

Finally, a decision

TAKE-OFF AT HEATHROW...EVENTUALLY



In our latest briefing, Dan Elliott, Director of Frontier's Aviation Practice, who has been advising Heathrow on runway related issues for the last five years, reflects on the decision, taken by a Cabinet Committee, through which the UK Government has finally backed the expansion of Heathrow. What are the challenges that still lie ahead?

There was general relief in the aviation and business communities when the news began to emerge a few weeks ago that a "decision" was imminent on the vexed issue of the new UK runway. At last we would be able to move forward. Everyone knew that the decision has involved a fiendish combination of economic, environmental and political factors. But everyone, except the most diehard anti-aviation campaigners, also knew that the UK is crying out for more airport capacity.

The Airports Commission began its task of advising where this capacity should be created in September 2012. In July 2015, the commission announced that its unanimous recommendation was to develop a third runway at Heathrow. But since then the Government has deferred making a decision, ostensibly to allow time for additional analysis of the environmental impact, but in reality because of the intractable nature of the political decision involved.

10 years

The time Heathrow has already been operating at full capacity

The expansion of Heathrow is phenomenally complex and expensive. The immediate effects, environmental in particular, fall largely on the local population while the wider economic benefits accrue to the country as a whole. Trading off national and local interests is never easy. But this problem is exacerbated by the UK's Government's wafer-thin parliamentary majority, and consequent desperate need to avoid alienating voters in a handful of key marginal constituencies on the Heathrow flight path (several of whose MPs currently sit round the Cabinet table). Hence the decision is, even now, ringed about by permissions to voice concerns about this "decision" until a Parliamentary vote in just over a year.

WHY HEATHROW, ANYWAY?

The commission may have been unanimous, but politically it did not deliver a knock-out blow. Yes, it found that the benefits of Heathrow expansion outweigh the costs, but in effect it reiterated what we already knew: that the benefits are national while the costs are local. Its report contained detailed recommendations for dealing with these local issues, but nevertheless it passed the trade-off back to the Government to resolve politically.

The technical case - largely lost in the political debate - was however compelling. Firstly, there is not much doubt that expansion at Heathrow would pass the private investor test: that is to say, the users of the extra capacity would be willing to pay more than enough to fund the expansion. This means that most of the investment could come from the private rather than the public sector. And that affects the second, and most important measure: the extent of the public benefits relative to the public cost. On this measure, Heathrow was shown by the commission to be clearly a better option than Gatwick.

Secondly, the expansion at the two airports would facilitate different types of additional air traffic. Growth at Heathrow would improve connectivity with a wider range of long-haul destinations outside Europe, supporting the growth of international trade and foreign direct investment. Expansion at Gatwick would largely support the growing intra-European leisure market. That is far from unimportant, but wider economic benefits of the business connectivity are more significant, an argument whose weight has only been increased by Brexit.

Thirdly, the pro-competitive arguments for expanding Heathrow are also stronger than for expanding Gatwick. This might at first seem an odd contention: after all, Gatwick has persistently argued that allowing it to expand would enable it to compete more vigorously with Heathrow. But this piece of the “case for Gatwick” is not as strong as it looks.

Closer examination demonstrates that the two airports serve very different market segments, limiting the amount of competition that really exists between them. (The charges they can levy on the airlines using them are, therefore, already regulated by the Civil Aviation Authority.)

The fact that Heathrow has been so very congested for so long, while Gatwick has until recently had spare capacity, further illustrates the fact that airlines and their passengers do not see the two as particularly close substitutes, especially for long-haul travel. Indeed, even with Heathrow as congested as it is already, there is a history of airlines switching services from Gatwick to Heathrow when slots become available, but little evidence of a flow the other way. So spare capacity at Gatwick has not, historically, provided much competition to Heathrow, and there is no particular reason to think this would change materially in the future.

On the other hand, we would expect to see significant reductions in long-haul fares at Heathrow if a third runway allowed new airlines to enter and compete head-to-head with the incumbents. Today, those incumbents are protected from the threat of competitive entry by the shortage of slots and the existing “grandfathering” of landing rights.

The final element of the commission’s calculus was its assessment of the environmental costs. This is obviously the most sensitive area of the work that was undertaken, and a great deal of care was taken on both the environmental science and the economic valuation of the environmental impacts that expansion would bring. The conclusion the commission came to, which was inevitably unpopular with the environmental lobby, was that the expansion at Heathrow is possible within existing noise and air quality regulations, after factoring in forecast improvements from other sectors and with proper planning and controls. Inevitably, that conclusion involved an element of judgement.

18%

**Frontier’s estimate
of congestion
premium on long
haul fares at
Heathrow**

THE ECONOMY, STUPID

Despite the commission’s clear recommendation last year, the Government continued to prevaricate. So what has changed now? Economics, environmental arguments and politics; the first of these being, as ever, the most straightforward to assess.

First, and simplest, in the year that has passed since the report was completed, demand for air travel has grown far more rapidly than the Commission anticipated. Gatwick, too, is getting close to capacity, reinforcing the case that something has to be done. (That “something” might now more reasonably include a runway at Gatwick as well, but that does not alter the basic logic that Heathrow would provide the better route to long-haul connectivity.)

Second, there is Brexit. There is a close link between GDP growth and aviation traffic growth, so Brexit might seem to weaken the argument for a new runway. IATA has recently estimated that the macroeconomic consequences of a “hard” Brexit could reduce UK air traffic by up to 9%. But even such a hit would not make a huge difference to the runway case. The extent of excess demand at Heathrow remains so great that it is highly unlikely that Heathrow would see a drop in traffic. Moreover, runways are very long-term investments, and the effect of a Brexit hit to growth would delay rather than destroy the likely return on the reasonable assumption that growth would resume.

On the environmental side, the Government's studies since the commission reported seem to have confirmed its findings that Heathrow can be expanded within existing environmental limits. This is a difficult area and will almost certainly be subject to further challenge, legal or otherwise. The Government will have to make sure it's evidence is as robust as possible. But official confirmation of this aspect of the commission's findings removes a key stumbling block.

And then, of course, the political landscape has changed dramatically. Although the new Prime Minister's own constituency is affected, she does not have as many words to swallow as her predecessor would have done. And if she can ill-afford by-elections threatened from within her ranks, her standing in the opinion polls, aided by a weak opposition, is currently strong. Moreover, but the next general election, the fallout from Brexit may well dwarf fallout from a Heathrow decision, even locally, making it easier for Government to take such a decision today.

Moreover, the post-Brexit policy emphasis on trade relations with the world beyond the EU increases the policy argument for better long-haul connectivity. Of course, artificially engineered connectivity does not create trade when it would not otherwise be there. But connectivity is a key enabler without which trade cannot flourish. So if the UK were not prepared to provide for connectivity to the world beyond Europe, this would undermine its now obvious and urgent need to diversify trading relationships.

The recent news that BA is pulling its service from Heathrow to Chengdu does not – as some have suggested – disprove this strategy. Capacity is an enabler, but airlines provide the services in a competitive environment. Chengdu was just an idea ahead of its time. The passenger numbers for that route show that load factors were persistently low. Having tried it for three years BA could not afford to continue to use scarce capacity at Heathrow for such a marginal service. But what is also clear is that it could not have operated it at all without the one-third of its passengers that connected onto it at Heathrow from other destinations. This is the way the economics of hub airports work – allowing a greater range of new growing destinations to be served sooner, without having to rely solely on domestic demand. As for Chengdu, with continued economic growth and more runway capacity it will be back when the time is ripe.



Connectivity does not create trade, but it is a key enabler without which trade cannot flourish

DOORS STILL TO MANUAL

The Government announcement, when it came, was in two parts: the first an announcement about the announcement, laying out the political framework under which the decision would finally go ahead. This was followed a week later by confirmation that, following the recommendation of a Cabinet Committee, the Government will finally back a new runway at Heathrow. However, the parliamentary vote needed before the planning inquiry can begin will not happen until the winter of 2017-18. If all goes to plan construction could begin in 2021 with the new runway opening four to five years later.

However convoluted, the Government's approach makes some sense, and the "delay" is not simply more prevarication - it is needed in any case to pin down the details before asking Parliament to vote. Whether the Prime Minister's colleagues will stick to the terms of the political compromise, or seek to over-turn the decision itself, is however another matter.

Giving the decision itself to a committee that included the PM and the Chancellor, but excluded any local London MPs, may have been clever way of saving their faces: only time will tell. While it may have made sense to permit Cabinet ministers who have expressed long-standing opposition to continue to express their concerns publicly, it also remains to be seen whether they stick to the proviso that they neither campaign against the decision nor vote against it in Parliament. The distinction between "voicing concerns" and "campaigning" is a fine line. But in principle, this decision may allow the Government to have its cake and eat it politically – nationally it takes the tough decision of backing Heathrow expansion, while locally MPs can distance themselves from the choice.

As for the vote itself, under English law, it would be impossible for Heathrow to obtain planning permission without legislative backing. If a new runway at Heathrow (or Gatwick for that matter) were subject to the normal planning process conducted by local councils, it would never get a green light.

So to proceed, the Government needs to produce a National Aviation Policy Statement, which sets out its strategy for the development of the sector - and provides a legal framework that allows the planning process to proceed on national as well as local criteria.

The new announcement confirms that Heathrow expansion will form a key plank of this strategy, but the wider details remain to be made clear. The year's "delay" is to permit a consultation around these details, not to allow a further year's debate on Heathrow vs. Gatwick, although only an unremitting optimist would suppose that in reality it is possible to create such a neat separation.

RUNNING THE ENGINES

This National Policy Statement will need to address a range of issues. How will the runway make its contribution to sustainable development? How will it be integrated with other government policies (road and rail, regional development)? How will safety issues be addressed? How will the local impact be redressed? The Airports Commission's original decision already made important recommendations as to the necessary reassurances. They included restrictions on night flying, a commitment that there would be no fourth runway, legally binding noise limits and a range of other proposals to protect the interests of local people and help the communities benefit more from the economic activity that the new runway will bring. But consultation is an opportunity to put flesh on these bones, and establish if they provide a sufficiently robust body of local protection.

There are also economic issues to be tackled in more detail. Regional connectivity deserves attention, to establish how new capacity at Heathrow can best be utilised to spread the economic benefits nationwide. Competition issues are also important, to make sure that consumers and businesses benefit as much as possible from greater inter-airline competition. And there also needs to be a focus on long-haul capacity, to ensure that connectivity to the fastest-growing markets is secured. There is a full year's work, and in particular consultation, to be done before trying to take off through Parliament.

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