

Report to Partnership Meeting 15 September 2017

CONSULTATION

Air Departure Tax (ADT) – Consultations on an overall 50% reduction policy plan

PURPOSE OF REPORT

This report invites Members to consider HITRANS draft response to the Scottish Government consultation on a 50% overall reduction of Air Departure Tax (ADT).

Summary

The Scottish Government is undertaking two public consultations relating to Air Departure Tax (ADT):

- Consultation 1: On the Scottish Government's policy for an overall 50% ADT reduction by the end of the current session of the Scottish Parliament;
- Consultation 2: On an assessment of the likely significant environmental impacts from the overall 50% ADT reduction policy (Strategic Environmental Assessment Environmental Report).

A copy of HITRANS proposed response to the consultations is included in **Appendix 1** attached to the end of this report.

Background

Air Departure Tax (ADT), a tax payable by aircraft operators and charged on the carriage of chargeable passengers on chargeable aircraft by air from airports in Scotland, is expected to come into effect in Scotland from 1 April 2018, replacing UK Air Passenger Duty.

As part of introducing the Air Departure Tax, the Scottish Government has committed to a 50% reduction in the overall tax burden by the end of the current session of the Scottish Parliament and also abolishing the tax when resources allow.

The Scottish Government believes that a 50% reduction in the overall burden of ADT by the end of the current session of Parliament will boost Scotland's air connectivity and economic competitiveness, encouraging the establishment of new routes which would enhance business connectivity and inbound tourism and help generate sustainable growth.

Important decisions have yet to be taken on how the overall 50% reduction could be delivered, including how the reduction will be distributed across tax bands (e.g. short-haul and long-haul flights) and tax rates and the profile of the reduction to ADT.

The Scottish Government is currently undertaking a Strategic Environmental Assessment (SEA) in relation to the overall 50% ADT reduction policy, in compliance with the requirements of the Environmental Assessment (Scotland) Act 2005, which requires that a SEA be carried out where a policy plan or programme is likely to have a significant environmental impact.

HITRANS response

A copy of HITRANS response to the two consultations relating to the Air Departure Tax is attached in Appendix 1. The response highlights a number of key issues including;

- HITRANS recognise aviation's role as a catalyst for business development and inbound tourism. That is both in the Highlands and Islands and Scotland as a whole. Reducing ADT will stimulate demand for air travel through lower fares. In turn, this will support both new routes and improved frequencies / timings on existing ones. We are, of course, keen to see these developments happen in the HITRANS area. However, we also recognise that international route development at other Scottish airports will also benefit the communities and economy of the HITRANS area. Thus, we support the reduction - and eventual abolition - of ADT as a means of achieving this.
- Reducing ADT on flights to / from the Highlands and Islands is particularly welcomed because of the vital role they play in the region.
- We are concerned that simply reducing the ADT rate for all Scottish airports could, in effect, reduce the compensatory benefits afforded to the region by the current exemptions. We assume that it is not Scottish Government's intention that reducing ADT should result in, effectively, a reduced recognition of the critical importance of aviation to the Highlands and Islands.
- We propose the following:
 - A. Complete removal of ADT from all internal Scottish scheduled passenger services.
 - B. Intervention to support continued route development in the Highlands and Islands.

Recommendation

Members are invited to;

1. Approve HITRANS response to the Scottish Government Consultations;
 - a. On the Scottish Government's policy for an overall 50% ADT reduction by the end of the current session of the Scottish Parliament;
 - b. On an assessment of the likely significant environmental impacts from the overall 50% ADT reduction policy (Strategic Environmental Assessment Environmental Report).

RTS Delivery

Impact - Positive

Comment – This work supports RTS Strategic priority enhance regional and intra-regional connectivity

Policy

Impact - Positive

Comment – This work supports development of the Aviation policies set out in the RTS.

Financial

Impact – Positive

Budget line and value – N/A

Equality

Impact – Positive

Comment – Improving Regional and Inter-regional connectivity helps improve the competitiveness of business across the Highlands and Islands

Report by: Neil MacRae

Designation: Partnership Manager

Date: 6th September 2017

Background Paper – Appendix A Draft HITRANS Response to ADT Consultation

Appendix A - Draft HITRANS Response to ADT Consultation

Consultation 1: The Scottish Government's policy for an overall 50% ADT reduction by the end of the current session of the Scottish Parliament

1. Do you support the Scottish Government's policy plan to reduce the overall burden of ADT by 50% by the end of the current session of the Scottish Parliament?

Yes

HITRANS recognise aviation's role as a catalyst for business development and inbound tourism. That is both in the Highlands and Islands and Scotland as a whole. Reducing ADT will stimulate demand for air travel through lower fares. In turn this will support both new routes and improved frequencies/timings on existing ones.

We are, of course, keen to see these developments happen in the HITRANS area. However, we also recognise that international route development at other Scottish airports will also benefit the communities and economy of the HITRANS area. Thus, we support the reduction-and eventual abolition-of ADT as a means of achieving this.

Reducing ADT on flights to/from the Highlands and Islands is particularly welcomed because of the vital role they play in the region. This reflects:

1. Long distances that have to be travelled to/from main centres in Scotland and elsewhere in the UK.
2. The long journey times these require when using surface transport. For many HITRANS area communities the alternatives to air are slow and often infrequent ferry services.
3. Air is especially suited to certain types of journey. In particular, day trips, urgent trips (e.g. in times of illness/bereavement), and connecting with an onward flight at another airport.
4. The need to access personal services (e.g. health, legal advisors)-and for companies-markets and business partners-not available in the local area.
5. Given the need to access services and markets elsewhere, that flights are used by many members of the community rather than confined to more prosperous ones.

HITRANS recently commissioned independent research into the value of transport. The draft report concludes that there is good evidence of the economic benefits of smaller and regional airports. It states that:

"...there seems a consensus in the literature that employment and population growth seems most prevalent for airports in rural or remote regions...that increasing air services leads to economic growth in peripheral regions in the US and remote, rural or regional airports in Australia. Small airports also have a positive impact on both economic activity in their locality and on regional per capita income (productivity)"

The crucial importance of aviation to the Highlands and Islands is recognised in current APD arrangements. That is, through the exemption for departing flights from Highlands and Islands airports. The exemption covers both internal Scottish and cross-border flights.

As well as benefiting passengers, the exemption also helps create more of a level playing field with Scotland's largest airports in terms of route development. That is by helping to sustain/strengthening existing routes and support the introduction of new ones.

We are concerned that simply reducing the ADT rate for all Scottish airports could, in effect, reduce the compensatory benefits afforded to the region by the current exemptions. We assume that it is not Scottish Government's intention that reducing ADT should result in, effectively, a reduced recognition of the critical importance of aviation to the Highlands and Islands.

These issues are developed further in our response to the second consultation question below.

2. **Please provide any suggestions you may have on the most effective way, in your view, in which a 50% reduction in the overall ADT burden should be applied across tax bands and tax rate amounts in order to achieve the Scottish Government's overall connectivity and sustainable growth objectives. For example, should: (a) all of the ADT reduction only be applied to short-haul flights; (b) all of the ADT reduction only be applied to long-haul flights; (c) ADT be reduced equally by 50% across all flight types; (d) some other differential combination be applied?**

We propose the following:

- C. Complete removal of ADT from all internal Scottish scheduled passenger services.
- D. Intervention to support continued route development in the Highlands and Islands.

The case for each is set out below.

A Zero rated ADT on internal Scottish scheduled passenger services

1

The essential role of air services for communities in the HITRANS area was described in our response to Question 1. A zero ADT rating in both directions of travel (not simply from a HITRANS area airport) would fully recognise this essential role.

It would also bring practice into line with other mechanisms that recognise the need to reduce fare costs. For example, ADS applies to both legs of a return flight, while Road Equivalent Tariff ferry fares apply on both legs of a return crossing.

2

The surface alternatives for accessing main centres in Scotland are much poorer than those available in most other parts of the country. This is illustrated in below.

Trip	Air		Ferry/Car	
	Weekday Frequency	Journey time (Hours-Minutes)	Weekday Frequency	Journey time (Hours-Minutes)
Tiree to Glasgow Airport	2 flights	0-55	1 sailing	6-00
Stornoway to Glasgow Airport	7 flights	1-00	2 sailings	7-00

This illustrates the much longer journey time, and limited frequency, of ferry crossings compared to air. For both Tiree and Stornoway the flights allow a day trip in either direction. Thus, air is the only viable means of undertaking some journeys.

3

Independent research commissioned by HITRANS (e.g. into the case for restoring ADS to business flights) has consistently found that fare levels are by far the main barrier to use of the internal air services. That is the case for all user types-residents (even allowing for ADS), business travellers and inbound tourists.

While very welcome ADS still leaves many fares above those on similar length domestic flights elsewhere in the UK. This reflects the very much thinner markets for internal Scottish routes and, consequently, the use of small aircraft.

Removing ADT will help to address these issues. It will lower air fares for what, in many cases, are essential trips rather than discretionary ones. Additional demand could strengthen the existing air services, with potential for increased frequencies.

4

By stimulating demand, removing ADT could help sustain the thinnest commercial routes that operate in the Highlands and Islands. These are ones that, while providing valuable connections to main centres, are operated by smaller aircraft often with low passenger loads. For example, Benbecula-Inverness and Wick-Edinburgh.

5

Lower fares will also sustain and stimulate demand for flights which connect with international services at Aberdeen, Edinburgh, Glasgow and Inverness. That will be on existing international routes and new ones introduced following the reduction of ADT.

Thus, lower fares on the internal flights will contribute to increased traffic levels on Scotland's international services. That will be, first, from additional flights by local residents and businesses.

Second, more flights by visitors to Scotland through allowing them more affordable access to the HITRANS area. This will contribute to dispersing visitors across Scotland.

6

Rather than a drain on other public spending, the removal of ADT on internal flights will help increase the impacts of investments by Scottish Government, HIE and other organisations in the HITRANS area. That will be through addressing the critical issues of transport services and transport costs, thus increasing the economic impacts of public investment in businesses, tourism facilities, etc. by providing more affordable access.

The consultation document identifies *Internationalisation* as one of the four priorities which underpins Scotland's Economic Strategy. Another of the Strategy's priorities is *Inclusive Growth*, which it defines as including:

“regional cohesion to provide economic opportunities across all of Scotland”

Removing ADT from internal flights will help to contribute to this priority. It will thereby increase the HITRANS area's contribution to sustainable economic growth in Scotland.

B Intervention to support continued development of Highlands and Islands air routes

1

It is recognised that cross border flights from Inverness cannot be considered “lifeline” services. However, they are vital to the communities and economy of Inverness Airport’s catchment and some other parts of the HITRANS area.

This reflects, first, the distances from the catchment area to main centres in the UK and abroad. For example, a car journey from Inverness Airport to Heathrow Airport takes more than nine hours. By train it is between 8 and 11 hours, with only two direct services per day. Clearly these journey times are not viable for many trips to/from London. That is particularly the case for business passengers.

2

Businesses in the Inverness Airport catchment are very reliant on external markets. This reflects that its population is just 320,000 providing only a small consumer and business base.

Key sectors have developed based on large external sales and international ones in particular. For example, the exports of Food and Drink products such as salmon, whisky and bakery products to both UK markets and overseas. Life Sciences, another growing sector is highly internationally focused; as it is across Scotland as a whole.

Therefore, air has a crucial to play in connecting local businesses to their customers. This is in addition to connections with suppliers, advisors, partners and funders-some of whom will look to travel to the area to meet with local companies.

Tourism is another sector of the economy where the Inverness Airport catchment area performs strongly. Visit Scotland data show the Highlands area receiving the third highest number of overseas visitors in 2015-behind only Edinburgh and Glasgow.

It has also historically been the case that Inverness Airport is one the few in the UK that sees more *inbound* leisure visitors than *outbound* ones. Thus, the Airport makes a positive net contribution to tourism.

Improved international connections will benefit the key sectors of the local economy. As well as direct services that would include existing flights to key hubs. These are Heathrow (particularly for the key North American market) and Amsterdam (for connections to/from the east).

The importance of hub connections are illustrated in Highlands and Islands Enterprise’s current Operating Plan. It states that, to support Scottish Government’s Internalisation priority, HIE will seek to:

“Influence the development of connectivity into the region with a focus on air routes to international hub airports

3

The small population and economy of its catchment means Inverness finds it much harder than the main Scottish airports to build up a cross border route network that meets the needs of its economy and residents.

As a result, many air trips that start or end in the catchment area use a Scottish airport other than Inverness. Based on CAA data it has been estimated that nearly 500,000 passengers “leaked” from Highland and Moray to other Scottish airports in 2013.

This means additional travel time for those who use these other Scottish airports. By car it is over 2 hours from Inverness to Aberdeen Airport and around 3 hours 20 minutes to reach Glasgow Airport. This is an inefficient use of travellers’ time-particularly for business passengers.

Inverness’ route network has grown over time. Yet many of its cross-border routes continue to operate at just one return flight per day-and often at non-business friendly times. These include Heathrow, Dublin and Birmingham.

The underlying potential for further growth at Inverness is clear from recent trends. Terminal passenger numbers rose from 611,000 in 2014 to 782,000 in 2016, an increase of 28%.

An enhanced route network from Inverness would reduce the number of passengers leaking to other Scottish airports. This would have the benefits of:

- a. Reducing the number of surface journeys to these other airports, saving passengers’ time and also reducing surface transport emissions.
- b. Allowing visitors to spend longer in the HITRANS area. That is because their journey to/from Inverness Airport is shorter than travelling to one of the other three Scottish airports.
- c. Stimulating additional visitor trips to the area-and possibly Scotland as a whole-by allowing direct air access to their Scottish destination of choice (i.e. the Highlands).

The HITRANS area already makes a significant contribution to Scottish Government’s Internationalisation priority. However, Inverness Airport has underdeveloped links to main UK centres. The importance of strengthening these also needs to be recognised within the objectives of a lower ADT.

An enhanced cross-border route network should include international connections (both direct and via major hubs) *and* improved UK services. Improving domestic connections is much less of an issue for Aberdeen, Edinburgh and Glasgow. However, it is vital to Inverness Airport’s catchment area.

Overall, there needs to be continued recognition of the:

- Difference in the current levels of air connectivity at Inverness and those from main Scottish airports; and
- Challenges Inverness faces in developing a route network that more fully meets users’ needs.

There is concern that the in ADT reduction will be of less benefit to the Highlands and Islands given the exemptions currently in place. It can be argued that the current exemptions provide a more level playing field for Inverness’ route development. This would be lost if ADT is simply reduced across Scotland with no consideration of other means of supporting route development at Inverness.

There are already a number of forms of support given to Highlands and Islands air services. Therefore, further thought would need to be given to the size and nature of an intervention to support route development, in tandem with the ADT reduction. This would require the input of Scottish Government and Highlands and Islands stakeholders to considering the best means of support.

At this time our suggested intervention is the one set out in the HITRANS response to 2016's "A consultation on a Scottish replacement to Air Passenger Duty", as follows.

The UK Government has a Regional Air Connectivity Development Fund (RACF), which has been cleared with the EU. It is of relevance to Scotland for certain route development propositions. However it is possible that the Highlands and Islands could develop its own parallel and potential matching route development fund. This could be based around the already approved RACF format, but with criteria for support that fit the region's needs. At this time we suggest that it could cover:

- Cross-border services to key hubs.
- Cross-border short haul routes to main centres, which currently have limited frequency and/or suboptimal timings.
- Adding to/strengthening the stock of internal Scottish air routes.

As set out in our 2016 response we do not anticipate that State Aid concerns would be inhibitory. That is because the following EU categorisations can be used as a basis to build intervention cases:

a. Development Regions

Article 107(3)(a) of the Treaty provides that:

"aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation"

may be considered to be compatible with the internal market.

According to the Court of Justice:

"the use of the words abnormally and serious in Article (107)(3)(a) shows that the exemption concerns only areas where the economic situation is extremely unfavourable in relation to the [Union] as a whole"¹

In the UK context DfT² appears to accept Assisted Regions status (such as the Highlands and Islands hold) as significant in this regard.

¹ 23.7.2013 Official Journal of the European Union C 209/25 EN

²https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266383/pso-policy-guidance.pdf

b. Islands

The European Union's Consolidated treaty in Article 174 recognises that special attention should be given to the specific characteristics of territories with serious and permanent handicaps. This recognises that they have more limited options (e.g. modes of transport and constraints on economic activities) and that these matters should be taken into account in the implementation of the single market.

c. Sparsely Populated / Low Population Density Areas

Regions with low population densities can fall within the definition of "least populated regions" as set out in Regional Aid Guidelines. If these regions are also facing depopulation there is potential for further derogation of state aid rules.

C Summary

The issues covered above are summarised below.

Zero rated ADT on internal Scottish scheduled passenger services
1. Essential role of internal air services-many trips are necessary rather than discretionary
2. Surface transport alternatives are slow and infrequent, in a context where many trips are over a long distance
3. Air fare levels are by far the main barrier to increasing demand. Growth in demand from reduced fares could help increase frequencies on existing routes
4. Additional demand from reduced ADT could help sustain the thinnest internal commercial routes
5. Lower fares will stimulate demand for flights which connect with Scotland's international air routes, supporting their sustainability
6. Addressing the key issue of air transport services and air fares will increase the return from other public investments in the HITRANS area's economy. Zero ADT will contribute to achieving Scottish Government's <i>Inclusive Growth</i> priority

Intervention to support continued development of Highlands and Islands air routes
1. Cross-border services from Inverness are not "lifeline"-but they are vital to the economy. Reflects the long distances to main centres and very long journey times by surface transport
2. High reliance on external markets given the small local consumer and business base in Inverness Airport catchment area
3. Size of local consumer and business base makes it much more difficult to develop an Inverness route network that meets users' needs. Results in large leakage of trips to other Scottish airports. This has negative impacts on efficiency of travel, surface transport emissions and levels of visitor activity. Recognition of the different issues facing Inverness compared to the three main Scottish airports needs to continue-and the issues addressed.
4. A general ADT reduction would mean even less of a level playing field in terms of route development compared to the three main Scottish airports. Therefore, need for an intervention to specifically support route development in the Highlands and Islands

These initiatives would, along with ADT reductions in other parts of Scotland, allow Scottish Government to maximise achievement of its strategic objectives for air connectivity and sustainable economic growth.

Consultation 2: An assessment of the likely significant environmental impacts from the overall 50% ADT reduction policy (Strategic Environmental Assessment Environmental Report).

We recognise that the SEA is a relatively high level exercise and does not provide analysis at an area or airport specific level. However, some additional contextual information would be useful regarding what the consultation document terms “four of Scotland’s main airports”- i.e. Edinburgh, Glasgow, Aberdeen and Inverness.

We are concerned that the document does not describe the different existing positions at the four airports. Without this context some readers may assume that Inverness Airport’s passenger numbers-and environmental impacts-are broadly on a par with the other airports. Clearly, that is not the case.

The consultation document states that in 2015 the four airports accounted for 94% of total passenger numbers at Scottish airports. However, it would have been useful to have noted that Inverness accounts for a very small share of that total (i.e. less than 5%). CAA data for 2016 show Inverness with c0.8 million terminal passengers in 2016. That is greatly below the levels at Edinburgh (12.3 million) Glasgow (9.3 million) and Aberdeen (3.0 million).

Further useful context could have included discussion of the types of aircraft used on Inverness services, the altitudes at which they operate and the number of air traffic movements. The broad environmental implications of Inverness’ activity compared to that at the other Scottish airports could then have been spelled out.

As noted earlier further route development at Inverness would claw back some of the air trips that leak to other Scottish airports. This would give a beneficial environment impact through reduced surface transport emissions. These would result from more passengers being able to fly local rather than making longer surface journeys to Aberdeen, Edinburgh or Glasgow.