Malaysian Aviation Commission
Suruhanjaya Penerbangan Malaysia
MAVCOM

COMMENTARY

FORMS OF GOVERNMENT ASSISTANCE TO THE AVIATION INDUSTRY | **JULY 2020**

EXECUTIVE SUMMARY

Governments' relief efforts highlight the importance and strategic nature of aviation: In 2020, the global aviation industry is forecasted to see a USD411.0bn reduction in revenues due to the COVID-19 pandemic crisis. Many governments have stepped in to provide relief to the aviation industry, suggesting that it is recognised as a key strategic sector to provide connectivity and enable essential economic activities. Various forms of government assistance have been provided, including equity, debt, grants and deferment or waivers of fees.

State aid may result in anti-competitive effects or moral hazard: Direct financial assistance to corporations are widely perceived to be a bailout by the government. If distributed indiscriminately without a clear framework, it may reduce competition or risk moral hazard if given to industry players that were already in difficulty or would have inevitably faced declines in the business. In addition, public funds would be put at risk, unnecessarily burdening taxpayers and potentially directing funds away from critical areas such as healthcare and education.

The role of independent oversight will become more important in the event of reduced competition: In the event that state aid results in reduced number of players and reduced competition, there is a concern that the airline industry could become increasingly re-regulated in the long run. Countries may see a return to nationalised market access, reduced competition and higher ticket prices—further underlining the importance and role of independent oversight and regulation.

Financial assistance should be predicated on good governance practices: Given the risks, governments should ensure that any financial assistance are provided out of a clear framework consisting of identified principles (such as non-discrimination) and specific objectives (such as minimising job losses and ensuring connectivity). They should be given together with predetermined conditions such as requiring proof that all commercial avenues have been exhausted (i.e. government lending as a last resort), building in a sunset clause and ensuring no unjust enrichment (by limiting executive compensation, share buybacks and dividend payments).

An opportunity within the crisis to embark on best practices: A clear and transparent framework for government assistance should be created, similar to the EU, US, Australia, and Japan. The COVID-19 crisis, whilst devastating, can be a golden opportunity to introduce long-term good governance practices which will benefit all stakeholders—including aviation players—in the long run.

FORMS OF GOVERNMENT ASSISTANCE

The plunge in passenger traffic due to the COVID-19 pandemic has resulted in airlines, airport operators and ground handlers experiencing significant deterioration in revenues, with airlines forecasted to lose up to USD314.0bn and airports predicted to lose up to USD97.0bn in 2020 respectively[1]. Many governments globally have stepped in to provide relief at the request of the aviation industry, including the GoM[2].

To provide some guidance and context based on good governance principles, the Commission has reviewed a non-exhaustive selection of financial assistance as listed below:

- Waiver or deferment of aviation-related fees and taxes;
- Subsidies;
- Equity-related instruments;
- Debt instruments;
- Route support; and
- General aid not specific to aviation companies.

Waiver or Deferment of Aviation-Related Fees and Taxes

Many airlines have requested for a waiver or deferment of aviation fees and taxes. As the crisis began, waivers and deferments of fees were short-to-medium steps that were provided by many governments and airport operators to alleviate airlines' cashflow problems such as those in UK, Australia, Singapore, France and the Philippines. These include the deferment or waiver of aviation-related fees such as air traffic management fees, aircraft landing and parking charges as well as office space rental payments.

Some governments—particularly those with sufficient public resources at their disposal—have been able to provide tax waivers or deferments. For example, the Chinese government is providing airlines exemptions from Civil Aviation Development Fund payments and is deferring concession fees owed by the airport operators. The US government meanwhile is relieving airlines from certain federal excise taxes[3] as part of the US CARES Act.

The GoM had also announced similar measures for airlines. The GoM, through the initial Economic Stimulus Package in February 2020, announced a 15.0% discount on monthly electricity bills to airlines, rental rebates as well as aircraft landing and parking rebates (though details of the implementation have yet to be announced at the time of writing).

[1] International Civil Aviation Organization (2020).
[2] Government of Malaysia.
[3] Section 4007 of the Coronavirus Aid, Relief, and Economic Security Act.

Subsidies

Provision of subsidies is another option of fiscal support. On top of tax deferment or waivers, some governments have provided subsidies to aviation players to allow it to weather the pandemic. Though many countries announced wage subsidy programs for all businesses, some launched specific schemes for aviation companies. For example, the US CARES Act provides a USD32.0bn Payroll Support Program to compensate airlines workers' wages, while the Singapore government co-funds aviation workers' compensation at 75.0% of wages.[4]

Waivers and Subsidies: Potential implications and risks

Economic costs need to be considered. Though the waiver or deferment of fees, taxes and imposition of subsidies are useful immediate steps, they may impact operators' (airport operators and air navigation service providers) and governments' cashflow if maintained over a longer period. There are also administrative costs for the government to disburse and monitor funds, as well as any impacts to the future tax burden. Any economic benefit may also be minimal as airport fees and government taxes form a small portion of airlines' operating costs compared to fuel and staff salaries. However, imposition of subsidies for employee welfare would be a positive step as it is targeted to help protect workers rather than corporations, though monitoring of the expenditure would be an additional step required to ensure that the funds would be deployed to its intended recipient.

[4] Singapore Ministry of Finance (2020).

Equity

Direct Equity Stakes

An increase in direct equity stakes of national flag carriers, despite state aid rules. It has been interesting to observe that in the European Union—a proponent of fair competition law—some member states have offered aid directly to the airlines typically seen as the national flag carriers, though this was done within a Temporary Framework and certain guiding principles[5]. Examples include Italy's re-nationalisation of Alitalia[6] and Germany's aid package for Lufthansa.[7]

Several airlines returned to the capital markets to raise funds. Several airlines have announced rights issues and private placements, drawing new capital from shareholders as well as governments. Cathay Pacific announced a recapitalisation via a combination of share sales and loans, raising up to USD5.0bn (backed by the Hong Kong government)[8], while Singapore Airlines announced rights and bond issuances of SGD5.3bn and SGD9.7bn respectively (backed by sovereign wealth fund Temasek Holdings)[9].

An exception is Thai Airways, where the government reduced its equity stake to enable a restructuring. The Thai government declined to provide a rescue package to allow its flag carrier, Thai Airways, to undertake a 5-year restructuring program through the bankruptcy court. The program will see the government's stake fall below 50.0%[10], in line with the government's aspirations for the airline to rehabilitate itself and compete globally.

Options, warrants and hybrid instruments

Alternatively, an optional take-up of equity may be preferred. Hybrid instruments, options, or warrants, which allow the government to recoup its capital in the future, have been used in some packages. For example, the New Zealand government announced a NZD900.0mn convertible loan to Air New Zealand[11] while the US Treasury received options on airlines' stock in exchange for aid. [12]

Equity-related measures typically come with conditions. Air New Zealand's convertible loan is subject to certain requirements such as maintaining services to existing local destinations and cancelling future dividends.[13] The US CARES Act imposes several conditions[14] for the recipients of aid, such as the requirement to maintain employment levels without pay and benefits reductions, as well as limits on stock buybacks, dividend payments and executive compensation.

[5] Garcia (2020).
[6] Reuters (2020c).
[7] Deutsche Welle (2020).
[8] Nikkei Asian Review, 2020
[9] Reuters (2020a).
[10] Bangkok Post (2020).
[11] Radio New Zealand (2020).
[12] Nye, Unnava, and Wiggins (2020).
[13] Radio New Zealand (2020).
[14] Thornton (2020).

Equity: Potential implications and risks

The decision to take up equity in airlines illustrates the critical nature of aviation infrastructure, though the degree of appropriate intervention remains debatable. For governments who have taken up equity stakes, their decisions likely reflect the belief that aviation is a key strategic sector which enables job creation and economic growth, and therefore deserves protection. However, the issue remains as to the degree of appropriate involvement by the government and whether they generate anti-competitive effects.

Equity stakes may risk public funds and moral hazard. Equity stakes, a permanent form of capital without guaranteed returns, are widely perceived to be a form of bailout. This may risk moral hazard and prolong inefficiencies if given to a player that is already in difficulty or would have faced inevitable declines in the business. In addition, public funds would be put at risk, unnecessarily burdening taxpayers and potentially diverting funds away from more critical areas such as healthcare.

Government equity stakes usually comes with conditions attached. Airlines typically dislike government support that comes with ownership, arguing that private investors would prefer commercial management at the helm of airlines.[15] However, a government equity stake—if accompanied with appropriate conditions—may help to provide critical funds whilst providing a stamp of credibility and stability. To reduce the risk of public funds wastage, government equity stakes should be an act of last resort as stipulated in the UK government's Project Birch plan[16] and the US CARES Act' loan program.[17]

The airline industry could become re-regulated in the long run. There is concern, however, that the aviation industry could become increasingly more isolated and inwardly regulated in the long run, potentially undoing decades of liberalisation and deregulation with a return to nationalised market access, reduced competition and higher ticket prices. Direct aid that results in anti-competitive effects may result in an increasingly distorted market structure which puts the recipient firms at an advantage compared to its competitors, or even worse, attain regulatory capture. In such situations, economic regulation plays a greater role than competition regulation, further underlining the importance and role of independent oversight and regulation.

[15] Horton (2020).
[16] The Guardian (2020).
[17] United States Treasury (2020).

Debt

Loan guarantees

Governments may provide partial or full guarantees on loans to airlines. Debt is commonly provided in government relief plans as the borrower has a commitment to pay back the funds with interest. However, private lenders may refuse lending to companies in severe financial distress, resulting in many governments stepping in to provide guarantees. Like equity funding, this has tended to benefit historically-linked national flag carriers the most, such as Air France-KLM which obtained France's 90.0% guarantee on an EUR4.0bn syndicated loan.[18] There are also states who direct their banking industry to provide preferential loans with lower-than-market interest rates to aviation industry players, such as China and Russia.

Direct loans

Governments may also lend directly to their airlines. France has given a direct shareholder loan of EUR3.0bn to Air France-KLM, while Germany has lent approximately EUR0.6bn to charter airline Condor[19]. Though state-linked flag carriers typically have been the recipients of direct government loans, Dublin-domiciled Ryanair[20] and the Spanish parent company of British Airways, IAG, recently obtained loans from the UK government's Coronavirus Corporate Finance Facility[21] (as well as loans from the Spanish government which are earmarked for its Spanish airlines Vueling and Iberia[22]). The US meanwhile has provided USD29.0bn in loans or loan guarantees to all eligible passenger airlines, ticket agents, MRO operators and cargo airlines[23] that are based in the country.

Debt: Potential implications and risks

Loan and loan guarantees should not be given carte-blanche. Similar to equity funding, government-assisted lending should be provided within a clear framework with predetermined principles. The loans should be structured to incentivise the borrower to pay off or refinance the loan quicker[24] (thus minimizing taxpayer losses); ideally carrying terms that are on par with commercial terms available in the market.

Risk of anti-competitiveness remains. If state loans are not distributed uniformly to all industry players or within equal eligibility rules, other privately held carriers who are headquartered or tax-domiciled in the same country would argue that they should be equally eligible for the loans[25]. Again, this may risk moral hazard, prolong inefficiencies, and risk taxpayers' funds, as well as potentially reducing competition.

[18] Air France KLM (2020).
[19] Reuters (2020b).
[20] Aerotime Hub (2020).
[21] Bloomberg (2020).
[22] Evening Standard (2020).
[23] Section 4003 of the Coronavirus Aid, Relief, and Economic Security Act (as amended).
[24] Wiggins and Unnava (2020).
[25] Ryanair (2020).

Route support

Route subsidies or grants

Route support primarily driven by socioeconomic needs. Some governments' decisions to support their network of routes is driven primarily by socioeconomic needs rather than the profitability, particularly in geographically diverse and remote areas. For example, the Australian government announced an AUD198.0mn grant called the Regional Air Network Assistance Package[26] and awarded Qantas and Virgin Australia AUD165.0mn to subsidise flights between state capital cities. Other countries who announced route support measures include China[27] and New Zealand[28]. In Malaysia, the GoM has continued its support for RAS operations in Sabah and Sarawak throughout the MCO period to provide essential transport for remote communities.

> ### Route Support: Potential implications and risks
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> **Route support is vital to ensure the preservation of essential routes to maintain connectivity.** Route support is a type of government assistance that would be most palatable to all stakeholders given governments' clear mandate to ensure essential connectivity and transportation links. In this context, route support covers any route which a government deems as "essential", in particular domestic routes where no viable substitute transport is available and international cargo routes which deliver essential goods to and from the country. It is the government's moral obligation to ensure that no one is left behind when it comes to giving aid, and that includes meeting the essential transportation needs for all communities.

Other types of relief instruments

Other general financial assistance programs have also been made available. Instead of industry-specific programs, many governments have provided other assistance such as providing wage subsidies schemes, working capital loans, rental compensation, infrastructure spending schemes as well as simplified processes or rules. Hong Kong[29] and South Korea[30] have even launched schemes to purchase tickets to boost airlines' cashflow with plans to disburse the tickets in the future.

A summary of the types of government assistance is provided in **Appendix I.**

[26] Department of Infrastructure, Transport, Cities, and Regional Development (2020).
[27] Civil Aviation Administration of China (2020).
[28] Government of New Zealand (2020).
[29] Hong Kong International Airport (2020).
[30] South Korea Ministry of Land, Infrastructure, and Transport (2020).

Denial of specific airline assistance

Some governments refuse to provide specific aid to aviation players. Some governments, such as the UK and Malaysia, have refused (to date) to provide specific aid to aviation industry players and instead have focused on providing aid to all industries and sectors. This is likely to minimise risk of taxpayer losses and ensure that aid is provided to all sectors irrespective of sizes.

Governments have been selective in extending aid to airlines. It is interesting to observe that in most direct bailouts, governments have chosen to rescue airlines with historical links and the aid is typically not extended to other foreign-owned airlines. The Australian government's decision not to rescue Virgin Australia was due to fears that it would end up bailing out the airline's 90.0% foreign shareholders[31]. Similarly, British Airways' Spanish-based parent IAG, obtained loans from the Spanish government for its Spanish airlines Vueling and Iberia but not for British Airways. Another example of territorial-linked assistance is the French government extending loans not just to its home carriers but also to airlines in its overseas territories such as Air Tahiti[32].

Some governments provide state aid to all eligible airlines. However, as stated earlier, some governments do provide aid irrespective of nationality, such as Ryanair and British Airways parent IAG recently obtaining loans from the UK government's COVID-19 relief fund. This is because the UK Coronavirus Corporate Finance Facility and US CARES Act programs provides aid to all eligible airlines who are able to meet the criteria.

[31] Wall Street Journal (2020).
[32] French National Assembly Proceedings (12 May 2020).

CONCLUSION

Various forms of relief have been provided to weather the pandemic crisis – will this be enough? The sheer scale, suddenness and uncertainty of the COVID-19 crisis has resulted in various forms of government assistance being provided. There is a risk that government assistance may be anti-competitive, risk moral hazard, prolong inefficiencies and put public funds unnecessarily at risk (potentially inviting the criticism that there tends to be a "socialisation of losses, privation of profits"). Countries may see a return to nationalised market access, reduced competition and higher ticket prices—further underlining the importance and role of independent oversight and regulation. Thus, despite the different approaches and mechanisms, the underlying conclusion remains that government assistance should be provided only with good governance practices to justify public funds usage.

GoM needs to ensure that any financial assistance is predicated on a clear framework with specific principles and well-targeted objectives. There are no current laws or guidelines governing GoM assistance in Malaysia and it has yet to announce any significant form of aviation-specific assistance. Therefore, the GoM should ensure that any specific financial assistance is provided out of a framework consisting of identified principles, clear objectives and provided only as a last resort. Drawing from other jurisdictions, a framework with the following principles should be established:

- **Non-discriminatory:** Criteria for assistance must be equal and non-discriminatory, i.e. eligibility should not be based on factors such as ownership structure;
- **Clear objectives:** The aid should be premised on clear policy objectives which should include employment preservation, loss minimisation, and connectivity support, rather than protection of commercial or private interests;
- **Well-defined targets:** The aid should be well-scoped, have a defined duration and not be used for other purposes unaligned with policy objectives. The terms of state assistance, as well as the opportunities for reform should be addressed in the longer term to prevent discouragement of private investment (which also hinders access to capital markets); and
- **Accountability and transparency:** The aid scheme should be made publicly available and should be subject to regular audits and reporting by independent auditors;

An opportunity within the crisis to embark on best practices. A clear and transparent framework for government assistance should be created, similar to other countries such as the EU member states, US, Australia, and Japan. COVID-19, while being a pandemic crisis, can be an opportunity to introduce long term good governance practices. Therefore, the Commission reiterates its earlier commentary for the GoM to embark on good governance practices and transparency to avoid distorting the competitive landscape whilst ensuring the protection of jobs and the viability of the domestic aviation industry.

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APPENDIX I: SUMMARY OF GOVERNMENT ASSISTANCE FOR THE AVIATION INDUSTRY

	Types of Government Assistance	Notes
1	Waiver or deferment of aviation fees	• France, Singapore, Republic of Korea, United Kingdom, Norway, Hong Kong, and the Philippines agreed to defer payment by airlines of certain aeronautical taxes, VATs and departure levy • The Australian government launched an AUD715.0mn relief package, including a waiver of fees including aviation fuel excise, air services charges on domestic airline operations, as well as domestic and regional aviation security charges • Brazil's Ministry of Infrastructure announced that the government will implement a package of measures for the civil aviation sector, including the deferment of air traffic management fees, airport fees and passenger refund obligations and exemption from penalty fees • China exempted airlines from paying into the Civil Aviation Development Fund (total savings of RMB600.0mn/USD85.2mn per month)
2	Waiver or deferment taxes Subsidies	• The US government would provide relief to air carriers from certain federal excise taxes that normally apply to transportation services until 1 January 2021 • Denmark also launched a DKK970.0mn (EUR130.0mn) tax scheme to ease the liquidity constraints of SMEs. The schemes will take the form of tax deferrals and similar measures concerning VAT, payroll tax, and accelerated capital allowances on qualifying capital expenditure incurred on machinery and business refurbishments • The Singaporean government introduced the COVID-19 (Temporary Measures) bill to ensure the pass-through of the 100.0% tax rebate for non-residential properties • Many countries announced wage subsidy programs of up to 80.0% of wages for all qualified businesses across all sectors; as an example, Singapore announced that it would co-fund aviation industry workers' compensation at 75.0% of wages for the first USD3,245 of monthly wages • China will provide full financial subsidies for its airlines to refit safety electronic equipment on transport aircraft. The government also extended the maximum carry-over period of losses incurred in 2020 from five years to eight years for businesses in difficulty • Singapore announced that it would raise course fee subsidies and absentee payroll to 90.0% for skills upgrading for the aviation industry until June 2020
3	Equity Options, warrants, and hybrid instruments	• The Italian government will inject at least EUR3.0bn to take complete control of Alitalia from its owners, on top of EUR0.5bn state-backed financial stimulus in March for the Italian airline industry; • The Portuguese government, a 50.0% owner of TAP Portugal, has stated its intention to take control of the airline if it were to provide a state-backed loan of EUR350.0m and if the private investors decline to commit funding • The Latvian government will inject EUR204.0mn into flag carrier airBaltic and convert EUR36.0mn state loan into equity which will increase the Latvian state's stake in the carrier from 80.1% to 91.0%; and • Singapore's sovereign wealth fund, Temasek Holdings will subscribe to Singapore Airlines' rights and bond issues of SGD5.3bn and SGD6.2bn • The New Zealand Government's NZD900.0mn convertible loan to Air New Zealand is subject to certain requirements such as maintaining services to all existing domestic destinations and cancelling any future dividends to its shareholders • The US CARES Act allows the US Treasury Department to purchase equity in any airlines who have qualified to receive more than USD100.0mn in aid
4	Loan guarantees Loans	• SAS received state-guarantee on loans of DKK1.5bn, NOK1.5bn and SEK1.5bn respectively from Denmark, Norway, and Sweden • Air France-KLM obtained France's 90.0% guarantee on an EUR4.0bn syndicated loan • The Chinese government supported state-owned banks to provide loans with preferential interest rates and financial discounts to key enterprises engaged in the production, transportation, and sale of key medical materials and daily necessities • France has provided a direct loan of EUR3.0bn to Air France-KLM with a maturity of 4 years, with two consecutive one-year extension options. Meanwhile, the Dutch government has pledged between EUR2.0bn to EUR4.0bn of financial assistance to AirFrance-KLM but this has yet to be finalized • Germany has lent approximately EUR0.6bn to charter airline Condor and is participating (via state-owned development bank KfW) in an EUR3.0bn syndicated credit facility to flag carrier Lufthansa • The United States has made available a total of USD29.0bn to be provided as loans or loan guarantees to passenger and cargo airlines under the CARES Act • EgyptAir has been granted a loan worth EGP2.0bn (USD127.4mn) by Egypt's Finance Ministry

5	Route support	• The Australian government announced an AUD 198.0mn grant called the Regional Air Network Assistance Package in addition to another AUD 100.0mn of financial assistance for application by smaller regional airlines; • Other countries who announced route support measures include China, New Zealand and Norway , whereby these governments agreed to either subsidise routes where there is no basis for commercial operations or provide financial support to maintain key routes transporting high-priority goods (medicine and other essential items).
6	Other relief instruments – wage subsidy schemes	• The European Commission approved many schemes to support SMEs in its Member States, involving loan guarantees as well as wage subsidy support. Program criteria vary across states —in Denmark, the scheme compensates companies experiencing revenue declines of more than 40.0% from March to June 2020 with up to 100.0% compensation of fixed costs. In France, the government launched a EUR7.0bn French "umbrella" scheme to support SMEs and large corporations • The UK's Coronavirus Job Retention Scheme (CJRS) would now be open until the end of June. The scheme allows firms to furlough employees with the government paying cash grants of 80.0% of their wages up to a maximum of GBP2,500 • The US government launched the Paycheck Protection Program where SMEs across all industries were offered up to eight (8) weeks' wage subsidies • Canada's subsidy program covers up to 75.0% of an affected employee's wage on the first CAD58,700 (USD 41,369) earned and is applicable to large companies, SMEs as well as charities • Malaysia's MYR13.8bn Wage Subsidy Program covers up to MYR 1,200 for up to 200 workers for each SME, as well as a MYR600 payment for workers furloughed under the Employee Retention Program • The Russian government provided direct financial support for small and medium-sized businesses in the worst-hit industries beginning from May to support employment with the condition that companies receiving them have to preserve at least 90.0% of the staff they employed on 1 April
7	Other relief instruments – Rental compensation or deferral	• The Lithuanian government launched a scheme to provide direct grants to cover the rental costs of tenants operating in certain sectors whose annual turnover in the previous year does not exceed EUR 50.0mn[33] • The GoM announced tax breaks for landlords providing rental waivers or reductions for SMEs during and up to three (3) months after the Movement Control Order (MCO) period, as well as a six-month waiver on rental payments on all government-owned premises • The Singaporean government has also provided rental waivers for office, commercial, and agriculture tenants of government agencies
8	Other relief instruments – Simplification of licensing processes and temporary relaxation of rules	• The European Commission adopted a package of measures that will provide relief to the transport sector (aviation, rail, maritime, inland navigation, and road). For aviation, the relief proposal addresses ground-handling services and air carriers and comprises licensing rules amendments, easing of traffic rights restrictions and prolonging of ground handling contracts until 31 December 2021 • The Russian government eliminated additional expenses related to administrative procedures, such as non-application of penalties, a moratorium on inspections, and simplification of various procedures • The GoM provided an automatic moratorium of 30 days to allow companies to submit statutory documents to the Companies Commission of Malaysia from the last date of the MCO. On the slot allocation front, it was announced that airport slot rules in Malaysia for the Northern Summer 2020 schedule would be relaxed, whereby airlines would get to keep their slots for the rest of NS2020 even if they do not utilise those slots.
9	Other relief instruments – Spending on infrastructure	• The Australian Government launched the AUD5.8mn Remote Airstrip Upgrade Program to enhance the airstrip infrastructure in remote areas to improve the delivery of essential goods and services • The Korean government announced that it will frontload its investments worth more than KRW 3.3tn (USD 2.7bn) in the public sector and provide over KRW 14.4tn (USD 11.8bn) worth of support to encourage early investment and prepayment in the private sector including aviation

[33] European Commission Case SA.57135

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