



From the Secretary of State

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Prime Minister (4)

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CONFIDENTIAL

John Sparrow Esq  
Head of Central Policy Review Staff  
Cabinet Office  
70 Whitehall  
London  
SW1A 2AS

ms 10 September 1982

Dear Mr Sparrow,

Thank you for your letter of 31 August suggesting that it would be useful to do further work on international comparisons of the BAA's performance. I have also seen George Younger's letter of 6 September endorsing your proposal. Although this has been overtaken by the discussion at E(NI) on Wednesday 8 September, you may find it useful to have this record of our position in the matter.

I agree that international comparisons can be a useful indicator of relative efficiency and my officials have been working on this with the BAA for some time in response to a similar recommendation made by the Public Accounts Committee. As you recognise, the task is fraught with difficulties because of the wide disparity in the way airports are operated and financed. Few other airport authorities (even in the United States of America) publish anything like the amount of disaggregated financial and performance material provided by the BAA and there are at present no international arrangements for the exchange of such information of the kind that we have in ICAO for airlines.

Last year, my Department commissioned Professor Doganis, Professor of Transport Studies at the Polytechnic of Central London, a recognised expert who had already done some work in this field, to carry out a feasibility study. The result, owing to the lack of disaggregated and published information, was disappointing and we concluded that it was unlikely that outside experts would be able to obtain the necessary information for worthwhile results.

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This approach having failed we then asked the BAA to pursue the matter using its close contacts with other European airport authorities to obtain unpublished, and, in some cases, sensitive information. This work was given added urgency by the need to prepare for the forthcoming litigation.

This "in house" study is now virtually complete. I have seen some of the initial results and these suggest that the BAA compares well with other major European airports on most measures of financial performance and efficiency. However, the study is still being finalised and will not be made publicly available until the exchange of expert evidence in the litigation in November. Until then its very existence must remain confidential both to protect our position with the plaintiffs and the position of those airport authorities overseas who have co-operated with the BAA in helping with this part of the legal defence.

I think for the moment that it is best to allow the BAA to complete this work. If, when it is made available in November, it does not produce sufficient information of the sort that we want we can consider whether any further work should be commissioned but I shall need to consider the impact of our instituting such an examination on our handling of the litigation.

So far as international comparisons of charges are concerned, I am afraid that this is also more complex than might at first appear. Few other countries have reached the stage where their airport facilities are totally unsubsidised and the very different methods of financing mean that comparing like with like can be extremely difficult. Again, a good deal of research is already in hand as part of the preparations for the litigation (including work by outside consultants in the United States of America) and I do not think it would be helpful to our defence to duplicate such work at this stage. Again, the existence of these studies must be confidential at this stage.

I expect to refer the BAA to the MMC in due course, but this could not be until after the present litigation is resolved. I am advised that it would be inappropriate to establish a competing forum for considering the costs and efficiency of the Authority

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while the matter is before the High Court, and that it would be unhelpful to our defence, while the litigation is in progress, for me to take action which implied that I regarded the BAA's activities as meriting investigation on monopoly grounds. Nor do I think it would be helpful to our defence to institute other outside examinations of them in parallel with the litigation.

I am sending a copy of this letter to the Prime Minister and other members of E(NI).

*Yours sincerely*

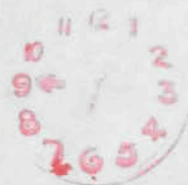
*John Winterton*

*for* LORD COCKFIELD

*(Approved by the Secretary of State  
and signed in his absence)*

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10 SEP 1982





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cc JV  
 Prime Minister  
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The Rt Hon The Lord Cockfield  
 Secretary of State  
 Department of Trade  
 1 Victoria Street  
 LONDON SW1

7 September 1982

*D. Arthur*

BRITISH AIRPORTS AUTHORITY

I have seen the recent correspondence in which doubts have been expressed about the operating efficiency of the British Airports Authority (BAA).

I am of course in favour of setting tough targets for nationalised industries and I am all for exerting maximum pressure on BAA to reduce operating costs. I have no doubt that there is scope for substantial further improvements, particularly through more efficient use of space.

There is, however, one important point that needs to be made in BAA's defence on the question of planning for new capacity. In his letter to you of 16 August Michael Heseltine called for a more critical review of BAA's investment programme because it seemed liable to produce "massive over-capacity" among the south east airports. In your reply you contended that there was bound to be some excess capacity for a time when a major new terminal is completed. You could have added that provision of some margin of estimated spare capacity is prudent practice given the fluctuations in the number of passengers and the very long lead times for new construction. Lack of such a margin combined with the long gestation period of Terminal Four have led to the situation you describe at Heathrow, where traffic is expected to exceed capacity before the new terminal is completed.

All this seems to me to highlight the problems caused by our excessively long planning process. In order to allow sufficient time for public enquiries, Ministerial consideration and everything else that is involved, BAA need to set planning in



hand at a very early stage, long before they can be reasonably expected to predict the timing of growth in demand. If they could expect planning decisions within 12 months, they would no doubt be able to plan new capacity rather more precisely.

I am copying this letter to the Prime Minister, other members of E (NI) and to Sir Robert Armstrong.

*J. G. [unclear]*  
*N. [unclear]*



CABINET OFFICE  
Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

From: John Sparrow

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Qa 06046

31 August 1982

The Rt Hon Lord Cockfield  
Secretary of State for Trade  
Department of Trade  
1 Victoria Street  
SW1H 6ET

Dear Arthur,

British Airports Authority

I have seen the correspondence, in which doubts have been expressed by the Prime Minister and more recently by Michael Heseltine as to the operating efficiency of the BAA. A question mark also exists over BAA's ability to offer landing rights and other airport services at internationally competitive prices, although this also depends on the financial target expected of the BAA and is currently the subject of litigation.

We might learn more about BAA's efficiency and its international competitiveness if a study were to be carried out of BAA's charges, costs and performance by comparing these with information about other major European and North American international airports.

Inevitably there will be difficulty over such comparisons. The scope of operations may vary and circumstances may differ. However it is difficult to assess in a monopoly situation whether performance targets, including financial targets, are reasonable without comparisons of some sort, and lessons would I am sure be learnt from such an exercise.

The BAA has not yet been referred to the MMC, and there may be good reasons for deferring a reference while the present litigation continues. In those circumstances, could I suggest that one way of carrying out the

Prime Minister

There will be a chance to discuss this proposal at ENI on 8 September

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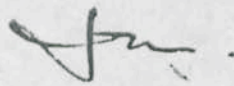
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suggested review would be to ask BAA to appoint, jointly with your Department, a firm of consultants who have had some experience of examining the operations and finances of international airports.

I am sending a copy of this letter to the Prime Minister and to the other members of E(NI).

*Yours sincerely,*



John Sparrow





cc JD  
WA  
27/8

From the Secretary of State

ms

The Rt Hon Michael Heseltine MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
London  
SW1P 3EB

27 August 1982

Dear Secretary of State,

1 Thank you for your letter of 16 August in which you express your concern at my apparent broad-brush treatment of the British Airport Authority's Corporate Plan. I really cannot believe that any purpose would have been served by burdening you and E(NI) colleagues with a detailed account of our review of the Authority's performance and Corporate Plan - a review incidentally which had been discussed and agreed on a bilateral basis with the Treasury - especially since my remit was to clear this matter by correspondence this year, and since I had recommended some strong measures. However in the circumstances I am sending you a copy of our report with this letter.

2 Of course I understand your concern that we should make sure there are adequate surrogates where market pressures are absent. It is for this reason, as well as the need to price at economic levels, that the Authority were given in 1980 a tough financial target plus two performance aims each covering the three year period 1980/81 to 1982/83. These targets were:-

- (a) To achieve an average of 6% per annum CCA return on average net assets;
- (b) To achieve a growth in the number of passengers handled per employee of an average of 3% per annum;

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- (c) To achieve a reduction in real terms of operating costs per passenger handled of an average of  $2\frac{1}{2}\%$  per annum.

The results so far and forecasts for the current year as follows:

	Forecasts				
	Target	Outturn			
	Av/pa	80/81	81/82	82/83	Av/pa
Passengers/employee	+ 3%	- 1.1%	+ 4.9%	+ 6.6%	+ 3.4%
Costs/Passenger	- $2\frac{1}{2}\%$	+ 1.3%	- 0.7%	- 4.5%	- 1.3%
Financial target	6%	5.9%	5.6%	4.7%	5.4%

3 As you will see the first performance target has been comfortably met. After a poor start the improvement last year and that expected this year are substantial.

4 The second performance target, that of costs, has been missed - by a margin of about 1% - but the Authority has had to face escalating costs quite outside its control, not least an astronomical increase in rates, 62% in two years, a matter which falls within your responsibility not mine. Despite these difficulties we expect by next year the cost target will be met - that is averaged over four years there will be an improvement of  $2\frac{1}{2}\%$  per annum.

5 The financial target has been missed but only by a very small margin - the average is expected to come out at 5.4% per annum compared with the target of 6%. This shortfall is due almost entirely to the Authority's decision, under pressure from the airlines and the threat of international arbitration by the United States Government, to freeze its airport charges this year.



*From the Secretary of State*

6 In summary, of the three targets the first was met with something to spare. The second was not met in the three years but will be met by the fourth. The third target has been narrowly missed. In the circumstances I cannot accept the bald statement in your letter that "the BAA .... has failed to meet .... the targets it has been set".

7 There are two other general comments I would make. First the targets were set in February 1980 when economic circumstances and in particular the position of the aviation industry were much more favourable than they have turned out to be. Second, as you will see from Leon Brittan's paper E(NI)(82)24, which reviews the performance of the nationalised industries generally, the financial target set for BAA was a great deal tougher than those set for most of the nationalised industries and BAA's outturn a great deal better.

8 You also say in your letter that "landing fees per passenger have risen 17.6% in real terms in the last ten years". This is not a fair comparison. If adjustment is made, as it should be, for the change in the way that airport security has been financed the Authority's landing fees per passenger declined in real terms between 1971/72 and 1979/80 by  $2\frac{1}{2}\%$ . The whole, and indeed more than the whole, of the 17% increase you refer to was the result of the very big increase in landing charges made in April 1980. This was in response to Treasury pressure on the Authority to introduce economic prices which would earn the required rate of return and reflect long run marginal costs. It was this increase which prompted a case which is now before the Court.

9 I am surprised and concerned at your comments about the Authority's investment programme bearing in mind it reflects our present airport policy, endorsed in Cabinet, and the succession of public inquiries concerned with the three main elements of the programme: Terminal 4 at Heathrow, the second terminal at Gatwick and the development of Stansted. This last Inquiry is of course still in progress. The question of the need for additional capacity in the South East airports has been the subject of intensive examination in two inquiries, and indeed



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in each case the Inspector recommended the need to provide the proposed additional capacity though in the case of Gatwick he also recommended phasing the development to meet demand as it developed. You and I have not yet given our decision on that Inquiry since we decided to allow further representations in the light of the revised traffic forecasts which were produced last year. I cannot of course prejudge the outcome of the Stansted Inquiry though the Inspector is aware that in the Government's view the additional capacity which this development would provide will be needed in due course.

10 But neither the Authority nor I would want to commit capital expenditure in developing this new capacity until it was necessary. But it is simply not possible to avoid there being some excess capacity for a time when a major investment of this sort takes place. Even if the new terminals were built at the earliest possible time however the excess capacity on our present forecasts would be a great deal less than you claim: in 1986 only 11%, falling to 5% in 1987 and 1988 taking no account of the difficulty of matching precisely the supply and demand at each airport. Clearly there is a limit to the congestion which can be tolerated in existing facilities beyond which costs increase and severe delays in processing both aircraft and passengers are experienced, and possibly safety hazarded. At Heathrow for instance we expect the traffic to exceed present capacity before the new Terminal is completed, due largely to the delays caused by the excessively long planning processes: it will have taken ten years from start to finish to provide this Terminal and had it not been for the recession which has temporarily slowed traffic growth, and which was not foreseen at the time, Heathrow would already be impossibly congested.

11 As I pointed out in my note E(NI)(82)19 in recognition that the Corporate Plan programme is now unlikely to proceed as planned, the proposed expenditure was cut by 20% overall to allow for slippage and other factors. None of us can forecast demand with any certainty and, given the very long lead times, it is vital to set planning in hand at a very early stage in the knowledge that investment can always be delayed but not advanced. Adequate control over timing can then be exercised through the normal investment approval processes.



*From the Secretary of State*

12 Certainly I do not accept that planning investment early enough implies a monopolistic weakness - it is simply a recognition of the need to allow adequate time for consideration on matters of considerable public interest. In our examination of the Authority's past performance we were unable to find any evidence that the Authority had invested unwisely. I believe the progressive development of its airports in line with traffic demand is proof in itself but this is further emphasised by the fact that its capital expenditure per passenger declined in real terms by 56% between 1975/76 and 1978/79, and though it is now increasing it was still, in 1981/82, 26% lower than in 1975/76.

13 By comparison with some of its competitor airports, the capacity of the Authority's two main airports is highly utilised. Thus at present Heathrow is about 91% utilised compared with Frankfurt, now the second busiest airport in Europe, which is only 59% utilised, Schipol less than 50%. The Authority constantly seeks to remove capacity constraints in its existing facilities and accepts some degree of congestion at peak hours is unavoidable. But it is constrained in what it can achieve by the capacity of its runways and the demands of scheduled airline carriers. I have no doubt the Authority will continue to strive to use space and facilities more effectively and my officials examine in detail each year its capital programme which itemises every project costing over £1 million.

14 I am just as concerned as you are that we should not over-provide airport capacity. There is no evidence that we are so doing. Indeed the evidence points the other way. Nevertheless this is a matter which I propose exploring further.

15 My note also indicated that I am not happy with the Authority's pricing policy and I believe that there is some scope for further cost cutting; to this end I have recommended that the Authority should not receive the additional external finance it sought for the agreed investment programme and should be limited to the existing base line, a saving of £50 million over the three year period. It is not for me to tell the Board how to achieve the necessary savings but I shall expect it to take some tough decisions on pay and prices. It is inevitable that major investments



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in new capacity will affect productivity for a time, since costs will increase commensurately faster than revenue from the build up in traffic. But each investment is subject to a thorough appraisal to see whether it generates an appropriate rate of return allowing for risks. I am afraid there is little scope for achieving economies of scale in this case and the timing of capital expenditure and the control of operating costs are both necessary if these major investments in terminal capacity are to be profitable.

16 Over the course of the next six months I shall hope to agree a set of objectives with the Authority, in accordance with the E(NI) remit, and also a new financial target and performance aims. These will, of course, have to reflect in a realistic way the forecast traffic growth as well as the timing of capital expenditure in deciding on the appropriate level and period over which these targets should be achieved. I shall keep colleagues informed.

17 I am copying this letter to colleagues in E(NI).

*Yours sincerely  
John Whitlock.*

*for* LORD COCKFIELD

*[Approved by the Secretary of State  
and signed in his absence]*

## PERFORMANCE REVIEW OF THE BRITISH AIRPORTS AUTHORITY - 1982

### Nature of Business

1 The British Airports Authority was established in 1966 to own and operate three of the four main London area airports (Heathrow, Gatwick and Stansted) and Prestwick in Scotland. All were formerly under direct Departmental control. Subsequently it has also acquired responsibility for Glasgow, Edinburgh and Aberdeen airports.

2 Under the Airports Authority Act 1975, the general function of the BAA is to manage these aerodromes and its duty is to provide such services and facilities as are in its opinion necessary or desirable for their operations. In carrying out this duty the Authority is required to have regard to the development of air transport and to efficiency, economy and safety of operations. Except with Ministerial consent, the BAA is precluded from providing air navigational services, which are provided by the Civil Aviation Authority (CAA).

3 There are a wide range of other activities conducted at its airports for which the BAA is not directly responsible. For example, at the London airports virtually all baggage-handling, check-in and passenger-handling services are provided by the airlines or appointed handling agents while the requirements of the regulatory authorities (eg Customs, Immigration etc) are an important determinant of the numbers of passengers which can be handled within the airport terminals in any given period. In addition, the BAA has a policy of hiving off to the private sector as many as possible of the ancillary functions required at its airports. Thus car parking, shops, fuel supplies, transport, catering facilities etc are all normally provided on a concessionary basis which reduces the BAA's exposure to a fall in traffic and enables changes to be made if the quality of service falls below acceptable levels. The result of this complex system of inter-relating organisations is

- (a) that there is a considerable problem of co-ordination which is off-set to a large extent by the flexibility of the system to continue to operate even when one part is operating less effectively (eg during industrial disputes). Unlike other forms of transport, the major airports have very rarely been brought to a complete halt despite their vulnerability to some forms of disruption (eg if fire cover were ever to be withdrawn).
- (b) that the BAA is able to keep its staff numbers to the minimum. For example at Heathrow in 1980/81 the number of employees by category of employer was as follows:-



BAA	3767	7%
Government	2715	5%
Concessionaires	6467	12%
Airlines	40822	75.6%
Contractors	231	0.4%
Total	54002	100.%

### Corporate Objectives

4 The BAA have prepared annual Corporate Plans for many years to provide a strategic framework within which the Authority plans its activities. Considerable efforts are made to ensure that the staff are involved in discussions over the Authority's corporate objectives.

### Primary Objective

5 The BAA's primary objective has remained essentially unchanged since it is based on the statutory duties set out in the Airports Authority Act 1975. It is stated as follows:

"To operate, plan, and develop its airports efficiently and profitably to meet the present and future needs of air transport, both international and domestic, so that air travellers and cargo may pass through safely, swiftly and as conveniently as possible".

6 This general objective is supported by more specific policies each of which is considered in more detail below. However the achievement of its primary objective is linked inextricably with the policy the Government itself has formulated to cope with the growth in demand for air transport, and with the fact that demand is largely determined by developments in the civil aviation industry which are beyond its control. The main determinant is the growth of traffic demand and a note on this and the changes in the forecasts over a number of years is shown at Appendix 1. There is little scope for improving revenue by more effective marketing since, ultimately, the use of its airports is dependent upon the success or failure of its airline customers who, in turn, operate in a highly regulated environment.

7 A statement on the development of airports policy since the abandonment of the Maplin Project in 1974, is attached at Appendix 2. The BAA's specific corporate objectives must be viewed in the light of that policy and of the regulatory framework within which the air transport industry must necessarily operate.

### Examination of Specific Policies

#### Service to Customers

"To maintain high standards of safety for aircraft, passengers and airport staff, and to ensure that these standards match development in the air transport industry".

8 The Authority maintains a Department of Airside Safety and Operations whose task it is to initiate improvements to installed equipment and operating practices with the objective both of improving standards of safety and of operational efficiency. At the international level the Authority has links with the Western European Airports Association, the Airport Operators Council International and the International Civil Aviation Organisation (ICAO) where it represents the Airports Association Co-ordinating Council at meetings of a number of divisions of the organisation concerned with safety and standardisation of equipment and procedures.

9 Specific areas in which the Authority has been active have included extended trials of the Precision Approach Path Indicator system at Heathrow and Gatwick and of the new Mark II Vasis lighting system. Improved facilities and procedures have been agreed with the CAA over the last three years in respect of both Gatwick and Edinburgh, raising their ILS and lighting equipment from Category II to Category III and joining Heathrow and Glasgow in the higher category. Particular attention has been paid to fire fighting. A major new fire fighting foam tender (the Javelin) has been built to the Authority's specification and is on trial.

10 All runways at BAA airports have been closed down for varying periods during the last three years for the purpose of completing maintenance works necessary to aircraft and passenger safety but there has been no significant loss of operating capability.

11 The general assessment of the BAA's achievements in the safety field is that its standards are high and well up to those to be found at airports in any other developed country.

"To ensure, within the limits of the Authority's powers, high standards against terrorism and crime in its airports".

#### Anti-terrorism

12 BAA assumed responsibility from the airlines for passenger search in 1978. At about the same time the financing of the activity was transferred from the taxpayer to the air transport industry and an appropriate levy was placed on arriving passengers from which BAA (and other airport authorities) reimbursed. The total employed at BAA airports on all security duties (passenger search and access control) in March 1979 was 2,037 increasing to 2,222 a year later: the number reported to have fallen in 1982 to 1,695.

13 To aid baggage searching a mechanised systems incorporating X-Ray machines installed at the major BAA airports: these machines, BAA report that efficiency of security procedures won approval in their 1978/79 passenger surveys. In March 1981 centralised search procedures were introduced at Heathrow at Terminal 3 and at Gatwick: these are reported by BAA to have greatly helped passenger processing and significantly reduce

security costs which in 1980/81 totalled just over £24 million (about 75% of costs are said to be for searching). The average total cost per passenger (including civil police and other costs) were lower at BAA airports than the average of other UK airports in 1980/81. To date there have been no successful hijackings from BAA airports.

#### Prevention of Theft and Other Crime

14 Prior to 1974 policing of BAA airports was carried out by the BAA Constabulary assisted, in cases of serious crime, by the local police. In that year the BAA Constabulary was transferred to local forces (funding remaining with the Authority). Airside access control remains with the BAA.

15 In 1980, the Metropolitan Police reported 2,262 crimes at Heathrow of which thefts from baggage accounted for 120. Total thefts of or from passenger baggage at all BAA airports rose from 514 in 1978 to 559 in 1979 with thefts at Gatwick in both years (342 and 308) substantially outweighing those at Heathrow (137 and 202). In 1980 baggage thefts reported at Heathrow represented 0.0003 per cent of the 40 million pieces of baggage handled at that airport or 0.006 per cent of its estimated total value and were about one fifth of the levels recorded in 1972.

"As the airport's owner, to accept general responsibility for the range and quality of all services available to all air travellers, cargo shippers and airlines using the airports".

16 This is the most nebulous of the BAA's objectives and performance is difficult to measure. The Department and the BAA have been unable so far to implement a recent recommendation from the Public Accounts Committee that the Authority's performance aims should be extended to cover consumer satisfaction and that more should be done to secure information enabling valid comparisons of efficiency to be made with other countries' airports. In both cases the difficulty lies in the fact that there are considerable organisational differences between airports as to responsibility for handling the passenger and there are no internationally agreed measures in this field. Even within the BAA's own airports, the responsibility for baggage-handling (a vital service to the passenger) varies from airport to airport.

17 So far, it has not proved possible to identify a single measure of consumer satisfaction within the area of BAA's direct responsibilities which can be translated into a performance aim. But as a result of discussions with the Department, the BAA now provides in its Annual Report an analysis of the consumer complaints it receives at each airport. The first such published analysis pointed to a significant decline in the level of complaints received during 1980/81 compared to the previous year but this result may well have been influenced by the absence in that year of any significant air traffic control disputes in Europe. In addition to this analysis, the BAA has commissioned a

survey of passengers' reactions to its facilities, the results of which should be published in the next annual report. Further work needs to be done in the area of international comparisons of performance but the difficulties are formidable.

"To market the BAA's skills and experience in its own specialist field as a consultancy service and thus generate increased export opportunities for British consultants, contractors and suppliers".

18 In April 1978, the BAA and International Aeradio Limited (IAL), a subsidiary of British Airways, formed a joint company called British Airports International Limited (BAIL). Initially, its activities did not extend to wider participation in airport development and management for which the BAA then lacked the statutory powers. These powers were acquired later in Section 24 of the Civil Aviation Act 1980.

19 BAIL was set up so that BAA and IAL might compete, jointly, more effectively for consultancy and management-type contracts abroad. BAA were able to bring their expertise in the management and development of large handling international traffic, which IAL lacked; IAL on the other hand, already had a wide experience in foreign markets, especially in airport management abroad. The company was also set up to promote more effective competition in overseas markets against other national organisations such as Aeroport de Paris (France) and NACO (Netherlands), by providing an "arrow-head" for British consortia in any aspect of airport design, construction, equipping or manning, managing and training.

#### Achievements

20 In view of its quasi-governmental nature, BAIL is attractive to overseas clients and it frequently supports private sector consultants in their bids. Such cases include projects in Abu Dhabi, Brunei, Morocco and Yemen where BAIL have joined consortia with private sector consultants. Since its establishment in 1978 BAIL has become recognised as a major force in airports consultancy and has successfully challenged the hitherto dominant position of Aeroport de Paris. Major projects obtained include the management consultancy contract for a new Athens Airport, a master plan for an expanded Bahrain airport, and the preparation of a complete national airport plan for Malaysia.

#### Performance

21 The company made a small profit, for the first time, in the year ending 31 December 1981 reducing its cumulative deficit to £137,827. It is financed by equity capital which is now all issued and fully paid, a second issue of 500 shares at £100 having been made during 1981 to provide increased working capital.

## Use of Resources

- (a) "To provide new facilities at its airports as are necessary to enable them to meet the needs of air transport safely, efficiently and economically".

22 The major problem facing the BAA has been how to plan for the growth of traffic particularly at its London airports and at Aberdeen which has experienced substantial growth as a result of North Sea oil development.

23 Although the BAA has powers as a statutory undertaker under the General Development Order 1977 which should allow it to develop its facilities with fewer constraints constant pressure from environmentalists concerned with the problem of aircraft noise meant that since the 1978 White Paper it has become the practice for the Secretary of State for the Environment to direct the BAA to seek specific planning permission for any proposal to build a new terminal. The fourth terminal at Heathrow was the first major project to be subjected to the normal planning procedures.

24 The result is that it can now therefore take a decade or more from the first proposals for additional capacity to the completion of construction. Thus the plans for the Fourth Terminal at Heathrow were drawn up in the mid - 1970's; were subjected to a public inquiry in 1978 and obtained outline planning permission in 1979 and detailed planning permission in 1981. Construction will not be completed before 1985. The outline planning application for a second terminal at Gatwick was submitted in 1979; the public inquiry took place in 1980 and a Ministerial decision on the Inspector's report is still awaited. The terminal cannot now be available before 1987. The lead-times on the Stansted project (involving a proposed new terminal beside the existing runway with a capacity to handle up to 15 million passenger a year) have also constantly slipped back as a result of the planning procedures and it now seems improbable that a planning decision will be taken inside the life of the present Government despite the rapid initial decision by the Government to invite the BAA to proceed.

25 The capacity of airports to handle growth in demand is governed by a number of constraints which include:

- a) the number of aircraft movements which can be handled on a runway by air traffic control in any given hour.
- b) environmental controls which restrict the number of aircraft movements at night and, in the case of Heathrow, are intended to limit the annual number of air transport movements to 275,000 when Terminal 4 opens.
- c) terminal capacity which is measured in terms of the number of passengers which can be handled at each stage at acceptable standards during one hour.

A note on the capacity of the BAA's South East and Scottish Airports is at Appendix 3.

26 The Authority's Corporate Plan sets out each year a five year investment programme designed to improve its airport facilities with the purpose of removing constraints, raising the standard of service and providing additional capacity when this is needed. Table 1 illustrates the continuous process of revision of investment programmes to take account of changes in forecast demand and planning delays. In this respect the table shows the changes in timing of the start of expenditure on the major projects planned at the South East Airports.

Table 1 Corporate Plan Investment Programmes

<u>Plan:</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>Actual</u>	<u>Slippage</u>
£m (March 81)							
77/78	75					54	29%
78/79	71	70				45	36%
79/80	76	90 (T4)	92 (T4)			63	32%
80/81	70	91	149	109		78	28%
81/82	78	84	119 (T2)	164 (T4/2)	124 (T4)	79	38%
82/83		95	131	169	153 (T2)	113(E)	
83/84			115 (TLA)	146 (TLA)	161 (TLA)		
84/85				154	177		
85/86					151		

### Conclusion

27 To date the BAA has managed to fulfill this part of its Corporate objectives. The severe congestion at Heathrow which peaked in 1978-79 has not recurred there partly because of the unanticipated depth of the current recession (and its effect on inbound tourism), the success of the Government's policy of switching growth to Gatwick and a continuous programme of improvements designed to remove constraints. Against an assessed capacity of 30 mppa when the present central area improvements are completed, Heathrow handled 26.5 million passengers in 1981-82, a fall of 8.3 per cent from the peak of 28.9 million in 1979-80. Demand at Gatwick, however, has continued to increase sharply by about a million passengers a year and reached 10.9 millions in 1981-82 against an assessed capacity of 16 mppa (when the satellite now under construction is completed) and is now the world's fourth largest international airport. In Scotland, Aberdeen has coped with a doubling of traffic over the last five years to 1.54 mppa in 1980-81 through a constant programme of improvements to the terminal and other facilities. The Authority's ability to provide new facilities to continue to meet growth in demand depends on the granting of the necessary planning permissions. The unexpected depth of the economic recession has provided a breathing-space which compensated for the delays imposed by the planning process. The most serious problem over the next few years will be at Gatwick (the base for the major private-sector UK carriers) where the second terminal, originally intended to open in 1985, cannot now be completed before 1987 even if planning permission were granted soon.

## Use of Resources

"(b) As a public enterprise, to maintain a competitive and commercial approach to its operations and to ensure as far as possible that it meets the financial and other targets agreed with the Government from time to time".

28 The first part of this objective has been one of the Authority's corporate policies for many years. The second part however was first expressed in this form in 1980 reflecting the agreement reached with the Government that year on a new financial target, after a gap of 4 years, of an average of 6% over the three year period 1980/81 to 1982/83 on average net assets valued at current cost.

29 Also in 1980 two performance aims were agreed with Government which were intended to supplement the financial target as a means of demonstrating that the Authority was making productivity gains and not achieving its target solely through higher prices or increases in traffic. These aims, (the first of which is discussed in the Section on labour), are;

- (a) a growth in the number of passengers handled per employee (allowing for changes in activities) of an average 3% per annum and
- (b) a decrease in expenditure (before depreciation) per passenger of an average of 2½% per annum.

## Size of the Business

30 It would be possible to analyse performance over the whole period of the Authority's existence but it is more appropriate to consider only the period from 1975/76 when the Authority acquired Glasgow Airport (its seventh airport) since which there has been no expansion by acquisition. However any analysis should be seen in relation to the size and growth of the business Table 2 below shows the growth since 1975/76.

Table 2: Growth of Business

1971/72 = 100

	<u>75/76</u>	<u>76/77</u>	<u>77/78</u>	<u>78/79</u>	<u>79/80</u>	<u>80/81</u>	<u>81/82</u>
Passengers	134	147	150	172	186	183	181
Cargo	129	139	151	162	164	157	154
Air Transport Move- ments	123	128	129	145	158	156	152
Employees	109	119	127	164	172	168	160

31 Three points are worth noting. First, growth in traffic has been continuous over the period through until 1980/81. Secondly, the growth rate in air transport movements until 1978/79 was very much slower than that of passenger traffic reflecting the introduction of

wide-bodied jets, and therefore more passengers per movement, on international services. But the growth rate in air transport movements since 1978/79 has been very similar due to the considerable increase in the number of new air services and destinations served from the Authority's airports. Thirdly the growth in number of employees is distorted by the introduction of passenger search procedures which in 1978/79 increased the number employed by over 2000, an increase of about 40%.

32 In numerical terms the size and growth over the same period is shown in Table 3 below

Table 3: Size of Business: numerical growth

	<u>1975/76</u>	<u>1980/81</u>	<u>1981/82</u>
Passenger (millions)	31.8	43.3	42.9
Cargo (1000 tonnes)	580.7	706.6	618.4
Air Transport Movement (1000's)	695.3	763.3	536.7
Employees (excluding security)	4,870	5,428	5,139

33 The business should also be seen in unit terms as a means of judging performance. It is appropriate to do so by taking a passenger as the unit though a more precise analysis would take cargo traffic into account. Table 4 shows the two most useful measures, revenue and expenditure (before depreciation), that is to say operating costs, at constant prices per passenger (total) over the period from 1975/76.

Table 4: Business Performance in Unit Terms

	<u>1975/76</u>	<u>76/77</u>	<u>77/78</u>	<u>78/79</u>	<u>79/80</u>	<u>80/81</u>	<u>81/82</u>
£ (March 81 prices) per passenger							
Revenue	4.68	4.91	5.13	5.38	5.05	5.97	6.02
Expenditure (excluding depreciation)	3.04	2.88	3.05	3.58	3.47	3.82	4.04

34 Three points are worth noting First the reduction (at constant prices by reference to the RPI) in expenditure per passenger in 1976/77 though there is no immediately obvious explanation of this. Secondly, the real increase in revenue per passenger in 1980/81 is an indication of the considerable increases in user charges imposed in November 1979 and April 1980. Thirdly, the increases in income and expenditure per passenger from 1977/78 reflects the introduction of the security levy, and the security costs incurred, amounting to £0.67 per passenger by 1980/81.

#### Performance aim

35 This excess of security levy must also be discounted in considering the Authority's performance against the aim of reducing expenditure per terminal passenger by 2½% pa. In 1980/81 the first year of the aim, the Authority reported an adverse result of + 1.3% partly reflecting a decrease in the number of passengers that year but



mainly the continuing real increase in fixed costs in particular rates and utilities. In 1981/82 the result improved to -0.7%.

#### Generation of Surplus Funds

36 This part of the Corporate objective is now stated in the form of the financial target of 6% CCA return on net assets. The target was derived from the required rate of return of 5% on new investment as a whole as specified in Cmnd 7131. In the period from 1976/77 to 1981/82 BAA achieved financial self-sufficiency in all but the final year when a NLF loan of £5 million was needed to supplement internal resources. Table 5 shows capital expenditure, trading profit before depreciation both in total and in unit terms at constant prices.

Table 5:

	<u>Investment</u>						
	<u>1975/76</u>	<u>76/77</u>	<u>77/78</u>	<u>78/79</u>	<u>79/80</u>	<u>80/81</u>	<u>81/82</u>
(March '81 prices)							
<u>£ million</u>							
Capital expenditure	81.06	70.3	53.48	44.98	62.85	78.39	78.87
Trading profit (excl depr)	52.45	70.68	74.02	73.21	69.44	88.45	90.28
(1) In CCA terms						(1)	(1)
<u>£</u>							
Capex/passenger	2.55	2.01	1.51	1.11	-1.43	1.81	1.83
T. Profit/passenger	1.65	2.02	2.08	1.80	1.58	2.04	2.10
						(1)	(1)

37 In real terms 1975/76 was the peak year for capital expenditure since the Authority was created. Indeed although annual capital expenditure is increasing again in real terms, even in 1981/82 it has not reached the 1975/76 peak. Also notable is the unit capital expenditure which declined quite sharply until 1978/79 even though growth in passenger traffic was increasing over that period at an average rate of 9% per annum. This contrast reflected the pause created by the formulation of a new airports policy in the period leading up to the 1978 White Paper.

38 Until 1980/81 the Authority's cash limit/EFL was zero but in 1980/81 an EFL of £20 million was agreed of which £19 million was in the form of money on local authority deposit. The Authority has stayed within its cash limits but it is doubtful that these imposed any real constraints on capital expenditure until 1979/80 when the Authority had to cancel a number of projects under construction at Heathrow and Gatwick in order not to breach its EFL. Generally it seems likely that capital expenditure was held back by other factors of which delays in formulating policy and granting planning permission were the most significant.

## Return on Investment

39 It is not possible to measure directly the Authority's achievement in relation to its corporate target internal rate of return - 10% on traffic projects and 8% on commercial projects - and thus its performance in relation to the Government's required rate of return of 5% on new investment as a whole. Virtually all revenue earning investments have been incremental and thus largely concerned with improving and expanding facilities which were constructed some time previously; Terminal 4 at Heathrow will be the first identifiably independent major revenue earning project for many years.

40 But a useful indirect measure of return on investment, are the initial calculations carried out in deriving the Authority's financial target suggested a traffic revenue (excluding security levy) per passenger of £2.34 at March 1979 prices would be required to earn the 5% RRR on new investment; or £3.16 at March 1981 prices. This assumed that the major part of the investment would be concerned with airports (traffic) operations and would include the Second Terminal at Gatwick and that revenue from commercial sources would be excluded. The Authority however assumes that all its revenue is traffic-related and therefore should be taken into account. Table 6 below shows the income (excluding security levy) per passenger both in total and by source.

Table 6: (excluding security levy) per passenger

£ (March 81)	<u>1975/76</u>	<u>76/77</u>	<u>77/78</u>	<u>78/79</u>	<u>79/80</u>	<u>80/81</u>	<u>81/82</u>
Landing fees	2.23	2.47	2.53	2.42	2.16	2.81	2.81
Commercial	2.33	2.44	2.60	2.44	2.34	2.35	2.52
Total	4.68	4.91	5.13	4.86	4.50	5.16	5.33

41 As may be seen the revenue from landing fees in 1980/81 and 1981/82 fell somewhat short of the target; and even though there had been a considerable real increase in landing fees in 1980 and a consequential real increase in landing fee revenue of about 28% over the previous year, the unit revenue is some 10% below the required level. But by its own standards the Authority's unit revenues have been well in excess of the required level to achieve the 5% RRR and probably approached the level required to achieve the IRR stated in its Corporate Plan. The figures for the previous years are shown for comparison only since the target revenue does not apply to those years.

42 In accordance with internationally - approved practice the Authority seeks to maximise non-aeronautical revenue with the result that the profits from activities have allowed landing fee revenue to fall short of expenditure on traffic operations (except recently at Heathrow).

43 The Authority's policy for determining the structure of its landing fees undoubtedly reflects the principles embodied in marginal costing eg peak/off-peak pricing, differentials between

airports to reflect in the same way fully utilised under utilised capacity. But it seems unlikely that the actual charging level fully reflects these costs.

44 Whilst the Authority continues to generate substantial profits its accounting rate of return is somewhat below the present target which was agreed in 1979 before the current recession in economic activity. In 1980/81 the first year of the new target period the Authority the return shown was 5.9% though discounting factors not envisaged in the determination of the financial target such as re-living of assets and interest receivable, which was high that year, the comparable return was probably about 4.5%. In 1981/82 the return was 4.7%. But CCA rate of return on net assets at its South East Airports alone has increased from 5.3% in 1977/80 to 7.6% in 1980/81.

#### Scottish Airports

45 Over a number of years it has been corporate policy that the Scottish Airports as a Group should move towards break even: in the 1981 Corporate Plan it was to do so in CCA terms by 1983/84. In fact as Table 7 shows the performance in 1980/81 was lower than that achieved in 1975/76 - the first full year of operation of the Group in its present form as a result of the substantial decline in traffic at the Scottish airports. A similar result is expected in 1981/82. The Group is however a net cash generator for the BAA.

Table 7: Scottish Airports: Group performance

£'000	1975/76	76/77	77/78	78/79	79/80	80/81
Revenue	8,837	11,863	14,492	19,587	23,842	32,960
Expenditure (incl. capital costs)	9,001	17,170	16,465	22,357	32,358	35,841
Revex ratio	0.98	0.69	0.88	0.88	0.74	0.92

"As a good employer to ensure fair pay and conditions of service for employees and to encourage a working partnership leading to higher productivity and higher standards of service to the public through proper arrangements for participation, consultation and negotiation".

46 BAA's performance in the area of staff pay and performance must be measured against a variety of criteria. There have been no serious stoppages by BAA staff during the review period and our impression is that during the last two years in particular there has been a successful tightening of controls over staff costs which has, for example, enable the transfer of BAA's headquarters from London to Gatwick to take place with a net reduction in the labour force.

## Pay

47 The comprehensive review of the pay and grading structure which was carried out in the mid-1970's to achieve a more rational system of relativities and differentials was introduced during 1978/79 accompanied by a self-financing productivity structure. The scheme, formulated on the basis of the ratio of "added value" to employee costs gives variable payments to staff, dependent on the BAA's performance and employees' co-operation with agreed efficiency measures.

48 Since the new grading and productivity scheme was introduced annual pay awards have been as follows consistently moderate compared with the annual rate of inflation:

1979: 9% increase in basic rate, including overtime. A bonus was offered to all staff prepared to accept monthly pay at a net loss of 1% of the wage bill. An attendance condition was introduced in the productivity scheme. In return, productivity payments were increased from 7½% to 10%. Estimated increase in average earnings 10.5% (RPI 14%).

1980: 15% increase in basic rates from the operative date of 1st January with a further 2% from 1st April. Estimated increase in average earnings rather less than 15% (RPI 20%).

1981: 9% increase in basic rates. Payments under the productivity scheme to continue at 10% of the new rates of pay conditional on payments not being made for absences other than approved annual leave and special leave. Estimated increase in average earnings 9% (RPI 16%).

1982: 6% increase in basic rate and shift allowance; productivity payments frozen at 1981 level. Estimated increase in average earnings 5.6% (RPI 12%).

## Consultation with Employees

49 There has been continuing development of the role of the unions in the greater involvement of employees both in the formal consultative machinery and in participative exercises such as the design of new uniforms, airport ancillary furniture and planned preventive maintenance. The importance of communicating with employees was recognised by, an extensive programme for involving the staff in consultations on the Corporate Plan each year and for informing them about the results announced in the annual report.

## Staff Numbers and Costs

50 The number of staff employed fell in 1980/81 and again in 1981/82: Table 9 shows the number of staff employed over the past five years. The increase in 1978/79 was largely accounted for by the BAA staff taking over responsibility for passenger searching at Gatwick, Stansted and the four Scottish airports in 1978.

Table 8: Staff Numbers (31 March)

	All Staff	% increase	Excluding Security Staff	% increase
1976/77	5351	4.6	4746	NK
1977/78	5789	8.2	4902	3.3
1978/79	7298	26.0	5261	7.3
1979/80	7655	4.9	5433	3.3
1980/81	7459	(2.6)	5322	(2.0)
1981/82	7120	(4.5)	5139	(3.4)

41 This is an indication of the success of the Authority's productivity arrangements and tight control of recruiting. This is further illustrated in Table 9, Staff costs; which also show the measure in costs due to the new pay and grading structure introduced in 1978/79 during the previous Government's pay policy.

Table 9:

Staff Costs

(March 1981 Prices)

	Total £'000	% increase	Av employee £	% increase
1976/77	45,797	-	9,167	-
1977/78	47,292	3.26	8,872	(3.2)
1978/79	67,250	42.20	10,722	21.9
1979/80	77,910	15.85	10,929	1.9
1980/81	75,755	(2.77)	10,482	(4.1)
1981/82	75,368	(0.51)	10,339	(1.4)

52 Finally a breakdown of staff costs reveals that overtime now accounts a decreasing proportion of total costs: Table 11 shows this and for comparison basic pay as a proportion of total staff costs.

Table 10:

Percentage of Staff Costs

	<u>Overtime</u>	<u>Basic Pay</u>
1976/77	7.8	57.2%
1977/78	8.5	55.2%
1978/79	10.0	55.1%
1979/80	9.5	52.9%
1980/81	6.9	54.1%
1981/82	6.4	53.5

Performance Against Target Aims: Labour Productivity

53 In 1980/81, the first year of the target period, despite a reduction in budgeted staff numbers and cost, the outcome was -1.1%, due mainly to a substantial reduction in the number of passengers during the years. In 1981/82 the result was much better at + 4.9%.

## Impact on Others

"To live in harmony with the communities adjoining the BAA's airports and to take action to maintain a balance of interest between the communities and the needs of air transport."

### Commentary

54 Living in harmony with neighbouring communities is probably the most difficult task of all since the BAA's airports together handle 60% of all air transport movements at UK airports and its London airports alone account for 42%. Moreover, in accordance with the Government's policy, the Authority is responsible for planning, and eventually implementing the largest airport development projects in the country, indeed in Europe, and securing public acceptance of its proposals.

55 Because of their size and growing activity, it is not surprising that the environmental impact of the BAA's airports is a matter of constant concern to the communities adjoining them and a source of friction. The problem requires careful attention, first because of the human suffering involved which requires effective mitigating measures, and secondly because nearby communities represented by their local authorities, MP's and amenity groups tend to be vocal objectors at Public Inquiries into airport expansion proposals. Thus, if the Authority is to fulfill its statutory duty to meet the needs of air transport at its airports, it must seek to foster a better understanding by all concerned of conflicting interests such as the needs of the travelling public, the national benefit of developing tourism, trade and employment opportunities and, on the other hand, the disturbance cause by airports to local residents. These objectives are pursued by the Authority through the airport Consultative Committees and by taking action (voluntarily or in implementation of Government policies) to reduce environmental disturbance.

### Conclusion

56 Within the statutory framework, the Authority has achieved a good measure of understanding with neighbouring communities and has implemented effectively measures to reduce the environmental impact of its airports.

Traffic Forecasts

Given the long lead times involved in airports planning, it is clearly essential that there should be forecasts of the long term growth in demand for air transport to guide the Authority both in its Corporate Planning and in its assessment of the need for additional airports capacity. The present air traffic forecasting model of the BAA was developed in 1976 and fresh forecasts are prepared at least once a year both for the Corporate Plan and for the series of public inquiries in which the Authority has been engaged in recent years. Some assessment of the Authority's forecasts can be provided by a comparing forecasts made in previous years with the latest projections:

Forecast for South East Airports  
(Including Luton)  
Millions of passengers per annum (MPPA)

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
1981	39.0	42.6	42.5	44.8	45.9	39.5	39.3*	-
1984	50.5	52.4	53.4	55.4	57.0	52.5	49.9	46.8
1989	75.1	74.5	75.0	77.1	75.4	69.3	66.9	62.8

\* Actual

The Department's economists can find no evidence that, over the longer term, BAA forecasts have been consistently over-optimistic. Since 1979 however, forecasts have been revised downwards to reflect the depth of the current recession which was unforeseen by either the BAA, or most other forecasters. The final outcome for 1981 reflects closely the forecasts made in the mid-1970's. As a comparison, the forecasts prepared by the Department of Trade in 1977 for the Airports Policy White Paper projected a high forecast of 41.9 mppa for 1980 and a low of 36.7 mppa. The actual out-turn was well within the forecast range.

To reflect the economic climate since the recession began the BAA's longer term forecasts have also been revised downwards in recent years:

London Area  
"Planning" Forecasts  
(MPPA)

<u>Corporate Plan</u>	<u>1985</u>	<u>1990</u>	<u>1995</u>
1979	59	82	-
1980	59	78	-
1981	53	70	87
(Stansted statement of case)			
1982	49	67	85

Again a comparison can be provided with the three most recent air traffic forecasts published by the Department of Trade:

London Area Airports (MPPA rounded)

	1985		1990		1995	
	H	L	H	L	H	L
1978 White Paper	64	51	89	66	-	-
1979 ACAP	61	55	81	69	100	82
1981 ATFWP	51	45	70	52	89	60
1982 Ec2	54	46	71	53	89	58

It will be seen that the forecasts have also been substantially revised in the light of more pessimistic economic assumptions. More recent work within the Department suggests that the 1981 ATFWP forecasts, particularly for 1985, may be too low.

Following the 1981 revision of its air traffic forecasts, the Department of Trade presented a paper to the Stansted Inquiry which stated that for policy purposes the Department was adopting a narrower band of values symmetrically disposed within the ATFWP range of forecasts, as follows:

	<u>UK</u>	<u>MPPA</u>	<u>LONDON AREA</u>
1985	65 - 71		46 - 50
1990	79 - 96		56 - 67
1995	91 - 119		65 - 84

In assessing proposals for long term expansion of capacity, the Department has stated that it will use values towards the top of this narrower band. This is not a judgement about the most likely outcome, but a prudent reflection first of the possibility that the actual traffic may prove to be close to the top end of the forecasts; and secondly of the consequences of under-estimation of demand. This range encompasses the BAA's Planning forecasts.



Airports Policy

Following the abandonment of the Maplin Project in 1974, the Government undertook a comprehensive review of airports policy in Great Britain to serve as a basis for consultations on the way in which future air traffic might be handled. It was felt essential to ensure that decisions concerning the development of particular airports were reached after taking full account of the views of all those who would be affected by them. To facilitate this process the Government produced a two part Consultation Document entitled Airport Strategy for Great Britain. Part I published in November 1975 covered the London area airports and Part II published in June 1976 dealt with the regional airports. Nearly 1,000 organisations throughout Great Britain were invited to comment on these documents which set out a number of possible scenarios for future airports development.

2 The results of the Government's consideration of comments received during the consultative process were presented in February 1978 in the White Paper Airports Policy. The strategy for a national airports policy outlined in this White Paper was based on the recognition that the air transport industry made an invaluable contribution to the economy; the principle that air transport facilities should not in general be subsidised by taxpayer or ratepayer, the need to take careful account of the environmental impact of airport development; the adoption of a flexible approach in planning and development related to the growth in demand; and the importance of consulting those concerned with airports in the development of policy.

3 The White Paper concluded that additional airports capacity would be necessary in the South East in the 1980's to meet the forecast demand for air travel. It stated that the diversion of passengers with origins and destinations in the South East to airports in other parts of the country neither made sense in transport terms nor would it lead to an overall decrease in the numbers of people affected by aircraft noise. The limited scope for diverting passengers from the London area airports to those in other regions did not remove the need for additional airport capacity in the South East. It was therefore proposed that foreseeable demand in the region should be met by the expansion of the existing London area airports. Outside London, air services would be encouraged to concentrate at a few selected airports which might thereby be able to offer a range and frequency of service to meet local demand and at the same time provide a stimulus to air travel outside the South East.

4 The White Paper confirmed the decision to abandon the Maplin project and concluded that to meet forecast demand in the 1980's proposals for a fourth terminal at Heathrow should be examined at a public inquiry and that proposals for a second terminal at Gatwick should be brought forward. The Government accepted that limits should be placed on the growth of the existing airports and concluded that Heathrow would be limited to not more than

four terminals and that the proposal for a second runway at Gatwick should not be revived thereby effectively limiting development at Gatwick to a maximum of two terminals. Luton was not considered suitable for development beyond a single terminal with an estimated capacity of 5 million passengers a year.

5 The White Paper did not suggest a solution to the longer term provision of capacity in the South East but instead proposed the establishment of a formal consultative machinery to include consumers, local authorities and amenity groups, to consider the longer-term airport options. As a result two bodies (ACAP and SGSEA) with representatives from a wide range of organisations, were set up in 1978, and reported to the Secretary of State for Trade in November 1979. ACAP concluded that the effective capacity of the existing four London area airports, even taking into account a fourth terminal at Heathrow and a second terminal at Gatwick, was likely to be exhausted towards the end of the 1980's. SGSEA evaluated sites for a Third London Airport but reached no conclusion on which of the short-listed six sites should be chosen as it considered that this was a political decision.

6 On 17th December 1979 the Secretary of State for Trade announced that the Government had decided not to build a major new airport of the kind considered by the Roskill Commission nor would it resurrect the Maplin project, even in a revised form. The Government would, however, encourage the fullest use of regional airports and provide additional airport capacity as the traffic developed, based on the existing airports in the South East, particularly Heathrow, Gatwick and Stansted. It was announced that the Government had decided to accept the Inquiry Inspector's recommendation to construct a fourth terminal at Heathrow but that, in accordance with the Inspector's recommendation, the Government had concluded that a fifth terminal at Heathrow should not be provided. The BAA were therefore invited to bring forward detailed proposals for the construction of a new terminal and associated facilities at Stansted capable of handling up to 15 mppa. The Stansted Public Inquiry opened in September 1981 and is unlikely to conclude before the Spring of 1983.

7 The 1978 White Paper did not reach any firm conclusions on the future of the Scottish airports because responsibility for Scottish airports policy was expected to pass to the Scottish Assembly after the desolution referendum. It noted, however, that there was no shortage of runway or terminal capacity in Scotland and that all the major airports had extensive modern facilities. It also noted that any substantial transfer of passenger and cargo services away from Prestwick would affect the viability of Prestwick. Successive Governments and the BAA have taken the view that the Scottish Lowland airports should operate as complements to each other with Prestwick as the Gateway international airport for long-haul flights serving the whole of Scotland, Glasgow catering for domestic and short-haul services

for the West of Scotland and Edinburgh serving a similar function for the East of Scotland. The present Government has, on a number of occasions, confirmed this allocation of traffic as part of their airports policy.

Capacity of the London and Scottish Airport London AirportsLondon Airports

The existing capacity of the central area terminals at Heathrow is assessed by the BAA at 30 mppa. The provision of a fourth terminal, currently under development, will increase the capacity of the airport as a whole to about 38 mppa in the late 1980's. The distribution of capacity between the three Central Area terminals and the fourth terminal will depend on the nature of the traffic distribution within the airport.

The existing capacity at Gatwick when current developments are completed is assessed at 16 mppa. The provision of a second terminal at Gatwick would enable capacity to be increased ultimately to about 25 mppa. In practice a throughput of 25 mppa will not be achievable at Gatwick until aircraft loads have increased sufficiently for the runway capacity to match terminal capacity and this is unlikely until the mid-1990's. The second terminal can therefore be phased to take this constraint into account.

The present capacity of Stansted airport is assessed at 2 mppa and of Luton airport at  $3\frac{1}{2}$  mppa (once the current terminal improvement programme is completed). Thus the present aggregate capacity of the London area airports system totals about  $51\frac{1}{2}$  mppa and will ultimately rise to  $68\frac{1}{2}$  mppa once the fourth terminal at Heathrow and the the second terminal at Gatwick (assuming planning permission is granted) and completed. There may be scope for further increases in the capacity of Heathrow in the early 1990's but this will be more than offset by the delay in fully utilising the terminal capacity at Gatwick (as a result of the runway constraint) and the impossibility of perfectly matching demand to supply. This so called mismatch factor reflects the fact that the licensing of new services and frequencies is not in the hands of the BAA and that airlines do not switch services between airports to reflect changing patterns of constraint. There is a general Government policy of transferring demand from Heathrow to Gatwick which has been highly successful in recent years. Traffic at Gatwick has increased at over a million passengers a year in the last few years so that by 1981 it had become the fourth busiest international airport in the world. This policy has only been operable because there has been ample spare capacity at the latter airport. Individual airlines already operating at Heathrow have fought long and bitter campaigns against being required to switch their services to Gatwick often with the open support of their Governments in the case of foreign carriers.

Because of the problems of matching air transport demand to supply it is not practicable to direct the airlines (who often operate under international air service agreements which give them considerable freedom to expand frequencies as they see fit) in such a way that as demand reaches the aggregate of individual

airport capacities it will precisely match those capacities. For this reason, additional capacity within the system should become available before total demand falls short of total capacity. The Inspector at the Gatwick Second Terminal Inquiry concluded that a 10 per cent allowance should be made for this mismatch problem in assessing future capacity requirements. The Government invited the BAA to bring forward its proposals for Stansted because the 1979 ATFWP forecasts suggested the need for still further capacity by 1988. The subsequent recession and revised air traffic forecasts now suggest that the need for the Stansted Development has receded to 1990 at the earliest but, as with the earlier projects, such delays are likely to be more than compensated for by slippage in the planning process. The detailed case for Stansted and the alternatives which have been proposed (a fifth terminal at Heathrow, for which a planning application has been submitted by the local authorities around Stansted, and now airports at Maplin and Severnside) is being scrutinised in great detail at the current Stansted Public Inquiry.

### Scottish Airports

As elsewhere, the regional airports in Scotland have, for the most part, ample capacity for foreseeable traffic demand. Following extensive modernisation and improvement by the BAA during the 1970s the three lowland airports have estimated capacities as follows:

	<u>Approx. Terminal Building Capacity</u> (mppa)	<u>Runway Length</u> (Metres)	<u>Terminal Passengers</u> 1980 ( '000's)
Prestwick	1.5	2987	392.8
Edinburgh	2.0	2560	1162.9
Glasgow	3.75	2566	2340.4

The main problem for these airports is an excess of capacity over foreseeable demand. The Government's policy towards these airports was stated most recently by the Secretary of State for Trade in his statement on 13 May 1981. No significant additional traffic is expected to be created in Scotland if demand is diverted from the South East and the present capacity of the three lowland airports is more than sufficient to cope with foreseeable demand in their local catchment area.

Aberdeen airport faces particular pressures as a result of North Sea oil development. Its present terminal capacity is assessed by the BAA at 1.2 mppa but the Authority has a major investment programme of £10.8 million in hand to cope with forecast increases in oil related traffic. Inter alia, this programme will increase terminal capacity to 1.5 mppa.



Prime Minister

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LONDON SW1P 3EB

Lord Cockfield's paper and  
this letter from Mr Heseltine  
(as well as any response from  
Lord Cockfield) are to be discussed  
at E(N1) on 8 September.

My ref: H/PSO/15309/82  
Your ref: 16 August 1982

Arth

Wh  
23/8

No answer

I have already let you know that I am unhappy about the note you circulated on the British Airports Authority on 23 July, because it is so broad-brush in character. I would have hoped for more specific proposals about the ways in which the BAA might achieve the targets it has been set but, so far, has failed to meet. And I would have expected its investment programme to be more critically reviewed, when its implementation seems liable to produce massive over-capacity among the south-eastern airports.

My principle concern is that we get a model for these exercises that is universally tough. I am in many ways trying to learn from the ways in which you are tackling problems that I face in other fields.

These are the problems of improving the efficiency of organisations which are not much affected by market pressures. The BAA, with a virtual monopoly at least of south-eastern airports, is such an organisation. The figures you circulated show that it has failed, over the last 2 years, to meet the relatively modest aim of reducing real costs by 2.5% a year. In the longer term, measures of performance are confused by the addition of security staff to its payroll in 1978-9; but they present a rather unflattering picture before 1978. They only show a marked improvement since 1979, despite its failure to cut costs. Landing fees per passenger have risen 17.6% in real terms in the last 10 years, despite an increase of 84% in passengers. These figures must raise a question mark about its efficiency and cost-consciousness.

The BAA's attitude to planning future capacity also suggests some lack of concern with costs. The investment proposed in its corporate plan would give it over-capacity in the south-east, compared even to the top end of your department's traffic forecasts, which amounted to 18% in 1985-6, 26% in 1986-7 and 32% in 1988. I am glad that you say that the timing is flexible though you approve the plan; the BAA's own proposed timing seems very far from optimal.

This evidence is worrying, because it implies that the BAA has at least some of the weaknesses to which a monopolist is prone. It therefore presents us with that most intractable of problems, how to induce an organisation to adopt uncomfortable measures to improve efficiency when it has little incentive to do so. I would have hoped that your note might have discussed this problem, and perhaps proposed some more specific objectives for the BAA's future performance.

The case for such an approach seems all the stronger when I see that

the summary of the corporate plan that you circulated does not discuss ways of improving efficiency, and that your own note suggests that future improvements in productivity will be smaller than those in the past because of the new terminals which will be opened. The BAA also expects to miss its 3-year target for cost reductions, though it hopes that increasing traffic will let it meet its target for productivity.

the implication of this evidence is that real costs are liable to rise in future, especially if the BAA is allowed to equip itself with the capacity proposed in its plan.

I am glad we shall now have an opportunity to discuss the BAA's plans at E(NI) next month. I am sure it would help our discussion then if you could consider how far you can amplify your note to take account of the worries I have expressed, and in particular whether you can discuss possible ways of reducing real costs in future. For example, could productivity of existing facilities be improved, as an alternative to increasing capacity; and could the effects of higher traffic be exploited more effectively, to obtain greater improvements in productivity. There should, I imagine, be some scope for economies of scale in the airports business, as there is in most others.

Lastly, I think we would be mistaken if we weakened our pressure on the BAA to reduce costs and plan realistically for new capacity because it is under so many external attacks. Our objective should rather be to encourage the BAA to eliminate any justification there may be for these attacks.

MICHAEL HESELTINE

23 AUG 1982

