

MEMORANDUM OF THE TEES VALLEY JOINT STRATEGY UNIT TO THE TRANSPORT COMMITTEE'S FUTURE OF AVIATION INQUIRY

SUMMARY

- The Tees Valley Joint Strategy Unit is funded by Darlington Borough Council, Hartlepool Borough Council, Middlesbrough Borough Council, Redcar and Cleveland Borough Council and Stockton on Tees Borough Council to develop on their behalf strategic Tees Valley wide policy on economic development, planning, housing, tourism and transport. The Unit also acts as a secretariat to Tees Valley Unlimited, a sub regional partnership with the private sector.
- The Tees Valley economy is based on the largest integrated process industrial complex in the UK based on a world class petrochemicals/energy/biofuels industry, the third largest port in the UK and a world class advanced engineering industry. The petrochemicals industry alone contributes £3.5 billion to the UK economy and 70,000 jobs in the UK depend on it. £4 billion of investment in the complex is expected in the next 5 years.
- International connectivity is vital to the industry. Most of the major firms in petrochemicals are foreign-owned multi-nationals – SABIC, Dow, Huntsman, Growhow etc. The advanced engineering industry depends on international air links to reach markets. The direct flight from Durham Tees Valley to Heathrow and Amsterdam are vital to both industries to travel to markets and for head offices to reach them.
- The closure of the Durham Tees Valley – Heathrow service will directly impact on the Tees Valley economy. 88,000 people used the service in 2007 of which 24% were business passengers interlinking with other services at Heathrow to reach destinations around the world. The cost to passengers of the withdrawal of the service is £2.3 million/year and to the business community £1.4 million/year.
- The key factors in BMI's decision to terminate the flight are the charging structures at Heathrow and the recent increases which favour long haul flights at the expense of short haul flights. BAA is unique in that its landing charges are the same regardless of the type of aircraft thereby pricing small aircraft for regional services out of Heathrow. Because of the lack of capacity at Heathrow, airlines can also produce greater profits from long haul flights than regional flights.
- Because Heathrow is the only UK airport with connections to all over the world, it is the only UK airport of importance to the global business traveller. Consequently, the introduction of alternative flights to London airports would not compensate for the loss of the service to Heathrow. The alternative rail service would take about 3½ to 4 hours because of the need to travel from Kings Cross to Heathrow.

PSA Target 7 is concerned with improving the economic performance of the English regions and to narrow the gap. The inability of the Department for Transport to regulate landing charges at Heathrow which enable regional flights to continue together with a reluctance to pursue a public service obligation means that the competitiveness of the Tees Valley economy will be damaged and the ability to achieve PSA target 7 will be more difficult.

The Tees Valley Joint Strategy Unit

- 1.1 This submission to the Transport Committee's inquiry on the Future of Aviation has been prepared by the Tees Valley Joint Strategy Unit on behalf of the five Tees Valley authorities – Darlington Borough Council, Hartlepool Borough Council, Middlesbrough Borough Council, Redcar and Cleveland Borough Council and Stockton on Tees Borough Council – and Tees Valley Unlimited, a partnership of the Tees Valley authorities and the private sector.
- 1.2 The Tees Valley Joint Strategy Unit is funded by the Tees Valley authorities to develop strategic Tees Valley wide policy on economic development, planning, housing, tourism and transport and acts as a secretariat to Tees Valley Unlimited, a partnership of the Tees Valley authorities and the private sector concerned with improving the economic performance of the Tees Valley.

The Tees Valley Economy and the Airport

- 1.3 The economy of the Tees Valley is based on the largest integrated process industrial complex in the UK based on petrochemicals, energy/renewable energy/biofuels, steel making, a port which is the third largest in the UK and a world class advanced engineering industry based on the design, construction and maintenance of petrochemical plants, steel works, power stations and major infrastructures such as bridges. In addition the region has in the Wilton Centre, Europe's largest non-military private sector research centre. The petrochemical industry alone contributes £3.5 billion to the UK economy and 70,000 jobs in the UK depend on it.
- 1.4 To give an example of the world scale of this industry the Saudi Basic Industries Corporation (SABIC) is constructing the world's largest low density polyethylene plant at Wilton, an investment of £200 million. The Biofuels Corporation operate the world's largest biodiesel plant at Seal Sands and ENSUS are currently constructing the world's largest bioethanol plant. In addition, there is an expected pipeline of £4 billion in renewable energy plants, biofuel plants and advanced engineering.
- 1.5 It is important to recognise that the integrated chemical complex formally in the ownership of ICI is now owned by 26 separate multi-national companies such as SABIC, Dow, Huntsman, Avecia, Johnson Matthey, Growhow for whom air connections to these plants are important. For the world class advanced engineering companies such as AMEC, Whessoe, Aker Kvaerner, Cleveland Bridge, K Home Engineering, our links to international markets are vital.
- 1.6 The region sees Durham Tees Valley Airport as an important asset which can by itself attract development using the airport to drive the economy. Planning permission was given last year for the development of the Skylink International Business Park to provide large units for industry in the logistics area which will use the airport. Peel Holdings propose to invest £110 million in the first phase of a development which will provide 2000 jobs. One

NorthEast and the Homes and Communities Agency are providing gap funding for the scheme.

1.7 To a region like the Tees Valley, the proximity of an airport with links to international hubs like Heathrow and Schiphol is absolutely vital to the future growth of an economy which depends on future investment by global industries and which has a global market for its advanced engineering services. The announcement by BMI of the withdrawal from the 28th March 2009 of the Durham Tees Valley to Heathrow service will have a detrimental effect on the Tees Valley economy and therefore the competitiveness of the Tees Valley economy in world markets. The prime reasons for the withdrawal of the route has little to do with the Tees Valley economy but more to do with BAA pricing policy.

1.8 BMI in their press release stated:

“The operational efficiencies of the routes have been severely challenged with changes to charging structures and cost increases implemented by BAA at Heathrow deliberately targeted towards short haul flying. This has led to price increases to bmi that are way over the rate of inflation. All these factors coupled with the introduction of higher Government imposed APD (air passenger duty) charges for air travellers have increasingly marginalised those choosing to fly. This has reduced the competitiveness of air travel against other forms of transport such as Government subsidised rail travel. The fact is that due in the main to BAA’s inflation-busting increases and changes to its pricing structures that place a considerable disadvantage on short haul flights, travellers in the North of England are losing their important links to Heathrow. Instead of Heathrow they will now have to rely on European airports such as Amsterdam, Brussels and Frankfurt to connect to worldwide destinations. BAA, through its tactics, would appear to want to completely cut itself off from the UK regions. This is a strategy that will inevitably have a negative impact upon the economic growth and inward investment in those key areas.”

1.9 In our memorandum we will show the impact the removal of the Heathrow service on the economy of the Tees Valley and the changes in Government policy required to allow regional connectivity to be maintained.

1. **WHAT IS THE VALUE OF AVIATION TO THE UK ECONOMY? WHAT ARE THE ROLES OF THE LONDON AND REGIONAL AIRPORTS? WHAT COMPETITION DO THEY FACE FROM ABROAD?**

1.10 The Durham Tees Valley to London Heathrow service is operated by BMI. It provides a link between Tees Valley and the airline’s main base at Heathrow, the UK’s only true hub airport. The service is, therefore, both important in providing access to London and in enabling onward connections via Heathrow’s route network to the rest of the world. In 2007 the service was used by 88,000 passengers of which about half were travelling to points beyond Heathrow i.e. interlinking with other services. The route is heavily

used by business passengers (60%). 24% of passengers were interlinking with other services at Heathrow for business purposes.

1.11 In April 2008, the Tees Valley Joint Strategy Unit commissioned York Aviation to carry out an economic assessment of the impact of the withdrawal of the Durham Tees Valley – Heathrow service. This study shows:

- Across all passenger segments the withdrawal of the service would have resulted in additional costs to passengers using the service of about £2.3 million in 2007;
- The great majority of these losses would be borne by Tees Valley residents who would incur as a result of closure around £1.5 million of additional time and fare costs in 2007;
- Tees Valley business users would have been particularly disadvantaged as the result of the withdrawal of the service facing additional costs of around £1.4 million per annum; largely because of additional time costs by users currently interlinking at Heathrow and by higher fare costs on point to point travel, primarily relating to the cost of rail fares versus air costs.

In short there is estimated to be an extra additional cost of £1.4 million year to Tees Valley businesses as a result of the loss of the Heathrow flight.

1.12 The key factor in BMI's decision to terminate the Heathrow flight is charging policy at Heathrow. At most hub airports around the world domestic and short haul services happily co-exist with long haul networks. Landing charges are based on the take off weight of the plane with smaller aircraft having lower landing charges than larger aircraft. At Heathrow landing charges are the same regardless of the size of the aircraft. At Heathrow the airport is operating at capacity. Airlines make more money from long haul flights than short haul flights and therefore are keen to use scarce slots for these flights.

1.13 For BAA a key driver of its financial performance is its ability to maximise ancillary revenues from areas such as retail or catering. Central to achieving this is maximising passenger throughput at the airport. It is, therefore, in the interests of BAA to encourage larger aircraft to operate from the airport at the expense of smaller aircraft, considering that it has extremely limited opportunities to grow the number of aircraft movements.

1.14 The existing charging structure at Heathrow reflects these incentives. In the table below an analysis is set out of the effective per passenger charge that would apply at Heathrow for three different aircraft types. We have included an Embraer RJ145 and an Airbus A319 operating domestic services (domestic services attract a lower per passenger charge). These two aircraft types have been used recently on the MME to LHR route. We have also included an Airbus A330, the main type of aircraft used by bmi for medium and long haul services.

1.15 This analysis demonstrates this effect quite clearly. The smallest aircraft, the RJ145, results in, by some margin, the highest per passenger airport charge, despite the fact that operating a domestic service reduces its per passenger charge rate. With the A319 operating a domestic service, its per passenger airport charge liability is slightly below the charge for an A330 operating an international route. However, this is quickly reversed if both aircraft are assumed to operate international routes. The A319's per passenger airport charges rose to around £10.42, significantly above the £8.68 for the A330 passengers.

1.16 The differential comes from the unusual structure of the landing fee at Heathrow. Essentially, the landing fee is largely fixed whatever the aircraft type. Only if an aircraft is exceptionally quiet (and usually small) does it gain any reduction in landing fee or conversely if an aircraft is exceptionally noisy does it incur a higher landing fee. Therefore, it is possible to spread the landing fee cost across a much larger number of passengers with a larger aircraft. More normal practice by airport operators is to charge landing fees on the basis of the maximum take-off weight of the aeroplane, thereby making larger aircraft pay more.

Example per Passenger Airport Charges at Heathrow 2007/08 Charges			
	RJ145	A319	A330
Noise Chapter	3-	3	3
Relevant Landing Charges	£461.25	£512.50	£512.50
Seats	49	144	244
Load Factor	55%	55%	72%
Minimum departing charge	£155.25	£155.25	£155.25
Departing Pax Charge	£8.31	£8.31	£14.21
Departing Pax Charge Total	£233.95	£658.15	£2,496.41
Nox	2.1	10.8	36.1
Nox per kilo	£1.10	£1.10	£1.10
Nox charge	£2.31	£11.88	£39.71
Total Charges per rotation	£687.51	£1,182.53	£3,048.62
Per Pax	£12.76	£7.47	£8.68

Source: York Aviation analysis of BAA Heathrow charges

1.17 In operating the rise in charges with the cap, BAA will seek to recover the full extent of the increase from airlines and charge up to the cap. BAA will also continue to structure its charges to favour large aircraft. On the basis of the charges proposed by BAA our consultants estimate that the rise in airport charges results in a 6.4% increase in the operating cost for the Durham Tees Valley – Heathrow service compared to 0.8% from Heathrow to the Middle

East. Hence the rise in charges has a substantially greater impact on operating margins for short haul services which combined with the substantial incentive for operators at Heathrow to switch slots to long haul services has resulted in the loss of the Heathrow – Durham Tees Valley flight.

- 1.18 In response to these pressures BMI puts pressure on regional airports to reduce landing charges. Because of the importance of these flights landing charges are reduced to a low level at regional airports. There is now no scope for further reductions. Consequently increases in landing charges at Heathrow make regional airports less profitable.
- 1.19 Our consultants used a connectivity index to identify the loss of connectivity by the loss of the Heathrow service leaving only Amsterdam as the major hub serviced from Durham Tees Valley. The result is that there are no direct links to Australasia from Amsterdam, and reductions in connectivity to the Middle East by 45%, Asia (27%) and North America (31%). The reduction in the Middle East connectivity is particularly significant for the petrochemical industry.
- 1.20 Representations to Government have been made on these issues but the regulators seem unwilling or unable to intervene to safeguard links from Heathrow to regional airports. The result is that despite Heathrow being one of the best connected airports in the world, businesses based in the Tees Valley will no longer be able to feed into Heathrow by air. PSA Target 7 is to improve the economic performance of all English regions and reduce the gap in economic growth rates between regions. How can this be achieved if Government disadvantages peripheral regions with world class industrial sectors if they fail to regulate airports to safeguard links to regional airports? Why cannot the CAA improve a differential pricing structure on BAA based on the take off weight of aircraft in order to protect regional links?
- 1.21 The Tees Valley authorities have been pressing the Department for Transport to consider a public service obligation. The Department for Transport's White Paper – The Future of Air Transport – published in December 2003 sets out Government policy on the issue of slots at London airports. Paragraph 4.44 states that:

“In recognising the importance of regional services, the Government is prepared to intervene in well defined circumstances to protect slots at the London airports for such services by imposing Public Service Obligations (PSOs). The imposition of a PSO enables the slots used for that service to be ‘ring-fenced’, so that airline cannot use them for a service to an alternative destination. The rules for imposing PSOs are set out in European regulations (Regulation 2408/92 and Regulation 95/93).

4.45 – The Government will apply PSOs where, in accordance with the existing EU Regulation 2408/92, three criteria are met:

- The route is to a peripheral region, or to a development region, or is a ‘thin’ route; we will consult shortly on the details of this.

- The air service concerned is vital to economic development for the region; and
- A PSO is required to ensure an adequate level of service. We will be consulting regional stakeholders and the aviation industry shortly on an appropriate definition of ‘adequate’ bearing in mind the importance to travellers of services at both peak and off peak times.”

1.22 The Department seems very reluctant to go down the Public Service Obligation route. A critical issue is costs which the Department require to be funded by either a local authority or a regional development agency.

2. IS THE CURRENT AVIATION INFRASTRUCTURE ADEQUATE FOR THE NEEDS OF UK BUSINESS AND INDIVIDUALS AND HOW SHOULD IT BE DEVELOPED?

1.23 In the case of the Durham Tees Valley – Heathrow example, it has been suggested that Manchester, Newcastle, Gatwick and Stansted could be used as an alternative. Newcastle Airport is 90 minutes from the Tees Valley and the Heathrow flight is under the same pressures as Durham Tees Valley in the medium term. Newcastle does not offer sufficient connectivity to other European destinations to replace the Heathrow link. Manchester is 2½ to 3 hours drive away from the Tees Valley and its range of destinations has been reduced by the withdrawal of British Airways European services from the airport. Gatwick, Stansted and London City are fine for passengers just travelling to London but business travellers look to interlink and these three airports have little interlinking capacity. It is vitally important that regional flights to Heathrow are safeguarded and that the Third Runway takes place to give capacity for regional services long term to be reinstated to Heathrow.

3. TO WHAT EXTENT CAN RAIL PROVIDE AN ALTERNATIVE TO SHORT HAUL FLIGHTS?

1.24 At the present time the normal journey time from Darlington to Kings Cross is 2½ to 3 hours. To reach Heathrow, it is necessary to use the Piccadilly line or the Circle line to Paddington and the Heathrow Express. Both routes add a further hour to the journey time. This compares to a direct flight of about 1 hour. If Manchester Airport is used the normal rail journey time is 2 hours 40 minutes from Middlesbrough and about 3 hours by car. There is little prospect within the next 10 years of any improvements in these times. Only in the long term could a high speed train service from Heathrow to the north or a new Trans Pennine line from Manchester make any appreciable difference.

5. WHAT IS THE IMPACT OF THE TAXATION ON THE AVIATION SECTOR NATIONALLY AND REGIONALLY?

1.25 The Tees Valley authorities accept the principle that taxes and charges should be used as a mechanism to internalise environmental externalities of transport when this cannot be achieved through market mechanisms. The Tees Valley authorities welcome the Emissions Trading Scheme due to be introduced in 2012. However they consider that the Air Passenger Duty should be repealed

in 2012 because it would act as a second measure of taxation in addition to Emissions Trading – a sort of double taxation.

- 1.26 However, the Tees Valley authorities remain concerned about the impact of APD on the cost of air travel from northern airports and how this influences the development of air services from the North. Given the mix of business and leisure passengers and the traffic volumes, evidence indicates that scheduled routes from Northern airports are more finally marginal than similar routes from London airports. The planned increases in APD for 2009 and 2010 will continue to increase the total costs of air travel, having the potential to reduce demand and detrimentally impact the economics of key routes to the North of England, at a time when the recession is already putting significant pressure on the economics of regional air services. This is an area that merits further research and consideration by the Government. In the meantime, the Tees Valley authorities would support a holiday from the scheduled increases in APD for regional airports over the period 2009 to 2012.

6. WHAT IS THE IMPACT OF THE AVIATION SECTOR OF CHARGES OF THE SECURITY ENVIRONMENT

- 1.27 The North's airports are incurring significantly higher costs associated with changes in the security environment and increased requirements from aviation security checks and processes. This is one of a number of incremental costs being incurred by the North's airports. In some European countries these additional security costs are not incurred by their airports, as it is a cost covered by the State. As airports compete for air services, and the hosting of aircraft, these additional costs put the North's airports at a competitive disadvantage.

A copy of the report prepared by York Aviation for the Tees Valley Joint Strategy Unit, "Economic Impact Assessment of the Durham Tees Valley to Heathrow Service", is available on request.