AIRPORTS COMMISSION - DISCUSSION PAPER 02: AVIATION CONNECTIVITY AND THE ECONOMY

Response from the City of London Corporation
Submitted by the Office of the City Remembrancer

Introduction

1. The City of London's leading position as an international finance and business centre is heavily dependent on it being easily accessible not only from across the UK but, crucially, also from all over the world.

2. Aviation services are vital to the wellbeing of London and the UK economy, and the City welcomes the creation of the Airports Commission to consider options for maintaining this country's status as an international hub for aviation. There is evidence to suggest that constraints on capacity are damaging to economic growth and the lack of capacity will continue to have a detrimental impact until a long term solution is found. In this context, concern remains over the length of time the work of the Airports Commission is expected to take. The timetable for solving the problem needs to be shortened substantially, the interim report being as soon as possible and government being committed to take a firm decision as soon as the final report is received.
~~The current capacity constraints must be a substantial concern looking forward and flexibility to maintain capacity is key.~~

3. The City Corporation recently published research to build on the previous City-backed studies into the importance of aviation set out below. The new research is in two parts looking at the importance of hub capacity and London's connections to emerging markets. Both were undertaken to feed into the work of the Airports Commission and copies are appended to this response.

4. This response summarises the key findings arising from the City Corporation's research into connectivity. The questions posed in chapter 5 of Discussion Paper 02 are also considered in the appendix to the response.

The importance of connectivity

5. T~~More recently t~~he City Corporation has recently published two reports, by York Aviation, exploring London's Air Connectivity and they have been prepared as a contribution to the on-going debate on how to meet London's airport capacity needs and the importance of retaining hub status. The first report, '*London's air connectivity: the importance to London of having world class aviation hubbing capacity'* examines the importance of London's hubbing capacity to the maintenance of connectivity by air to key business markets, focusing on the extent to which hub connecting traffic underpins the provision of services in London to 20 key business centres. The second, '*London's air connectivity: emerging and growth markets*' examines London's current connectivity, by air, to 22 growth and emerging markets, and compares this region's connectivity with four other primary European

air travel hubs (Amsterdam, Frankfurt, Madrid and Paris) and with another growing global hub, Dubai.

6. The need for businesses to travel to and receive visitors from emerging countries will increase over time as their economies grow. The principal concern, therefore, is the extent to which London will be able to keep pace with its competitors in future. The vast majority of London's business related air connectivity beyond Europe is provided by Heathrow.

7. Overall, the City's research found that London is most well-connected global hub to these 22 markets, and has direct connections to 17 of the 22 considered. But although well-connected to India and China, London is less well connected to Latin America in particular. However, the research indicates that whilst London remains ahead of competing hubs its status is being challenged by rapidly expanding Middle East hubs, Dubai in particular, and especially towards non-European destinations[1].

8. A key reason why services to the emerging economies tend to be concentrated at Heathrow is its status as a hub. Often routes to individual cities within emerging countries are too small to support direct services without feeder traffic through a hub. The dependence of particular markets on transfer traffic overall varies considerably, with routes to countries such as Brazil, China, India and Mexico far more dependent on transfer passengers than routes to countries such as Pakistan, Poland or Turkey. In terms of services from Heathrow, these are much more dependent on transfer traffic than routes from Gatwick or, indeed, the other London airports[2]. Almost 85% of the 28 million[3] of transferring passengers using London airports used Heathrow Airport, at which over 34% of passengers were using the airport to connect between flights[4]. This reflects the ability of Heathrow to function as a hub and the ability to operate such routes from a hub airport.

9. In some markets, transfer passengers from Heathrow make up a very high proportion of overall demand; as high as 65% in the case of the route to Mexico City from Heathrow. Other countries with particularly high dependence on transfer traffic from Heathrow include the Czech Republic, India and South Africa. It is also evident that British Airways is more dependent on transfer passengers than other airlines at Heathrow. For example, over half of BA's passengers on Heathrow routes to Brazil, Egypt, India, Morocco, South Africa and Taiwan are making transfer connections onto such flights.

10. The ability of Heathrow to function as a hub is a factor in securing a wider route network than would otherwise be the case. The analysis found that for British airlines and British Airways in particular, having an airport capable of functioning as a hub is critical to the development of new routes and services. These additional routes and

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[4] "*London's air connectivity: the importance to London of having world class aviation hubbing capacity*", York Aviation, published by the City of London Corporation, December 2012.

services are often to emerging business centres and, hence, provide UK businesses with a wider range of opportunities[5]. This is relevant to considering the extent to which Heathrow will be able to continue to provide a gateway for the opening up of such point to point services in future.

11. Heathrow has been constrained for some time, running at almost full capacity. Nevertheless, carriers at Heathrow have been able to adapt their networks so that, in overall terms, key business connections are maintained. This, however, has been at the expense particularly of UK domestic connections and connectivity to Europe from Heathrow. This is where other London airports have made a particular contribution, with a particular increase in the range of European services overall across the London airports.

12. It is clear that the scope for enhancing the range of services to the emerging economies at Heathrow is ultimately limited by the shortage of slots. Where there are capacity constraints airlines tend to focus on income generating routes - high value long haul and high volume short haul. Hence the routes you would expect to see suffer in these circumstances are the lesser established long haul routes, for example to emerging markets. The extent to which it will be possible to introduce services to newly emerging world cities will be limited by the need for these services themselves to be supported by feeder traffic, largely from the European and domestic network but also by services from the US, which also provide feeder traffic onto routes to Asia and to Africa.

Previous research into the importance of aviation

13. The City Corporation first commissioned research into the importance of aviation in 2002. The study[6] identified that the provision of air services in London that are able to compete with and outperform services available in other financial centres are essential if London is to remain globally competitive. This was updated by a further study published in July 2008[7] which looked at the extent to which City businesses relied on air travel. Although it did not go as far as placing a monetary figure on the value of aviation to the UK economy, this research demonstrated that, at the time, 64% of businesses regarded air travel as critical or very important for internal company purposes, and that 73% considered aviation critical or very important for meeting external clients or service providers. In addition, 82% of businesses regarded Heathrow as critical or very important to their operations, making it the most highly-valued airport in the South East by some margin. This was largely attributed to the wide range of destinations served and the frequency of the service. The research concluded that that this hub airport plays a key role in the functionality of the financial services industry in the UK.

14. The 2008 report concluded that, in recent years, Heathrow had stagnated and lost some of its market share to European competitors. This is reflected in the fact that,

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[5] "*London's air connectivity: emerging and growth markets*", York Aviation, published by the City of London Corporation, December 2012.

[6] "*The Use of Aviation Services in the City of London and the Central London Business District and the Implications for Future Aviation Policy*", Oxford Economic Forecasting, published by the City of London Corporation, December 2002.

[7] "*Aviation Services and the City*", York Aviation, published by the City of London Corporation, July 2008.

while the frequency of services from Heathrow rose between 2003 and 2008, the number of destinations to which it provided air services declined and, in comparison with other major European hub airports where additional runways have been built to meet rising demand, the rate of expansion has been noticeably slower. Furthermore, 50% of businesses surveyed regarded road and rail access to London's airports as worse than that of airports in other major cities.

15. Whilst recognising the importance of Heathrow to London's business community, both pieces of research highlighted major weaknesses in the airport's management. The 2002 report indicated that there was real concern about time wasted at airports waiting for security checks reflecting the expense to companies of having staff unable to work because of overly-long airport security processes. The 2008 report also identified that inefficient security procedures led to passenger delays and also prevented many flights leaving Heathrow at the time scheduled.

16. The 2008 research[8] identified some of the environmental concerns inevitably attached to any of the expansion options, in particular aircraft noise disturbance and local air quality. This aspect has also been recognised by the Corporation as important.

~~***The importance of connectivity***~~

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Conclusion

17. Whilst to date it would appear London has not lost connectivity in either absolute or relative terms because of capacity constraints, this may not continue to be the position as economic power shifts to new centres and demand for air travel to new routes increases. This underlines the importance of the work of the Airports Commission to find an urgent long-term solution which enables the UK to keep pace with the connectivity provided by competing centres' airports. It is suggested a greater range and frequency of connections to key cities in the emerging economies is more likely to develop through a focus on hub capacity than relying on non-hub airlines to develop services feeding their own hubs overseas.

April 2013

Questions posed in chapter 5 of Discussion Paper 02.

5.4 Questions relating to the nature of connectivity in the UK and its drivers:

- Do you agree with the definition of connectivity presented in the paper? What other factors, if any, should we take into account and how do they impact connectivity?

Research undertaken by the City Corporation in 2008, ~~and~~ 2011 and 2012 has identified the following key features of connectivity which are required for an effective airport offer for business passengers:

***Breadth of European connectivity** – the City of London's role as a financial and professional services 'hub' for Europe drives the need for extensive European connections, with an obvious focus on major business centres and capital cities. These are essential for firms operating European headquarters type activities from London, such as either US or Asian banks;*

***Links to major intercontinental business cities** – these destinations make up much of the air travel demand for either companies with global headquarters in London managing activity at 'hub' offices in other world regions or, vice versa, companies with global headquarters in other world regions seeking to manage their UK or European operations in London;*

***Depth of service** – one of the key messages from the consultations in the City's aviation studies is the need for high frequency of service to the world's major business destinations. This is essential in enabling highly time sensitive individuals to use their time effectively, giving flexibility to allow peoples' plans to change at short notice and in providing resilience where flights are missed;*

***Concentration of service** – this links to the depth of service issue. Companies have expressed a preference for air services to be concentrated at a single airport so that the flexibility and resilience offered by high levels of frequency can be genuinely utilised;*

***Direct connections** – having to change planes to reach a destination is unpopular with users. It wastes time and adds uncertainty to a journey through the potential for missed connections. This reinforces the requirement for the breadth of connectivity;*

***Proximity to point of departure/arrival** – users want air service connectivity that is close to their starting point or destination point. For instance, London City is felt to be excellent for inbound travel to London or for trips that start or end at the office as it is so geographically close to the City and Canary Wharf. However, it is substantially less good for outbound trips starting from home, which many day trips in particular do, as the employees of many City firms primarily live in West London. Heathrow is still by far the best option for most trips from home given the current pattern of residential locations;*

Ease of Access *– delivery of effective air services starts well before the user actually reaches the airport. Surface access is very important. Users want speed and certainty. From this perspective the Heathrow Express and DLR service to London City are increasingly popular;*

Punctuality *– Heathrow, in particular, has become notorious for delays. The lack of capacity and hence resilience means that average delays are felt to be substantially higher than at other airports. CAA Delay Statistics to some extent bear this out but there has been improvement in the last couple of years. The City user is, as described above, highly time sensitive. Delays have a significant impact on productivity and on London's reputation as a place to do business. This is particularly an issue for short haul connections where delays can be a significant proportion of overall trip time;*

Efficient Transit through the Airport *– security is highly valued and users generally would rather have more than less if this enhances safety. However, overall efficiency in passenger transit through the airport is important in minimising dead time;*

Availability of Premium Class Travel – *City companies are significant purchasers of premium class air travel, particularly for medium and long haul travel. Getting staff to their destinations in a good state to work and be productive is vitally important and premium class services are very important to this goal.*

- <u>Do you agree with the assessment we have made of the UK's current aviation connectivity?</u>

The assessment of the UK's current connectivity is largely consistent with the research undertaken by the City Corporation: "London's air connectivity: the importance to London of having world class aviation hubbing capacity", York Aviation, published by the City of London Corporation, December 2012. "London's air connectivity: emerging and growth markets", York Aviation, published by the City of London Corporation, December 2012.

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- <u>What factors do you think contribute to the fact that the UK is directly better connected to some regions of the world than others?</u>

London's air service connectivity mirrors where the UK has traditionally done business, hence it has good connections to established business centres in the US, Europe, Japan and the Commonwealth countries. Levels of connectivity to emerging markets are relatively low and, with the exception of India, London has poorer connections to the BRICS countries than its European competitors. The ability of UK carriers to extend the range of destinations served is heavily dependent upon the attraction of transfer-traffic through the Heathrow hub. Thus the capacity at Heathrow to accommodate additional routes is of critical importance in this context.

- Given connectivity trends in the UK versus other European countries, how much scope is there for route network available to UK residents to radically change over the coming years?

Without an increase in hub capacity there is likely to be further erosion of the network as long-haul routes, which are higher yielding, replace domestic and short-haul services at Heathrow. There will also be a tendency towards frequency increases on existing high volume routes at the expense of new services to emerging markets. Without an increase in capacity there is little prospect of any significant improvement in 'quality of service' issues such as delays which are particularly important to business travellers.

- To what extent do you consider indirect connectivity to be an important part of presenting an accurate picture of the UK's nature of connectivity?

Direct connections are the critical component of connectivity as measured by the Business Connectivity Index (BCI). However, indirect connections through other hub airports, such as Chinese cities via Hong Kong, have a part to play for those routes currently lacking sufficient demand for direct services. Indirect services can also bolster effective frequency on routes that can only justify a limited number of direct services.

5.5 Questions relating to the assessment of how aviation connectivity supports (1) trade in goods, (2) trade in services, (3) tourism, (4) business investment and innovation, and (5) productivity:

- To what extent do you agree with evidence that aviation connectivity supports the UK's economic growth through facilitating each of (1)-(5)?

The City Corporation strongly agrees that aviation connectivity supports the City of London's and the UK's economy:

***Production process** - 40% of the UK's exports go by air; shipments to Europe and Asia have increased, on average, by 10% annually, reflecting importance of aviation to trade with high-growth markets.[14] Oxford Economics found 80% of firms reported air services as important for production efficiency.[15]*

***Trade and investment** - The Civil Aviation Authority found a strong coefficient of correlation (0.87) between the countries businesspeople travel to or from, and the*

[14] "An Integrated Policy Framework for UK Aviation: 4 Connecting the Economy for Jobs and Growth", AOA, October 2012

[15] "Airline Network Benefits: IATA Economics Briefing No. 3", Oxford Economic Forecasting, commissioned by IATA, July 2006.

UK's success in trading with them.[16] *The UK's previous success in attracting foreign direct investment could be compromised by declining levels of air connectivity; 51% of companies said international transport links were an important factor in location decisions and 8% of companies reported quality of air transport links had been material in a decision not to invest in the UK.*[17]

The tourism industry - *Aviation also drives growth in tourism, the UK's sixth largest industry, contributing £115bn or 8% of UK GDP in 2009. 72% of inbound visitors arrive by air.*[18]

UK businesses trade 20 times as much with emerging market countries with a direct daily flight to the UK, and the lack of direct flights to emerging markets may be costing £1.2bn annually as trade goes to competing centres; this loss could reach £14bn in the next ten years.[19]

The high growth markets also provide potential for growth in new tourist markets, particularly India and China.

Aviation traffic projections necessitate making the best use of existing airports and the development of terminals, runways and other infrastructure.

Government abolition of the regional layer could create obstacles to aviation development as divergences exist between costs and benefits at a local versus regional or national level.

The cost of inaction is high; capping flights at 3% below current levels or failure to develop airports will cost the economy up to 210,000 jobs/£8.9bn or 112,000 jobs/£5bn by 2030 respectively.

Direct international air connections are crucial for the economy; 63% of IoD members consider them important to their business over the next decade and emerging markets are projected to comprise 70% of global GDP by 2050.[20]

Lack of a positive aviation strategy, particularly in relation to necessary runway expansion, high airport taxes and unwelcoming visa and border systems, have left the UK unable to exploit economic opportunities aviation presents.

- ~~Are there other channels through which aviation connectivity might facilitate economic growth? What are they, and what evidence is there to support this?~~

Comment [NA1]: Take out

[16] "Flying on Business: A Study of the UK Business Travel Market", CAA, 2010
[17] "An Integrated Policy Framework for UK Aviation: 4 Connecting the Economy for Jobs and Growth", AOA, October 2012
[18] "An Integrated Policy Framework for UK Aviation: 4 Connecting the Economy for Jobs and Growth", AOA, October 2012
[19] "Connecting for growth: the role of Britain's hub airport in economic recovery" Frontier Economics, prepared for Heathrow, September 2011
[20] "Flying into the Future", IOD, December 2012

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- How effective do you consider that the aviation connectivity of the UK may facilitate economic growth now and in the future? What risks and opportunities does it present?

Consensus among economic forecasters suggests emerging market economies will play an increasingly important role in the world economy and trade.

Goldman Sachs projects that BRICS countries and Mexico, Korea, Turkey and Indonesia will triple their share of world GDP by 2050 to 46%, while existing developed countries' share falls from 78% to 31%.

The IMF predicts over the next decade half of all economic growth will be in the eight largest emerging market countries; the BRICs, Mexico, Korea, Turkey and Indonesia[21]. The World Bank forecasts Brazil, Russia, India, China, South Korea and Indonesia will account for half of all growth by 2025[22].

China's GDP is forecast to grow threefold by 2030, overtaking US GDP before 2025[23].

GDP and international trade are the major drivers of demand for travel[24]; therefore as these high growth markets develop and patterns of international trade change in line with expectations, demand for air travel to Asia, Latin America and other emerging centres will increase.

Of these high growth markets, the UK lacks connectivity with Brazil, China, Indonesia and Mexico, and does tend to have a lower market share in more geographically distant markets[25], so improving air connectivity to these markets could promote trade flows.

	Brazil	China	Indonesia	Mexico
UK's share of exports (09)	1.8%	0.9%	0.7%	0.6%

In terms of opportunities for City firms in financial and business services, high-growth economies present significant opportunities for expansion. Financial, legal and other professional services will be demanded by internationalising firms.

[21] "World Economic Outlook – Slowing Growth, Rising Risks", IMF, September 2011
[22] "Global Development Horizons 2011: Multipolarity – The new global economy", World Bank, May 2011
[23] "Strategic Infrastructure Needs to 2030, International Futures Programme", OECD, June 2011.
[24] "International Air Passenger Transport in the Future", OECD/International Transport Forum, December 2009
[25] "UK trade performance across markets and sectors", Department for Business, Innovation and Skills, February 2012

23% of the UK's 2009 services exports to Mexico were in financial services and 17% in other business services[26]*, and the UK has a comparative advantage in service provision in Mexico, especially financial services.*

Indonesia's under-developed financial system, coupled with the need to boost capital raising and investment, suggests Indonesia could embark on a period of rapid catch-up in all areas of financial services; offering opportunities for City-based firms[27].

London currently has good connections to Russia, India and Turkey, however in order to ensure UK business remains internationally competitive and London retains its role as Europe's business gateway, improvement in London's connectivity to other emerging economies, particularly Brazil, China, Indonesia and Mexico, is essential.[28]

~~How important do you consider connectivity for each of (1)-(5)?~~

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~~Are there other relevant policy issues which should be taken into account?~~

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~~To what degree can causality between connectivity and (1)-(5) be established? Are there any particular research methods that we should be looking at and why?~~

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Comment [NA2]: Bruce would you have a line we can put in here to say very important for all but especially business investment and innovation (4 on list) etc?

Comment [NA3]: Take out unless Andy or Bruce you can think of anything else not already mentioned?

Comment [NA4]: I would suggest taking out

5.6 Questions relating to what the UK's objectives for the future aviation should be:

- What is the best approach to measuring the UK's aviation connectivity?

  The City Corporation has found that measuring the value to business of an airport's destinations can be ~~the York Aviation Business Connectivity Index (BCI)~~ a helpful approach which provides a relative assessment of an airport's business focussed connectivity compared to other airports at~~or~~ different points in time.

~~Connectivity depends on many factors, such as number and frequency of flights and time and cost of travelling to passengers. Do you consider any of these factors to be of particular relevance to facilitating any of (1)-(5)?~~

~~See answer to first question above for factors of particular relevance to business travellers.~~

[26] "UK trade performance across markets and sectors", Department for Business, Innovation and Skills, February 2012
[27] "The Challenges and Opportunities for Financial Services in Indonesia", Chatham House, published by the City of London Corporation, July 2010
[28] "London's Air Connectivity: Emerging and Growth Markets", York Aviation, published by the City of London Corporation, December 2012

~~We have outlined a few different measures of connectivity in the paper. What alternative measuring approaches that we have not mentioned should we take into account?~~

~~22~~

Comment [NA5]: Take out?

- What kinds of impact do you consider capacity constraints to have on the frequency and number of destinations served by the UK? And, if any, are any particular kinds of routes or destinations likely to be more affected than others?

Current capacity constraints are a substantial concern looking forward. It should be noted that most business consultees do not see increasing the size of London's airports as a key end in itself but they do want them to be 'better'. They want a level of connectivity that will enable them to compete effectively in world markets and they want high levels of service quality. It is in many ways difficult to see how these things can be secured in the long term without some expansion of capacity.

The current market dynamic at Heathrow is damaging the short haul network, which is bad for companies with major European operations serviced or managed from London or potential new investors looking for a European base, is potentially damaging to second tier intercontinental business destinations, which are often key markets for specialist services and products based in London, and is bad for coverage of emerging business centres, which may be fruitful markets for the future for companies currently based in London and will limit likely inward investment from these countries.

London and the South East's overall air connectivity has improved since 2005, however with the exception of India and China, London is at a disadvantage in terms of connectivity to the BRICS, particularly with Latin America, compared to competing hubs. In terms of connectivity to specific emerging countries versus other European hubs and Dubai:

- *London provides an equivalent or superior service than competing hubs to most European and some Far Eastern destinations (with the exception of Dubai on the latter).*
- *London lacks connectivity to China; when flights to Hong Kong are discounted the South East of the UK ranks poorly compared to competing hubs. This is important as other Chinese cities may become more economically significant destinations over time, and demand for business travel will increase accordingly.*
- *London lacks connectivity to much of Latin America, in particular Brazil, Mexico, Chile, Colombia and Peru.*
- *London lacks connectivity to South Asia, in particular Indonesia and the Philippines.*
- *While overall London remains well linked to key emerging business centres, London is currently at a disadvantage in terms of connections to Central and*

Latin America. Rapidly expanding Middle East hubs, in particular Dubai, will also challenge London's position especially towards non-European destinations such as India (Pune in particular), Malaysia, Pakistan and Thailand.

- To what extent do you consider that the need for additional connectivity may support the argument that additional capacity may be required?

  Hubbing is key to securing a wider route network, and additional hub capacity is essential to sustaining connectivity to both emerging and established business centres:

  - *Routes to high growth markets, such as India or Latin America, are dependent on hub feeder traffic to sustain current service frequencies.*
  - *Routes to established business centres also benefit from hub capacity through the provision of connecting traffic underpinning route viability to new and emerging markets.*
  - *Alliances also play a role in connecting traffic to a hub; to the extent that services need to be supported by a hub feed at both ends of the route, a foreign airline may favour service to an alliance hub.*
  - *The presence of a hub is critical to the development of new routes and services; allowing more routes to be served at a higher frequency than would be the case without.*
  - *28 million airport passengers used London airports to transfer between flights in 2011 and according to the Business Connectivity Index (BCI) London is currently the best connected city for business in Europe. However London's position is being challenged by rapidly expanding Middle Eastern hubs, particularly Dubai, offering better connectivity to non-European destinations.*
  - *The additional routes and services provided as a result of hubbing capacity connect London to emerging high growth markets, provide UK businesses with a wider range of opportunities for trade and investment, and facilitate inward investment in the UK.*
  - *Access to aviation services is a vital requirement for businesses across the UK, with 73% considering it critical or very important for their operations*[29] *.*
  - *The ability to attract transfer passengers will remain crucial to developing and maintaining aviation capacity to new high growth markets. The rapid growth of competing hubs illustrates the importance of expanding the capacity of our own aviation infrastructure, to maintain London's international competitiveness and retain the economic benefits hubbing capacity brings to the UK.*

[29] "The Use of Aviation Services in the City of London and the Central London Business District and the Implications for Future Aviation Policy", Oxford Economic Forecasting, published by the City of London Corporation, December 2002.