Item:
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Report to Partnership Meeting 15 June 2012

RESEARCH AND STRATEGY DEVELOPMENT

North of Scotland Air Issues Evidence Note

Purpose of Report

To report to Members on the output of the North of Scotland Air Issues Evidence Note commissioned jointly by HITRANS and Nestrans.

Background

HITRANS and Nestrans (the regional transport partnership for North East Scotland) have been working closely to develop a collective approach to ensuring that the aviation needs of the North of Scotland are fully understood by the Department for Transport as they take forward their Aviation Policy Framework which is shortly to be the subject of a detailed consultation.

A key area of concern for both partnerships is the need to keep our regions connected to global markets. To this end our links to the key London hubs of Heathrow and Gatwick are essential. In a changing market sector, our status quo must as a minimum be preserved and evidence based representations must continue to be made in a coherent fashion for the Highlands to regain access to London Heathrow.

The purpose of the Evidence Note is to deliver evidence based analysis to support a public relations exercise being pursued by HITRANS and Nestrans in support of making the case for stronger legislation to protect access to Gatwick and Heathrow for UK peripheral regions which have no effective alternative means of land based transport to access these hubs and through them to world markets. The Note seeks to support the case for preserving existing air links to the north of Scotland and investigating opportunities to improve our worldwide connectivity.

The key issues that the commission required the consultants to consider and present in the final evidence note are:

- The evidence note must present a clear and coherent overview of the air access provided to the north of Scotland.
- The evidence note shall support the case for the north of Scotland on internal aviation issues that are reserved to UK Government.
- Need to maintain existing connections from Aberdeen to London Heathrow
- Need to maintain existing slots at London Gatwick for flights to and from Inverness

HITRANS appointed MVA Consultancy to deliver this work which has been delivered at a total cost of £12,872. Costs have been shared equally with Nestrans.

Summary of Study Findings

The Evidence Note has been prepared in a particularly fluid policy environment. The original timetable for delivering the work was designed to fit with the commencement of the Department for Transport Aviation Policy Framework consultation which was scheduled to commence in Spring 2012. This was subsequently delayed by the UK Government providing additional time for the Evidence Note to be prepared and adjusted to reflect the changing market. The Evidence Note has thus kept pace with developments following from the recent acquisition of bmi by International Airlines Group (IAG) owners of British Airways. This development has seen an additional 41 daily slot pairs at London Heathrow transfer to BA.

The Executive summary of the study findings are reproduced below. The full report will be uploaded to the HITRANS website where it will be available to download at http://www.hitrans.org.uk/Corporate/Research/Air

Air Links to London - Executive Summary

HITRANS and Nestrans have major concerns about the prospects for retaining high quality air links to London in the medium to long term, if the Government maintains its agreed policy stance of not supporting the development of any new runways in the South East of England. In the increasingly constrained capacity environment that would result from this slots at the UK's 2 most important gateway airports, Heathrow and Gatwick (LHR and LGW), would be at a premium. Those currently used by domestic services would be under severe pressure from airlines seeking slots for new long haul services that offer the prospect of higher margins.

With this in mind, and given the importance of existing air links to LGW and LHR to their respective regional economies, HITRANS and Nestrans commissioned MVA and Northpoint Aviation Services to prepare an 'evidence based' case for the retention, and in HITRANS case expansion, of services to these gateways from Aberdeen and Inverness. Based on detailed analysis of current schedules and markets for air travel between London and the North of Scotland and an assessment of the role of such connectivity for the principal economic sectors in the North of Scotland, this 'Evidence Note' forms HITRANS and Nestrans response to the Department for Transport's consultation on its 'Sustainable Aviation Framework for the UK' to be published in June 2012.

Historic Trends in Regional Air Access to London

The last 20 years has seen:

- A significant reduction to six (around a third of the 1991 network), in the number of regional cities with services to Heathrow.
- The displacement of a significant number of the regional markets formerly served from Heathrow to Gatwick including Inverness.
- The emergence of competitive low cost services, mainly on the large well established London to regional city markets, at Stansted and Luton during the late 1990's and early 2000s. At first this stimulated the overall market size but then these services began to capture some of the point-to-point traffic that had previously used the primary London airports as capacity to Heathrow was priced-off in response to slot shortages
- The development of a business focused point to point niche market to London City, which again principally drew traffic being displaced from LHR and LGW.
- And, most recently, a significant reduction in both the range of services on offer between major UK regional cities and London airports (dropping from 43-33 in the period 2001-

11), and passenger volumes as a result of the forgoing and the impact of a 260% increase in Air Passenger Duty (APD) on both legs of a return domestic air journey, since 2005.

The evidence of the deleterious impact on regional air services to LHR, and more recently LGW, and the associated loss of onward connectivity to a range of global destinations, arising from the consistent failure of Government policy to address capacity pressures in the South East's airport system over the last two decades, thereby creating significant distortions in normal market mechanisms is, therefore, hard to dispute.

<u>UK Regional Air Access Policy</u>

Regional access only began to emerge as a significant aviation policy issue in the run up to the 2003 Air Transport White Paper. First raised by the Transport and Regional Select Committee in 1998-99, who noticed an increasing de-coupling of the UK regions from the national hub at Heathrow, it was raised again in the report of the Transport Select Committee in 2002-03, which robustly dismissed CAA and DfT's attempts to downplay the problem in their evidence to the Committee. Despite this, the 2003 White Paper, and subsequent policy 'guidelines'[1], issued in 2005 after a public consultation, which set in place a conservative policy which has done little to stop further regional routes being lost, particularly from Heathrow and Gatwick.

It is unclear whether this was the consequence of the philosophy of non-intervention in the market that dominated DfT and CAA's outlook on the industry at the time, or an excessive reliance on intellectual attractions of 'allocative efficiency' as the optimum method for slot distribution (despite the distortions which Grandfather Rights and capacity constraints themselves create), which led to this laissez-faire approach. The assumption that the two new runways in the South East provided for in the 2003 White Paper would be constructed may also have contributed. That policy and the subsequent attempts of the CAA to defend it in its CAP 754 and 775 reports, has now been shown to reflect a flawed assessment of how the regional aviation market would develop in future years. In reality, the number of new routes to London has not continued to grow as the CAA predicted; instead they have declined materially since their peak in 2006-07.

The evidence of the last few years suggests that there has been a lack of focus on the need to protect these essential transport connections and economic lifelines for regional economies. The current Government's announcement of a "no new runways" policy and the recent sale of bmi to IAG, have both raised concerns about the potential cannibalisation of 'regional' slots at Heathrow and Gatwick and have served to return the issue to public prominence amongst regional businesses and policy makers.

It is interesting, therefore, that in its recent Insight Notes to DfT, which formed part of its response to the Government's 2011 Sustainable Aviation Review consultation, the CAA included the following advice:

<u>CAA Insight Note 1: Consumer Choice</u>

"… passengers in the UK regions need to use a transfer airport to access the majority of global destinations …"

"While Heathrow dominates on long-haul routes to most world regions as a result of its size, its 'comparative advantage' on transatlantic routes to North America is apparent"

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[1] DfT: Gudance on the Protection of Regional Air Access to London; Dec 2005

CAA Insight Note 3: Aviation Policy Choice

"For medium and long-haul routes, consumers should have access to direct services from the UK to key global markets. Recognising that some routes may only be commercially viable if operated from a hub airport, the Government should seek to facilitate successful hub operations in the UK. Consumers using other UK airports should have 'single-stopover' transfer access to the same key global markets."

"As a result, passengers in the UK regions will continue to need to use a transfer airport to access the majority of global destinations: either Heathrow, accessed by surface transport or a domestic flight, or a foreign airport."

"Aviation Policy for the Consumer noted that … there are likely to be increasing pressures on regional connectivity to London. The provision of additional capacity would be expected to at least partially relieve this pressure, creating slots for commercially viable regional services."

"… other major hubs in Western Europe and beyond play a positive and important role in providing additional choice and value to UK consumers. However, there may be 'security of supply' risks if foreign hubs also become capacity constrained in the future. Forecasts … predict that by 2030, capacity constraints at airports across Europe could mean … some 10% of predicted demand, will not be accommodated. Under this scenario, it might be expected that connections to UK regional routes would get 'squeezed' as has been the case at Heathrow over recent years".

The strategic policy advice the CAA is now offering to Government, appears to recognise explicitly the need for UK regions such as the North of Scotland, to have access to hub airports to facilitate travel to the wider world. While foreign hubs may offer choice, there are clearly risks in relying solely on non-UK airports to provide such essential connectivity, especially when Heathrow is the dominant hub in Western Europe in terms of the access it offers to long-haul markets (eg North America, but also the Middle East and certain parts of Asia and Africa). The former, in particular, is crucial to the export/tourism markets of both Aberdeen and Inverness, but the other continents Heathrow serves well, are also important to extending the opportunities available to Aberdeen's world leading oil and gas sector.

CAA's revamped policy advice and the forthcoming Sustainable Aviation Framework Consultation would appear, therefore, to provide a perfect platform from which to press DfT to re-visit its overly restrictive, and now clearly out-dated, regional air access policy. This is especially the case, because 'connectivity' has emerged as a key policy issue in the current aviation review. With the UK economy now struggling in a way that it was not between 2003-05, and cross-cutting themes such as re-balancing the economy, encouraging private-led investment and securing access to faster-growing emerging economies to increase export volumes having greater prominence in Government policy, this is not surprising as improved connectivity is a key element in the delivery strategy for each of these growth objectives.

This Evidence Note has focused on improving the transparency of connectivity issues as they relate to the North of Scotland's air services to London, and on improving the understanding of why these links are of such importance to the economy of the region and that of the wider UK as a whole.

Inverness

In the case of Inverness the principal arguments which make retention of the existing core services to London Gatwick essential are:

- The absence of any viable surface transport alternatives (travel times are between 8-10 hours by rail or road) to London, the UK's capital city and global business centre, a problem that will continue to exist even if HS2 is eventually extended to southern Scotland.
- Gatwick dominates the point-to-point aviation market between London and the Highlands, both in terms of the scale and consistency of volumes it attracts and the share of its market (28%), which is business orientated.
- The important, though sub-optimal when compared to Heathrow, opportunity it offers for interlining traffic (which makes up 20% of the total of 220-240,000 passengers pa), despite the relatively poor onward connectivity it offers.
- Gatwick's provision to Highland employers of an air travel gateway to London and wider international markets for outward facing and exporting sectors in the region (eg Whisky, Optical and Medical Equipment Manufacture and the Energy Sector), and also ready access to specialist external expertise which growth sectors such as life sciences need to help grow their businesses.
- The inadequacy of other London airports (such as Stansted, Luton and London City) as an alternative to Gatwick because of their more limited and leisure orientated connectivity, longer access into the heart of London and in City's Airport's case, the operational restrictions and expensive charges it levies on airlines;
- The strategic importance of not having to rely solely on foreign hubs for global connectivity and the difficulty of expanding the new Amsterdam link to a sufficient level of frequency to make it a genuine alternative because lacks an underlying point-to-point market on the scale available to the London market.

Notwithstanding which, the case for re-introducing flights to Heathrow in parallel are also strong, not least because of:

- The inconvenience and economic inefficiency of up to 60,000 outbound passengers from the Highlands and Islands, being forced to make surface journeys of 3.0-3.5 hours to a Lowland Scottish airport to secure access to global connectivity via a hub.
- The disincentive to many inbound visitors to the Highlands of having to make similar surface journeys from a Lowland Scottish airport, or travel between London Airports, to access the Highlands, creating significant barriers to attracting additional international tourists and increasing their average length of stay and spend.
- The fact Heathrow continues to dominate airfreight exports from the UK, making access to this form of distribution system sub-optimal for Highland based firms in the absence of service to the UK's primary air cargo hub. This is particularly significant for the high value seafood export markets that local firms would like to access, because in 2011 Heathrow accounted for 95% of UK long haul seafood exports by air.

The arrival of Inverness's new Amsterdam service, does not solve the ongoing problems of access to global connectivity caused by the lack of air services between Inverness and Heathrow, not least because the single daily frequency it offers remains far from ideal for onward connectivity. Re-introducing morning and evening services to Heathrow would not only capture leaking traffic and stimulate the overall air market between the North of Scotland and London it would also provide far better global connectivity particularly to the North American market that is so important for businesses and the tourism industry within the Highlands.

<u>Aberdeen</u>

In the case of Aberdeen, arguments based on the absence of viable surface alternatives, the inconvenience of the Scottish Lowland airports, the inadequacy of other London and regional airports as hubs and the need for good overseas access for Aberdeen and Grampian Region's principal economic sectors are common to those associated with Inverness and the Highlands. But Aberdeen's case, there is also compelling evidence highlighting the essential role of existing links to Heathrow and the frequency of services to it from Aberdeen. This is not only because of:

- The high proportion of business traffic (around 55%) that Aberdeen to Heathrow services cater for, more than double that of other Scottish Airports; and
- the unusually high onward connectivity quotient it offers;

It is also because of:

- Its primacy in the high value North American long-haul market; and
- Its ability to offer good quality access to several major oil producing regions, more than any of its competitor hubs in Europe to which Aberdeen is already, though much less well, linked.

In many ways, Aberdeen Airport offers an archetypal example of the kind of 'network' solution the CAA is advocating for regional air access. Whilst its economy exemplifies the kind of privately driven, high skill, high value and export focused approach which the Government is seeking to foster. With an economy dominated by the oil and gas sector, but seeking to diversify into 'new' sectors such as life sciences, and renewable energy, whilst increasing the international market for its tourism offer, geography makes high quality air 'connectivity' essential to the functioning of what currently is one of the most prosperous part of the UK and a major source of exports and tax revenues for UK plc. This requirement cannot be met adequately by reliance on foreign hubs or regional hubs elsewhere in the UK; continued high frequency access to Heathrow is demonstrably the key to maintaining access both to London, the number one World City, and to the wider global economy.

Analysis of the impact of cannibalisation of Heathrow slots on the point-to-point market to London, demonstrates the material impact continuation of laissez-faire policies will have on Aberdeen's economy. And that is before the deleterious affects reduced hub-connectivity that diminution of access to Heathrow from Aberdeen will have on:

- access to global markets for one of the UK's most important economic sectors;
- one of the few regional economic hotspots outside the South East of England; and
- on the Government's own future revenue streams, given that according to Oil and Gas UK, production from the UKCS in 2008 contributed £12.9 billion in corporate taxes, 28% of total corporation taxes received by the Exchequer.

<u>A Proportionate Policy Response</u>

There is, therefore, the need for DfT and Whitehall more generally to recognise the importance of maintaining, or even improving either in:

- supporting new runway capacity in the South East – ideally at Heathrow, but failing that at Gatwick or a new Thames hub airport and of facilitating regional access to it; or
- if no new runways are permitted – by pro-actively intervening in the existing slot market to iron out market distortions its own policies have potentially created for crucial regional air links to London such as those to Aberdeen.

Collectively, the regions making up the North of Scotland, alongside their counterparts in the far South West England and Northern Ireland, have a strong claim for a measure of prioritisation within the regional air access component of the Government's forthcoming aviation policy framework. This is because:

- High-speed rail will provide considerably improved access to London, and prospectively Heathrow or a new hub airport in the Thames, for all English regions except the far South West of England.
- HS2 will particularly benefit the Midlands and North of England and electrification of the Great Western Mainline could materially cut journey times from Bristol and South Wales.
- These schemes, will draw heavily on the Exchequer for their funding and therefore will be contributed to by taxpayers across the UK, including those in peripheral regions such as the North of Scotland for whom there will be little or no benefit.

In recognition of this and the duty Government has to provide adequate transport access and socio-economic connectivity, both within the UK and internationally, to all its citizens, HITRANS and Nestrans believe the UK Government should be willing to accept a small amount of prioritisation at the UK's hub airport and at Gatwick in order to guarantee fair and equitable treatment in terms of connectivity and market access for those living in more peripheral regions.

Such a policy does not require subsidy; the routes themselves are commercially viable. It therefore provides a well-targeted and low cost solution to the important problem of geographical remoteness, which the population and economies of peripheral regions such Aberdeen and the Highlands face.

Proposed Slot Reservations for the UK's Most Peripheral Regions

Airport	Heathrow		Gatwick	
	Current	Proposed	Current	Proposed
Aberdeen	11	11	4-5	5
Inverness	0	2	4-5	5
Belfast	9-10	10	9	10
Total	20-21	23	17-19	20

If for example, the slot reservations set out in the table above, were to be made at Heathrow and Gatwick for the UK's four most peripheral regions, the total claim on the slot portfolio at the two airports would be:

- Heathrow: 8,395 pairs of slots per annum, or 3,6% of currently available annual capacity (470,000 ATMs); and
- Gatwick: 7,300 pairs of slots per annum, or 5.6% of currently available annual capacity (265,000 ATM's).

The North of Scotland's share of that would be around half (ie. 1.9% and 3% respectively). This amounts to a very small policy intervention for maintaining viable transport connectivity between all parts of the Union and between the UK's peripheral regions and the wider world.

In this context, the Evidence Note also highlights that even though there are already high frequency High Speed Train (HST) services to Brussels and Paris from London offering attractive travel times for point-to-point journeys between these cities, air services on these routes still absorb 372 slots per week (or over 50 per day) at Heathrow alone, 10 times more than the extra slots needed to meet the service levels for UK peripheral regions proposed above.

Imposing some form of modest route based frequency cap on these routes, or others such as Amsterdam and Dusseldorf which should be reachable from London by HST within 3-4 hours, in conjunction with appropriate changes to the Government's regional air access guidelines and the slot allocation rules appertaining at Heathrow and Gatwick, would seem the most easily achievable, and least disruptive way of generating the small supply of additional slots required to meet the needs of the UK's most peripheral regions, while protecting those which already exist. As such, it represents in our view a proportionate policy response to what for the regions concerned is a critical infrastructural and economic issue and one which should also be of strategic importance to the UK as a whole.

Next Steps

The next stage of advocating adequate connectivity for our regions to world markets will focus on using the Evidence Note to support the case for ensuring the North of Scotland continues to have access to the key London hubs of Heathrow and Gatwick. Primarily this will see the note used as the HITRANS and Nestrans input to the Department for Transport Aviation Policy Consultation when UK Government launch this, hopefully later this year. The note will also be used to help inform key decision makers and in particular to encourage North of Scotland political figures to act as advocates to raise the Issues and endorse the proposals made through the Evidence Note. To support this process a short key issues paper will be prepared by MVA. This document is intended to be a 2 – 3 page summary of the Evidence Note with the main focus being on the recommendations of the paper. This document will underpin lobbying activities which will be undertaken by HITRANS and Nestrans over the next 6 months. This will focus on providing key decision makers in Westminster, Brussels and Holyrood, with an evidence based case for securing air connectivity for the peripheral regions of the UK to ensure that the long term economic competitiveness of these regions is not eroded for short term gain.

The information gathered in the Evidence Note has recently been used to inform correspondence that HITRANS have sent to British Airways urging their consideration of reinstating a service between Inverness and London Heathrow using a very small proportion of the large number of increased slot pairs that are now available to BA as a result of the International Airlines Group acquisition of bmi.

Recommendation

1. Members are asked to note the report.
2. Members are asked to approve the use of the Evidence Note to support HITRANS' response to the DfT Aviation Policy Consultation.
3. Members are asked to approve the use of the Evidence Note to support an influencing campaign in support of North of Scotland Air Issue remedies as identified in the Note.

Risk	Impact	Comment
RTS delivery	√	This research supports RTS objectives.
Policy	√	This research is designed to support delivery of our Aviation policy.
Financial	√	The cost of research has been met from within the Research and Development programme budget and attracts 50% partner funding.
Equality	-	No impact on Equalities issues.

Report by: Ranald Robertson
Designation: Partnership Manager
Date: 1st June 2012