



HOUSE OF LORDS

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Inquiry on

THE AIRPORTS COMMISSION

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Questions 1 - 15

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4.05 pm

Witnesses: Sir Howard Davies and Philip Graham

Members present

Lord Hollick (Chairman)
Baroness Blackstone
Lord Forsyth of Drumlean
Lord Kerr of Kinlochard
Lord Layard
Lord Monks
Lord Sharkey
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

Sir Howard Davies, formerly Chairman, Airports Commission, and **Philip Graham**, Head of Secretariat, Airports Commission

Q1 The Chairman: Sir Howard, welcome to the Economic Affairs Committee. We are doing this one-off hearing to hear from you and ask you a few questions about the commission's report. Perhaps I can start on the question of demand, which is a central issue to the economic assessment that you carried out in respect of the various options and is presumably a strong factor when it comes to successfully financing a new runway at Heathrow in the public markets. How confident was the commission that there is a sustained demand for additional runway capacity and that the UK can meet its climate change obligations at the same time as increasing aviation?

Sir Howard Davies: Thank you, Lord Hollick. I am very happy to answer that, but perhaps I could just make two very short preliminary remarks. One is that this is an ex-commission. If I were not nailed to this chair, I would be pushing up daisies, so to speak. We have expired. We are not doing any continuing work. Secondly, the secretary to the commission, Phil Graham, is on my right and I am sure will be a helpful evidence provider when I stumble. On your point about demand and financeability, there are several ways of answering that question. One is that the airport itself and Gatwick are very determined that there is demand. They see demand and they are prepared to assure us that they will finance the lion's share of this project. Secondly, we did quite a lot of consultation in the financial markets ourselves to check the financeability, and the way people saw the viability of these two projects was very reassuring.

We also used the various models of demand that there are. We wrote a discussion paper about the demand models, because there is a lack of consensus in this territory about what demand will be in the future. We chose eventually as the basis for our demand the Department for Transport's model, which has a number of different factors in it. Mainly, however, there is a GDP factor and a trade factor, et cetera, which tend to explain much of the change in demand for aviation. Those forecasts were verified by the OECD and by something called the International Transport Forum, which did some work for us on them. There was a broad consensus that the demand needed to make an additional runway in London and the south-east viable would almost certainly be there. In the past, there was a bit of a kink in the demand line associated with the financial crisis and the recession surrounding it, but the upward trend in demand for business flying but also tourism flying and particularly visiting friends and relatives has been very strong. One statistic I enjoy quoting is that in 1989 there were 180,000 seats per year from the UK to Poland, and last year there were 6 million. The Poles like to go home to mum. If you take the three components of demand—business demand, tourism and visiting friends and relatives, which is the way the market is broken up—it looks to us that the underlying factors that are contributing to that increase in demand are likely to persist.

Then you have to ask yourself: can we allow such demand to be met in the context of our climate change objectives? This is not a simple question to answer, because whilst the Committee on Climate Change provides an overall framework for emissions in the UK economy, envisaging significant reductions by 2050, it does not provide sector-based forecasts. However, our conclusion, which I believe the Committee on Climate Change supports, is that you could allow one new runway's worth of new capacity to come into operation whilst not implying an implausible degree of decarbonisation of the rest of the economy. Beyond that, you need to look very carefully at what is happening to fuel efficiency in aircraft and in the rest of the economy. In order to add a kind of belt and braces to this, we said, "Supposing carbon emissions had to be constrained to 37.5 million tonnes, which is consistent with a reduction of 80% by 2050, would you still have demand for additional runway capacity in the south-east?". Our conclusion is that you would. We believe the underlying factors are strong and that another runway allowed to operate at full capacity would be compatible with our climate change objectives, even if you met those objectives by a straightforward cap on carbon emissions.

The Chairman: When you looked at these demand forecasts, to what extent did you take into account the slowdown in traffic since the financial crisis, the potential slower growth rates in Europe and, separately, the emergence of new hub airports in the Middle East, for instance?

Sir Howard Davies: Yes, we did that. We had a central forecast, which in our jargon is called the “assessment of need”, which derives from the Department for Transport forecast. We also looked at a number of different scenarios, which we developed along with the International Transport Forum, which is a subset of the OECD. We looked at a number of different possibilities: much slower growth in Europe, a future that was heavily dominated by low cost, but also a future where emerging-market growth continued to outstrip developed-country growth, et cetera. Our conclusion was that in all these scenarios the need for additional capacity in London and the south-east was still clear. So, yes, we did look at that. In fact, demand dipped over the financial crisis in 2009 and 2010 but has picked up fairly steadily since then.

Q2 The Chairman: Looking at traffic growth, we were rather struck by the different rates of growth as between Gatwick and Heathrow. You assume that Heathrow would add 12 million passengers after one year and 35 million passengers after five years, but Gatwick would only add 2 million passengers in the first year, which is less than the 2.7 million they added last year, and they would only add 8 million passengers over the five-year period. How did you come to those conclusions?

Sir Howard Davies: The position in the last few years has not been, if you like, a natural market position, because for a number of years Heathrow has been operating at full capacity in the numbers of take-offs and landings, or “air traffic movements” in the jargon, so Heathrow’s growth has been only in passengers per plane. There is a general drift upwards in that in each aircraft category, whether it is the short-haul 737/A320 market or the medium-haul or long-haul 747/A380 market, each generation of planes tends to be a bit bigger, so there is a natural upward growth rate in the number of passengers per plane. That is really the growth that Heathrow can capture, not growth in numbers of flight movements. Gatwick is not yet completely full. It will be full in the not too distant future. It is more or less full at peak hours at the moment. It has been able to benefit not just by the passengers per plane growth factor but by increasing the numbers of take-offs and landings, which Heathrow is not able to do. That explains the differential growth rates recently, in our view.

Looking forward, you have to look at where the demand appears to be. Some of this is model-driven, but some of it is driven by what airlines tell us. The suppressed demand for take-off slots at Heathrow is very high. Insofar as these slots are traded, which they are on a kind of shadow market, if you like, suggests that a slot pair at Heathrow goes for about £20 million. The right to land and take off a plane every day at a particular point in the day for a year costs you £20 million just to start to do it. That is not the case at Gatwick. We have also seen flights come into Gatwick and then, when a slot has become available at Heathrow, migrate. Vietnam Airlines, for example, did that. There is, in our view, quite a lot of evidence that there is significant suppressed demand at Heathrow, particularly by the three big alliances and the component airlines therefrom, and that therefore the growth rate in the early years of opening a Heathrow runway would be quite high because there are already planes and airlines that want to get in there, whereas Gatwick will still be competing during that period against Stansted, Luton and Southend, because it is largely a tourism market. The proportion of business and visiting-friends-and-relatives passengers at Gatwick is significantly below that at Heathrow. When Gatwick opened, it would be opening a runway in an airport that was still tourism and visiting friends and relatives-dominated, and opening it with a significantly higher take-off charge than obtains at other airports that still have some additional capacity, notably at Stansted, whereas Heathrow is not competing for a legacy airline—an Air Canada wanting to put on an extra flight to hook into Lufthansa's Star Alliance network. Heathrow is not facing competition for that. That is why we think that Heathrow will grow more quickly in the early years.

We do think, to be fair, that in the end Gatwick would fill up, because in the end, if you had a totally constrained Heathrow, people would have to start looking at other options and there would be some more long-haul flying at Gatwick, but not as quickly or, indeed, in the end anything like as much as you would get from opening Heathrow.

The Chairman: Can I infer from that that you expect that there would be demand for a new runway at Gatwick at some time in the next couple of decades?

Sir Howard Davies: Yes, that is quite likely. The question would be whether you felt that within your climate change objectives you could contemplate that.

The Chairman: Can I just come back to funding? You said that you had taken soundings in the market, because this is to be funded in the private markets. Did you look at and were you satisfied with the ability of what is already, if I recall, quite a leveraged company—

namely, Heathrow—to borrow amounts of money that far exceed the borrowing by individual companies that we have seen in the last few years over the next decade and a half?

Sir Howard Davies: Yes, we asked that question specifically. The answers we got were rather positive. There are a couple of reasons for that. One is that Heathrow has some very well-resourced shareholders: GIC of Singapore, CIC, Abu Dhabi. They are very committed to the company; they came to see us and told us that they were. They are very long-term investors who have an appetite for large infrastructure projects in developed countries, particularly in the UK. There is a commitment from the shareholders to put some additional shareholder capital in. On that basis, the people we talked to in the markets suggest that there would be sufficient appetite for their bonds for a project that most people think is an extremely viable project with a very good demand profile.

I have to add that at the moment, with interest rates where they are and with liquidity rather easy, it is perhaps not surprising; people are desperate for yield and a project of this kind looks terrific when people's alternatives are not so exciting. One would have to look at the markets at the time they wanted to borrow, but I would say, looking forward, that the appetite for an infrastructure project of this kind in the markets is really quite strong.

The Chairman: Does it remain strong if interest rates go up by two, three or four percentage points to their more long-term average?

Sir Howard Davies: Is this a forecast? I hope you are not a member of the Monetary Policy Committee in your spare time, because it would be rather troubling for the markets to talk about that. The real interest rate would have to adjust. The question would be whether there was any reason to think that real interest rates in the economy as a whole would rise. I am not sure. I do not think that would make a difference in itself.

The Chairman: Just to confirm, the shareholders would be prepared to put in sufficient additional capital, if it were required, to support the borrowing.

Sir Howard Davies: We believe so. As a commission, we were not in a position to negotiate with these shareholders. What we could do was ask them the right questions, we hoped, and consult widely, and we were given persuasive answers. But since there are various things that the Government would need to do to facilitate this process—not least a national planning statement or a hybrid Bill, but also some investment in surface access—I am sure that the Government would want to secure firmer undertakings than it was possible for us

to secure as a condition of that support for the project. We did what we could in this area and our researches came up with rather positive conclusions.

Q3 Lord Forsyth of Drumlean: Sir Howard, I welcomed your report when it was published, but having now read it I have one or two anxieties about Gatwick in particular. The Gatwick proposal was expected to be around £15 billion cheaper than the new north-west runway at Heathrow. I just wonder why you decided that that extra cost is worthwhile. The data at table 7.1 on page 147 of your report suggest that there are virtually no differences between the schemes in terms of net present value. Would you agree?

Sir Howard Davies: The table on page 147 is what it is, but that is talking about the customer benefit, if you like—the producer surplus, the consumer surplus, et cetera and a monetisation of the other costs. We sought in this project to look in addition at the broader economic benefits, which are to do with agglomeration effects, both around the airport and the impact on the regional economy. That is what produced our estimate of the broader GDP effect. We had PwC do a large project for us on this. This is only a small part of the picture. The broader picture suggests that the broader economic benefits of Heathrow would be considerably greater.

Lord Forsyth of Drumlean: But would you agree that the economic case, as calculated using the Treasury guidelines, is quite finely balanced?

Sir Howard Davies: Using the Treasury guidelines is a rather narrow interpretation, but I do not think I would agree that the economic case was finely balanced overall. We think that it is pretty decisively in favour of Heathrow, particularly in fact in a carbon-capped world.

Lord Forsyth of Drumlean: Just going back to the costs, Gatwick costs £7.9 billion, including the transport and access work, which might be paid for by the taxpayer, and brings £127 billion of benefits, so that is a ratio of 16 times. Heathrow costs £22.6 billion on the same basis and secures benefits of £211 billion, which is a lower ratio of 9.3 times. The cost difference between Gatwick and Heathrow is £14.7 billion, and the incremental benefits are up to £84 billion, a ratio of 5.7 times. Although you concluded that Heathrow was better value than Gatwick, it is difficult to see where the guidance is on why the £14.7 billion produces a better return than 5.7 times and why that is justified. What I am trying to say is that it produces more benefits but at the margin these benefits look quite costly.

Sir Howard Davies: These are unusual calculations, because this is not a public project like HS2 that is on the public purse and you have to look at it in that narrow way. This is

something that private investors are prepared to finance, so to some extent the costs and the revenues are matters for them. We chose to take the much broader approach of looking at the overall economic benefit to the country, particularly to the regions because the economic benefits to London are relatively clear, of the Government facilitating this investment. That is a better way of looking at this than looking at something that makes sense, perhaps, if you are talking about putting your hand in the public purse for it. For the nation as a whole, the investment that you would be facilitating here, not conducting yourself, generates an absolute economic benefit in our view that is considerably greater than the Gatwick one. That is what led us to that conclusion.

Lord Forsyth of Drumlean: Could I just quickly switch to Heathrow? I should perhaps have declared an interest, because I am a director of a company that owns a freight-forwarding business at Heathrow. I also fly to Heathrow every week from Edinburgh. Do you know what the full return economy fare is from Edinburgh to Heathrow?

Sir Howard Davies: No.

Lord Forsyth of Drumlean: It is over £600.

Sir Howard Davies: What is the train fare?

Lord Forsyth of Drumlean: I have no idea.

Sir Howard Davies: I bet it is not that far off.

Lord Forsyth of Drumlean: It is £600, and quite a lot of that is made up of airport taxes and other duties and taxes. Do you really think that low-cost carriers will open up services from Heathrow with an additional charge of £30 per passenger? Why have you discounted the effect of charge increases on demand in your traffic models?

Sir Howard Davies: There are two or three things to say about that. I did not look specifically at the Edinburgh one, although I think that may be of more personal interest to me in the future—I may be rivalling your own travel to Edinburgh and back quite shortly—but we did look at whether passengers were paying a premium as a result of Heathrow congestion, and we believe that to be true. We believe that the fact that Heathrow is constrained allows people to charge a higher fare, so we believe that opening up Heathrow will generate consumer benefits in the form of lower fares at Heathrow because there will be more competition.

You asked whether I think low-cost flyers will go in there, to which my answer is yes. In fact, easyJet has said that it would put 20 aircraft into terminal 4 at Heathrow if the runway were

expanded, and compete with BA and others on a major city-pair network in Europe. It thinks that it can do that even with significantly higher landing charges because the yield available at Heathrow is significantly higher than the yield available at Gatwick or other London airports in terms of the mix of passengers that you get. You get a larger proportion of business passengers—it is 30% at Heathrow versus something like 14% at Gatwick—and you can sell business travel packages to Heathrow in a way that you cannot at Gatwick at the moment. There is also freight. Freight is much more remunerative at Heathrow, which has a whole network of freight forwarders around it that does not exist around Gatwick. We believe—and our soundings from airlines, which have said that they would definitely do this, suggest—that there would be demand at Heathrow for that kind of travel.

Lord Forsyth of Drumlean: I think you will find that your colleagues from the Royal Bank of Scotland travel to City Airport rather than Heathrow because of the congestion and frequent delays that we experience when we go to Heathrow.

Sir Howard Davies: The last time I went, I went out from City and back to Heathrow because I live in west London, so that will be my route.

The Chairman: Can I just come back to the public purse? There are associated public investments required in infrastructure at both Gatwick and at Heathrow, but particularly Heathrow. Are you satisfied that you have captured all that? To what extent have you fed that into the economic analysis?

Sir Howard Davies: We have fed it into the economic analysis and I hope that we have captured it. We consulted the Highways Agency, Network Rail, Transport for London, et cetera. The amount that would be funded by the public purse is, however, not certain and it would have been inappropriate for us to say how much that would be. We believe that it would require investment of about £5 billion around Heathrow and roughly £1 billion around Gatwick, but we did not say how much of that should be publicly funded, because that seems to us to be a matter for negotiation between the Government and the airport promoter. I am quite sure, if I were the Government, that I would begin with the proposition that the airport promoter should pay for this, but where they would end up in that negotiation is not something that we can easily forecast. The maximum it could be, we believe, would be £5 billion.

Q4 Lord Turnbull: Like Lord Forsyth, I started with this procurement model, thinking that if you bought the cheaper one you had money you could divert, and I realise that that is not

correct, as you said. This is more like the award of a franchise. The nearest equivalent, I suppose, would be the National Lottery, in which case you have to judge it on the credibility of the business model and the section of the report on deliverability in particular. The Heathrow project is so much bigger and so much more complicated and there is a lot of difficult engineering construction. I had not realised until I saw the maps that, unlike the original third runway, this one requires tunnelling the M25. There are much bigger risks in this thing and I just wonder how confident you are that we are not going to be in the position we were with the Channel Tunnel rail link, where the private sector told us that it could do it and then came along on bended knee saying, "Sorry, it is not working out. Can we have some assistance?". It was a guarantee in that case; it happened to be a gamble that paid off. Is there not a significant greater risk to the bigger, more complex project?

Sir Howard Davies: There probably is, but I would say that in the consultations that we undertook with the relevant authorities—and we had a variety of consultancies look at the engineering and the associated surface access works—we did not encounter any obstacles that we thought were insuperable. It is early stages for the project, but the advantage of the Airports Commission process is that this has now been pretty widely consulted on and canvassed and people have had quite a lot of time to claw over it, not least the rival promoters, of course, in each case. I cannot say that there would be no risk to it, but the basic infrastructure of runways is fairly well understood; rather a lot of them are built around the world, although not so many here. The basic infrastructure of the airport exists and we think that the additions to that are fairly straightforward; there would be another terminal, but the airport knows how to do that. The one that you identify, the tunnelling of the M25, is the one that causes one an intake of breath, but the Highways Agency was not particularly fazed by that at all. The land would be there for the new runway, so diverting the road around it while you do the tunnel is quite straightforward, because that land would then become part of the airport; you do not have to take some other land that you are not ultimately going to use. I have to say, although no one can tell you that it is risk free, that it looks perfectly feasible, and Phil will remind me how much optimism and risk bias there is in our £5 billion.

Philip Graham: About one-third of that.

Sir Howard Davies: Yes. There is about a 35% risk and optimism bias in that number.

Lord Turnbull: Can you just go over again who are the ultimate backers of this project? You mentioned some of the shareholders, but who owns Heathrow?

Sir Howard Davies: Heathrow Airport Limited is owned by a consortium of shareholders led by Ferrovial of Spain, which is a major Spanish infrastructure company. The others are largely sovereign wealth funds. I always get them mixed up because there are sovereign wealth funds in Gatwick as well, but it is certainly CIC, the Chinese investment sovereign wealth fund; and certainly the Singaporean sovereign wealth fund. I always forget which of the Arab ones it is; is it Qatar or Abu Dhabi?

Philip Graham: I think it is Qatar at Heathrow. Also, one of the big Canadian pension funds owns a chunk.

Sir Howard Davies: We can give you a list. I am sorry, I just do not have it in my mind.

Lord Turnbull: You think that the risks of a CTRL-style coming for a rescue are slight.

Sir Howard Davies: The risks of it costing materially more than we suggest are slight. We have built in quite a big risk factor here still, because we think that is appropriate at this stage of the project. As I say, we asked the experts so far as we could. I do not think there is anything as innovative as tunnelling under the Channel involved in this.

Q5 Lord Monks: In the same territory as those questions, I note what you said about the interest of potential investors. The ones that you mentioned are all from overseas. Do you detect any UK investor interest in this project? If not, why not?

Sir Howard Davies: We need to divide investors between shareholders and bondholders. I think there would be quite a lot of UK appetite for bonds. The big infrastructure investors in the big life-insurance companies and asset managers have large infrastructure funds now, and I think there would be a lot of UK appetite there. It is interesting—I cannot really tell you why—that the shareholding of airports in this country is so heavily foreign-driven. It is the case with pretty much all our airports. Gatwick is owned by Global Infrastructure Partners, which is a private equity fund that raises money from everywhere, but the other main shareholders are foreign pension funds and sovereign wealth funds. That includes City Airport and Edinburgh, which are owned by the same people. Birmingham is owned largely by an Australian pension fund and a Canadian teachers' pension fund. I am afraid that is the case. Why our big funds have less appetite for this kind of equity is an interesting question. The Chancellor has been trying to stimulate greater investment by our pension funds and life insurance companies. Lord Turnbull would know that some of the answer to that is

Solvency II, a new insurance regulatory regime that biases insurance companies and pension funds in this country against equity investments and into bond investments. That is part of the answer. Otherwise, I am afraid there is a slight mystery here as to why it is, but it is the case with all our airports and with ports too.

Lord Turnbull: They are not even that favourable to bonds, necessarily.

Sir Howard Davies: Not to infrastructure bonds, no.

Q6 Lord Sharkey: Sir Howard, the commission considered that APD was a valuable feature of a sustainable aviation industry, and it also refers to a noise levy. Is the noise levy a replacement for or a supplement to the air passenger duty? Would it operate at all airports?

Sir Howard Davies: On APD, you might say, although no one so far has, that we were slightly exceeding our brief. I am sure that some of the aviation industry would say so, but we did take very seriously the question of how demand for aviation would be constrained within our climate change objectives, which are legislated, so we have to take them as a given. It seemed to us that a tax regime was part of the answer to that, so it seemed to us to be slightly strange to be thinking of moving that away. Our view is that the noise levy is a different thing and that it would be on top of APD. Our argument is that that should apply in principle at all airports, but in fact at airports that create a significant amount of noise for a significant number of people. We modelled for ourselves various different ways of doing it, but if you had a 50p per person passenger charge based on the number of people within a 57-decibel population band or some calculation like that, the lion's share of it would be generated at Heathrow. There would probably be some at Manchester and some at Luton, and not so much at most of the other airports. The yield would be more at Heathrow than anywhere else. The justification for it would be specifically to fund projects around the airport that emerged as time went by. Heathrow has proposed a pretty large package of measures of compensation and mitigation as part of the package of building the airport, but in our view to have a continued funding stream that could fund projects as the need for them emerged around a noisy airport would be a useful addition. It would also create a glue for engagement between the airport and the local community. As you know, we have argued for a community engagement board on the Schiphol and Frankfurt model, and if that were able to influence a funding stream that could pay for particular projects at schools and community centres et cetera, we think that would create the right kind of engagement between the airport and the community. As for where you put it, as I say, we modelled

something at 50p, which would hardly be noticed by Lord Forsyth on his Edinburgh fare but would create £50 million a year or something at Heathrow.

Lord Forsyth of Drumlean: Many a mickle makes a muckle. If you were to introduce something of this kind, how would you avoid people who were next to noisy railways or noisy roads or HS2 demanding the same kind of deal?

Sir Howard Davies: Luckily, that is not part of my brief.

Lord Forsyth of Drumlean: But it is a principle that you are advancing that the passenger should pay a levy and that people should be compensated for the noise. If that is to be a principle in our country, surely other people who are affected by other transport would be on pretty strong ground, would they not?

Sir Howard Davies: Our general view at the commission was that if you looked at the way in which other airports operated internationally, but also at the way in which other projects were being conceived now, whether fracking or other things where the benefits accrue to the many and the disbenefits to the few, there does seem to be a need, in order to generate acceptance of these projects, to alter to some extent the balance as to where these benefits and costs fall. Other places, notably France, have a specific noise levy around airports that funds this kind of thing. The contribution that Heathrow makes to its local community is significantly lower on a per passenger basis than most other airports in Europe. Other countries in Europe have a model of this kind, and they manage to distinguish between airports and other projects. I cannot deny, Lord Forsyth, that there could be a read across, but we have been looking at analogies elsewhere and applying them only to the airport sector.

Q7 Baroness Wheatcroft: Sir Howard, you had a strict brief to look at increasing airport capacity in the south-east. I wonder whether you think that was the right one. We are conscious on this Committee, having looked at HS2, that the one thing this country lacks is any sort of joined-up transport strategy. Is it possible to opine on where a new runways should be without looking at it in that context? What about Birmingham? What about Manchester? A lot of those Poles flying home to mother probably live outside the south-east.

Sir Howard Davies: That was in the brief and we did do that. The brief was to look at what was needed to maintain the UK as Europe's most important aviation hub; it did not specifically say about London. Indeed, we did quite a lot of work on looking at whether you

could encourage the use of other airports in order to offset the capacity constraints in the south-east. In our interim report, we modelled the things that you might do in order to achieve that.

First, I should say that the options are not that great, because, consistent with international rules and the European rules that we are signed up to, you cannot tell airlines where you want them to fly to and from. There is no great air traffic controller in the sky who can say, “You will go to Birmingham”. You have to look at what you can do in order to incentivise people within the legal framework that you have. Roughly, we think there are a couple of things. One of them we think is relevant to our recommendation, which is to do with the use of public service obligations, but that really applies only to London. We looked at whether you could incentivise airlines to fly from other places by imposing a kind of congestion charge, effectively, at Heathrow—that would really have been what it was. We modelled the impact of doing that. It would have to be pretty high in order to get anybody to move, partly because the propensity to fly in London and the south-east is significantly greater, but also because you would end up with a significantly less efficient network of flights. You would be able to incentivise some people to fly two-thirds-full planes to Birmingham but to destinations that you already have, but you would not generate any additional routes to destinations that you do not have because they are only realistically likely to emerge at a hub airport that has a network of feeder routes into it. Our conclusion was that doing such a thing would be costly, would not generate improved connectivity and would generate an environmentally less friendly network of flights than concentrating on increasing capacity in London and the south-east.

We did another piece of work in the course of preparing our final report on the role of regional airports, and that is a quite interesting picture. When you go to most regional airports, what they really want is access to Heathrow. That is what they think will boost them. I went to Inverness and Aberdeen. Inverness has lost its flight to Heathrow. It has a flight to Schiphol, but they say, “Look, we do not want to have to tell American tourists who are coming to play our golf courses or tramp around in the Highlands that the best way of getting there is to fly to Amsterdam and then up to Inverness”. That just does not fit terribly well with a tourism proposition. Nor does it really make a lot of sense to tell inward investors in the oil industry in Aberdeen that in order to get to Chicago they have to go via Frankfurt. Most of the regional airports, except for the really close ones, want access to Heathrow.

That is why we have suggested a different use of public service obligations to ensure that some of the additional capacity generated went to developing those regional routes. There are now only six regional airports that have a regular route to Heathrow and 20 that have one to Schiphol. We feel that we should have a mechanism for ensuring that some of the additional capacity at Heathrow went to developing regional links, which would be very positive for those economies. That is what they really want. In Scotland, for example, they are very keen that there should be some North Atlantic links, and a daily flight to JFK is probably realistic, but will you get an Edinburgh-Denver flight or an Edinburgh-Chicago flight? No, you will not. That is in nobody's forecasting. The key thing is to get them to have decent connections into Heathrow—to that network that will only exist, we believe, in Heathrow.

Baroness Wheatcroft: If it is difficult, indeed impossible, to tell airlines where they must fly to, is there not an argument in favour of leaving it to market forces? Some of the people who responded to the commission suggested that the three south-eastern airports ought to have a choice to build the runways where they wanted when they wanted, when they thought the market was ready for it, and the risk would be a commercial one once they got planning permission.

Sir Howard Davies: That last bit is quite important. There are two or three problems with that. One is that it is very important to recognise that this country is the only country in the world in step here. In other words, we are the only ones who believe that airports should be financed privately. That was the framework that we accepted. It is not surprising that we have rather constrained capacity, because if it is private-sector funded, people on the whole will not build well ahead of demand. The reason why you have six runways at Schiphol and four runways at Frankfurt, which does not really need more than two at this point, is because they are built by public money. They have built well ahead of need, and that is a strategic move as part of Finanzplatz Deutschland and all that. In the UK, that is not the policy route we have chosen.

If the Government were to say, "Right, we will facilitate development at both Heathrow and Gatwick"—I do not think three airports would make any meaningful sense; Stansted is not yet half-full, so I cannot see why Stansted would even think about it at this point—I do not believe that two of them would be built. I believe that it would be extremely difficult to get funding for a project at Gatwick if Heathrow were allowed to expand. That would be highly

unlikely. Here I am speculating. I cannot absolutely prove that, but if you gave Heathrow planning permission and Gatwick planning permission, I believe that only one of them would be built, and in my analysis it would be far more likely to be Heathrow. I also think that you would have a significant problem on your environmental policy, particularly on climate change. I am not quite sure how you would describe that policy in a manner that is consistent with your climate change objectives. The only consequence, if you tried to do it, would be essentially that you would be closing down some regional airports. You would have to because you would not be able to tolerate that degree of flying, or else you would be imposing a decarbonisation challenge on the rest of the economy that would be implausible. I do not quite know what the narrative surrounding such a decision to say, “This is market forces”, would be.

Q8 Lord Monks: I am a supporter of the report, but the opponents are rather noisier than the supporters at the moment. I am concerned about the way in which perhaps the voice of some of the supporters, including a significant amount of the existing workforce at Heathrow and people who are looking for work in some of the poorer Thames Valley towns, is not coming through loud enough against some powerful interests in the Thames Valley and particularly in some of the political parties and in the Government. Do you have any sense of the public debate? Would you like to see the supporters more vocal, more insistent, and perhaps matching at least some of the decibels that are generated by the opponents of an expansion of Heathrow?

Sir Howard Davies: I am reluctant to be dragged into the political territory. I do not know if you know anybody in the trade union movement, Lord Monks, but if you did perhaps you could speak to them. Trying to stick with my analytical brief, if you like, when we exposed our consultation we had 72,000 responses, of which more than 50,000 were from individuals supporting Heathrow expansion. It is fair to say that a lot of that was a campaign that was stimulated by the airport, but they were individuals who still filled in a card and sent it in. If you look at the opinion polling evidence, the Populus polls—admittedly commissioned by Heathrow but done by Populus according to their methodology—would show you that there are far more people around the area who support the airport than oppose the airport. Generally, if you try to ask people whether they are more inclined to vote for a candidate who is in favour of expansion or against, it is very balanced in all constituencies except Richmond. The impression that you are given—which I recognise—that this is about the

business community being in favour of being able to get on more business flights and the local community being against is a long way from the truth. We spent a lot of time visiting around the area and the one thing that everybody agrees with is they do not want it to close, which would have been the implication of an estuary airport. Of the councils, Slough Borough Council and Spelthorne are in favour of expansion, and Hillingdon is against, as is Wandsworth. Hounslow has a campaign called “Better not bigger”, but our argument is that a lot of the things they want on the “better” front can be delivered best if it is bigger—in other words, a ban on night flights before 6 am and that kind of thing. You could do that if the airport were bigger and therefore able to reschedule those flights to later. The views around the airport are much more nuanced than appears in the public debate.

The Chairman: One assumption the commission makes is that the southern rail access will be built, yet that has been opposed for donkey’s years, so how were you able to make that assumption with any confidence?

Sir Howard Davies: There are two sorts of southern rail access, I believe. There is the one into Waterloo.

The Chairman: Yes, that is the one I am referring to.

Sir Howard Davies: Which we believe is quite plausible.

Philip Graham: There was a previous version of southern rail access, called Airtrack, which created some particular problems around the use of the level crossings in the area, such that in peak hours you would get enough trains going past that the level crossings would be down—I do not know the exact number, but 40 minutes in every hour or something. We have looked at a modified version to get round that problem. All our modelling has been done on the basis of trains splitting, with part of the train going into Heathrow and part of the train going on down the line, so that you provide the access into Heathrow without requiring any extra train paths in the part of the line where those level crossings are. We have also looked at some slightly different elements of the design to move away from some of those problems, and the costs of the scheme are captured in the £5 billion that Sir Howard was talking about earlier.

Q9 Lord Kerr of Kinlochard: It is a very high-quality report. It comes out with such a clear recommendation and the arguments stack up so well that one is tempted to ask what took you so long.

Sir Howard Davies: What took us so long is that getting a decision that is not open to challenge on unreasonableness grounds is quite difficult. First of all, we had to deal with the issue of whether there was demand. We published our views on that, we consulted on that, we took the responses into account and we published feedback statements on the responses, et cetera. Then we published a set of appraisal criteria, because in order to generate any kind of consensus on these issues you need to say what you are going to evaluate these schemes against, and we consulted widely on those. Then we asked for specific locational proposals to deliver the amount of additional capacity that we thought was needed and could be justified, and we had more than 50 schemes proposed to us, which took quite a lot of winnowing down to the three that we shortlisted. Then we thought that you needed to be clear about just what was involved. You could have looked at it and said, “We think additional capacity at Heathrow is required, full stop”, but then you would not be at the point you now are, with well worked up, reasonably detailed engineering plans. There is still some risk involved, as Lord Turnbull would cause me to acknowledge, which I would do, but nonetheless it is a pretty specific proposal. People can bite on it. They can say, “That is where the runway would be, those are the roads that would have to go, that is where the river would be culverted, and that is what would happen to the local rail networks and road networks”, et cetera. These are very specific proposals, which you could not have developed in much shorter a time. They have been reviewed by a whole series of consultants: economic consultants, engineering consultants, environmental consultants, et cetera. I think it is a pretty robust base. The Government now have a clear proposal to take a view on. There is an alternative, clearly, which we think is not favoured, but it is a much more advanced process than it was, and all the work that we have done would have had to have been done by the Government if we had not done it.

Lord Kerr of Kinlochard: Very convincing. It sounds as if there were no political constraints at all on timing.

Sir Howard Davies: I would put it this way. I was told that the Government did not want a response until after the election. Okay. That is fine. I agreed with that. My view was, “How do we use this time most effectively to ensure that we do not slow this process up?”. In other words, you do as much as you could of the preparatory work and the consultation work, et cetera, so that what you get is a fairly oven-ready project. It was not that we then spent two and a half years not doing it. We looked at it and said, “How can we make it so

that the Government would then be able to hit the ground running?”. I believe that we have used that time constructively.

Lord Kerr of Kinlochard: I meant it when I said it is a very high-quality product. In particular, I understand your hub argument, I understand your Inverness argument and I think I understand your agglomeration argument, all of which point very clearly towards the option that you have gone for. What I do not understand is why you feel it is possible to rule out a fourth runway at Heathrow. First, it seems to me, all these arguments will remain equally valid when you have the new runway that you are recommending. I do not see why all these factors should switch off. Secondly, no Parliament can legislate for its successor. How valid is the law that you call for banning a fourth runway, which you seem to think is quite important? It seems to me that it is as valid as the life of the Parliament that passed it. If demand were to continue to rise, if the economic arguments were to stretch further out than you believe they will judging by this report, pressure for a fourth runway would build up again, would it not?

Sir Howard Davies: There are two or three different answers to that. One is that we think that there are operational reasons why a fourth runway is a very remote, implausible proposition at Heathrow. National Air Traffic Services have argued to us that they do not think you could manage more than 800,000 traffic movements from one location in the congested airspace of the south-east of England. If that is true, and that is what they say, you would only get another 60,000 movements out of a fourth runway at Heathrow that could be managed within the airspace constraints. That is one argument, which looks to us to be quite persuasive.

A second argument is that we looked at all the various options for runways at Heathrow and thought in the end that the two that we looked at were really the only ones that were feasible. The south-west runway that was proposed at one point and that would have had some advantages in moving the traffic a little further to the west so the arrivals would be higher over central London has a major problem with it, which is that it involves the draining of a very large reservoir. While we have not built another full-length runway in the south-east of England since 1945, we have also not built a new reservoir since 1945. That was an obstacle that we could not see a way round. We do not understand physically where else you could put a fourth runway even if you allowed them to have a fourth runway.

A third point, speaking to your point about demand, is that whilst we believe that there is a need for additional hub capacity at present, we also believe that a huge city like London with an enormous origin and destination market—still the largest in the world—benefits from a range of competing airports offering a different balance of services to the customer, with some of them operating on a much cheaper, cut-down model primarily targeting the tourism and visiting-friends-and-relatives market. We just think there is a benefit to a competing network of airports, which is one reason why we were not attracted by the idea of five runways at Stansted or a huge one in the estuary, et cetera, and the air traffic problems there. If you could envisage affording another runway within your environmental objectives, you would almost certainly want to put that somewhere else to avoid the dominance of one location as well.

I do not believe that you would want to do it now or could justify it now, but it makes me think that another runway, if you could afford it in climate change terms, would be 2050, and therefore the one after that, which would be the first time Heathrow would remotely be a bidder, would be 2070. You may have long horizons; that is beyond my horizon. All kinds of things might be different—we may have planes landing vertically, we may have silent planes. I do not know what we will have by 2070, but I cannot see circumstances in which, on an airport model such as the one we currently have, you would want to have another runway at Heathrow. I just cannot see it. Therefore, as much reassurance as you can give to the population that they will not have that seems to me to be a good thing in order to generate more support for the third-runway package. Constitutionally, I am sure you are absolutely right, but nonetheless it is more difficult for Governments to change legislation than to change their minds.

Q10 Baroness Blackstone: Coming back to Lord Monks' question about the political aspects of this, out of interest have you been given any indication by the Government as to when they are going to respond to your report?

Sir Howard Davies: They have said two things. The Chancellor and the Secretary of State for BIS have both said that the Government are committed to building a new runway. They have not said where exactly. I believe the Secretary of State for Transport has said that he will make that decision—I think it is his decision—by the end of the year.

Baroness Blackstone: By the end of this year? We are not going to have to wait until after the election of a new mayor in London?

Sir Howard Davies: That is not what I have been told. I have been told that he will make that decision by the end of the year.

Baroness Blackstone: Okay. Coming back to your answer to the issues that Lord Kerr was raising about reassuring the population about a fourth runway and that it will not happen, what about the other mitigations? For example, you have said that the curfew on night-time flying should be binding, but how can you make sure that this happens? I have heard quite a lot of the criticism from people who are going to be affected around Heathrow, who say that this is not worth the paper it is written on, that it cannot be binding and that the pressures from the airlines to land from Hong Kong at 5 am will continue.

Sir Howard Davies: The current restriction is 16 flights before 6 am and that is rigorously complied with, is it not? I believe so.

Philip Graham: It is, absolutely. It is the Government's job to regulate night flying at Heathrow, Gatwick and Stansted; it is not a voluntary decision by the airlines.

Sir Howard Davies: Yes, they can regulate it and the airports would then be breaking the law.

Baroness Blackstone: I understand that, but my question is whether these regulations will continue, with huge business pressures to continue some landing at 5.30 am and some of the other mitigations that you suggest, because they are not in the interests of the airlines or business travellers from some parts of the world.

Sir Howard Davies: There is undoubtedly a cost to this. We analysed in some detail—it is in the report—where these flights come from. There would probably be a bit of diversion of traffic, probably principally to Frankfurt, because some people would say, “I want to connect into continental Europe at an early hour. Getting in at 4.35 am allows me to connect to a flight to Berlin or wherever, and if I cannot do that I am going to go straight into Frankfurt”, and they probably would. I guess my view would just be, “Well, there you go. You cannot have everything”. Heathrow is an airport in a congested area and it has to operate in a way that reflects that. But if the Government were to be clear and say, as they have been up to now about the 16 flights before 6 am, that they regulate night flights and that they will not be allowed before 6 am, then I just do not think that you would get people changing it. I think the airlines would reconfigure their routes and that would be that. I honestly think it would stick. It does in other places. In Frankfurt, they are about to scrap night flights as a condition of getting their fourth runway, and that has stuck.

Lord Turnbull: Just following that up, what has been the response from Heathrow itself to the 6 am figure?

Sir Howard Davies: I can only read the response in the newspapers, like you, because nobody is responding to me. I have gone, if you see what I mean. The mail gets put on it, "He has left, with no forwarding address". "Sir H Davies, Scotland" is my current address. I gather that they have been a little cautious, as I read what they have said, and that they would like to discuss it.

Philip Graham: They have not ruled it out. Equally, they are not signing it off at the moment. The package of measures, of which this is one that the commission put forward, was pretty ambitious. It was meant to go further than Heathrow Airport would necessarily be comfortable with, so I would have been very surprised if they had picked it up immediately and said, "Right, we can sign off everything on that list".

Sir Howard Davies: Also, to be fair, they would have to talk to the airlines about that, because clearly it would depend on the response the airlines gave. If BA said, "We are going land all our early morning flights at Birmingham now", that would have one set of consequences for Heathrow. If BA said, "All right, we will take off at 1.30 from Hong Kong instead of at 11.45", Heathrow would be relatively indifferent to it. I am not surprised that they cannot respond instantly. They will need to discuss with their customers.

Q11 Lord Turnbull: I assume they will assume that 90% of the loaf is better than no loaf. Can I come to the question of scarcity rents? It is listed as one of the benefits. Elsewhere, at paragraph 11.21, it says that this is going to be a very expensive project and that it is going to add to costs. You are also arguing that there is a great queue of people waiting to take this up. Are you really expecting landing charges to fall? I cannot really see that it makes much difference.

Sir Howard Davies: No, we would not expect landing charges to fall, but we would expect fares to fall because of heightened competition. I guess that is what we would assume.

Philip Graham: Yes. We would expect landing charges to go up to pay for the additional capacity, but we believe that there is sufficient suppressed demand and sufficient lack of competition in the market at Heathrow at the moment that despite the landing charges going up, the overall effect on fares on average would be for them to fall. If you look at long-haul routes at Heathrow, because of the lack of capacity a large number of them are only served by one airline. There is scope with new capacity to address that and, as previously

discussed, there is definitely appetite on the part of the low-cost carriers, which have been kept out of Heathrow up to now because of the high cost of securing slots at the airport, to come in and undercut the legacy airlines.

Lord Turnbull: So there is a distinction between the scarcity rents of landing charges and the scarcity rents of fares. They could move in different directions.

Philip Graham: For the landing charges, there are no scarcity rents, because they are regulated. The airport cannot charge scarcity rents because it is heavily regulated, but the airlines, which are not, can charge scarcity rents because there is not that much competition on many of these routes.

Sir Howard Davies: The airport charge will go up by whatever the regulated asset base goes up times whatever the CAA return is. There is no reason why they should charge less than that. That is what they will be allowed to charge. But the way the airlines behave is what we are trying to get at here. The one bit in the argument—the numbers in the chart to which Lord Forsyth drew our attention on page 147—is that we have a consumer surplus, which is the removal of scarcity rents in airline price charging, and then a producer surplus, which is negative. That is what comes out of the model that we commissioned. Personally, I do not think that is really likely. I do not think that that producer surplus would be such a strong negative, because airlines would find a way of making their services more efficient to compensate for that. That assumes that every consumer surplus is a producer deficit, which is, in my view, a slightly peculiar way of thinking about it. It is not the way we normally think about competitive markets.

Q12 Lord Layard: I want to follow that up, but I just wanted to say that I think it is an excellent recommendation. It is essential that one does not get into this benefit-cost ratio way of thinking about it, because that can totally distort the argument. It should be the total net present value. If anybody comes up with the other argument, they should be objected to.

I do not fully understand this question of the allocation of slots. I do not know how they are allocated now. What is your picture as to how the extra slots would be allocated? To what extent is there a market bidding process? How would you take into account some of the other social issues that you raised about greater connectivity to regional airports and so on? Could you perhaps explain how the slots are currently allocated and how you envisage that they would be allocated?

Sir Howard Davies: Yes. This is an area of some complexity, but essentially under European rules there is an independent slot allocator. There are the European Union slot regulations, which are not to do with slot machines but to do with airports, and there is a slot co-ordinator in the UK. The rules say that half of any new slots created would be reserved for new entrants to the airport. The Government cannot influence that. That is operated by the slot co-ordinator in a neutral and independent manner. Formally speaking, there is no auction process, but we know that slots are traded.

Philip Graham: Slots are not sold by the airport. The airport creates the slots, which are allocated by the slot co-ordinator, so you cannot buy a slot from the airport. Where there is greater demand for slots than there are slots available there are secondary markets. Heathrow has the biggest secondary market for slots in the world. That is where you have seen airlines trading slots between themselves for £20 million or £30 million a slot pair. When new capacity is created as a result of expansion and therefore new slots become available, those are initially allocated by the slot co-ordinator through a bidding process, of which one of the rules is that 50% have to be made available to airlines that do not currently use the airport. New entrants, in order to increase competition, effectively have first dibs. That is the opportunity that makes it possible for airlines such as easyJet and Ryanair to get access to Heathrow, which they have not been able to achieve in the past.

Sir Howard Davies: We have suggested that the Government should use the public service obligations that are permitted within EU rules to allow the creation of routes to disadvantaged—well, not disadvantaged—

Philip Graham: To peripheral areas. I cannot remember the exact phrase, but it is something like that.

Sir Howard Davies: Whatever the word, it is not great when applied to Scotland. We have argued that the Government could use that in a slightly different way from the way they use it at the moment and attach it to specific airports. You could say, “We will support a route from Inverness to Heathrow twice a day and we will require the slot co-ordinator to make that route available specifically from Inverness to Heathrow”.

Philip Graham: You can attach a new slot to that. You cannot attach it to a slot that someone else already owns and is using for a different purpose, but when new slots become available you can then attach a public service obligation to them.

Lord Layard: Are you expecting flights that currently go into Gatwick or Stansted to try to get into Heathrow?

Sir Howard Davies: There might be some, although easyJet, for example, argues that it will just net expand and that it will not take planes away from Gatwick in order to run them from Heathrow. I suppose it is conceivable that some flights would move. Gatwick might fear that because there are some emerging-market airlines—the Chinese have one or two and Garuda was in there for a while—that have not been able to get into Heathrow that are currently flying into Gatwick, but whose clear preference, if there were an expanded Heathrow, would be to go to Heathrow. I would expect a few to move at the margin, but probably not that many. What would be more likely is that people would expand their route network. BA would tell you that after buying bmi, and I suppose now Aer Lingus, it has some slots available to develop routes to new destinations, but only for the next five or six years. Beyond that, it would need additional slots if it was going to have a Chengdu flight, a Chongqing flight or whatever. That is what we think we would most likely see.

Q13 Lord Layard: All this is going to happen many years hence. What is going to happen between now and then? How much will we be losing between now and then with airlines going to other hubs?

Sir Howard Davies: Our view is that we have already lost some. If you look at the networks, although London is still a well-connected city there are signs that we have lost business to some Russian cities and some Chinese cities that now have direct flights from Frankfurt, Schiphol and Charles de Gaulle. You will see the network effects in our report. In some cases, we have lost connections that almost certainly would have been at Heathrow. We have lost regional connections to Heathrow, as I discussed earlier, with people going via Schiphol. We are losing some traffic to Middle Eastern hubs, because in the absence of getting into Heathrow there are now flights from Newcastle, Glasgow and Edinburgh to Dubai and then on to the Far East. We are being disintermediated on some of that traffic. Undoubtedly, we would have been better off had this commission been appointed 10 years ago and we had a runway operating now, because there is certainly demand for it now.

As to what will happen in the interim period—we think 2026 is realistic if the Government make a decision this year and get on with it—our modelling shows that the other London airports that still have some spare capacity will fill up. They will all be full by 2040. Stansted has a planning cap of 35 million passengers and currently has about 20 million, so there is

quite a bit of capacity there. There is a certain amount of capacity at Luton, a bit at Gatwick but not much, quite a bit at Southend and a lot at Birmingham. We would expect to see growth at these other airports, but it will not be the kind of growth that we think is most needed in an economic sense. If you want to put on a flight to Krakow, you can find a place to put it still, but what you cannot do is incubate a new long-haul route that needs feeder traffic into it. The next 10 years will be difficult and we will lose some business, but there is not much I can do about that from here.

Lord Layard: Is there any margin of choice whereby if one spent a bit more money one could do it faster? Is that an issue?

Sir Howard Davies: We believe that the planning process and all that is what takes about half the time, so if Parliament is prepared to work longer hours perhaps that would speed things up.

Lord Forsyth of Drumlean: Sir Howard, I think I am being a bit thick. Lord Layard has just said that we should look at these two schemes in terms of net present value, which I very much agree with, but I still cannot get my head round why table 7.1 does not show that there is pretty marginal difference between the two schemes in terms of net present value. I know that I have asked you that, but could you just try to help me to understand why, if we are looking at it on a net present value basis, as Lord Layard has just said, the differences are not quite marginal?

Sir Howard Davies: Phil, can you produce a better answer than I produced earlier? What I was trying to get across was that this was a series of just the direct costs. I pointed out that I believe personally that the negative on the producer surplus line is rather implausible, because you would not get that kind of reduction in producer surplus; you would have a stimulus to additional efficiency. But our overall economic view is that you try.

Philip Graham: The commission's view first of all, as Sir Howard was saying earlier, is that the key thing to look at is the level of benefit and economic impact that you are creating by facilitating this investment through the planning system.

Lord Forsyth of Drumlean: I understand that. It is the point about the net present value that I am asking about.

Philip Graham: The net present value figures, if you take into account the costs of the scheme, are in that table. Heathrow performs more strongly in relation to our carbon traded forecasts. It performs less strongly than Gatwick in relation to the so-called carbon capped

forecasts. One question is where you place the emphasis in the calculations. Do you base it solely on the net present value? Do you look more strongly at the net social benefit or other factors? Another question is: what is captured within this table? You can only place a value on the things that we have the tools to measure. A large number of those things are captured in that table, but as Sir Howard said you also look at the freight benefits, the local economic benefits and the wider GDP impacts. On all those assessments, the commission's view was that the benefits of Heathrow were noticeably greater than those of Gatwick.

Lord Forsyth of Drumlean: Yes, but when your report was published, your emphasis was not on that broader thing. You sold it very much on the benefits on economic grounds.

Sir Howard Davies: The figure I mainly quoted was on the overall GDP economic benefits, not the net present value. I do not think I mentioned these.

Philip Graham: No, and that was the figure of £147 billion from expansion at Heathrow compared to £89 billion from expansion at Gatwick.

Sir Howard Davies: Those were the figures I quoted.

Q14 Lord Monks: We had earlier a brief discussion about point-to-point versus hub airports and whether or not, as some allege, hubs are a dinosaur—that the new generation of planes will permit Edinburgh to Denver or something like that. I had a meeting the day before yesterday with the airline Norwegian—I should perhaps have mentioned, Chairman, that I am president of BALPA, the airline pilots' union. I do not know about Edinburgh-Denver, but it sees a big future in point-to-point flying. It also sees a big future, I have to say, in hubs, but I wonder to what extent I can tempt you to say a little more about how you see the point-to-point development, which takes some of the pressure off the expansion of Heathrow if it is true.

Sir Howard Davies: We looked into this quite carefully. It involves the 787 and the A350. I went to Charleston to see the 787 people. It is certainly true that in principle these aircraft allow longer, thinner routes to be more profitable. Essentially, they are longer-range aircraft but not as big as the A380 and the 747. However, it appears that they are mainly being bought by the "legacy" airlines that operate networks based on hubs and are not primarily being bought by low-cost, long-haul, point-to-point airlines. Norwegian is something of an exception. It has operated a small number of long haul routes at Gatwick. We speculated as to whether that might grow. I have to say that on balance the low-cost airlines that we talked to have continued to argue to us that they see low-cost long haul as being at the

margin of what can be done. One advantage of low-cost airlines is cutting down on staff. A second is cutting down on service. You can cut down to a certain extent on staff on long haul, but not as much as on short haul, because you still need to offer people more service. Also, cutting down on services and saying “no meals” or something is less appealing on an 11-hour flight than it is on a two and a half hour one. Also, the opportunities for more utilisation of the aircraft are much less on long haul routes. The key trick for easyJet and Ryanair in Europe has been to get the planes going in and out twice a day to Corfu and back. If you look at the timings and the length of sectors, you just cannot do that on the long haul. Our overall judgment is that the 787 and A350 are not likely to alter the model substantially. We got the International Transport Forum to do some modelling of this for us and that was its conclusion.

Philip Graham: The other point to make about low-cost long haul is that where it has been established it is to routes that are already served by legacy carriers. Norwegian flies out of Gatwick to New York, Los Angeles and Florida. Where does it fly from Stockholm and Oslo? It flies to Bangkok. These are routes where competition is valuable, but they are not expanding connectivity.

Lord Monks: They are certainly not doing Edinburgh to Denver.

Sir Howard Davies: No.

Philip Graham: No.

Q15 The Chairman: Could I just finish with a brief question on the competitive dynamics, if you like, between the airports? A key assumption of yours is that none of the alliance airlines will move to Gatwick, yet if there were a second runway at Gatwick, would it not become a very attractive hub for one of the alliance airlines, rather in the way that Newark has got United Airlines to move from JFK? Secondly, on the other side of the coin, Heathrow was required to sell Gatwick so that it did not have a monopoly. It seems to me that you are recreating that near-monopoly position by now allowing Heathrow to have a third runway.

Sir Howard Davies: On the second point, I really think that is quite wrong. Gatwick argues that point and I simply do not recognise it in our analysis. As I said in response to the question about the fourth runway, we strongly see the benefits of a competitive airport network. London will continue to have City, which is expanding; Southend, which has come on to the landscape relatively recently; Stansted; Luton; and Gatwick, which is still a big airport and the busiest single-runway airport in the world. If you look at the capacity figures,

Heathrow will certainly still not have half the London market when it has expanded, so I honestly do not think that is right.

As to the first question, a variety of different arguments have been advanced for what would happen in an expanded Gatwick. One of them, at an earlier stage, was that one of the alliances would move. All we can do is talk to the alliances, and I cannot tell you how adamant they are that this is not what they would do. You may say, “They would say that, would they not?”, and I suppose it is possible that if you absolutely said that Heathrow is never going to expand—I guess that would be the interpretation if it did not get expansion now—people would have to start to think about whether they would move, but an alliance is not a command-and-control structure. The alliances are fairly loose alliances of airlines that do a degree of mutual taking in of each other’s washing, a degree of through-ticketing and stuff, but SkyTeam and Star Alliance, which we met, are not in a position to sit in their headquarters in Schiphol and say, “We are going to Gatwick”. They would have to bring a lot of airlines together to reach that conclusion. They are very heavily invested in Heathrow. They get business from each other. Their networks are a complicated set of things. I found it very difficult for us to assert that that could happen in the face of all the evidence that it is not what they want their business model to be.

The Chairman: Sir Howard, earlier in the session you asked the cost of a return fare by train from Edinburgh to London. The clerk informs me that it is £281 standard class.

Sir Howard Davies: I am sure Lord Forsyth travels business.

Lord Forsyth of Drumlean: No, I do not. There is no business class, as you will discover.

The Chairman: First class is £478. First class is not available on the airline. Thank you very much indeed for your helpful and informative answers. Good fortune in your new role. We look forward to meeting again with you in your new role and hearing the progress to recovering the significant investment the taxpayer has in RBS. Thank you.