

NPS Consultation Response: **Thematic Paper**

Economic impacts and financeability

May 2017

Key Findings:

- Reporting ‘gross’ benefits for particular airport options is potentially misleading. Benefits should be reported at the net national level to reflect the forecast net effect after disbenefits have been accounted for.
- Based on the analysis undertaken by the DfT, TfL has calculated the benefit cost ratios that show that the economic performance of the Heathrow third runway is worse than a new runway at Gatwick.
- The DfT recalculated the potential number jobs in response to issues with the AC’s methodology, yet the NPS focuses on the higher AC estimate. The NPS does state that all jobs generated as a result of expansion need to be considered displaced, rather than new.
- The assessment should be based on full utilisation of a three-runway Heathrow, yet the NPS is inconsistent in its assumptions. The Government’s renegeing on its commitment to publish updated passenger demand forecasts during the consultation period is a serious omission.
- The NPS needs to spell out how Heathrow expansion can be financed without resorting to the taxpayer or significantly increasing aeronautical charges, as has been claimed by the Government.

1. Economic Impacts

- 1.1 The NPS has distanced itself from the inflated economic figures presented by the Airports Commission (AC) Final Report. Nonetheless concerns remain about the methodology used to estimate economic impacts.
- 1.2 The NPS estimates that Heathrow expansion will lead to £61bn in benefits over a 60 year appraisal period. However, presenting benefits without accounting for disbenefits is contrary to best practice. The NPS should have reported the net benefit, which includes disbenefits. When both benefits and disbenefits are considered together, the net benefit figure is £20.4bn only a third of that claimed in

the NPS.

Table 1: Monetised Benefits over 60 year Appraisal Period for Heathrow Northwest Runway

Description	£ billions, Present Value, 2014 prices
Passenger Benefits (A)	55.4
Government Revenue (B)	1.8
Wider Economic Impacts	2.0 to 3.9
Total Benefit	59.2 to 61.1
Airline Profit loss	-38.0
Environmental costs	-2.7
Total Disbenefit	-40.7
Net Benefit	18.6 to 20.4

Source: DfT Economic Impacts: further review and sensitivities report

- 1.3 It is particularly misleading for the NPS to include the passenger benefits that would result from increased competition which lowers fares but not the corresponding reduction in airline industry profits.

Comparative assessment between shortlisted options

- 1.4 The economic case to justify Heathrow expansion over the other shortlisted options is not as strong as the NPS presents it. Best practice for comparing schemes is to use the Benefit Cost Ratio (BCR) which incorporates the benefits, disbenefits and costs.

Table 2: Comparative Assessment of Economic Modelling Performance on AC shortlisted options (present value, £billion 2014 prices)

	Gatwick Second Runway	Heathrow Northwest Runway
Passenger Benefit (A)	48.5	55.4
Wider Economic Impacts (WEIs) (B)	1.4 to 2.7	2.0 to 3.9
Environmental Impacts (C)	-1.5	-2.7
Airline Profit loss (D)	-40.8	-38.0
PVB (A+C+D)	6.2	14.7
PVB including WEIs (A+B+C+D)	7.6 to 8.9	16.7 to 18.6
Government Revenue ¹ (E)	2.5	1.8
Scheme Costs (F)	6.3 to 6.4	12.9 to 14.9
Surface Access Costs (G)	0.6	1.4 to 3.4
PVC (F+G-E)	4.4 to 4.5	12.5 to 16.5
BCR (A+C+D)/(F+G-E)	1.38 to 1.41	0.89 to 1.18
Adjusted BCR (A+B+C+D)/(F+G-E)	1.69 to 2.02	1.01 to 1.49

Source: DfT Economic Impacts: further review and sensitivities report (BCRs calculated by TfL)

¹ Government Revenue should be treated as a negative cost, however, in order to be consistent with the published material in this calculation it has been treated as a benefit

- 1.5 The BCRs of the shortlisted options show that the Gatwick scheme represents better value for money compared to the Heathrow scheme (see Table 2), something the NPS does not acknowledge.

Impact of updating the baseline

- 1.6 The AC used the DfT’s Aviation model with 2008 data calibrated to 2011 to estimate the benefits reported in Table 2. Since the publication of the AC’s Final Report, passenger growth at Gatwick Airport in particular has exceeded the AC’s forecasts. The DfT has subsequently undertaken a sensitivity test to understand the impact of updating the models with the latest observed data.

Table 3: Comparative Assessment of Economic Modelling Performance on AC shortlisted options under updated baseline

	Gatwick Second Runway	Heathrow Northwest Runway
Net Benefits (A)	15.2	20.9
Scheme Costs (B)	6.3 to 6.4	12.9 to 14.9
Surface Access Costs (C)	-0.6	-3.4 to -1.4
BCR ² A/(B+C)	2.17 to 2.20	1.14 to 1.46

Source: DfT Economic Impacts: further review and sensitivities report (BCRs calculated by TfL)

- 1.7 The results of the DfT sensitivity test are shown in Table 3. Using the latest observed data to calibrate the model, the difference in BCRs between the Gatwick and Heathrow options has widened. This assessment demonstrates that the case for Heathrow is not as strong as the NPS makes it look and raises questions as to whether Gatwick should have been rejected as an inferior option.

2. Jobs

- 2.1 The NPS states that up to 77,000 new jobs could be generated in the local area by 2030 as a result of Heathrow Expansion³. This is based on the work undertaken by the AC.
- 2.2 The DfT identified a number of uncertainties and inconsistencies within the AC’s work⁴ and undertook a further assessment to re-estimate the likely impact of Heathrow expansion on the local economy. The new approach used the AC’s direct job creation assumptions but amended the indirect and induced job assumptions. Instead of relying on multipliers provided by the scheme promoters, the DfT used data based on current employment to approximate indirect and induced jobs. Following this new methodology, the DfT estimated that the total number of jobs generated would be around 38,000, 51 per cent lower than the AC’s estimate.

² Calculation of this BCR is not consistent with that of Table 2. The sensitivity analysis on DfT’s report did not include disaggregated entries for each of the BCR components and therefore a detailed analysis as that of Table 2 is not possible

³ NPS 3.27

⁴ Economic Impacts: Further Review and Sensitivities, DfT, October 2016, Paragraph 6.4

- 2.3 While the documentation supporting the NPS present the number of potential jobs as a range between 38,000 and 77,000, it is disappointing that the NPS itself only presents the upper end of this range.
- 2.4 The NPS' supporting documentation also states that there is insufficient evidence to suggest that the additional jobs created as a result of Heathrow expansion will be net additional to the UK economy. As such it concludes that these must be considered displaced from elsewhere in the UK rather than new⁵.

3. Passenger demand assumptions

- 3.1 Airport utilisation assumptions vary in the NPS according to the topic area. For example the economic assessment considers the expanded airport fully utilised, while the surface access modelling only considers a partial utilisation of a three-runway Heathrow. Such a mismatched approach is not credible. When any development proposal is considered, it is the norm that the impacts are assessed based on the scheme fully utilised as per the planning permission being sought. As such, the analysis underpinning the NPS should be based on full utilisation. Moreover, the NPS should stipulate that the Development Consent Order (DCO) assess the impacts on that basis.
- 3.2 The Government committed in the NPS consultation material to publishing the updated passenger demand forecasts on which it was working before the end of the consultation period. In the final weeks of the consultation, it announced that it would not be publishing them during the consultation period after all. Given the importance of the demand forecasts in the quantitative assessment of various aspects of the scheme, this is a serious omission and one which undermines the consultation.

4. Financeability

- 4.1 The Government continues to claim that an expanded Heathrow can be delivered without taxpayer support. Notwithstanding the significant surface access investment required – most of which Heathrow Airport Limited (HAL) does not believe it is responsible for funding – the scale of the investment in the airport infrastructure alone is considerable. According to the figures published by the AC, expansion will require more than doubling the Regulatory Asset Base (RAB) for Heathrow, requiring its owners to triple their equity and debt levels. The AC assumes this would entail a 45 per cent increase in aeronautical charges.

⁵ AoS Economy Appendix Paragraph 3.11.5

Table 4: HAL's equity and debt requirements for expansion

HAL Debt & Equity	Equity	Debt
Existing	£2.7bn	£11.7bn
Proposed – to fund expansion	£8.2bn	£33.8bn
Proposed – sensitivity	£8.5bn	£39.0bn

Source: Cost and Commercial Viability: Funding and Financing Update, PwC for Airports Commission, July 2015

- 4.2 Despite the AC's findings, Government has said that a third runway should be delivered without Government support and without any significant increase in aeronautical charges. The Government should publish the work it has undertaken on this which it cites in the NPS. Moreover, the NPS should set out clearly that the scheme should not require and will not receive public funding, including hidden subsidies such as risk guarantees or loosening of the regulatory framework. It is not rational to proceed with this NPS while there remains considerable uncertainty as to whether an expanded Heathrow can be delivered by the private sector alone. If this is not addressed, there is a substantial risk that costs will fall to the taxpayer.