Agenda

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Airports, regulators and governments: making big projects happen

How can we ensure that large infrastructure projects go ahead in a world where private investors, governments, regulators, users and local residents may all have different priorities? Drawing on more than 30 years' experience in the airports sector, Mike Toms, Oxera Non-executive Director, formerly Planning Director of BAA plc, and now a director of Birmingham International Airport Ltd, proposes a checklist for governments to consider when approving such projects

Until the 1980s, airports, like utilities, were owned and operated under an institutional framework which could be loosely described as monopoly statism. This framework had been stable for many years and was understood by all.

For any city or region, and indeed often for any country, airports were all owned by one body. That body was the state. There were subtle differences between airports run directly by central government, normally as part of the transport ministry; those run more autonomously as nationalised industries; and those run by local authorities. However, the essentials were the same. Airports rarely competed. They received their finance from the state and the state could intervene in setting landing fees, management and operations if it chose to do so. Any independent directors or executives knew perfectly well that their continued appointment was in the gift of the politicians. They also knew that the politicians would trade off their interests with those of their main customer, the national carrier, and with the broader priorities of government. The big investment decisions—new terminals and runways—were made by government and handed down to airports to implement. Many of these airports were considered to be much like the traditional utilities, and were often regarded with 'resigned disrespect' by passengers, airlines and the general public.

For the next 20 years from 1990, the institutional framework was transformed. The prevalent model in the UK and a number of other countries moved from statism to fragmented commercialisation.

Airports were sold to a variety of new owners, following the pattern established for the traditional utilities. The assets are traded in the market and ownership continues to change rapidly. The new private owners now compete ruthlessly with each other (and with the remaining publicly controlled airports) for the traffic of new privately owned airlines operating in deregulated markets. They appoint their own directors and executives, who are not beholden to politicians. In place of government interference there is supervision by regulators which are, to a greater or lesser extent, independent of ministers. Customers' 'resigned disrespect' for inefficient public monopolies has been replaced by hostility and, in some cases, contempt for rapacious private monopolies.

In this new world, government cannot tell airports if, where and when to undertake major new investment projects—its only direct control is the negative power to block such schemes. Airport companies make their own investment decisions based on commercial criteria, albeit these criteria do involve the industry regulator, which has a strong influence in bringing forward or undermining investment through price and capital expenditure determinations. Some regulators can, and do, avoid taking on this responsibility; others answer to the calls of government. The zone of discretion is wide. There is a general presumption by utility regulators that their job is more about avoiding unnecessary or premature capital spending than about encouraging companies to bring forward more investment (although in some cases regulators and governments now seem to be leaning on companies to bring forward politically favoured schemes).

So what has the result of these changes been? Some big generalisations follow.

- Airports have become better at innovating. Bright ideas for new products have sprung up and then spread more quickly than before. From fast-track services for business class passengers to pod hotels and teeth-whitening concessions, various new ideas have been introduced and then rapidly copied.

- Airports have become operationally much more efficient. Working practices have been reordered and staff costs have been cut, in terms of both numbers and pay rates.

- Service levels have changed, and not always in expected directions. Although there has been a general improvement in areas such as reliability of equipment and cleanliness, there has also been a trend towards simplification of the service offer, depending on the regulatory framework, especially at airports in the low-cost market. The old days of the 100% pier service target and 'Code C'—service standards specified by the IATA (International Air Transport Association)—have gone.

- Airports have become better at optimising the use of available airfield facilities and terminal floor space to squeeze more capacity out of existing facilities, using clever redesigns and extensions to their core infrastructure.

- Commercial arrangements with airlines have become much more sophisticated, with standard conditions of use and bland rate cards replaced by bespoke contracts with key carriers.

These successes are considerable and vindicate the trend to privatisation and competition. But they have also brought forward an investment problem that the new system seems ill-suited to manage.

Competitive industries are good at short-term optimisation of resources, but they are not always ideally suited to bringing forward major investment projects to a timescale favoured by policymakers. Private owners are less likely to be influenced by external benefits, such as their contribution to regional or national economic growth—although a number are not afraid to offer an opinion on this point. Governments and regulators can no longer tell airports when to build new terminals and facilities and, quite often, do not actually want the responsibility of doing so. Instead, they confine themselves to broad statements of policy and rely on companies to promote new schemes. However, this does not necessarily happen in the way that government might want. An individual airport may be in no hurry to invest in a hugely risky major project, reliant on traffic growth and increases in prices to attract new capital. Governments and regulators find themselves facing opposite directions—the government may want to demand new investment, but the regulator may believe that the market should decide, and will certainly not relish approving the big price increases that may be necessary to pay for the investment. So the airport faces conflicting signals, which simply increase nervousness about committing to big schemes.

Anyone doubting this model should take a look at the UK energy industry. The government wants expensive new nuclear and renewable power, but realpolitik ahead of the recent general election prevented the power companies from raising prices to pay for it. Meanwhile, on the whole the regulator believes in relying on the market to make investment decisions. In the airports sector, in 2003 the government decided that it wanted a new runway at Stansted and gave warm messages of support to BAA to invest in one. Regulators did not support the runway, wrote off a large part of BAA's investment in advance works, and instead engineered the break-up of the business so that decisions would instead be taken by competing airports. As a result, nothing happened. By 2015, having spent many hundreds of millions of pounds on planning studies, airports are still stuck in a policy swamp. The recent final report of the UK Airports Commission (the 'Davies Commission') is not an escape from the swamp, although it has highlighted possible paths.[1]

Some have argued that this problem can be avoided quite simply—that the 'hidden hand' of the market means that investment decisions should be left to the airports themselves. This is the kind of argument that separates economics from the real world. The airports market massively violates the textbook conditions of a perfect market, and reliance on the forces of competition to deliver a new runway or terminal would produce an optimal outcome only by chance. But much more importantly, it relies on a barely recognisable view of how the real world functions. Not least in terms of the law: big airport developments require planning permission; they have to go through elaborate processes of consultation and approval. This is a political process. Homes have to be bought and demolished. There are hundreds of thousands of votes under the flight paths of major airports, and not everyone can be bought off. Economists hate the UK system of planning approvals, but to assume it away would be naive.

That's not all. New airports, runways and terminals inevitably require integration into public infrastructure. Roads and railways are significantly affected. Governments have to make resource decisions about this infrastructure—how it can be developed, how much it can be loaded and who pays for the necessary changes. They are certainly not going to favour the notion that they must invest in capacity to satisfy all the alternative locations for runways, just to allow competition to flourish. They will make choices, and those choices will limit the options.

There are object lessons from this. They point to a set of actions that governments need to take in a fragmented, privatised, imperfectly competitive and regulated market if they actually want major investments to happen at a pace that meets their policy objectives.

- First, governments need to accept that major airport investment decisions are political. They should not hide behind 'the market', 'independent regulation' or Commissions of Inquiry.

- It follows from this that they need to take responsibility for making these difficult decisions in a considered, robust and orderly way.

- They then have to make their decisions on what should be built, when and where, clearly and unambiguously.

In making these decisions they have to take a realistic view of the likelihood and impact of legal challenges and how these may affect the chances and timing of delivery of the various options. (It should not be forgotten that the UK government has already decided once that there should be a third runway at Heathrow, only for that scheme to collapse under legal challenges in 2006.)

- They should also give full consideration to the delivery challenges associated with their plans, which the final report of the Airports Commission dealt with only briefly. Specifically, the UK government needs to ask itself hard questions about the recommended Heathrow option, which appears to depend on the airport operator and Network Rail (the GB rail infrastructure operator) delivering three major new rail schemes, all in tunnels, all under motorways, and all needing integration into Britain's main rail lines, in order to get somewhere near to meeting the legal air quality standards for the new runway—and all before it opens for business. The government will need to ask itself where the engineering resources for these schemes will be found at a time when HS2 (the planned rail line between northern England and London) will also be under construction. It will also need to get down and dirty on the details of how it is actually going to remodel and then bury one of the busiest sections of the M25 motorway and adapt two of its most heavily used intersections before the new runway can be built overhead. At the same time, it will need to get assurance from National Air Traffic Services that it can plan and deliver the rearrangement of London's airspace to accommodate the new runway. None of these projects should be impossible, but each one is massively complex and threatens extended periods of major disruption to travellers.

- Having made their decisions, governments cannot then rest, but must continue to deploy their political energy to maintain sufficient popular support for, or at least acquiescence to, the plans. This includes not just politicians, but also the customers for the project, who will not be keen to pay for something they may not want. It is not impossible that broad customer support for a new runway at Heathrow might evaporate when airlines begin to make the calculations about who is going to pay and who is going to benefit. In this respect, HS2 provides a model of what can be done, but the challenge will be to repeat it in the febrile climate of the airport debate.

- All the options require continued government involvement in the execution stages, especially where safety approvals are required, land uses need to change, land needs to be acquired, and/or alterations to the main road and rail network are required. This kind of massive project coordination challenge is not comfortable territory for many civil servants (or, indeed, airport managers). It can be done, as the delivery of the 2012 Olympics demonstrates, but it will need the same level of commitment, expertise and urgency.

- In the textbooks there is often an assumption that there are no constraints on equity capital. In the real world it is an unavoidable truth that, for many of the 'lumpy' infrastructure industries, the capital requirements of major projects exceed the appetites of their private owners. The Airports Commission has previously suggested that at least one option may be beyond the financing capacity of the airports' owners.[2] Governments need to address this before they finalise their preferred plans. They may have to put up money or provide guarantees if they want the job done. They need to budget for their own contribution and design an appropriate structure for subsidy in close cooperation with the industry regulator, bearing in mind the legal challenges that subsidies to airports operating in a competitive market will invite.

- Governments also need to make sure that the regulator has an explicit duty to support their decisions, and must be absolutely clear with the regulator on what this means.

- Finally, governments must inject big projects with a degree of urgency to make sure that they are embedded and seen as inevitable, before opposing stakeholders try to overturn them. Many great government ambitions simply fade over time, until they have to be reviewed or refreshed by another government. By that time, all momentum may have been lost. In 2003, for example, the UK government took the brave political decision to favour a new runway at Stansted, but then allowed the decision to be washed away by a tide of doubt, much of it emanating from within Whitehall itself.

If the UK government actually wants to see another runway built to serve London, it would do well to have this checklist to hand when it decides how to proceed with the Airports Commission's report.

Mike Toms

The views expressed in this article are those of the author alone.

[1] Airports Commission (2015), 'Airports Commission: Final Report', July.

[2] Airports Commission (2014), 'Consultation Document', November, para. 3.145.