# AIRLINE TRAVELLERS, COMPETITION AND AIRPORT EXPANSION

DISCUSSION PAPER

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The decision where to build a new runway in London and the south east will be one of the biggest that the next government has to take. This is true both from an economic perspective, because the runway will be a vital part of the UK's transport infrastructure for many years to come, and from a political perspective. It is vital, therefore, to understand the arguments about where the runway should be sited and the trends in the aviation industry that will determine which choice is the best.

This discussion paper summarises the main points from a roundtable meeting convened by IPPR and Gatwick Airport in December 2014. The meeting brought together a range of experts and representatives of interested groups to discuss expanding airport capacity in London and the south east of England, in the particular context of the interests of passengers and the role that enhanced competition in aviation could play in delivering better outcomes for airline travellers.

A range of views were expressed at the meeting and no consensus was reached. Therefore, this discussion paper flags up some issues for consideration, rather than presenting any firm conclusions.

## Background to the roundtable discussion

The roundtable discussion was framed by the continued investigation of the Airports Commission, chaired by Sir Howard Davies, into airport capacity. The commission was established in 2012 to examine the need for additional airport capacity and to recommend to the government how this can be met in the short, medium and long term. Its interim report, published in December 2013, argues that Britain's airports are reaching the limits of what can be achieved with their existing infrastructure and that the solution is to increase runway capacity in London and the south east.[1] Specifically, the interim report says that there is a clear case for one net additional runway in London and the south east to come into operation by 2030.

The interim report identifies for further analysis and assessment three options for new runway infrastructure at two existing airports, as well as keeping alive a potential fourth option: to build a new airport in the Thames estuary. However, this last idea was subsequently ruled out by the commission in September 2014.

The three schemes that are still under consideration by the commission are:

1. A new runway to be built at Gatwick Airport that would operate independently from the existing one.
2. A new runway to be built to the north west of the existing airport at Heathrow.
3. An extension to the west of the existing northern runway at Heathrow Airport, to allow it to be operated as two independent runways.

The commission will publish a final report in the summer of 2015, in which it will recommend to the government which of the three remaining options should be pursued. Although governments have a long track-record when it comes to delaying decisions on additional airport capacity – and the Davies commission is seen by some as another exercise in prevarication designed to get the government past May's general election – it is thought that the urgent need for action makes the commission's recommendations more likely to be implemented.

The commission has published an appraisal framework that sets out how it will assess the three competing schemes.[2] There are 15 appraisal modules in this framework, including strategic fit, economic impact, a range of environmental factors, cost, and delivery. Providing a better experience for airline passengers is only a sub-category of one of these (strategic fit). The purpose of the roundtable meeting was to consider whether the interests of passengers should be a more important

1 See: https://www.gov.uk/government/publications/airports-commission-interim-report
2 See: https://www.gov.uk/government/consultations/airports-commission-appraisal-framework

consideration in the debate about increasing runway capacity and whether enhanced competition is likely to deliver the best outcome for airline travellers.

### Competition in UK transport markets

Economists argue that consumers are best served in markets where there is a high degree of competition between providers. The existence of a monopoly or oligopoly is likely to lead to abnormal profits and to be to the detriment of the consumer. But achieving a high level of competition is not always easy, particularly in industries where achieving large scale tends to be highly rewarded and in which there are significant barriers to new firms seeking to enter the market.

In reality, most transport markets in the UK are a long way from economists' ideal. With a few exceptions, like the London to Brighton route, rail passengers cannot choose between different rail operating companies. To the extent that there is competition, it comes during the franchising process. But even here it is not clear that the government's main aim is to achieve the best deal for the consumer, as opposed to the best deal for the taxpayer. The situation for London buses is very similar.

When it comes to air travel, the consumer is better served. Consumers do have some choice among airlines – and airports – when they travel within Europe and, increasingly, on many long-haul routes as well.

## Competition and the interests of passengers

Participants in the discussion at the roundtable meeting agreed that ensuring competition between airports continues to flourish should be an important consideration in the debate about increasing runway capacity in London and the south east. Those who believed that the new runway should be at Gatwick Airport argued that this option would strengthen competition between Gatwick and Heathrow airports, while expansion at Heathrow would leave it in an overly dominant position in the London and south east air travel market. Those supporting Gatwick also felt that the UK would be better served by a network of competing airports throughout the country, serving their local catchment areas. They argued that expanding Gatwick would have a less negative impact on the ability of regional airports to compete for new routes and could leave space in the market for future expansion at, for example, Stansted or Birmingham airports.

Competition between airports has coincided with the growth of low-cost carriers in Europe, with different airports adjusting their business models to accommodate carriers such as easyJet, Ryanair and Norwegian. The growth of these carriers has helped to drive down the cost of flying in recent years and expanding Gatwick would provide further low-cost capacity for their continued expansion.

### How competition has lowered the price of air travel

When the Competition Commission recommended that the British Airport Authority (BAA) should be broken up through the sell-off of two of its London airports – Gatwick and Stansted – and of Edinburgh Airport, it did so on the grounds that splitting the ownership of the airports would encourage increased competition between them, to the benefit of passengers.

In making its recommendations, the commission followed standard economic theory, which suggests that if the break-up of airport ownership led to more competition on air routes, this would mean lower fares, as well as creating an incentive to provide better customer service and other benefits for air travellers. This appears to have happened on a number of routes. For example:

- When Air India began flying from Birmingham Airport to Delhi in August 2013, the price of an average Air India one-way fare fell by around one-sixth, despite strong demand (loads of 80 per cent within three weeks of operation). Furthermore, the cost of a British Airways flight from Heathrow to Delhi dropped by 10 per cent.
- Airfares from Heathrow to Moscow fell by £100–£270 in the year after easyJet began flying from Gatwick to Moscow in March 2013.

Conversely, those who supported expansion at Heathrow argued that the 'hub model' serves consumers best by increasing choice, allowing more passengers to get to more destinations via connections at Heathrow. This is particularly beneficial, they argued, for people living outside London and the south east who take domestic flights to Heathrow in order to connect to international flights to other destinations.

They also argued that it is only the capacity constraints at Heathrow that have stopped low-cost carriers from entering the market there, and that expanding capacity will enable different airline models to operate from Heathrow. Furthermore, those capacity constraints (a lack of supply) act in conjunction with strong demand to keep prices high; increasing supply at Heathrow would, they argue, increase competition between airlines and cause prices to fall.

**Key question: How important is competition between airports, as well as airlines, in delivering a dynamic market for air travel that provides choice and keeps fares low?**

## Hub versus point-to-point

Heathrow is often portrayed as the 'business airport' and Gatwick as the 'leisure airport'; in reality, a mix of both types of passenger uses both airports. Heathrow serves a large number of holiday destinations, and flights from Heathrow to cities around the world contain non-business as well as business travellers. Similarly, business travellers fly from Gatwick alongside those travelling for leisure purposes, particularly within Europe. If there is a distinction, surveys show that business travellers from large firms are more likely to favour Heathrow, while those from small- and medium-size firms are happier to use Gatwick.

The distinction between business and leisure travellers is, in any case, not a very useful one in the context of debating additional runway capacity in London and the south east. It is wrong to believe that leisure travellers prefer direct – or 'point-to-point' – flights, while business travellers are happier travelling via hubs. Ultimately, everyone is likely to prefer a direct flight. Furthermore, leisure travellers frequently travel via hubs to save money – stopping, for example, in the Middle East on the way to Asia or Australia – and they are increasingly doing their own 'hubbing' – using different airlines for different legs of a journey, rather than flying with one airline or alliance.

Operators of point-to-point airports are focussed on transporting passengers directly from origin to destination, while operators of a hub-and-spoke network place greater emphasis on connecting distant cities via a central hub airport. These alternative strategies affect the range of destinations served by an airport; the time, frequency and cost of flights; the mix of business and leisure passengers; and the infrastructure needed to provide the service. Gatwick Airport is dominated by point-to-point travel, with relatively fewer passengers in transit, while Heathrow Airport is more of a 'hub' (which is how it sells itself), although both airports operate a mix of the two models to some degree.

Heathrow is rather unusual in this respect. Most longstanding hub airports are situated near smaller cities (for example, Amsterdam and Frankfurt in Europe or Atlanta in the US), while new ones are being established in the Middle East, where there are fewer restrictions on flight times. Other major cities, such as New York, have sufficient demand from their local population and overseas visitors to allow a network of competing airports.

The future role of hub airports, therefore, is crucial to the debate about additional runway capacity in London and the south east. The presence of an airport is seen as a major benefit to a local economy. Heathrow supporters argued that the extra flights created by a hub airport mean more work for airport staff, retailers, local transport providers and other ancillary workers. They believe the risk of not protecting Heathrow's status as a hub is that a rival airport in Europe takes its business and creates jobs that would otherwise be filled in the UK.

The case for an additional runway at Heathrow Airport is, in part, based on its need to continue to develop as a hub airport. By pooling demand for different destinations from direct passengers, transfer passengers and freight (essentially filling flights up with non-UK residents), airlines are able to provide more frequent flights to more places. As a result, airlines using Heathrow are able to enjoy economies of scale, resulting in lower costs, which can be passed on to the consumer.

However, two trends within the airline industry could mean that the advantages of being a hub airport in western Europe diminish over time.

1. The development of long-range, mid-size aircraft like the Boeing 787 Dreamliner makes it possible for airlines to operate longer flights that bypass hubs altogether (although some routes will always only be viable by hubbing). Crucially, because they are smaller, these aircraft also make it profitable for airlines to offer more flights and thereby reduce the need for hubs to aggregate passengers or connect less-frequently served destinations.
2. The most rapid growth within aviation is likely to be towards the east, while relatively mature trans-Atlantic routes expand at a slower rate. London is geographically in the wrong place to serve as the aggregator of European passengers looking to fly to growing markets in the east, compared with the new purpose-built hubs that are on the way in Istanbul and the Middle East.

As low-cost services become the norm for leisure and business travellers on short-haul journeys, carriers will open up more and more point-to-point routes in Europe and make the most of new technology to apply the low-cost model to long-haul routes.

**Key question: How will aviation change over the next 50 years when it comes to connecting passengers to their destinations, and in particular will the importance of the hub model diminish as connectivity is delivered through a growth in point-to-point travel?**

## Environmental factors

Although the roundtable meeting focussed on competition and the interests of passengers, these cannot be seen in isolation. Benefits to passengers from airport expansion have to be weighed against other effects – in particular, the impact on the environment.

Indeed, the broader environmental effects of airport expansion and air travel mean, for some, that passengers *should* take second place to the planet. Given the UK's commitment to delivering an 80 per cent reduction in greenhouse gas emissions by 2050 (from the base of 1990 levels), any discussion of airport expansion in London and the south east must consider the carbon impacts of the aviation industry.

For many people, one of the most important impacts of airport expansion is the effect on their local environment. This comes down to a trade-off between the benefits to the local economy, particularly in terms of a large increase in the number of jobs provided by an airport, and the very serious negative impact on local residents of greater noise and air pollution. Airport expansion will benefit the local economy both directly, as most new jobs are likely to go to people living within easy commuting distance of the airport, and indirectly, through the increased spending of those who secure these new jobs. But all residents under flight-paths into the airport – including those who do not share in the local benefits – will suffer from the additional noise created when the number of flights increases, with a particular concern about flights early in the morning and late at night.

Many more people would be affected by the noise created by additional flights following expansion at Heathrow Airport than at Gatwick. This is not in dispute, as current noise numbers indicate the scale of the difference between the two. In 2011, 766,100 people were severely impacted by noise at Heathrow, compared to 11,300 people at Gatwick.[3] This has led to a large anti-expansion group around Heathrow because its flight paths are densely populated and many local residents, extending into south-west London, are affected by the noise caused by planes flying overhead (because of the prevailing westerly winds, 70 per cent flights go over Hounslow). Heathrow also fails to meet European air-quality targets on a regular basis, in part due to its location at the heart of a busy motorway interchange. Gatwick does not have the same local impact.

But Heathrow is also seen as critical to the local economy, and there is some support for its expansion because many Hounslow residents work there. It is widely anticipated that expansion at either airport would create more jobs in the local area.

**Key question: How do we trade-off the economic benefits of expansion against the local environmental impacts, and what level of human cost is acceptable when delivering economic benefits?**

## Where to build the new runway

The interests of airline passengers, who are best served by increased competition, should be given sufficient weight in the decision about airport expansion at Heathrow or Gatwick. From their perspective, expansion should be about the provision of more direct flights to more destinations at the most affordable price.

The roundtable discussion identified three key questions that the Airports Commission and any incoming government will have to weigh up when making its decision:

- How important is competition between airports, as well as airlines, in delivering a dynamic market for air travel that provides choice and keeps fares low?
- How important is the existence in London of a large hub airport, which aggregates European transfer passengers, to securing direct flights to new markets if a new generation of planes can deliver this direct connectivity for London without expanding the hub?
- How do policymakers balance the relative economic benefits of expansion against the negative environmental impacts on the local community?

These are not easy questions to answer, but the next government will need to address them if it is to finally solve the riddle of airport expansion in the south east.

3 For Heathrow, see http://www.caa.co.uk/docs/33/ERCD1204.pdf and for Gatwick, see http://www.caa.co.uk/docs/33/ERCD1205.pdf