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## State aid for airlines in the EU: policy changes during the COVID-19 pandemic

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### ABSTRACT

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The paper analyses the developments in the EU state aid policy as a result of the COVID-19 pandemic breakout. The general framework for state aid in the EU was presented. Based on a case study analysis of selected airlines that benefited from state aid following the COVID-19 crisis, changes in the European Commission approach were identified. In general, investigation of arrangements between the state aid cases is a complex (and thus often lengthy) process. The outbreak of the COVID-19 pandemic was a challenge for EU member states and the European Commission as well due to the unexpected, turbulent, and very profound nature of the crisis. It made it necessary to look for new or revised policies for state aid to respond quickly and keep airlines afloat in times when the flow of revenue was practically stopped. One of the key issues that needed to be addressed was inflexibility and lengthiness of state aid approval processes. To this end, additional guidelines were introduced to make the state aid policy of the EU more flexible. This way member states could respond to the ongoing developments in a more targeted and objective-oriented approach, which possibly made state aid more efficient. It should be stressed that it could have been achieved without changes to pre-existing legislation and by adjusting executive guidelines instead.

**Keywords:** state aid, airlines, COVID-19 pandemic, EU regulations

**JEL Classification:** H12, H25, L93, R410

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## Introduction

State aid is one of the forms of government intervention in the market. As such, it might have a profound impact and skew the conditions that would otherwise be in place. Thus, it is crucial to set out detailed policies aimed at establishing common grounds of state aid throughout the economy so that its effects on market equilibrium and competition among companies can be monitored, assessed, and controlled.

Aviation has traditionally been perceived in many countries as one of the strategic industries that need to be under the control of the government. The era of state-owned airlines is basically over these days but the governments still keep a firm grip on the industry through their regulatory powers. Some large airlines (mainly in Asia and the Middle East) are still owned by the governments, either completely or with a majority stake.

Flag carriers (national airlines) are considered an element of state identity, even if they are no longer state enterprises. This makes some governments eager to support these companies whenever they find themselves challenged by competitors [Burghouwt, de Wit, 2015], or in financial trouble, which may cause significant market disturbance when there are other players who do not benefit from this support. In the European Union, where the majority of the market share is taken by private-owned airlines, there are very strict rules according to which state aid is delivered.

The aim of this paper is to analyse the state aid provided to airlines during the COVID-19 pandemic crisis to identify any possible deviations from the standards used before in the state aid approval process. The research is based on a case-study analysis method.

## General principles of state aid provision in the EU

The European single market is one of the foundations upon which the European Union is built. Its main goal is to guarantee the four EU freedoms, i.e., free movement of goods, services, capital, and people. To ensure its proper functioning, it is vital to set common grounds for all businesses operating within this single market, especially in terms of equal competition. Therefore, it is important to determine precisely the rules according to which public aid is delivered and conditions that have to be met in order for it not to distort the single market. “State aid can be used as an effective tool for remedying market failures and, for example, ensuring the provision of public goods or correcting externalities” [Crocioni, Newton, 2007, p. 151]. The centre of this approach is competition in the market and the strive to preserve it. The focus is, therefore, on airlines only with little interest of the regulator in other stakeholders, i.e., airports, passengers, etc. This regulatory strategy has already been criticised in the literature where a more balanced approach is recommended that covers not only subsidies but also takes other forms of market intervention into account [Forsyth, Guiomardc, 2019]. Even though

the prime justification for granting state aid is market failure [Bartniczak, 2017], often there are other reasons behind it, such as protectionism, especially in the case of poorly-managed state-owned enterprises that are inefficient and underperform in a competitive environment. In particular, this is often the case in the air transport sector.

Investigation of the arrangements between the state and state-controlled entities and airlines is a complex (and thus often lengthy) process. Approval of state aid as an allowed measure of market intervention is subject to a detailed and multi-dimensional scrutiny in order to make sure the rules are followed and relevant conditions are met. In the first place, state aid has to be compatible with the internal market. The risk of a company exiting the market is not enough to justify providing aid by the member states. It needs to be in common interest that the aid is provided. There are many criteria that are checked in order to determine whether the common interest rule is followed. Moreover, the aid needs to be appropriate, i.e., distort market to the least possible extent. Related to this is the requirement of proportionality as well as limiting the scope aid provided to the minimum (*de minimis rule*). Checking for all the above-mentioned conditions takes time, especially when there are many cases of such aid to be evaluated at a time.

The outbreak of the COVID-19 pandemic was a challenge for the EU member states due to the unexpected, turbulent, and very profound nature of the crisis. It made it necessary to look for new or revised policies for state aid to keep airlines afloat in times when the flow of revenue was practically stopped. Following is a review of selected case studies of state aid granted to airlines in the European Union due to the crisis caused by the COVID-19 pandemic.

## **Financial support for air carriers during the pandemic: case studies**

### **Industry background**

Very poor results achieved in the passenger transport market in 2020, and several months of nearly total suspension of air operations put many European carriers in a very difficult financial situation. A comprehensive assessment of the scale of the crisis and its specificity have been widely discussed in the literature [Albers, Rundshagen, 2020; TOR, 2020; Abate, Christidis, Purwanto, 2020]. Carriers had to reduce operating costs to a minimum by temporarily grounding or completely decommissioning some aircraft, they also had to make some staff redundant or put them on unpaid leaves. The scale of the crisis and the gaps in the airlines' economic balance sheets were so large that a vast majority of European airlines required financial support from governments to survive and state aid was subsequently provided [Martin-Domingo, Martin, 2022].

The aid was necessary because airlines, despite the redundancies amounting frequently to several thousand people, would be forced to make even more redundancies in order to

mitigate the losses. Governments, on the one hand, had to counteract the increase in unemployment and threat of bankruptcy, but they also had to save the ‘national good,’ the term often referred to flag carriers. The COVID-19 pandemic showed how important an ‘asset’ for the nation its own airline is. Almost every European national carrier participated, first, at the beginning of the European lockdown, in bringing citizens from various corners of the world home, and at a later stage, helped to provide constantly the healthcare service and other institutions with the resources indispensable to fight the virus. This was a real necessity, and it was the easiest for the governments to use primarily the grounded planes of their carriers. It should be emphasised that cargo carriers operated almost normally, trying not to disrupt completely global supply chains.

The analysis of the problem of financial aid for airlines should assess the legitimacy of the support provided, its form, amount, and decisions of antitrust authorities, whose task is to secure and control fair conditions of competition in the market. The study goes on to present examples of support for aviation sector actors and their social and market assessment.

### **Lufthansa Group bailout**

One of the first and relatively largest financial case of support was the German government’s assistance to Lufthansa in the amount of 9 billion euros [TOR, 2020]. The aid package included 3 billion euros in the form of loans granted by the German state-owned investment and development bank KfW and the acquisition of a 20% stake in the share capital increase of the German carrier implemented by the Federal Government. However, receiving this aid required the consent of three parties: first, the Federal Government; then, the European Commission; and eventually, the Lufthansa Supervisory Board.

This aid package was also subject to the European Commission’s approval and it could not accept such a large amount of aid without setting specific conditions for the German carrier. In order to obtain the approval of the European Commission, Lufthansa took compensating measures and decided to sell 24 slots per week at its main hubs: at the Frankfurt am Main and Munich airports. In addition, the company had to provide 4 places to base aircraft of other carriers at these airports. Initially, the EC demanded the release of up to 72 slots, but this number was reduced 3 times; moreover, free slots were hedged with specific rules. During the first 18 months, these rights could only be applied to by carriers who had not been present at any of these airports before. If there are no applicants willing to participate in this package, after the deadline, other carriers could gain access to the slots.

Contrary to appearances, the restrictions imposed on Lufthansa may have a significant impact on its competitiveness in the long term. Lufthansa is a network carrier, basing its operations and commercial activities on connecting flights through its two hubs: Frankfurt am Main and Munich. A vast majority of carriers carry passengers for whom these airports are not destinations, but only transfer points for the next flight. That is why, on the one hand, Lufthansa operates a very wide range of long-distance intercontinental flights (mainly to North

America and Asia, but also many flights to Africa and South America), and thus a large fleet of wide-body aircraft, and on the other hand, a very extensive network of domestic, intra-continental and medium-distance connections. This network of shorter connections contributes to long-haul flights or other routes in Europe. Lufthansa, by giving away its slots, loses the opportunity to provide a convenient connection with its network of flights to many destinations.

The German carrier publicly expressed great dissatisfaction with the decision of the European Commission, but had to accept it, anyway. With no financial aid, the company employing a total of about 135,000 employees worldwide was threatened with bankruptcy.

## **Government support for Air France-KLM group**

Another large group which received a multi-billion dollar aid was the Air France – KLM group, a French-Dutch consortium of national carriers and low-cost Airline Transavia. The situation of this group was slightly different, the aid was definitely higher than in the case of LH. In 2020, the European Commission approved a loan of 7 billion euros to Air France and 3.4 billion euros to KLM. After receiving the first tranche of aid, both airlines asked their governments to recapitalise the group again.

The Air France-KLM group was not subjected to any serious operational constraints in connection with the receipt of government aid. The European Commission appreciated Air France's commitment to fighting the pandemic and its importance for the whole French economy. The received 7 billion euro aid was burdened with the French carrier's commitment to reduce CO<sub>2</sub> emissions, to rebuild its fleet, and not to compete with railways on rail connections shorter than 2.5 hours, resulting in the suspension of several Air France domestic routes, e.g., from Paris to Nantes, Lyon, and Bordeaux. However, the ban did not apply to transit passengers. In practice, it can be seen that it was only a media operation, because these routes are still being served. The French government also required Air France to make further investments in the modernisation of its fleet (mainly the European Airbus) and, consequently, a significant reduction in CO<sub>2</sub> emissions.

The aid given to the KLM-AF group in 2021 was connected with antitrust measures by the EC, but not as severe for Air France as the restrictions imposed on Lufthansa. Air France was obliged to surrender slots not at its main base, i.e., the Paris-Charles-de-Gaulle Airport, but at the port of Paris-Orly, from which it flies to its overseas territories in the Caribbean, to French Guiana or Réunion, and on several domestic routes (e.g., Corsica). It is, therefore, difficult to consider the actions of the European Commission equivalent.

However, the current cooperation between the two airlines at the operational (network) and investment levels (e.g., joint division of the fleet – Air France, with the exception of Boeing 777, operates almost exclusively Airbus aircraft, and KLM, apart from Airbus A330, which will be gradually withdrawn, operates mainly Boeing aircraft) significantly hinders any disintegration of the consortium. The relationship between the two carriers is very strong. Air France is a much larger airline and it is based in a very large French market, but KLM

seems to be a better organised carrier, not affected strongly by trade unions, which operate more rationally than those in France, it also has better financial performance of its aviation branch. The Amsterdam Schiphol Airport itself, i.e., KLM's main base, is a more modern, better perceived and rated airport than the Paris CDG.

## **Bailout schemes for other Western European carriers**

In addition to strong aviation groups, financial support also included smaller airlines. Many governments whose national carriers found themselves in a very difficult situation understood the need for such aid. Smaller carriers, which are not members of large consortia, were affected by this crisis even more strongly than large players, and at the same time recovering from the collapse and repaying the resulting obligations to the state will require a lot of commitment and financial effort from them. Among them were, for example, SAS airlines with a long tradition of operation. SAS has 3 main hubs: Copenhagen-Kastrup, Stockholm-Arlanda, and Oslo-Gardermoen. SAS is currently a privatised airline, in which Sweden and Denmark are holding their shares (14.8% and 14.2%, respectively), which is why the airline asked both governments for help in the face of the crisis. Sweden decided to support the aviation sector with an amount of 500 million euros, of which 137 million euros was to go to SAS. Denmark granted the same amount of loan.

Unlike in the cases of the Lufthansa Group and the Air France-KLM groups described before, the European Commission did not decide to impose any specific determinants on aid to SAS.

The Finnish government decided to support its national carrier, Finnair, a dynamically developing airline that had the ambition to become a European hub oriented to the Far East, offering a high-quality in-flight product in Europe. Faced with the crisis, Finnair was forced to accept the state aid. However, the case of this aid was different from the others. 58% of Finnair shares are controlled by the state. Finland opted for the recapitalisation of the carrier through the issue of new shares worth 500 million euros, with the state share not to be increased. A block of shares worth 214 million euros was offered in the market, but the preemptive purchasing of new shares was held by the existing shareholders. The European Commission approved this proposal, stressing the incentive to invest in Finnair on market terms, while not adversely affecting the competitive position of other carriers. In addition to the recapitalisation, Finnair also received credit options for a total amount of 600 million euros. As in the case of SAS, Finnair did not have to take any measures to mitigate its possible competitive advantages in the market.

TAP Air Portugal is one of the medium-sized European carriers, not a member of any capital group, but has been a member of the Star Alliance for many years. The airline has a long record of low business performance and persistent financial trouble. Due to the poor financial situation of the carrier before the pandemic, the Portuguese government could not benefit

from the aid under the rules of the Commission's State Aid Temporary Framework but used the principles of the Guidelines on Rescue and Restructuring. The European Commission has considered and accepted the application for a loan of 1.2 billion euros. The government had to oblige TAP to repay the loan within six months of receiving it or presenting a plan for effective restructuring.

Not only network lines with the status of national carriers, but also smaller lines could count on state aid. One of the examples is a German charter airline Condor. This is a holiday carrier with over 65 years of history. The airline found itself in a very difficult situation even before the COVID-19 pandemic in 2019, when its owner, the Thomas Cook Travel Agency, declared bankruptcy and if it had not been for the aid of the German government, it would probably have collapsed, laying off almost 5,000 employees and leaving a large gap in the holiday transport market. Then, Condor received a bridging loan and was to find a new owner as soon as possible. After several months of uncertainty, in January 2020, it turned out that the Polish Aviation Group (PGL) was interested in it. Condor was to merge with LOT Polish Airlines, and together they were to develop the holiday connection sector not only in German-speaking countries, where it had a strong position, but also in the region of Central and Eastern Europe, including Poland. A preliminary agreement was signed and it was planned to complete the transaction in April 2020, when the approval of antitrust authorities was to be issued. However, PGL withdrew from the transaction, and for Condor it meant the need to acquire a new strategic investor. The investor was Attestor Capital, which acquired 51% of the shares of the German carrier. The company pledged to increase its share capital by 200 million euros, and an amount of further 250 million euros was to be used to modernise its fleet. Despite such a significant investment, Condor needed state aid, anyway. Following the pandemic-induced crisis, the airline asked for state aid, which was subsequently endorsed by the European Commission in the amount of about 205 million euros as an aid package, and about 320 million euros as a package for further restructuring, in order to enable the return of the carrier on the path of profitability.

## **Government support for airlines in Central and Eastern Europe**

Among the carriers from CEE, e.g., Czech, Romanian, Latvian, and Polish airlines applied to their governments for aid. In the case of CSA, the national carrier of the Czech Republic, the government of that country did not support the carrier. This line has had problems for years, 98% of it is owned by Smartwings, whose main shareholder (49.9%) is the Chinese CITIC group, and it does not want to participate in the rescue operation of CSA, which is going bankrupt.

The Romanian government applied to the European Commission for the approval of aid of 190 million euros to be given to TAROM and low-cost carrier Blue Air, in the form of capital support and cancellation of part of liabilities. The EC had serious doubts as to the legality of this aid in the light of the presented restructuring plan of the TAROM line. At the beginning of 2020, the EC approved a government loan of 36.7 million euros to TAROM.

The Latvian government (the owner of 80% of AirBaltic's shares) decided to support it with 36.1 million euros in the form of a loan granted to the state-owned carrier AirBaltic, as well as to recapitalise its shares with 150 million euros. Similarly, Estonian Nordica gained a government aid package of 30 million euros approved by the European Commission consisting of 22 million euros for recapitalisation and 8 million euros in the form of a low interest loan.

Yet another airline from the region that benefited from state aid was LOT Polish Airlines. This carrier was supported with 650 million euros in total (250 million euros in the form of recapitalisation and 400 million euros as a loan). At the end of 2020, this aid was approved by the European Commission [2021]. At the same time, LOT Polish Airlines were obliged to follow a set of measures aimed at preserving competition in the market. The carrier was not allowed to use the aid to finance aggressive commercial expansion or commercial advertising. Moreover, it was not allowed to acquire more than 10% stake in competitors or other companies in the same line of business until at least 75% of recapitalisation is redeemed. On top of the above-mentioned measures, some additional conditions were set out. However, these commitments seem rather lenient compared to the scope of the aid. On the other hand, the approach to the LOT Polish Airlines case in this respect was in line with other EC's decisions on state aid delivered to airlines.

## **Ryanair protests against public aid offered to European carriers**

As shown in the examples cited, state aid to airlines was significant and concerned operators from different market segments and representing different business models and market potential. Such large tranches of government aid, which were approved by the European Commission, had to raise objections from the carriers which did not benefit from subsidies related to the pandemic. The greatest strength and effectiveness in the fight against manifestations of state aid violating the conditions of fair competition in the aviation market were shown in the protests of Ryanair, an Irish low-cost carrier.

Ryanair has been one of Europe's largest airlines for many years, with more than 19,000 employees and more than 140 million passengers a year. The airline also has more than 420 Boeing 737 planes in various versions as well as orders for more than 200 of these planes and 29 A320 Airbuses in the livery of Lauda Europe, a subsidiary of Ryanair. The Irish carrier's route network consists of more than 220 destinations and about 4,000 routes.

At the same time, Ryanair is a 100% private company. The carrier's shares are fragmented among many shareholders; however, the 9 largest ones account for more than 52% of all the shares. 85.3% of shares are held by various institutions, about 10% of shares are held by private shareholders. For many years Ryanair, along with very good transport results, also recorded very good financial results. In 2016–18, the company generated a profit of around 1.5 billion euros annually.

The Irish carrier has lodged complaints in 16 cases, which concerned aid to specific airlines as well as rescue programmes for the economies of individual countries. The complaints



regarding, for example, the EC's acceptance of the Spanish 10 billion euro fund, which was to support domestic companies, ended in failure, and a common court also upheld the European Commission's consent to help many airlines, such as SAS, Finnair, or Air France.

For many years, the Management Board of Ryanair has emphasised that one of the greatest achievements of the European Union was the liberalisation of the air services market and the creation of a single market for all members of the EU Community, including the LCC segment. Therefore, according to Ryanair, any direct financial aid departs from this idea and makes the mechanisms of fair competition in the market cease to work. In this way, ineffectiveness and inefficiency in the activities of air carriers are promoted. According to Ryanair, supplying European entities with public funds is discriminatory and distorts the functioning of the European market in the long run. However, such an opinion did not prevent Ryanair itself from taking advantage of the opportunity to use the state aid offered by the UK government in the form of a loan scheme made available by the Bank of England, to which any company could apply while operating in the United Kingdom and having a sufficiently high credit rating.

Not all of Ryanair's complaints have been examined so far, therefore, further decisions can be expected in favour of the Irish airline, but also, as Ryanair claims, the entire market and, above all, passengers. Ryanair questioned, for example, the legitimacy of granting state aid to LOT Polish Airlines.

It is worth adding here that Ryanair is a beneficiary of probably the largest local government subsidies in Europe, negotiating and receiving multi-million contracts under the so-called marketing agreements with airports, in theory for the promotion of a region, and in practice for offering routes from a specific airport. Also, special arrangements related to reduced airport charges for this carrier were identified as state aid that in some cases was determined to be incompatible with EU rules [Barbot, 2006].

The Irish carrier won some of the cases in a common court in Luxembourg, e.g., the one concerning the aid to KLM or TAP Air, where the court annulled the approvals of the European Commission. Moreover, in the case of the aid to Condor, the court found Ryanair's complaint to be well-founded, but did not order the return of the aid, only a reconsideration of its legitimacy.

## EU state aid policy developments

Until Q1 2020 state aid to airlines and airports in EU member states was handled according to guidelines published in 2014 [European Commission, 2014]. Following the outbreak of the COVID-19 pandemic in early 2020, the European Commission issued *The State Aid Temporary Framework* [European Commission, 2020] on March 19<sup>th</sup>, which was subsequently amended in order to ensure better flexibility of EU regulations of state aid to avoid lengthy endorsement processes. This temporary framework was not sector-specific. The integrity of EU Internal Market and its protection were stressed in the document. Specifically, compensation for the

losses to undertakings that suffered from the COVID-19 pandemic outbreak was made possible and the 'one time last time' rule (that in practice limited state aid to be delivered not more often than once in a 10-year period) did not apply to this kind of government support. As most companies struggled with their liquidity, state aid (including guarantees on loans) could be provided maintain viability of companies. However, it was allowed for a limited period of time only. Still member states had to notify the Commission of the measures taken and in some cases verification and endorsement procedures were to be employed. This prerogative of the European Commission was not given up.

Finally, it is the decision of the European Commission whether or not to approve state aid measures. Research shows that these decisions can often be biased [Alves, Brousseau, Yu-Cheong Yeung, 2021], so it is even more important to follow universal rules and procedures so that the verification and approval process is transparent and impartial. However, considering the unprecedented turbulence caused by the outbreak of the COVID-19 pandemic, it was necessary to adapt the standard long-established measures in order to manage effectively state aid when it was so much needed by the industry. The EU regulatory framework, which is commonly perceived as very inflexible, proved to be relatively easily adjustable and thus universal, even in such a dynamic situation.

## Summary

One of the most pronounced effects, and at the same time arguments against state aid, is that it leads to inefficient use of resources as bailouts let companies in trouble stay afloat [Jiang, Kim, Zhang, 2014]. However, external shocks may cause even well-managed ones fall into trouble. Therefore, it is of utmost importance to establish supervision measures and exercise controlling activities to ensure state aid is provided in an efficient way to the benefit of all stakeholders concerned. To this end, in the European Union there is a very detailed procedure of notification and approval of state aid. However, during the COVID-19 pandemic turmoil in the economy these procedures seemed not flexible enough and thus additional guidelines were introduced to make the state aid policy of the EU more flexible. This way member states could respond to the ongoing developments in a more targeted and objective-oriented approach, which possibly made state aid more efficient. It should be stressed that it could have been achieved without changes to pre-existing legislation and by adjusting executive guidelines instead.

The airline sector was one of the most badly hit industries in Europe and, due to its vulnerability (that stem in most cases from liquidity issues), were in a great need of state support. After more than two years since the breakout of the COVID-19 pandemic, it can be noted that most of this support effort proved to be effective and in most cases state aid proved to be legitimate. This is a positive example of state interventionism that serves the common interest.

As the COVID-19 pandemic crisis is most probably coming ever closer to its end and at the same time stagflation threats are more and more prominent in the global economy, the authors consider it appropriate to monitor closely the developments and how they impact the EU state aid policy to determine the factors influencing this policy. Also, further research on the impact of the state aid granted during the COVID-19 pandemic on airline competitiveness seems to be worth undertaking.

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