Introduction

The Transport and General Workers' Union (T&G) welcomes the opportunity to contribute to the Competition Commission's Airport Investigation into the proposed price controls at Gatwick and Heathrow Airports.

The T&G is the largest trade union representing nearly 50,000 people working in civil aviation in the United Kingdom.

We are also the largest trade union in the BAA representing over ? workers.

Also many of our 750,000 members and their families from the other trade groups of the union use Gatwick and Heathrow Airports as departures for their family holidays.

This we believe gives us a more diverse and representative interest base than most of the parties who will be contributing to this investigation. Many of whom will be presenting evidence from a far more partial position!

A New Pricing Mechanism or Single Till?

Before any consideration is given to the level of price increases at Gatwick and Heathrow Airports we believe that existing pricing mechanism has to be changed.

The T&G have serious concerns about the approach being taken by the Civil Aviation Authority (CAA) in continuing to support the single till approach:

> 'that – subject to airports demonstrating the potential benefits that moving to dual till could bring, and without prejudice to any wider debate on the future framework of airport regulation – the single till will continue to be the basis on which Heathrow and Gatwick airports are price regulated;' (CAA 2007: 177)

The T&G has consistently argued in the past that there should be a dual till approach. We believe that the Competition Commission should recommend a move to a dual till for three reasons. These are:

1. To eliminate the cross subsidy of airport services which should be regulated, by services provided by the BAA which should no be regulated;
2. Given the increasing importance being given to climate change and the impact of civil aviation on climate change we need to be able to calculate the "real" cost of air travel. This we believe can only be achieved by

eliminating cross subsidy allowing the real costs of airline and airports services and costs to be identified.
3. With the opening of Terminal 5 (T5) a considerable number of people will be using Heathrow as a shopping centre in its own right. The question then is it right for these non airport customers to subsidise both airport users, airlines and their service providers? In our view this wrong and believe the CC, given it role in protecting the consumer can concur with this view.

We will now go into a more detailed argument of these three reasons.

Elimination of Cross Subsidy

The London airports (Heathrow, Gatwick and Stansted) have been deemed by the Government as needing economic regulation – the Airports Act 1986 required the CAA to set maximum limits on airport charges at airports designated by the Secretary of State for Transport.

The regulatory regime is aimed at ensuring that the BAAs London airport cannot abuse their market power through excessive pricing. Together, BAAs London airports are responsible for 92% of the Capital's air passenger market.

Through the regulatory mechanism the CAA is also supposed to encourage the BAA to invest in providing new and improved airport facilities, and to achieve cost efficiencies.

However, it must be remembered that one of the economic rationales of the UK privatisation programmes was to improve the efficiencies of previously publicly owned companies. One way this was to be achieved was by the elimination of cross subsidies. But the CAA continues to use cross subsidies and this is we believe a questionable practice in the case of BAAs London airports.

Since its privatisation the market in which BAA operates has changed almost out of all recognition. In the 1980s the low cost sector of the market did not exist. Also during that period airline passenger expectations of using airports have changed. Increasingly airport shopping has become part of the wider travel experience.

In the financial year 2005/06 at Heathrow retail income at the airport, such that (excluding the World Duty Free concession fee) it accounted for 22.4 percent of Heathrow's total revenue.

There is a similar situation at Gatwick Airport where in 2005/06 retail sales were £113 million. Retail sales now accounts for 34.7 percent (excluding the World Duty Free concession fee) of Gatwick's income.

We find it difficult if not impossible to equate retail sales, where the airport customer has a variety of choices to the regulatory role of the CAA and the CC to stop the BAA abusing their market power through excessive pricing. The retail element of market is contestable, it has low barriers to entry, and does not have any larger elements of sunk cost than any other shopping centre owner.

In fact the current situation would appear to discriminate against retailers, especially those operating landside, against airlines, line service providers and possibly airside retails, who would benefit from the cross subsidy.

This distorts the markets for those landside retailers and consumers, who do not use the airside retail and airline services. This will become increasing important issue, especially when the new terminal opens at Heathrow. This will be discussed in more detail in our third point.

The Real Costs of Air Travel

Although aviation globally contributes a small contribution to global warming it is forecast to increase in the future.

‘Transport accounts for 14% of global greenhouse-gas emissions, making it the third largest source of emissions jointly with agriculture and industry. Three-quarters of these emissions are from road transport, while aviation accounts for around one eighth and rail and shipping make up the remainder.

…CO2 emissions from aviation are expected to grow by over three-fold in the period to 2050, making it among the fastest growing sectors. After taking account of the additional global warming effects of aviation emissions, aviation is expected to account for 5% of the total warming effect (radiative forcing) in 2050. (Stern Report Part III: The Economics of Stabilisation: 172**)**

‘Unfortunately aviation is unlikely to see technology breakthroughs, but there is potential for efficiency savings’ (Stern Report Part III: The Economics of Stabilisation: 207**).** It is important then that all parts of the aviation industry have identifiable and reliable costs, or else it will be difficult or possibly impossible to assess their contribution to global warming.

Given the importance of global warming we would find it difficult to understand how the CC could then justify the continuation of a single till at Gatwick and Heathrow Airports. The airports aviation customers: passengers; airlines; airline services providers and caterers should all pay the market price, this would allow them to pay the true environmental costs of using the aviation related airport services.
The main environmental impacts of aviation that can be quantified are noise from aircraft and the effects of aircraft emissions’ (The Eddington Transport Study: Main Report: Volume 3: 134), neither of these are in the control of the BAA.

T&G

‘However, any growth in aviation needs to be sustainable, and must take full account of its environmental costs. One of the most effective mechanisms for achieving this is by ensuring that air travellers pay the full environmental costs of their journey, including their climate change costs. The principle of ensuring users pay their full external costs was supported by the Government in the Air Transport White Paper and was strongly supported by the Stern Review of the economics of climate change’ (The Eddington Transport Study: Main Report: Volume 3: 135). The principle should be that the polluter should pay for the external costs of their externality. ‘ Under the current system it would aoppear that this is not the case, due to the existence of the single till resulting in cross subsidy.

Terminal 5

When opened T5 will have 21,600m^2 of retail space, this alone is 15.5 percent of the size of the Bluewater Shopping Centre[1]. Adding this to the existing 46,000m^2 of retail space will give a total retail area of 67,700m2 of retail space, nearly 50 percent the size of the Bluewater Shopping Centre. When completed T5 will allow a further 140 retail units to open, increasing the Heathrow retail portfolio by 50 percent.

We also believe that T5 will become a shopping centre in its own right, especially for local people, and again it could be argued that it is “bad” economics that pure retail customers will be subsidising both airport customer and airlines!

Given that T5 will, for airline services, be used by a single airline, it could be argued why should other airlines subsidies their competitor?

We will now look at two other issues raised within the CAA report we would like the CC to address.

Cost of Capital

Over the next two regulatory price periods BAA have announced that intends to invest approximately £9.3 billion (in 2007/08 prices)[2]. We are concerned that if the proposed cut by the CAAs to BAA allowed pre-tax real rate of return on investment from 7.75 per cent to 6.2 per cent this could have an serious impact on future investment in the London airports. The proposed real rate of return would give an equity internal rate of return at Heathrow for the next five years of under 12 per cent. This apparently is the equivalent to arguing there is less risk in investing at Heathrow than in electricity generation.

[1] The Bluewater Shopping Centre has 139,400m^2 of shopping space
[2] BAA News Release 25 April 2007

The problem will arise if the owners of BAA decide that other projects will give a greater real rate of return than those proposed by the BAA. If this is the case, they would be acting in an economically sound way if the resources were reallocated to other more profitable projects reflecting the opportunity cost of these projects.

We find the difficult to understand why the 'CAA did not consider it prudent to incorporate such high levels of gearing within the regulatory allowances, given that this could entail an undue degree of risk transfer from BAA's shareholders to its users. To do so would not be consistent with the CAA's view that the choice of financing arrangements is a matter for the airports' management and shareholders, and as such the risks associated with them should be borne by shareholders and lenders, and not by users' (CAA 2007: 123). Yet it prepared to see BAA subsidies existing users. It also raises an interesting economic question, can, should or is it possible to protect a customer/user from the inherent risk of any investment decision by a firm?

Future Pensions Policy

is prepared to see the existing users subsidised by BAA.While we agree with the statement in B.67 'Decisions about pensions have long-term consequences for both company and users'(CAA 2007: 183) they also have long-term consequences for BAA employees, as pensions are deferred earnings.

Also in principle we agree with 'B.68 The CAA's current thinking is that there is advantage in moving progressively away from the separate assessment of salary and pension costs towards a regulatory approach in which labour costs are evaluated holistically, and discretion afforded to the regulated companies – in this case Heathrow and Gatwick airports – to decide how best to remunerate staff'. (CAA 2007: 183). Therefore we would urge the CC to resist any suggestions that the existing BAA pension scheme should be altered. We find it ironic that some of those calling for changes to the BAA pension scheme have not been successful in managing their own pension's schemes, and this has resulted in our members in these companies suffering reductions in their pension``````ns benefits. Rather than interfere with the pensions policies of the BAA they would be more productive if they concentrated on maintained their own employees' benefits!

Bibliography

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