by Art. 107 TFEU, but instead is approved under the derogation provided by Art. 106(2) TFEU according to the requirements set out in Regulation 1008/2008 on common rules for the operation of air services in the Community.⁴¹ In

³³ See generally C. Wehlander, *Services of General Economic Interest as a Constitutional Concept of EU Law*, Kluwer, Alphen aan den Rijn: 2016, pp. 3-9.

³⁴ Ramos-Pérez, *supra* note 23, pp. 137-147; Fageda, Gonzalez-Aregall, *supra* note 30, pp. 70-78.

³⁵ Wehlander, *supra* note 33, pp. 171 et seq.

³⁶ J. Kociubiński, *Between Lifeline Services and Transport of Convenience – Question about the Model of Public Service Obligation in Air Transport*, 3 *European Networks Law and Regulation Quarterly* 232 (2014), p. 234.

³⁷ *Ibidem*, pp. 233-234.

³⁸ The list of all PSO routes (updated quarterly) is available at: https://ec.europa.eu/transport/sites/transport/files/pso_inventory_table.pdf (accessed 30 May 2021).

³⁹ Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community [2008] OJ L293/3, Art. 16(1); Commission Notice – Interpretative guidelines on Regulation (EC) No 1008/2008 of the European Parliament and of the Council – Public Service Obligations (PSO), [2017] OJ C194/1, section 3.2.3.

⁴⁰ *Ibidem*, Art. 16(9) and 17(8).

⁴¹ Art. 106(2) TFEU does not prevent a measure from being classified as state aid. *E.g.* Cases C-172/03 *Wolfgang Heiser v. Finanzamt Innsbruck* [2005] ECR I-1627, para. 51; T-354/05 *TF1 v. Commission* [2009] ECR II-471, paras 135-140.

principle the amount of compensation must not exceed what is necessary to cover the net cost incurred in discharging the public service obligation(s), including a “reasonable profit.”⁴²

The primary reason why PSOs *prima facie* constitute a particularly attractive regulatory alternative for the relaunching and sustaining of transport services during the predicted post-COVID-19 downturn lies in its flexibility: Unlike state aid falling under Art. 107 TFEU, the so-called “public service compensation” justifiable under Art. 106(2) TFEU does not, according to the rules set out in Regulation 1008/2008, require prior notification to the Commission within the meaning of Art. 108(3) TFEU. These measures are only subject to *ex post* control by the Commission (in contrast to the *ex ante* state aid control), and then only for “manifest errors of assessment.”⁴³

Indeed, the Commission has never successfully challenged a PSO imposed for air routes, nor the route designation nor any other parameter thereof. There are no decisions, thus one may only speculate as to what could constitute such a “manifest error.”⁴⁴ It should therefore come as no surprise that the current EU regulatory framework for the PSO system has often been criticized as for its open-ended nature, giving *carte blanche* to the Member States.⁴⁵ Its ease of use however may, on the one hand, be viewed as a convenient tool for aiding post-COVID-19 recovery – admittedly contrary to its original *ratio legis* – while on the other hand the question remains open whether a proliferation of PSOs could give rise to long-term adverse effects on the market due to the fact that they essentially roll back liberalization.

In the above context, it should be noted that although Regulation 1008/2008, which provides the framework for PSOs on air services, has introduced requirements as regards the designation of routes, these are easily met. In particular, the so-called “guarantee function” of SGEIs requires particular emphasis. The underlying argument runs as follows: even if a route turns out to be profitable, but not enough to consider it important (from the airline’s perspective), a carrier may still decide to abandon the route in search of better business opportunities. This may be due to Start-up aid being offered elsewhere. It may also be the case when a route experiences seasonal fluctuation in demand – an issue more pronounced in tourist destinations – that the airline may decide to either reduce capacity during off-peak months or to cease operations entirely. In such a situation, the PSO can guarantee a continuous and regular service in accordance with the requirements in terms of frequency, capacity etc. In reality however, it

⁴² Regulation 1008/2008, *supra* note 39, Art.17(8). See Case C-280/00 *Altmark* [2003] ECR I-7747, para. 85.

⁴³ See Cases T-289/03 *BUPA and Others v Commission* [2008] ECR II-81, para. 187; T-106/95 *FFSA and Others v. Commission* [1997] ECR II-229, para. 192.

⁴⁴ Kociubiński, *supra* note 36, p. 241.

⁴⁵ See also I. Santana, *Do Public Service Obligations Hamper the Cost Competitiveness of Regional Airlines?* 15(6) *Journal of Air Transport Management* 344 (2009); G. Williams, *European Experience of Public Service Obligation*, in: S. Bräthen, G. Williams (eds.), *Air Transport Provision in Remoter Regions*, Routledge, Abingdon: 2016.

remains an open question whether the risk of service interruption is real.⁴⁶ It will always remain unverifiable.

In light of the above circumstances, the following problems emerge over the applicability of a PSO for post-COVID-19 recovery efforts: Firstly, whether a route requires a subsidy, and thus whether the guarantee function is needed, is entirely dependent upon public authorities since it is up to the administering authority to determine the exact parameters of air services in terms of capacity, frequency, tariffs and so on.⁴⁷ If the required service level is set above the route's commercial potential, the connection would be automatically rendered unprofitable.⁴⁸ In other words, public authorities can decide on the existence of a market failure. It can therefore be argued that under the current interpretive approach, the predicted economic downturn constitutes, by itself, an unchallengeable justification for invoking the guarantee function, thus substantiating the need for a PSO.

It should also be noted that the ability to subsidize air operations – *de iure* as a tool for regional development, but in the context of the post-COVID-19 recovery *de facto* as a lifeline for ailing airlines and airports – is associated with limiting access to a PSO route to just one carrier.⁴⁹ The exclusive rights were put in place to prevent cherry-picking those segments (for instance specific frequencies) that are most profitable, thus resulting in route revenues being dispersed and as a consequence leading to a need for higher public service compensation.⁵⁰ Since the existence of a market failure largely depends on public authorities, it may be the case that other carriers may be willing to enter the market, albeit possibly at lower service levels (conceivably still adequate for the region's needs), or be willing to commence operations overtime, as demand gradually picks up again. Thus, a paradoxical situation arises: On the one hand there is an ability to sustain a certain number of routes, which may be crucial for some carriers and especially airports; but on the other hand, exclusive rights are blocking routes' development opportunities. Hence it can be said that when a route has some commercial potential, the imposition of a Public Service Obligation with exclusive rights as an expedient, crisis-driven measure, may hinder post-COVID-19 recovery in the long run, as this will block any chances for a market mechanism to restart.

Moreover, assuming a reduced demand for air services in the aftermath of COVID-19, which would automatically render Start-up aid ineffective, PSOs may prove to be an attractive alternative for airlines because they offer a "reasonable profit."⁵¹ Although Regulation 1008/2008 does not specify what profit can be deemed

⁴⁶ Intra-Canarian and intra-Balearic routes can be used as an example of PSOs imposed despite a relatively steady service being offered. X. Fageda, *Liberalization in Aviation: Competition, Cooperation and Public Policy*, in: Forsyth et al. (eds.), *supra* note 15, p. 94-95.

⁴⁷ Regulation 1008/2008, *supra* note 39, Art. 16(1).

⁴⁸ Kociubiński, *supra* note 36, p. 239.

⁴⁹ Regulation 1008/2008, *supra* note 39, Art. 16(9).

⁵⁰ See the interpretation of the rationale for exclusive rights for SGEIs in Case C-320/91 *Criminal Proceedings against Paul Corbeau* [1993] ECR I-2533.

⁵¹ Regulation 1008/2008, *supra* note 39, Art. 17(8).

“reasonable,” further guidance can be sought in the *Altmark* criteria and the Interpretative guidelines on Regulation 1008/2008 adopted by the Commission in 2017.⁵² While the general – non-sector-specific – SGEI framework formally does not apply to air transport, the *Altmark* criteria remain applicable.⁵³ Considering that so far no PSO imposed on air routes has ever been challenged by the Commission (which may be partially due to the vagueness of Regulation 1008/2008 with regard to the oversight mechanism), a compensation for public service obligations may be an attractive option for airlines if similar profits are unobtainable on a crisis-stricken market.⁵⁴

3. PROSPECTS FOR IMPROVEMENT

3.1. A regulatory challenge – quantitative versus qualitative criteria

An extensive body of transport research emphasises that one of the main problems in the European aviation market, casting shadows over the existing legal framework, relates to the significant degree of dependence of an airport on a dominant airline, which results in wasteful interregional competition – “subsidy races” to attract these “footloose” carriers. Any attempts to explore whether easily implementable, evolutionary changes could be accommodated within this framework in order to close identified loopholes by tightening eligibility criteria for Start-ups and for PSOs, must be carried out within this frame of reference.

At a certain level of generality, such tightening could be approached from two angles, i.e. by focusing on either qualitative or quantitative criteria.⁵⁵ Since the choice between these two types is part of the broader issue of regulatory policy design – and it is not the purpose of this paper to deal with that question extensively – suffice it to say here that qualitative criteria offer ample interpretive flexibility, but due to their open-ended terminology are highly susceptible to subjective and often arbitrary interpretations. Conversely, quantitative criteria – such as intensity thresholds – *prima facie* permit the achievement of legal certainty and leave little room for arbitrary interpretation, but they may become too rigid, formalistic, and overly detailed, resulting in an

⁵² Commission Decision of 20 December 2011 on the application of Art. 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L7/3, paras. 18–22.

⁵³ *Ibidem*, Art. 2(4); 2017 PSO Interpretative guidelines, *supra* note 39, para. 98.

⁵⁴ Even before the outbreak there were claims that in many cases public backing in the guise of compensation were in fact designed to keep regional carriers afloat, see R. Merkert, G. Williams, *The Impact of Ownership, Level of Competition and Contractual Determinants on the Efficiency of European Public Service Obligation in Air Transport Operations* (European Transport Conference, Glasgow, 11–13 October 2010).

⁵⁵ See generally S.K. Shah, K.G. Corley, *Building Better Theory by Bridging the Quantitative–Qualitative Divide*, 43(8) Journal of Management Studies 1821 (2006).

inability to adequately reflect all the specificities of a given situation, thus becoming susceptible to false negatives.⁵⁶

However, using an analysis limited to what can be realistically improved within a reasonable timeframe, the general terminology of qualitative criteria – like for instance the regional development goals of Start-up aid – are often insufficient by themselves to ensure consistent results in the future. At the same time there seems to be no practical way of formulating qualitative eligibility criteria other than by using such general, open-ended terms. They will have to be fleshed out further by the Court in subsequent case law, and by the Commission in its decision practice. This takes time. Therefore, having speedy implementation in mind one must of necessity focus on the more formal, easier to “grasp,” quantitative criteria, such as those related to aid intensity or traffic volumes.⁵⁷ In other words, the necessity to rely on quantitative criteria for a quick-fix solution appears unavoidable due to the constraints imposed by legislative technique on the one hand, and by the time needed to develop case law on the other.

At the same time, these quantitative criteria are already in place within Start-up aid, alongside qualitative ones arising directly from Art. 107(3)(c) TFEU; and secondly the whole concept of SGEI hinges on the ill-defined needs of society, and according to the existing well-entrenched *acquis* public service obligations can be imposed in order for the services in question to be capable of being performed in economically acceptable conditions, not where they are absolutely indispensable.⁵⁸ All this goes to show that in practice, framing a regulatory approach to subsidies’ eligibility as involving a choice between quantitative and qualitative criteria, i.e. between certainty and flexibility, is based on a false dichotomy. The question is not whether to rely on quantitative criteria to the exclusion of qualitative ones, or *vice versa*, but rather how to strike an effective balance between them. Therefore, supplementing the existing qualitative criteria (without changing them) with new quantitative ones seems to be the only realistic option available.

3.2. Amending the compatibility criteria for Start-up aid

As regards the changing compatibility criteria for Start-up aid, before beginning this analysis it must be noted that since Start-up aid is granted under Art. 107(3)(c) TFEU, it is appraised as part of the “common assessment principles” applicable to all decisions taken

⁵⁶ See generally R. Banakar, M. Travers (eds.), *Theory and Method in Socio-Legal Research*, Hart, Portland: 2005.

⁵⁷ The Commission enjoys a wide discretion in the application of Art. 107(3) TFEU and is under no obligation to approve aid under this provision. *E.g.* Case C-409/00 *Spain v. Commission* [2003] ECR I-1487, para. 94.

⁵⁸ *Corbeau*, *supra* note 50, para. 16; Cases C-67/96 *Albany International v. Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751, paras 108-111; C-437/09 *G2R Prévoyance v. Beaudout Père et Fils SARL* [2011] ECR I-973, paras 77-78. Therefore, Art. 106(2) TFEU is *de facto* not interpreted narrowly. *E.g.* L. Zhu, *Services of General Economic Interest in EU Competition Law: Striking a Balance between Non-economic Values and Market Competition*, Springer, TMC Asser, Den Haag: 2020, p. 97 and the case law quoted therein.

under that provision.⁵⁹ For this reason, these relatively vague qualitative criteria cannot be expected to change anytime soon, while at the same time they cannot be dispensed with.⁶⁰ Thus realistically speaking improvements must be sought in amending the supplementary, sector-specific criteria set out in the 2014 Aviation Guidelines.⁶¹ Drawing on experience from dealing with state aid assessment criteria in other sectors, and on the understanding of air transport's operational specificity, the following potential solutions can be explored: Operational commitments; limits on the cumulation of aid; and changes in airports' eligibility. These will be discussed in turn below.

Insofar as concerns the proposal to introduce operational commitments, i.e. to continue operations after subsidy payments have ceased, a key question arises as to whether they should depend upon route profitability.⁶² In the first place, every entry into new markets carries a risk. Although state aid can help to minimize this risk, it can never eliminate it in a market economy. In other words, even the best business plan can fail, particularly in volatile markets. If therefore said commitments are not profitability-dependent, it can be convincingly argued that the obligation to continue operations at a loss would be grossly disproportionate.⁶³

Conversely, if the commitments in questions are profit-dependent, since many costs are common to a number of different operations and are not allocated to particular flights, the beneficiaries of aid would be able to prove the lack of profitability by cost-shifting should they wish to disentangle themselves from the profit-dependent continuity requirements.⁶⁴ Such manipulations could be prevented by accounting transparency. While such solutions exist under Directive 111/2006 and are applicable to PSOs, in the field of state aid these standards are merely recommended practices.⁶⁵ All this raises a host of associated problems: It remains unclear, *inter alia*, how to come up with the date when the profit should have occurred and for how long the route must remain profitable; whether this profitability must be continuous and uninterrupted; and at what point the continuity obligation should fall due, etc.

Furthermore, a route's profitability depends on many factors, such as the structure of demand, operational costs, aircraft utilization, and so on.⁶⁶ It is therefore not beyond the

⁵⁹ E.g. Bacon, *supra* note 9, p. 100.

⁶⁰ In this context the Court, in the *Kotnik* Case (Case C-526/14 *Tadej Kotnik and Others v. Državni zbor Republike Slovenije* [nry]) confirmed the importance of establishing that state aid is necessary for the attainment of one of the objectives specified in Art. 107(3) TFEU.

⁶¹ The Court has also stated that these common assessment principles are not binding on the EC for decisions not taken under guidelines incorporating these principles (Case T-162/13 *Magic Mountain Kletterhallen and Others v. European Commission* [nry], paras 56-58).

⁶² Cf. 2014 Aviation Guidelines, *supra* note 10, para. 147.

⁶³ It can even be claimed that that it would run contrary to Art. 17 Charter of Fundamental Rights (CFR) setting forth the right to fair compensation.

⁶⁴ See S. Holloway, *Straight and Level: Practical Airline Economics*, Routledge, Abingdon: 2016, p. 265.

⁶⁵ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings [2006] OJ L318/17.

⁶⁶ See Holloway, *supra* note 64, pp. 423 et seq.

realm of possibility that even if a route is profitable (assuming that can be established), it might not fit well into the carrier's route network. i.e. as regards scheduling, fleet/crew allocation etc.⁶⁷ Given that all points in the airline's network are interdependent, such restrictive requirements may cause a snowball effect throughout the network.⁶⁸ Moreover, airlines' routes are rearranged as part of routine business activities, with low-cost carriers – the primary recipients of Start-up aid – being the most dynamic segment in this respect.⁶⁹ Finally, assuming there is a prolonged economic downturn, route profitability predictions may turn out to be overly optimistic, making them subsidy-dependent, thus further incentivizing route changes.

Imposing restrictions either by limiting the maximum number of aid measures available to any one carrier – either throughout the EU or at a specific airport – or by making carriers which withdraw from subsidized routes ineligible for further aid constitutes another option. Because carriers usually operate a number of routes, often between various states given the point-to-point networks of Low-cost carriers – primary recipients of Start-up aid – subsidized routes may be completely economically unrelated. Therefore route switching, potentially resulting in the subsidy races these restrictions seek to prevent, may occur in various geographic configurations. Low-cost carriers' networks contain operational flexibility to accommodate these changes at short notice and over large distances.⁷⁰ Yet for these reasons, while any geographic restrictions – such as ineligibility for further aid within a certain radius – would be counterproductive, there really does not seem to be a feasible alternative. It does not appear reasonable for carriers to lose eligibility throughout the EU for withdrawing service on one route. It is unclear what could be achieved through either of these restrictions, because it would primarily penalize regions, especially considering that the number of airlines serving provincial airports – recipients of Start-up aid – is rather limited. Rendering an airline ineligible would not only remove one of the few potential entrants into regional markets, but may also turn out to be disproportionately restrictive for them. For the same reasons, limits on how many subsidised routes a carrier can operate would be counterproductive. Being limited to a specific number of subsidised routes, airlines will likely select the relatively larger, more affluent regions rather than those most in need of new air routes. Thus, it will actually further exacerbate “subsidy wars” rather than reduce them.

A third option concerns changes in route eligibility. Passenger traffic thresholds must allow for economic sustainability, otherwise it would encroach upon the PSO's territory. This leads to a twofold risk. First, by limiting eligibility to those originating from the smallest airports, there is a risk that a route will not become profitable, especially in the

⁶⁷ *Ibidem*.

⁶⁸ Even for point-to-point airlines, where there are not transfers at a hub routes are operationally connected in terms of aircraft and crew scheduling. See Budd, Ison, *supra* note 15, p. 376. It is worth mentioning that similar commitments – so-called “frequency freeze” had been used in merger control, but were ultimately abandoned as ineffective.

⁶⁹ *Ibidem*.

⁷⁰ See Budd, Ison, *supra* note 15.

post-COVID market. This may ultimately require the imposition of a PSO once the initial aid has dried up.⁷¹ Second, the relatively larger regional airports which would fall outside the new eligibility criteria would be deprived of a legal means of stimulating air traffic, which may conceivably cause some to resort to the practice of luring airlines through various incentives, marketing deals etc. – a practice that the EC sought to eliminate through, *inter alia*, Start-up aid.

All these options should be seen in a specific context; i.e. that Start-up aid should have never been seen as an optimal legal solution, but rather as an attempt to provide some framework and a degree of oversight to formalize an already widespread practice of luring airlines to regional airports.⁷² Since an alternative, to be deemed viable, must be equally simple and practical as the practices it seeks to replace, adding more requirements is essentially throwing the baby out with the bathwater. In other words, the tighter the restrictions, the greater the risk that semi-legal practices will develop to evade them.

3.3. A PSO package for air transport?

As regards modifications to PSOs, unlike Start-up aid Services of General Economic Interest are directly anchored in the EU Treaties. Moreover, Art. 14 TFEU, Art. 36 CFR, as well as the Protocol on Service of General Interest confirm their places among the shared values of the Union and their role in promoting social and territorial cohesion.⁷³ Therefore the room for manoeuvre is much more limited, especially considering that providing lifeline services for small, isolated communities is undeniably necessary in principle. In this context, the question arises whether future PSOs can be limited to a necessary minimum.⁷⁴

The primary problem with PSOs in aviation lies in their imposition on potentially self-sustainable routes, and on those with a questionable developmental function.⁷⁵ However, neither society's accessibility needs, nor the "vital" nature of regional development, can be unequivocally described by purely quantitative criteria, such as those based on the number of reported/estimated passengers on a given route.⁷⁶ These are

⁷¹ This risk has materialized in, *inter alia*, Spain: *e.g.* Ramos-Pérez, *supra* note 23; Núñez-Sánchez, *supra* note 30.

⁷² P.S. Dempsey, R. Jakhu (eds.), *Routledge Handbook of Public Aviation Law*, Routledge Abingdon: 2017, p. 123.

⁷³ Wehlander, *supra* note 33, p. 67 et seq.

⁷⁴ The EC seems aware of this general issue, as the Overview (*supra* note 8) suggests a need for a stricter approach, but how much credence is to be given to such a questionable document remains to be seen.

⁷⁵ *E.g.* S. Bråthen, G. Williams (eds.), *Air Transport Provision in Remoter Regions*, Routledge, Abingdon: 2016, p. 111. Surprisingly, the EC's Overview (*supra* note 8) is very scant on this matter (pp. 7-8), which may suggest either a highly improbable lack of foresight or serious difficulties in addressing this issue.

⁷⁶ Despite being inherently linked by the functional relationship, airport operations pose completely different economic challenges from the one that occurs with regards to airlines, therefore no analogies can be drawn from PSO airport decisions. *See generally* S. Bråthen, G. Williams, *supra* note 75.

concepts which are difficult, if not impossible, to define. The same holds true, although to a lesser extent, for “market failures,” especially with regard to the guarantee function. Although the likelihood of service disruption will always remain unquantifiable, as long as it cannot be completely ruled out the need to guarantee SGEIs provision is likely to be successfully invoked.⁷⁷ Therefore, it remains highly doubtful whether it is possible to codify a stricter necessity test. Consequently, the only feasible qualitative “controlling” criterion is a negative one – the existence of viable, guaranteed transport alternatives (mainly railways).⁷⁸

Considering all these limitations, realistically speaking the imposition of minimum quantitative standards with respect to service levels – frequencies, prices, capacity etc. – offers the only somewhat viable avenue for improvement (alongside the existing purely procedural criteria relating to selection procedure). While it can be convincingly argued that, for instance, two rotations per working day is sufficient for accessibility needs without being too excessive, it might be too inflexible to take into account all case specificities (for example differences between the needs of a rural community on an isolated island and an underdeveloped city). The system must therefore have some built-in flexibility for special cases, thus marring the clarity offered by quantitative criteria.

Nevertheless, given the positive experiences with non-sector specific SGEI Packages codifying the so-called *Altmark* criteria – intended to provide guidelines for assessment whether undertakings carrying out PSOs are not subject to the state aid regime – such an approach, combining hard law together with soft law guidance on service levels is, in this author’s opinion, generally desirable.⁷⁹ However, while the Commission has already taken a modest step in this general direction in 2017, when it adopted Interpretative guidelines on Regulation 1008/2008 indicating a somewhat stricter approach to the existing criteria, it has not been followed in practice.⁸⁰ This reflects the general trend observable in other areas of SGEIs, whereby the EC’s initial strict approach is tempered over time, in no small measure due to the fairly more lenient, but not entirely coherent, approach taken by the Court.⁸¹

⁷⁷ The case of Intra-Canarian and intra-Balearic routes serves as an instructive example. Fageda, *supra* note 46, pp. 94-95.

⁷⁸ Railway passenger services typically run as PSOs under Art. 93 TFEU, thus guaranteed continuous operations can be assumed. As for other air routes, as long as there is no PSO imposed, their provision is not guaranteed.

⁷⁹ The regulatory package currently in force consists of Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to state aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L7/3; Communication from the Commission on the application of the European Union state aid rules to compensation granted for the provision of services of general economic interest [2012] OJ C8/4; Communication from the Commission, European Union framework for state aid in the form of public service compensation [2012] OJ C8/15.

⁸⁰ There have been no cases concerning PSOs imposed on air routes.

⁸¹ See E. Szyszczak (ed.), *Research Handbook on European State Aid Law*, Edward Elgar, Cheltenham: 2016, p. 313 and the case law quoted therein.

This however brings the discussion back full circle to the notion of “manifest error of assessment” – *conditio sine qua non* for successfully overturning an imposed SGEI. Since there is no relevant aviation case law, it remains unclear exactly what parameters, from those mentioned previously, may fall under that category. This author is of the opinion that the route designation is the most important issue, affecting all other aspects of PSOs. However, the wording of Regulation 1008/2008 indicates that the decision hinges on the purely subjective (qualitative) criterion of whether a route is “(...) considered vital for the economic and social development of the region.”⁸² It is therefore open to debate whether the EC could refuse the state’s choice based on the argument that it plays no role in regional development, especially considering the unanswerable question of how such a role could be unequivocally quantified. Moreover, under the current lenient approach to SGEIs, with “economically acceptable conditions” and “conditions of economic equilibrium” as constituting a sufficient basis for compensation, it is unclear what kind of error with regard to the existence of a market failure – either concerning the profitability or the risk of service disruption – could be regarded as “manifest.”⁸³

Assuming that the criteria pertaining to service levels would be set out in a dedicated regulatory package (similar to a general SGEI package), it can be argued that a breach of quantitative parameters – known *ex ante* – should constitute a “manifest error.” While this line of reasoning is not confirmed by the SGEI *acquis* – as fully *Altmark*-compliant cases are rare – the pandemic situation seems to warrant a departure from the previous approach.⁸⁴ Such a change, if adopted, would have procedural implications. Since all quantitative criteria must have flexibility built into them, a measure should ideally be notified before being put into effect in the same manner as state aid is in every case where not all the criteria are met. Although a departure from *ex post* control cannot be formally mandated within the existing *acquis*, it can be recommended as a best practice for atypical cases in order to ameliorate concerns over the lack of predictability and give an opportunity to develop the *acquis*. Nevertheless, the impact that the nature of *ex post* assessments may have remains a concern. Based on an analysis of how lenient is the oversight over SGEIs in other sectors, this author is of the opinion that since a negative decision would entail practical problems with respect to the dismantling of ongoing operations, it creates a certain reluctance to exercise a rigorous control.⁸⁵ Although this is primarily a question of policy rather than *verba legis*, nevertheless it may derail any attempts to tighten the oversight.

This analysis must thus conclude on a cautionary note: Similarly to Start-up aid, the more stringent are the assessment criteria, the greater is the incentive for evasion. Even if it is agreed as a matter of principle that PSOs in air transport should be subject to stricter control, an overly heavy-handed approach could deprive the authorities

⁸² Regulation 1008/2008, *supra* note 39, Art. 16(1) first sentence.

⁸³ See e.g. Corbeau, *supra* note 50, para. 16.

⁸⁴ See notably C-64/99 *Adriatica and others* [2020] OJ L332/1.

⁸⁵ See Szyszczak, *supra* note 81.

of an imperfect, but nonetheless viable, legal tool for restarting air operations post-COVID-19, without giving anything back in return.

4. *DE LEGE FERENDA* CONCLUSIONS

Subsidy races leading to waste and excess spending are to an extent unavoidable whenever state funds are being pumped into the economy. Therefore, rather than searching for a perfect legal solution, one must accept the discussed limitations in order to come up with a practically feasible option. Although in this author's opinion certain improvements can be made to PSOs by introducing more detailed guidance on service levels through soft law instruments, fashioned after the general SGEI package, this would provide only a partial solution because such attempts will inevitably suffer from a seemingly irreconcilable dilemma between adaptive flexibility and predictable certainty, so the opportunities for major improvement must be sought elsewhere.

Therefore, while it may seem counterintuitive, in the light of the efforts to restart the economy with stimulus spending, a *de lege ferenda* postulate raised is to repeal Start-up aid due to evident flaws in the design of its framework, exacerbated by dysfunctional regional airports' dependency on airlines. One needs to consider the question whether Start-up aid does indeed serve as a viable alternative to unregulated practices aimed at attracting air carriers. As the analysis in this article has shown, due to its temporary nature Start-up aid incentivizes airlines to switch between airports in search for new funding, thus creating an environment conducive to subsidy races. In other words, the current system cannot be relied upon to achieve the objectives of Art. 107(3)(c) TFEU. The postulate presented above does not however entail the removal of a viable subsidisation mechanism without offering anything in return – PSOs will always remain an option, and also a macroeconomic stimulus may materialise at some point. It is just that Start-up aid creates new problems without solving the existing ones.

In the author's opinion, all steps taken to increase the efficiency of state aid control are only suppressing the symptoms, rather than tackling the real cause. The facilitation of unviable airports' continuing existence has a negative ripple effect on the entire European air transport sector, because the availability of public funds for various incentives changes the airlines' perception of economic rationality, ultimately leading to dysfunctional airline-airport relationships. Assuming local governments will be willing to keep an airport which serves the area afloat – a plausible scenario considering that these airports are often seen as a matter of prestige – the motivation to employ various semi-legal incentives, such as generous discounts or marketing contracts, will remain.