THE COMPETITIVENESS CHALLENGE

2018 FRENCH NATIONAL AIR TRANSPORT CONFERENCE
(Assises du Transport Aérien 2018)
A strategic sector

The future of the French air transport industry is a major issue for the national economy. It is a value-creating sector thanks to the economic growth and connectivity it generates, and the regional development and job creation that it provides. **France needs a strong airline player as a tool in its prestige, development and sovereignty**, attracting flows of people and goods towards its regions. This is why the Air France-KLM Group welcomes the convening of the French National Air Transport Conference (Assises du Transport Aérien), for which it has long been calling. This major national consultation bringing together all the players in the air transport industry must be an opportunity for the French State to redefine a growth strategy for the flag carriers in French aviation and ensure an improvement in their competitiveness.

AIR FRANCE-KLM IN BRIEF

The three main activities of the Air France-KLM Group are: the transfer activity, point-to-point and maintenance. The medium-haul network is built around the Paris-CDG and Amsterdam-Schiphol hubs, offering multiple connecting opportunities within Europe. In long-haul, the company has a strong, balanced presence in all the leading global markets and, in 2017, reinforced its strategic partnerships with Delta Airlines, Virgin Atlantic, China Eastern and Jet Airways. In the French market, Air France’s ambition is to develop its point-to-point operations through its two companies, Transavia and HOP! In 2018, Transavia thus plans growth of 18% with a significant progression on departure from the French provinces. The domestic market remains a strategic priority for both French businesses, for whom this activity is key, and the attractiveness of the French regions to tourists. Lastly, the aeronautics maintenance business, ranked global number two in its industry, plays a strategic role in the Group’s development. This high-tech activity every year contributes more than €1 billion to French exports.

CAPTURING ITS SHARE OF THE GLOBAL INDUSTRY GROWTH

In 2017, air traffic increased by 6.1% in France, recording its best growth rate since 2011 in the home market and also posting a robust growth outlook at global level.

**AIRFRANCE**

However, French companies are only capturing a very small portion (10%) of the growth in the French market. Their priority is to recapture a fair share of the dynamism in this market.

Faced with these challenges, Air France has not remained immobile. Since 2012, it has been engaged in a transformation process through successive plans addressing both revenues and costs, as seen in the creation of Joon during 2017. **While substantial self-help efforts have been and continue to be deployed, government support is still required to reabsorb the shortfall in competitiveness owing to the French fiscal and social security environment.** Numerous reports from French institutions and parliamentary bodies from across the political spectrum have pointed these shortfalls and all have stressed the need for State intervention.

The French National Air Transport Conference must, in particular, contribute satisfactory and balanced results of a nature to redress the shortfall in competitiveness relative to our major European neighbors, estimated at several million euros a year. **Relative to Germany, the shortfall for the Air France Group has thus been estimated at more than €500 million, even as the new German government has already indicated its intention to reinforce the competitiveness of this sector by transferring responsibility to the public authority for all or a portion of airline security costs.**

This document summarizes the Air France Group’s proposals in the five themes adopted by the public authorities for the French National Air Transport Conference.
ECONOMIC PERFORMANCE

1. Structural disadvantages which distort competition

Faced with a doubling in air traffic over the next two decades, the competition between the global industry leaders is becoming more intense. The last ten years have seen the emergence of new players, some of whom relying on substantial State aid and benefiting from low social security charges. This new context has led companies to embark on numerous adaptation measures. But this is not enough. Unlike other countries, the French air transport industry single-handedly finances all its costs and investment in areas like security, infrastructure and the financing of its central administration and air navigation. Moreover, France is one of the few countries to levy a solidarity tax.

The reasons for the shortfalls relative to our competitors are largely:

- French taxes and social security contributions which are amongst the highest in Europe

The overall shortfall in competitiveness (taxes and social security contributions) between France, on one hand, and the Netherlands and Germany on the other is reflected, for Air

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1 Translation: Revenue reverting to Air France €1.13 / Solidarity Tax €4.52 / Airport charges €12.4 / VAT €0.23 / Airport fees/passenger €10.65 / Air navigation charges €4.05 / Airport fees/aircraft €5.60 / Tax on aviation noise disturbance (TNSA) €0.56 / Terminal fee at Nice €2.07
France, in an annual cost differential ranging from nearly €1 billion with the Netherlands (of which two-thirds linked to the difference in social security contributions and one third to the differential in taxes and fees linked to infrastructure costs) and €500 million with Germany. The main cause is the level of employer social security contributions and the absence of a cap. A cap on social security contributions is applied in all the leading European countries, with the exception of Ireland and France.

### Level of employer contributions
(2015 as a % of gross salary)

- **France**
- **Germany**
- **Netherlands**
- **Spain**
- **Italy**
- **United Kingdom**
- **Ireland**
- **Dubai**

• **Security measures financed exclusively by the airlines**

France is the only OECD country in which investment in airline safety and security is exclusively financed by the air transport industry whereas some countries finance this type of expenditure partly from public funds. As a result, for the French players, these costs are 35% above the European average: this figure is even higher for the connecting activities at Roissy-CDG and Orly, thereby justifying a reduction in the airport tax for this type of traffic.

• **An upwards trend in the costs associated with infrastructure use**

Since 2005, Paris airport charges have increased by 39.5% while numerous European airports have reduced their charges over the same period. In parallel, in terms of 2017 service quality, Paris-CDG was ranked only 32nd by Skytrax. This is the reason why the current regulatory framework must notably be reviewed and structured to guarantee airlines, airport management companies and the State their fair share of the added value generated by the air transport industry and ensure that airports deliver high-quality services under the best conditions for airlines and their customers. In the same spirit, it appears vital to modernize air navigation infrastructures and services to contend with a 40% increase in the number of passengers in 2035 relative to 2015.

• **Inequitable competition with the Gulf State carriers and some low-cost operators**

The former are likely to have benefited from subsidies from their respective States of origin amounting to some €50 billion over the past decade and operate out of infrastructures invoiced at marginal cost within a context of non-existent taxation and the absence of social regulations. The latter are developing, for some of them, practices equating to social dumping, practice fiscal optimization and benefit from illegal regional aid in the light of the European regulations governing State aid.
PROPOSALS:

Introduce a tax regime that is more favorable to the airlines:
- Extend the scope of the solidarity tax to other sectors to reduce the aviation contribution and envisage the development of innovative financing methods for international solidarity.
- Freeze the Civil Aviation Tax.

Reduce social security contributions:
- Implement a special social security regime, like the so-called “shipping” regime in the maritime industry, for example by capping the amount of employer contributions above a certain threshold.

Rebalance the financing method for security measures:
- Share responsibility for airport security measures with the State and reduce their cost.
- Full exonerations from airport security costs for connecting passengers.
- The State to assume responsibility for the cost of financing security measures in those airports handling a limited level of traffic.

Reinforce the regulations governing relations between airports and airlines:
- Strengthen the powers of the independent regulatory authority, particularly with regard to control over costs and the level of service quality.
- Enshrine in law a mandatory economic regulation contract.
- Promote the so-called “single till” principle or, failing this, establish a mandatory financial contribution from commercial activities to aviation services.

Create the conditions for the modernization and increased effectiveness of air traffic control:
- Implement a French national strategy to modernize air traffic control, enabling a reduction in the fees per passenger carried.

Promote a level playing field at national and international level
- Make the granting of new traffic rights to extra-European airlines conditional on their commitment to respecting the obligations incumbent on EU operators, i.e. no subsidies.
- Ensure respect by the local authorities of the rules on State aid governing airline subsidies and strengthen the system for verifying the employment conditions in some companies for their flight crews based in France.
PERFORMANCE AT THE SERVICE OF THE FRENCH TERRITORIES

2. Ensure the air connectivity of all territories

The Air France-KLM Group makes a significant contribution to France’s international prestige, its economy and the development of tourism across its territories. It is the leading air carrier for international tourists traveling to France, serving 328 destinations in 116 countries via its dual Paris and Amsterdam hubs, and actively participates in the different strategies for promoting France as a destination.

The Air France Group (Air France, HOP!, Transavia, Joon) is present at 44 French airports (continental France and the French overseas territories and dominions) and participates in the opening up of the territories. With €22 billion of economic spin-offs, it generates 1.1% of French GDP and creates 359,000 jobs in France (EM Strasbourg research 2016). With some hundred aircraft and more than 600 daily flights, HOP! Air France operates the most extensive domestic network in Europe, ensuring high-density coverage of the French territory. In the French Antilles, Air France has opted to develop a regional network based at Pointe-à-Pitre. Composed of two dedicated aircraft, it enables five destinations to be linked with flights under the company’s own banner and a further 15 with its partners.

While the regional deployment of the Air France Group aims to ensure the air links between all the French territories, the French airport network nonetheless requires rationalizing and the establishment of overall guidelines. The development of the Public Service Obligations may constitute an opportunity and provide some positive responses to the opening up of the territories at a cost lower than that of other transportation methods. This will nonetheless require the regions to make strategic choices between the financing of these routes and the aid provided to some low-cost carriers under questionable conditions and at a high cost to local authority finances.

Lastly, it seems appropriate for the French State and the local authorities to reflect on the opportunity to adjust the conditions (number of frequencies, days of operations) governing the operation of routes under the Public Service Obligation (PSO), to encourage carriers to propose a service at a reduced cost while continuing to comply with EU regulations.

PROPOSALS:

Revisit the role of the French State and the local authorities in the financing of the air routes operated in respect of the Public Service Obligations (PSOs) in continental France and the French overseas territories and dominions:

- Involve the regional players in the financing of their air route requirements (reinforcement of the PSOs)

Establish an assessment of the legality and effectiveness of the public aid granted:

- Re-orientate the public financing from regional authorities which is incompatible with the existing rules on State aid for airports and airline companies towards the Public Service Obligations (PSOs) which make an effective contribution to the opening up of the French territories.

Create a dedicated fund for the financing of air routes with Public Service Obligations (PSOs):

- This fund, jointly financed by the French State and that local authorities, must enable the funding of those routes whose operation is difficult to justify on a purely economic basis.

Step up the international promotional campaigns for France as a destination:

- Reinforce the financing of the world-wide promotional campaigns for France and its territories with the territorial promotion fund.

Support the development of air transportation to/from the French overseas territories and dominions:

- Improve the economic efficiency of airports and continue to finance infrastructures with the support of subsidies from the European Regional Development Fund (ERDF)
- Review the application scope for dock dues (return of the exemption for jet fuel imports)
- Cap local increases in kerosene prices and authorize the opening to competition of logistics (storage and loading)
Establish Public Service Obligations (PSOs) for air routes between the French territories and dominions and look into the implementation of equivalent models for local regional links.

SOCIAL PERFORMANCE

3. A commitment to jobs development

While Air France generates more than 50% of its revenues outside France, 93% of its staff pay social security contributions in France and are based throughout the French regions.

Since 2017, the Air France Group has again been recruiting significant numbers of ground staff and flight crews under permanent, fixed-term and internship contracts. It is one of the largest private sector employers in France. The Group’s staffing requirement is going to expand in 2018 with the prospect of 4,800 new recruits across numerous professions and specifically pilots, cabin crews, ground staff, young executives, mechanics but also new areas of expertise like digital, big data and product designers. Nevertheless, Air France is facing a number of challenges in terms of sourcing candidates, the need to make up for the incompatibility of the initial training received with the positions on offer, support for the business transformation underway with digital, together with the cost of this training, particularly in respect of the specific skills required by pilots and maintenance technicians. Note, in particular, that the capacity of the European pilot training schools is well short of the level required to meet the recruitment needs of the European airlines.

93% of our jobs based in France

To contend with changes in jobs, organizational structures and technologies, Air France invests substantial sums in training to which it devoted €180 million in 2017.

An active, regular employee dialogue is accompanying the business transformation: Air France is committed to a contractual HR policy based on negotiated collective agreements, enabling it to adapt to professional changes, integrate new technologies, implement new employee representative bodies and, more generally, achieve a compromise between the expectations of employees and the business needs.

Furthermore, Air France is seeking redress of the situation in which some players are contravening the regulations regarding the airline base concept and mandatory social security (URSSAF, ground staff and flight crews) and flight crew pension fund (CRPN)
It is calling for counter-fraud measures to be stepped up against the recourse to “false independents” or false secondments, and the implementation of a harmonized legal framework applicable to mobile staff in the European aviation industry.

- 49,788 employees at December 31, 2017 including Air France, HOP!, Transavia, Joon, Bluelink and CRNA
PROPOSALS:

Prioritize jobs and training to meet the business needs:

- Consolidate the recruitment needs on a three-year view at branch level.
- Introduce measures meeting the recruitment and training requirements for pilots, mechanics and customer relations staff.
- Implement measures to support the professional transformations linked notably to the development of digital technologies and the professionalization of staff.
- Create a center of excellence dedicated to data-science.

Reinforce checks on the employment conditions for personnel seconded to France, whether ground staff or flight crews, to prevent and sanction anti-competitive practices:

- Amend the European legislation to guarantee mobile aviation industry personnel the benefit of the social protection in the country in which/from which they perform their day-to-day duties.
- Put in place the resources required to prevent players from contravening the social security regulations governing URSSAF and flight crew pension fund (CRPN) contributions.

ENVIRONMENTAL PERFORMANCE

4. Continue the sustainable development of the air transport industry

-18%

CO₂ emissions relative to 2011

The air transport industry has long assumed its environmental responsibility via its UN specialist body the ICAO and the International Air Transport Association (IATA). The provisions adopted in these bodies enable three major themes to be addressed, i.e. greenhouse gas emissions, noise emissions and air quality around airports.

The Air France-KLM Group is recognized for its commitment to the environment by the international community and its stakeholders.

Climate change

Greenhouse gas emissions from the air transport industry currently represent around 2% of the total CO₂ emissions of human origin.

The international air transport industry is aware of its responsibilities and has set itself some ambitious targets in the form of a binding global agreement known as CORSIA, in which the Group is a stakeholder, aimed at attaining carbon-neutral growth as of 2020.

Beyond the regulatory requirements, the targeted improvement in Air France’s energy efficiency has been steadily increased since 2000 thanks to the ongoing renewal of its fleet, an improvement in its operational procedures and a reduction in the weight of equipment embarked on aircraft.

Furthermore, since 2012, the Group has also participated in the European Union carbon emissions trading scheme (EU ETS) on intra-European flights.
Lastly, sustainable alternative biofuels are also a promising lever for reducing CO$_2$ emissions at source over the short/medium-term. The signature of an Engagement for Green Growth (*Engagement pour la Croissance Verte* – ECV) with the French State and four other industrial partners in 2017 should enable the identification of the development conditions for this industry.

**Noise emissions**

Thanks to the regular renewal of its fleet and the recent retirement of its noisiest aircraft (Boeing 747), the Group has significantly reduced its noise footprint (**47% decline in the noise index for the ten principal French airports since 2005**), a trend that will continue over the next few years.

The Group favors the development of continuous descent procedures, actively contributes to identifying the conditions for their development and applies them when the authorities decide on their implementation.

**Air quality around airports**

In terms of the ground equipment directly linked to its activity, the Air France Group continues to invest in reinforcing its fleet of electric runway vehicles (nearly 50% of the fleet) and, with its partners, is pursuing efforts to investigate green taxiing. However, air quality in airport zones does not only depend on air traffic. The major impact linked to road traffic in proximity to airports requires a reduction in road congestion which can only be achieved via an improvement in public transport infrastructures.

**Biodiversity**

In this area, the Group is committed to developing responsible catering and supports a number of nature preservation projects. For its 85 million meals and snacks served every year, Air France prioritizes **local products, originating from organic production and designated origin (Appellation d’Origine Contrôlée)**, and deploys programs aimed at reducing food waste. Established three years ago, the **HOP! Biodiversity association**, a **ground-breaking and unique initiative** of which the French Civil Aviation Authority (DGAC) and numerous airports and airlines are members, reflects the Group’s determination to preserve and foster the wealth of biodiversity around airports. The initiative was thus recognized by the Environment Ministry as part of the French national biodiversity strategy in 2016. Lastly, Air France is committed to combatting the illegal traffic in protected species.
PROPOSALS:

Make CORSIA the single system for CO₂ emission offsetting and mitigation

- Contribute to the effective implementation, as of 2021, of the CORSIA emission offsetting system though the provision negotiated by the ICAO, to enter the implementation phase as of 2018.
- Defend CORSIA as the single system for offsetting the emissions from international aviation, in lieu of the EU ETS, to ensure equitable competition between operators.

Implement the Single European Sky

- Contribute to the implementation of the SESAR project with significant energy efficiency potential estimated at 10% a year via a reduction in waiting time and the adoption of more direct flight trajectories, while committing to improving the performance of French air traffic control.

Developing political initiatives rather than new regulations or punitive taxation

- Support the structuring of a sustainable biofuels industry. This implies defining the modalities of the financial incentives required to ensure the parity of the final cost of use with fossil kerosene and thus the viability of an alternative sustainable biofuels industry for aviation in France within the framework of the Engagement for Green Growth.
- Develop fiscal incentives (additional depreciation or tax credits) for investment in aircraft and ground equipment for handling aircraft with higher levels of environmental performance.

Access to an overall loan to accelerate the sound-proofing of housing for residents around airports

- Such access must enable a reduction in the waiting list for sound-proofing applications from local residents, while guaranteeing a foreseeable contribution level and not exceeding the 2016 rates for the operators.

PERFORMANCE AT THE SERVICE OF PASSENGERS

5. Enhancing the passenger experience thanks to the new technologies

The government target of 100 million tourists visiting France in 2020 requires some rapid changes, particularly in terms of facilitating passenger transit through airports. To this end, the Interministerial Council for Tourism has noted, in particular, the need to reduce the waiting time at border police check-points by setting a long-term target of less than 10 minutes. There has, however, been some delay in implementing the measures and the French National Air Transport Conference’s work could help to achieve this target. New technologies and in particular biometry must be able to be deployed at the service of passengers and enable the travel of the future to be redesigned.

Digital and personalization

For the past few years, Air France has placed the digital revolution at the heart of its transformation and is investing substantial sums in technological innovation to offer its customers new services and develop ever-more-effective tools for staff. The company thus offers a 24/7 personalized service available in seven languages, accessible by mobile phone via the AF app, the social media and conversational platforms (WhatsApp, Facebook Messenger).

The rate of innovation is being accelerated to reinforce personalization:
• By using Big Data and predictive algorithms: an open data portal has been operational since 2015.
• By equipping staff with tablets giving access to information at all points of contact (40,000 iPads distributed to ground staff, mechanics, flight crews, etc.).
• By redesigning the mobile application as a travel assistant.
• By embedding analysis, artificial intelligence and machine learning in our tools.

PROPOSALS:

Fluidify transit at border check-points within airports

• Adjust the number of police and technical resources to ensure transit through border check-points in under ten minutes.
• Extend sovereign tools like PARAFE to citizens of third-party countries.
• Deploy the Global Entry program to enable French citizens regularly traveling to the United States to benefit from accelerated customs clearance.
• Conduct research into baggage check-in at the Gare de l’Est for the CDG Express rail service.
• Put in place a “pre-Check” advance database interrogation system.

Plan the airport infrastructure of the future

• By committing to the investment required to respond to the traffic growth at both Paris-CDG (Terminal 4) and Orly (Hall 3).
• By planning a CDG Express service to Terminal 4 at Paris-CDG
• By prioritizing Paris Metro lines 14, 17 and 18 in the works schedule for the CDG Express.

Redesign the airport of the future

• By accelerating the roll-out of biometry and digital identity
• By enabling access to the public part of the chips on French passports for a minimum trial period of at least one year.
• By developing baggage identification using RFID.
• By applying augmented reality.
• By promoting research on autonomous gateways.

Promote the emergence of an innovation fund:

• This fund must enable aviation to dispose of specific financing to promote the emergence of projects enhancing the passenger experience and planning for the aeronautics maintenance of the future.
Key figures for the Air France-KLM Group

• €25.8 billion of revenues in 2017

• Contributing more than 1% of national GDP

• 552 aircraft

• Maintenance support on more than 2,000 aircraft for over 200 Air France Industries customers

• 80,595 employees (full time equivalent) of the Air France-KLM Group at March 31, 2018

• 314 destinations in 116 countries in 2018

• 74 new routes in the Summer 2018 season

• 98.7 million passengers carried in 2017

• 1.1 million tons transported by the Cargo business in 2017