

Ryanair Response to Airports Commission Paper 02: Aviation Connectivity and the Economy

Introduction

1. This brief note responds to a number of issues raised in the Airports Commission Paper 02: Aviation Connectivity and the Economy. It does not seek to address each and every point raised, but instead focuses on a small number of key principles.
2. If the Airports Commission (the Commission) would find it useful to explore or clarify any of the issues raised herein, Ryanair would be happy to discuss these further.

Executive Summary

3. Point-to-point operations are better for consumers. They are more efficient, offer better value and (crucially) do not force O&D passengers (who bring economic benefits) to subsidise transfer passengers (who do not) – and who would rather be O&D passengers.
4. Aviation is an important enabler of economic activity and de-regulation has seen its value increase. Air-transport is a well functioning market; however, airport capacity constraints at LHR have led to intensification of services to destinations where demand is greatest, at the expense of the range of destinations served, while the doubling of airport charges at STN has led to reduced traffic and range of destinations.
5. BRIC services offer better growth prospects, but are not currently as valuable as existing services. Airport capacity is the key issue. If airport capacity can be delivered or freed-up in the SE, then this will create the right platform for development. If not, then BRIC services must be developed elsewhere.

Network & Point-to-Point Operations

6. It is important to be clear from the outset about the characteristics of network and point-to-point operations.
7. Point-to-point operations require sufficient demand at origins and/or destinations (O&D), to ensure viability. It is always better to connect with point-to-point operations, which are more convenient for passengers, less costly and more reliable.
8. The Commission has rightly noted that where they were not initially considered to be viable, point-to-point operations may develop over time in maturing markets, initially served by network operations. Low cost carriers have increasingly demonstrated that routes previously considered unviable can be effectively served, at the right price level.

9. In markets where sufficient O&D demand does not currently exist at extant price levels, network airlines effectively seek to manufacture this by consolidating passengers from other origins.¹ Whilst this leads to less efficient deployment of aircraft assets, it facilitates certain long haul operations, where these would otherwise not be viable.²
10. Because transferring passengers have no specific interest in transferring (of itself), they are largely indifferent to where a transfer takes place. Their choice of route is consequently made in consideration of other factors, such as price and schedule quality. Therefore, on an aircraft carrying a mixture of transferring and O&D passengers, it is clear that transferring passengers are relatively more price-sensitive.
11. The Commission is therefore wrong to say that *‘[t]he number of routes served from the UK is supported by a large number of international transfer passengers [...] which allow airlines to supplement local demand in order to make a wider range of routes and destination viable.’*³ On the contrary, transfer passengers occupy scarce capacity, without bringing any meaningful economic benefit.⁴ Their existence simply incentivises airlines to deploy assets onto on a smaller number of high-yielding routes, as described in paragraphs 17-20, below.
12. The differential price-sensitivities of O&D and transferring passengers create an incentive for airlines and airports to apply higher charges to O&D passengers than to transferring passengers. They are able to do this, because O&D passengers have, in reality – and unlike transferring passengers, little choice about which airports they use.⁵
13. The Commission suggests that *‘indirect connections are [not necessarily] less valuable to connectivity in all respects than direct ones [because] they may be able to serve a destination more frequently and at a lower price.’*⁶ There is no evidence to support this view. Whilst it might be true that increased frequency may be achieved, the relative price to O&D passengers (those that matter) is likely to be higher, as they are forced to subsidise transfer passengers.
14. In conclusion, it is clear that point-to-point operations are better for consumers. This is not only because they are more efficient – and so offer better value, but also because there are no incentives to force O&D passengers (who have an interest and therefore come with an economic benefit) to subsidise transferring passengers (who do not).

UK Connectivity

¹ For example: JFK passengers originating in NCL would prefer to fly direct NCL-JFK; however, are forced to transfer through LHR, because there are not enough of them to make a NCL-JFK route viable.

² Because not every short haul aircraft feeding to and/or from a long haul aircraft can arrive or depart at exactly the right moment, network operations see both aircraft types spending a greater proportion of time on the ground, rather than flying.

³ Paragraph 2.4.

⁴ Transfer passengers may pay an airline, but less than would an O&D passenger; and they may spend money at an airport, but less than an O&D passenger would spend in the wider economy.

⁵ At airports with spare capacity, any attempt by airlines to increase prices above a competitive level, will quickly be competed away and so monopoly rents, where they exist, flow to airport owners.

⁶ Box 3.1.

15. The Commission rightly identifies that the value of aviation is essentially as an enabler of economic activity and that there has been a significant decline in real air fares, since de-regulation.⁷ This has been largely driven by new-entrants to the air-transport markets, which in the main provide low-cost O&D services.
16. There can be little doubt that this increased competition has led network carriers to make efficiencies and to revise pricing structures. Where alternative O&D services have emerged, network carriers have been less able to subsidise transfer passengers from O&D passengers.
17. The Commission's figures show that since 2005, the number of destinations served from UK airports has decreased.⁸ This indicates that, where airport capacity is constrained (LHR, in particular), airlines are deploying assets onto higher-yielding routes – those with the highest demand.
18. The Commission has also overlooked the reduction in destinations served from STN, where the doubling of airport charges in 2007 led directly to a marked decline in traffic and rendered a significant number of routes unviable.
19. These entirely natural behaviours on the part of airlines are a consequence of market forces; however, it means that whilst some passengers experience better utility (increased frequency and choice on high-yielding route ex-LHR) many others experience less. In the absence of new airport capacity and reduced costs close to where most demand is manifest (the SE), airline capacity to lower-yielding destinations can only be delivered elsewhere.
20. The key question, therefore, is whether the benefits of airlines focussing on higher-yielding routes outweigh the potential benefits of developing lower-yielding routes. If the Commission believes in market economics, then the answer must be yes! Airlines are rational players. If consumers valued emerging markets more than current markets, they would pay more for connectivity – and airlines would provide services accordingly.
21. In summary, aviation is an important enabler of economic activity and de-regulation has seen this value increase very significantly. Aviation's focus has been to provide those services most valued by consumers, which is to be expected in a well functioning market; however, capacity and cost constraints in the SE have tended to intensify services to destinations where demand is greatest, at the expense of others.

Emerging Markets

22. The Commission rightly sets out the value of emerging markets – and for simplicity, these will be referred to as BRIC in this note. As discussed above (paragraphs 17–20), they are not as valuable as existing markets. If they were, then consumers would pay for services.

⁷ It is noteworthy therefore that whilst '*[a]viation creates workplaces that on average are much more productive than in the rest of the economy*' (paragraph 3.5), the UK Government continues to tax aviation (APD) to the extent that the potential of these economic benefits is not realised.

⁸ Figure 2.1.

23. Nevertheless, BRIC markets doubtlessly have a value and it is capacity constraints that have mitigated the development of connectivity to the SE. The position appears to be that whilst BRIC markets are less valuable than current markets, they offer the best prospects for growth.
24. For these reasons, if connectivity to emerging markets is to be encouraged and/or facilitated, then this will require either increased capacity and reduced costs in the SE, or appropriate incentives for development elsewhere. It is unclear how Government policy might be able to deliver either of these.
25. One obvious way would be to abolish APD; another (less effective) approach would be to significantly reduce APD rates, both of which would incentivise the development of services to BRIC markets, where airport capacity is currently available. A third approach would be equalise requirements across O&D and transfer passengers, thus reducing the advantage currently enjoyed by transfer passengers and so reducing incentives to use scarce capacity
26. The Commission must in all eventualities, be careful not to introduce distortions to the well-functioning air-transport market.
27. As it offers the best prospects for economic growth, to encourage the development of BRIC connectivity, additional capacity and reduced costs are required. This could take the form of: new airport capacity in the SE; freeing up capacity (currently used by transfer passengers) at LHR; or better incentivising capacity elsewhere.
28. In summary, whilst BRIC services may offer the best growth prospects, they are not currently as valuable as existing services. Air-transport is a well-functioning market and if connectivity to BRIC is lower than to other destinations, then this is because it is less valued by consumers. Airport capacity is the key issue. If airport capacity can be delivered or freed-up in the SE, then this will create the right platform for development. If not, then BRIC services must be developed elsewhere.