

Response to CAA consultation: Heathrow capacity expansion – consultation on a shortlist of regulatory models

Consultation response | Alex Chapman and Christopher Mahon | June 2026

CAP3251: Executive summary

The New Economics Foundation, a charitable think tank, responds to documents published by the CAA on the 15th May 2026. As well as the brief commentary below on specific matters arising from the CAP3251, we also attach our response to CAP3238, where we provide more detail on issues equally relevant to the present consultation.

At the core of our concern is a fundamental omission: the CAA's shortlisted regulatory models do not adequately confront the two defining tests of any credible framework:

- Does the regulatory model ensure that the scheme can only proceed if it is cost-effective, and commercially viable on its own merits?
- Does it allocate risk and benefits fairly—particularly between investors and consumers, and between users and non-users of the new infrastructure?

We urge the CAA to explicitly set out for each shortlisted model how much cross-subsidy from existing airport users would be expected and over what timeframe. This is currently left opaque.

NEF concurs with the concerns attributed by the CAA to easyJet regarding Model 3—and we stress that these concerns apply, in substance, to all shortlisted models in their current form. Specifically, the models appear to:

“prioritise project financing over the protection of passengers, which will prematurely constitute an unacceptable risk transfer from investors to consumers over decades. [...] consumers would be permanently locked into paying for an overpriced and underutilised asset if costs proved to be lower than forecast, or if demand falters. This would contrast with the way in which investors would be shielded from such downside risks.” (p.95)

The CAA never confronts directly the question of what happens if demand for the new capacity falls materially short of forecast:

- (1) There is no mechanism proposed that would result in HAL or its investors bearing that loss rather than passengers.
- (2) The proposed regulatory modifications still allow the scheme proponent to profit from putting forward overly optimistic passenger growth assumptions.

- (3) The budget cap protects consumers from *cost overruns* but not from the scenario easyJet describes: an on-budget, on-time expansion that simply does not generate the traffic to justify it.
- (4) Ultimately, in not ruling-out cross-subsidy, the models go against international best practice and guidance as we set out in the CAP3238 response below.

This is not to say that some of the shortlisted models could not be adapted to address the issues we have raised. From our review, Model 7b seems most likely to enable full ring-fencing of commercial risk and reward, but insufficient detail is provided.

The potential costs of the proposed Heathrow works are extraordinary: £33-52bn for the expansion (Steer, 2026), £16bn for improvements to current infrastructure (HAL, 2026), and a potential £13-20bn for public transport upgrades (TfL, 2017 but in urgent need of update), a potential total spend of £62-88bn. Yet at the same time, the UK Climate Change Committee's analysis suggests additional UK airport capacity is not needed to serve expected passenger demand out to 2050.¹ In their current form, all shortlisted models risk an outcome in which an expensive and potentially unnecessary piece of infrastructure is funded by existing users, yielding investors a commercial gain without taking commercial risk.

¹ CCC (2026) The Seventh Carbon Budget. Climate Change Committee

CAP3238: Executive summary

Scheme costs

- Heathrow's monopoly position and 'regulated asset base' (RAB) funding model create perverse incentives for inefficient and anti-growth investment decisions.
- Government has explicitly stated that it wants a "cost effective" expansion "at no cost to the taxpayer". *The regulatory model chosen should create transparency over the project's viability on these terms.*
- A transparent assessment means avoiding hidden cross-subsidies. The proposed new infrastructure should be paid for by the new users. *The CAA should redesign its RAB model on this basis.*
- Such a 'user pays' principle is strongly recommended by ICAO, and has been deployed in other airport expansion projects around the world such as Sydney, Brisbane, Copenhagen, Vienna and Frankfurt.
- Embracing the 'user pays' principle (new slots paid for by new users) would create incentives for Heathrow to put more care into its business plan. *It also ensures Heathrow shoulders more commercial risk in order to yield a commercial gain.*
- By contrast, the current RAB design encourages 'expansion-at-any-cost' by relying on a cross-subsidy from existing users of existing infrastructure. *This cross-subsidy should be scrapped. Expansion costs should be ring-fenced to the new users of the new landing slots.*
- Our analysis (based on inputs from others) suggests a ring-fenced scheme would require passenger fees for the new runway and terminal in the range £48-£76 (£95-£151 per return flight) representing a 82%-188% increase on current fees.
- These fees exclude the costs of surface access improvements, which government is clear should be privately financed. *The CAA should provide more information on the potential surface access costs, how they would be paid for, and their impact on the viability of the scheme.*
- Our analysis suggests that under the current cost-pooling system users of the existing infrastructure could be expected to subsidise the expansion by £0.7-1.6bn per year equivalent to £7.50-£17.50 per flight, or £15-£35 on a return flight. *The CAA should establish its own estimate of this cross-subsidy so it can be publicly scrutinised.*

Cost-benefit analysis

- Demand for business air travel has been consistently overestimated by the DfT and other forecasters. Heathrow's business-travel market share has fallen sharply, with all recent growth in the London airport system coming from leisure passengers.
- Expanding Heathrow would therefore primarily expand leisure travel.
- Leisure travel is less impactful for UK growth, in part because the UK sends more tourists abroad than it receives. Thus expansion is unlikely to deliver the economic benefits Heathrow claims.
- Heathrow has incentives to overstate economic benefits, so the regulatory model should be redesigned to support expansion only when the business case is genuinely robust, not reliant on cross-subsidies from existing passengers.

- Capacity uplifts at other London airports, combined with longer-range narrow-body aircraft, make it imperative that the regulatory model steers away from encouraging ‘expansion-at-any-cost’.
- The case for expansion depends heavily on inelastic business travellers to generate congestion premiums and large consumer surplus — an assumption that looks unrealistic given declining business-travel trends.
- Demand forecasts (including those projected by Frontier) based on very high future ticket prices under capacity constraints appear unrealistic and rely on DfT elasticities suited only to small price changes. Evidence shows demand is far more price-elastic and in some case non linear. Put simply: above a certain price demand has a ceiling.
- Demand forecasts also underestimate the likelihood of passengers shifting to other airports (especially price-sensitive travellers) and the potential impact of future carbon taxes on prices.
- Designing a regulatory model that forces Heathrow to properly consider these risks and not rely on extracting cross-subsidies is key. This underlines the need for a model that ringfences expansion costs to the users of the new landing slots.

About this submission

The New Economics Foundation (NEF) is a charitable think tank working on UK and European economic policy. For many years, the think tank has examined how the UK's air-transport sector is managed, publishing analysis on aviation's broader economic role, its taxation, and its climate and environmental impacts.

NEF supports fair taxation of aviation and has consistently challenged airport expansion where the claimed benefits fail to justify the significant economic costs or environmental risks.

We make every endeavour to ensure that our analysis is robustly evidence-based. However, the RAB model and the regulatory framework governing Heathrow are exceptionally complex, and our organisation operates with far fewer resources than many other stakeholders. We therefore apologise in advance for any unintentional misunderstandings that may appear in our submission.

The cost of expansion, and the cross-subsidy

Heathrow has monopoly powers

Heathrow's size, location, infrastructure, and its position as the UK's only hub airport give it a partial monopoly over UK air travel. This dominance is formally recognised by the Civil Aviation Authority (CAA), which designates Heathrow as having "substantial market power". Such market power creates a clear risk that the airport could set inefficient or exploitative prices, ultimately harming consumers and constraining economic growth. To mitigate this, the CAA applies a bespoke regulatory regime to Heathrow.

Policymakers should remain alive to the possibility that Heathrow's monopoly position could change and diminish. The rise of competing, often cheaper hubs, longer-range narrowbody aircraft, changing consumer demands, and rising incomes and populations, could all contribute to a system shift. For this reason, care should be taken to ensure that Heathrow's proposed expansion is not *dependent* on the exploitation of its monopoly position.

Heathrow's charges are controlled

Heathrow's charges are capped by the CAA via the regulated assets base (RAB) model. Two factors have the biggest influence on the cap: the return on capital allowed, and the return on investment allowed (depreciation). In general, the actual running costs of the airport's everyday activities are covered by its other commercial revenues (e.g. duty free). Heathrow's revenues are capped based on a formula which allows the airport to make a fixed return on the value of its assets. At the end of 2025 Heathrow had a RAB worth £21.3bn. The value of the RAB is inflation indexed meaning Heathrow's return is protected in real-terms. In 2026, under the RAB model, Heathrow was permitted to charge £26.22 per passenger. The effective price per departing passenger, the more common metric for assessing an airport's cost competitiveness, is £52.44. Heathrow is usually placed among the top three most expensive airports in the world.

The RAB system creates perverse incentives

The RAB system exposes Heathrow to an unusual set of incentives. Its financial performance is less dependent than normal on being able to out-compete competitors with low prices and good service. Rather, the airport's revenue growth is tied to increasing the value of its assets. This creates a very significant incentive to invest in, and create, new assets. While investment is generally welcomed, a risk is introduced that Heathrow will make investments that are not economically efficient, and that would not be commercially viable in a normal, competitive, environment.

The government has been clear that the proposed expansion must be cost-effective and fully privately financed

On the 25th November 2025, the government stated:

*"The government's position is clear: expansion at Heathrow **must be cost effective**, minimising the burden on passengers and coming **at no cost to the taxpayer**. The project will be privately financed, including the core scheme and **any associated surface access improvements**."*²*[emphasis added]*

The scheme must be cost effective, and come at no cost to the taxpayer, including associated surface access improvements.

Heathrow's charges will rise if its expansion is approved

The proposed third runway at Heathrow would be very expensive. Heathrow Airport Limited (HAL) have costed the runway itself at £21bn and the associated new terminal capacity at £12bn, for a total expansion cost of £33bn. HAL's CEO has told the media that this would mean a cost of £15 per passenger journey. However, these cost estimates have not been subjected to public scrutiny. Most major infrastructure projects cost significantly more than was originally expected. The CAA-commissioned Steer report put the cost in the range £33-£52bn. The CAA suggests the upper estimate would lead to an increase in costs per passenger of £26. Heathrow Reimagined have claimed that it will cost £30 per passenger journey.

The current model pools and cross-subsidises investments

Under the existing regulatory framework, Heathrow is allowed to earn a single capped rate of return across the entire value of its regulated asset base. All investments—past and future—are therefore pooled. As a result, the costs of a new runway would be charged to **all** passengers using the airport, not ringfenced to only those travelling via the new infrastructure or using the newly created landing slots.

Depending on forthcoming CAA decisions, Heathrow may even be permitted to recover some of these costs from existing passengers before the runway is operational or fully approved.

New customers are being subsidised by existing customers.

² <https://www.gov.uk/government/speeches/heathrow-expansion-selection-of-a-scheme-for-anps-review-purposes>

The International Civil Aviation Organization advises against this model

The International Civil Aviation Organization (ICAO), the UN agency, explicitly warns against cross-subsidisation in its *Airport Economics Manual*:

"The principle is to charge users for the facilities and services that are directly related to their use of the airport or the airport system. The airport operator should avoid cross-subsidizing different user categories, as such cross-subsidization may not only result in discriminatory treatment of users, resulting in service pattern distortions, but also result in an economically inefficient use of the airport." (p.4-28)

Heathrow should shoulder the commercial risk for the commercial gain

A cost-effective and economically efficient expansion should pay for itself. The test is whether revenue raised from passengers using the new infrastructure is sufficient to cover the costs of the investment. This ensures that Heathrow shoulders the full commercial risk for the commercial gain, rather than exploiting its monopoly position.

If the revenues do not cover the costs, then the costs of expansion outweigh the purported benefits. Heathrow needs a regulatory framework that addresses this question.

The proposed expansion does not look cost-effective

Our indicative modelling, based on cost ranges published by the CAA, Steer, and figures reported in the media, assesses the viability of such a self-financing approach. Such reports suggest the expanded scheme might achieve an average of 50 million additional passenger per year on top of a base of 90 million from the existing airport facilities. Those 50 million additional journeys need to cover expansion costs in the range £33bn-£52bn, plus surface access costs.

Our modelling suggests that the new runway and terminal facilities would need to charge a fee of £48-£76 per passenger (£95-£151 per return journey) to cover the scheme costs, with a central estimate of £62 (£123 per return journey). These figures exclude the cost of public-transport upgrades, which remain uncoded but could materially increase the required charge. The approach may, however, miss some investment benefits that will genuinely accrue to existing users and therefore might warrant a contribution.

Our estimates, which are in current prices, sit 82%-188% above the current fee charged at the airport. The current fee is already considered among the most expensive in the world. It is difficult to see how the proposed scheme could be considered cost effective at these levels.

Table 1: Estimates of the passenger fees necessary to fund expansion if charged only on users of the new infrastructure, and the implied cross-subsidy if costs are pooled across all users

Cost outturn of new capacity	Fees per pax under current regulatory model	Total annual revenue to airport assumes 140m pax per year average over period	Fees per pax assumes costs of new capacity are ringfenced to new users (50m pax per year)	Increase on current fee	Estimated annual cross-subsidy requirement	Cross-subsidy per passenger additional fee paid by existing users
£33bn	£17	£2,380,000,000	£48	82%	£687,000,000	£7.5
£42.5bn	£22	£3,080,000,000	£62	135%	£1,137,000,000	£12.5
£52bn	£26	£3,780,000,000	£76	188%	£1,587,000,000	£17.5

Source: NEF analysis of Steer, CAA, HAL

The cross-subsidy could be worth £0.7-1.6bn per year

If the CAA and government retain the current RAB model, Heathrow would be able to cross-subsidise the expansion by charging existing passengers. We modelled the scale of this subsidy using deliberately conservative assumptions, including no pre-opening contributions from current passengers.

Our approach estimates the annualised expansion cost that remains after accounting for the contribution made by new passengers paying the existing £26.22 charge. This residual cost is then spread across all airport users (140 million passengers).

Using this method, the cross-subsidy borne by existing passengers totals £700m, £1.1bn, and £1.6bn in each of our three scheme cost scenarios (Table 1). This means a passenger taking a return flight from Heathrow's existing infrastructure will pay £7.50-£17.50 per flight, or £15-£35 on a return flight, in cross-subsidy towards infrastructure they have not used. These figures rely on the new infrastructure achieving a high utilisation rate over its initial years of operation, otherwise they would likely be higher.

Surface access improvement costs need considering

The government has clearly stated that any surface access improvements associated with the expansion scheme must be privately financed. The cost of the surface access and wider transport improvements required to support a third runway and prevent congestion costs and externalities are disputed. The Western Rail Link and the Southern Rail Access link have variously been costed at £1-2bn each by interest groups. TfL however, in 2017, costed the full suite of necessary improvements at £10-15bn. This analysis identified major potential crowding on the Elizabeth and Piccadilly lines as key issues and, notably, put the cost of Southern Rail Access at £5.1bn (around £7bn in today's prices).³ The TfL also identified the potential for wider transport improvements to manage the induced employment and population growth. Unless robust business cases demonstrating that the full suite of required schemes can be privately self-financed are brought forward, the current consultations around the RAB must make provisions for the possibility that the airport will be required to cover these costs. The CAA must therefore make provisions addressing this in its ongoing work.

³ TfL (May 2017) NPS Consultation Response: Thematic Paper on Surface Access. Transport for London.

Other regulated airports do not use this model

There are numerous examples of major airport expansions worldwide, each shaped by its own regulatory framework. Our brief review indicates that the prevailing international practice is **not** to socialise expansion costs across all airport users (Table 2). Instead, charges are typically directed toward the passengers and airlines that actually use the new infrastructure. The table below summarises several illustrative cases.

Table 2: Selected examples of non-socialised airport expansions

Airport	Expansion	Cost allocation
Frankfurt	Pier A-Plus new stands	Pier-specific charges used to levy costs on the users of the new infrastructure
Copenhagen	CPH Go terminal	Ring-fenced passenger charges associated with the new terminal
Vienna	Skylink terminal	New tariffs targeted at airlines using the new infrastructure and services
Sydney	Terminal 1 expansion	Funded through charges applied only to the affected airlines
Brisbane	New runway	Funded through runway specific prices on airlines using the new infrastructure

Other factors impact on passenger demand: demand shifting to other airports and carbon taxes

To assess how the price increases outlined above might affect future demand for air travel—and therefore the case for expansion—we must consider the broader forces that will shape the long-term cost of flying. It is widely recognised that air-travel prices will need to rise to meet climate objectives. This upward pressure will come from higher carbon taxes, offsetting requirements, the increased cost of sustainable aviation fuels, and the expense of engineered carbon removals.

Given these expected cost increases, the UK Committee on Climate Change projects little to no passenger-growth over the next two decades. Any limited growth that does occur could be accommodated within existing approved airport capacity.

Moreover, higher fees at an expanded Heathrow mean that any marginal demand is likely to shift toward other airports with significantly lower charges, especially given expansion plans at many competing airports.

Comments on the 'benefits to consumers'

NEF will be making further contributions on the wider economics of Heathrow expansion throughout upcoming proceedings. Here we make a small number of comments directly relevant to the CAA's latest decision.

Business demand

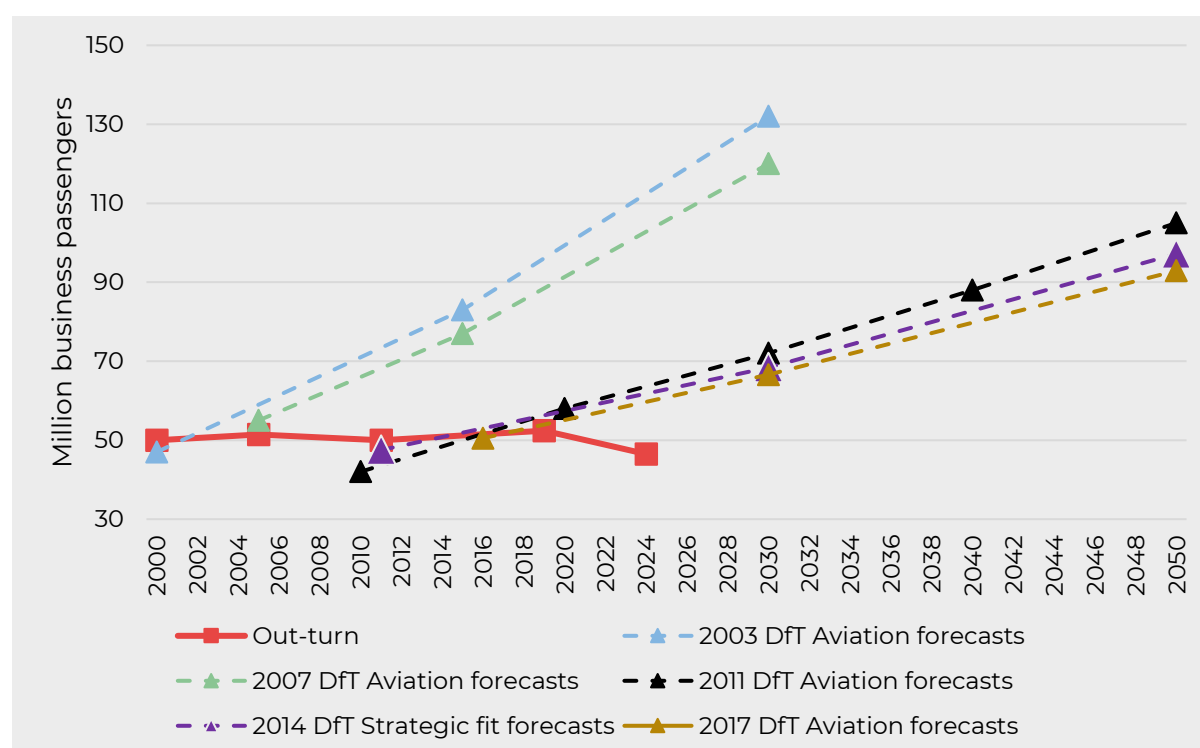
Forecasts have been consistently wrong about the level of business air travel demand. Four consecutive DfT forecasts revised future expectations of business air travel demand downwards (Figure 1). Yet actual demand has still fallen short of even the most recent projections. Business passenger numbers at Heathrow have been in steady decline as a share of the market. Earlier DfT and Airports Commission assumptions have already been shown to be significantly overstated.

Business passengers are critical to the scarcity rent question. Their low price elasticity drives a very significant proportion of the rent or, conversely, the air fare savings expected from airport expansion. If the DfT, and others, are significantly underestimating how close the business air travel market is to saturation then the long term congestion premium will be substantially lower.

‘Scarcity rent’ is a poor reason to increase prices for existing consumers

Expansion proponents are confusing rent redistribution with investment economics. Reduced scarcity rent is not a gain to be harvested through higher prices for existing customers. Arguing that existing users should pay more is equivalent to imposing sharply higher levies on one rail operator to fund expansion at another, or charging ferry customers for the Channel Tunnel. Other infrastructure sectors do not use rent erosion as a justification for a cross-subsidy from existing users. The project should stand or fall on its own economic merits, not by transferring the costs of additional commercial infrastructure onto pre-existing customers.

Figure 1: Projected business air passenger demand in DfT aviation forecasts (central, capacity constrained, scenario) made in 2003, 2007, 2011, 2014, and 2017 and historic demand (CAA/IPS).



Source: NEF analysis of DfT aviation forecasts

Appropriate elasticity selection

Most analyses of scarcity rent or consumer surplus rely on the DfT forecast model elasticities. While suitable for national-level forecasting, they are poorly suited to estimating Heathrow-specific scarcity rents. Much of the projected net present value arises late in the forecast period, when capacity constraints and rising demand drive ticket prices sharply upward.

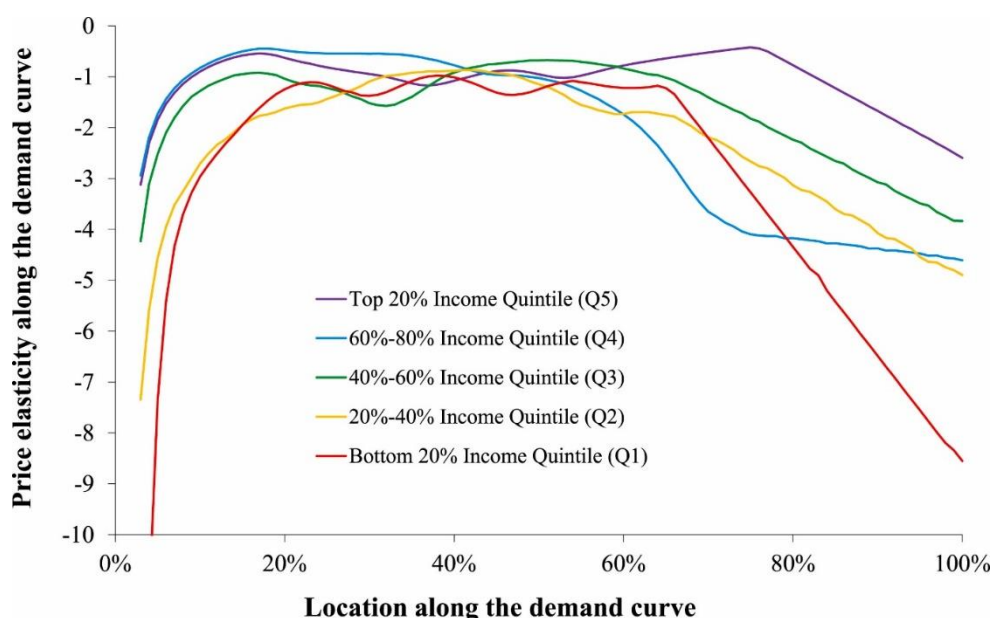
Two issues follow:

First, if willingness-to-pay were genuinely this high, other UK airports—or foreign hubs for transfer passengers—would likely step in to serve these travellers at lower prices. The rollout of long-range narrow-body aircraft further expands the scope for such competition, and the risk of oversupply in the South East should not be ignored.

Second, it seems highly unlikely that demand is truly this inelastic. Almost all demand growth is in the leisure market, particularly among frequent-flyer leisure travellers, who are typically far more price-sensitive, as shown in earlier NEF work.⁴ Moreover, research by Fouquet and O'Garra (2022) suggests that the price-demand relationship is in fact non-linear, and that demand is far more elastic away from the centre of the demand curve.⁵

The key implication is that prices alone might dissuade more passengers from flying from a capacity-constrained airport. Demand may be far more elastic than assumed by analyses such as Frontier's. Adjusting for this information could significantly reduce the congestion premium they propose.

Figure 2: Fouquet and O'Garra (2022), Price elasticities along the 2019 demand curve for air travel in the UK by income quintile



⁴ Chapman, A. (2025) Flying Fair: Modernising the air transport tax system. New Economics Foundation

⁵ Fouquet, R. & O'Garra, T. (2022) In pursuit of progressive and effective climate policies: Comparing an air travel carbon tax and a frequent flyer levy. *Energy Policy*, 171: 113278

Contact: alex.chapman@neweconomics.org

New Economics Foundation

www.neweconomics.org

info@neweconomics.org

+44 (0)20 7820 6300

NEF is a charitable think tank. We are wholly independent of political parties and committed to being transparent about how we are funded.

Registered charity number 1055254

© 2026 The New Economics Foundation