PURPOSE OF REPORT
To provide the Comhairle with the background to the establishment of the Air Discount Scheme, with details of other fare support mechanisms utilised in the EU, and with an update on the suggestion that a Public Service Obligation (PSO) air service be established between Benbecula and Glasgow.

COMPETENCE
1.1 There are no legal, financial, equalities or other constraints to the recommendation being implemented.

SUMMARY
2.1 The Comhairle agreed in September 2017 that the Director of Technical Services provide a Report “detailing aspects of the Air Discount Scheme and Public Service Obligation air service fare support mechanisms” and “subject to a response from the Transport Minister to a letter from Dr. Alasdair Allan, MSP regarding the suggestion of a PSO on the Glasgow/Benbecula route, agree that the Director address options for this proposal in the above Report”.
2.2 This Report provides a summary of the proposal developed by the Highlands and Islands Strategic Transport Partnership (HITRANS) which sought the establishment of a network of Public Service Obligation (PSO) air service bundles across the region. The proposal identified that, by reducing fare levels by one third, by improving schedules and increasing the frequency of services, traffic in the region was forecast to increase by some 90%.
2.3 The implementation of the improved network and service arrangements was proposed by HITRANS to the Scottish Executive in 2004. In 2006 the Scottish Executive announced in 2006 its intention to establish the Air Discount Scheme and the Minister for Transport and Islands, Derek MacKay MSP, announced in February 2015 that the Scheme was to be extended until 31 March 2019.
2.4 With regard to the reinstatement of business user eligibility, Scottish Government’s Empowering Scotland’s Island Communities Prospectus confirmed that the “Scottish Government notes the wishes of the Island Councils for the scheme to be extended to include certain types of business travel” and “invites the Councils to produce a costed and legally compliant business case for consideration by the Scottish government”.
2.5 As reported previously to the Comhairle, the campaign seeking the reinstatement of eligibility for business users of the ADS was only partially successful. Whilst it appears that Scottish Government are now accepting of the legal argument for its reinstatement, the unaffordability of what is proposed remains a currently unsurmountable hurdle.
2.6 The scale and nature of PSO air services across the EU are described in the body of the Report, including a full list of these services at December 2014 as detailed in Appendix 1 to the Report.
2.7 A number of parties continue to press Scottish Government to establish a Public Service Obligation (PSO) air service on the Glasgow to Benbecula route. A copy of the most recent response from the Minister for Transport and the Islands to Dr Alasdair Allan MSP is included as Appendix 2 to the Report and from this it can be seen that “given the commercial nature of the current service, [Scottish Government] have no plans to impose a Public Service Obligation (PSO) on the Benbecula to Glasgow service”.

RECOMMENDATION
3.1 It is recommended that the Comhairle note the Report.

Contact Officer: Iain Mackinnon, 01851 822656 and Ext 211466
Background Papers: None
Appendices: 1 EU PSO Air Services (April 2017)
            2 Letter from Minister for Transport and the Islands; 19 September 2017
4.1 The Report “An Expanded Air Services Network for the Highlands and Islands”, prepared by the Air and Travel Consultancy (A&TC) on behalf of the Highlands and Islands Strategic Transport Partnership, was published in February 2003.

4.2 In 2001, the network of scheduled air services linking the ten airports of the Highlands and Islands to the Scottish Mainland cost approximately £22.4 million to operate ‘empty’, before allowing for the marginal costs of carrying the then current level of 383,000 passengers a year.

4.3 It was estimated that the net passenger revenues on these routes, having deducted the same marginal costs, was of the order of £24 million, suggesting that the routes overall were marginally profitable for the airlines. Certain routes were calculated to be significantly profitable, while many of the smaller routes incur operating losses.

4.4 At the same time, there was a general consensus that fare levels on these routes were very high compared to other domestic routes and that they were holding back the economic and social development of Scotland’s peripheral regions. Growth of air traffic in the Highlands and Islands had been stagnating for many years while traffic to and from lowland Scotland had continued to grow apace.

4.5 It was identified that fare levels were high because the average costs of operating scheduled services in this region were high for two main reasons. Firstly, the low density of demand required the use of small aircraft in order to provide the frequency of service needed - the cost per seat-mile of a 30-seat turboprop is significantly higher than that of a 150-seat jet. Secondly, the average annual hourly utilisation of aircraft in this region is severely compromised by the current opening hours of many of the regional airports, caused in part by the high cost of staffing them to CAA standards.

4.6 The study sought to determine the cost to society of breaking this vicious spiral and converting it into a virtuous spiral of economic growth and improving levels of social inclusion.

4.7 In October 2002, A&TC presented the findings of its ‘Cost Modelling Study for Air Services in the Highlands and Islands’ to HITRANS.

4.8 The main purpose of this pilot study was to determine the aircraft operating costs on five major, representative air routes within the Highlands and Islands and to assess the impact of reducing air fares by a substantial proportion, of improving the schedules and of increasing the frequency of flights. The five routes, each of which would possibly become the subject of Public Service Obligation orders (or PSOs), were Sumburgh to Aberdeen, Kirkwall to Inverness, Wick to Edinburgh, Stornoway to Glasgow and Islay to Glasgow.

4.9 The study concluded that, on the specific assumptions made, the annual subsidy required to operate these five major routes at the desired frequencies and fare levels was of the order of £2.0 to 2.8 million. On this basis, the Report concluded that adding in all other significant intra-Scottish routes to and from Highlands and Islands airports might cost an additional £5.0 to 8.0 million a year. It was assumed that the £1.0 million subsidy (through PSO) to routes from Barra, Tiree and Campbeltown would continue, giving a total annual subsidy requirement in the region of some £8.0 million to £11.8 million.
4.10 Upon consideration of this pilot study, HITRANS commissioned A&TC to extend its study to cover all intra-Scottish routes, and this Report contains the methodology, assumptions and conclusions of that second Study.

4.11 A copy of the full Report and its appendices, published in February 2003 and updated in March 2004 is available on request from the Director of Technical Services and online using the links:

https://hitrans.org.uk/Documents/Expanded_Air_Services_Network_Volume_I_-_Text.pdf

and

https://hitrans.org.uk/Documents/Expanded_Air_Services_Network_Volume_II_-_Appendices.pdf

4.12 The 2004 Report sets out an assessment of costs and revenues on the operations and yields at that time and estimates the impact of reducing fares on demand levels. The report provides detail of a proposed PSO route network, assesses the costs and revenues of the proposed network at the anticipated yields and then presents assessments of additional subsidy needed and the level of capital funding and revenue funding required.

4.13 The study concluded by estimating that the total cost of operating a significantly expanded network of air services in the Highlands and Islands would be likely to cost around £43 million a year, up from the 2003 levels of around £25 million.

4.14 The proposed network was assessed as being profitable, although there were several routes that are believed to make significant losses. By reducing fare levels by an average of one third, by improving the schedules and increasing the frequency, air traffic within the region was forecast to increase by some 90%.

4.15 The overall network loss was forecast to be around £11.9 million in 2005, reducing to around £8.5 million by 2008. Long-term losses are estimated to be in the region of £9 – 10 million annually. The net impact upon continuing subsidy requirements is likely to be only half this level, after allowing for existing PSO payments, the improvement in HIAL’s operating results and the decrease in Government-funded air travel costs throughout the region. Finally, these continuing, or ‘revenue’, subsidy requirements do not include any additional ‘capital’ expenditure on necessary infrastructure improvements.

4.16 The results of the study were presented to representatives of the Scottish Executive in February 2003 with the case for a PSO network being made on the basis of:

- Investing in PSOs makes economic sense
- Transport subsidies in Scotland are already made for rail; road; ferry; HIAL, Barra, Campbeltown and Tiree flights to Glasgow; and Inter-island flights
- The principle of transport subsidy to facilitate economic development is already well established in Scotland.
- Full economic impact still needs to be measured
- The principal of providing significant support to air services for broader economic gain is well established in the USA and other EC countries
- Delivers higher quality, improved access compared to others forms of transport on similar sectors
- Better potential return per £ invested by SE
• Improved service integrity, increased accessibility, improved reputation and confidence = increased traffic
• Establishes a virtuous spiral – traffic – economy – social inclusion
• Is consistent with the aims of the new route development fund
• Supports Government’s policy priorities

4.17 Further work was commissioned by HITRANS which included a review of all costs taking on board the outcomes of dialogue with existing operators, including Loganair, and the production of a sensitivity analysis. In addition, following consultation with the European Commission Directorate General for Energy and Transport and noting the outcomes of a study at that time of Norwegian PSOs, A&TC recommended dividing the proposed network into four geographically based bundles which could be tendered separately:

• Shetland comprising five daily rotations from Sumburgh to Aberdeen; three rotations to Inverness; two to Edinburgh; and two to Glasgow via Kirkwall.

• Orkney comprising five daily rotations from Kirkwall to Aberdeen; three to Inverness; and three to Edinburgh; this bundle would also serve Wick with two rotations to Glasgow; two to Edinburgh; one to Aberdeen and one to Inverness

• Western Isles comprising four daily rotations from Stornoway to Glasgow; five to Inverness; two to Edinburgh (note the mid-day Edinburgh bmi jet service was not included in the PSO); and one to Aberdeen. This bundle will also provide two rotations from Benbecula to Glasgow and two to Inverness; and two rotations from Barra to Glasgow.

• Argyll and Highland comprising three daily rotations Campbeltown to Glasgow; three from Islay to Glasgow; two from Oban to Glasgow and one from Oban to Inverness; two from Skye to Edinburgh; three from Inverness to Glasgow and three Inverness to Edinburgh.

4.18 A phased approach to the introduction of a PSO network was proposed and Justifications and Specifications, enabling their administration by the Scottish Executive in anticipation of their approval, were drafted by HITRANS.

4.19 The Board agreed in April 2004 that a formal request be submitted to the Scottish Executive to proceed with applications for PSOs for the Shetland, Orkney and revised Western Isles bundles, as described above, in terms of the justifications and specifications drafted and that a meeting should be requested with the Minister to press for early consideration of this request.

SCOTTISH GOVERNMENT AIR DISCOUNT SCHEME

5.1 Following its consideration of the representations by HITRANS and others, the Scottish Executive announced in 2006 its intention to establish the Air Discount Scheme, the key elements of which were set out in Notification N169/2006. A paper copy of this, along with subsequent prolongation notices, are available on request from the Director of Technical Services and using the following link:

5.2 On its introduction, the main aim of the ADS was, and remains, to make air services affordable for remote communities in the Highlands & Islands and facilitate accessibility and social inclusion by providing a discount of 40% on the core air fare on certain eligible routes.

5.3 With regard to eligibility, anyone whose permanent/main residence is in Colonsay, Orkney, Shetland, the Western Isles, Islay, Jura, Caithness and North West Sutherland is eligible. In addition registered Third Sector organisations who have employees/volunteers that have their permanent/main residence in an eligible area can take advantage of the Scheme.

5.4 Conversely, those who are currently not eligible under the Scheme are:

- People whose residence is not in the eligible geographic area, except students that are studying away from home and their main residence is in an eligible area
- People travelling on Public Service Obligation (PSO) flights
- People travelling for the purpose of business. Business related travel is considered any journey where there is a business component, regardless of whether there is also a leisure-related component
- People travelling on NHS-funded trips
- Anyone in the eligible geographic area who does not have a live, valid card

5.5 The Minster for Transport and Islands, Derek MacKay MSP, announced in February 2015 that the Scheme was to be extended until 31 March 2019.

5.6 As reported previously to the Comhairle, the campaign seeking the reinstatement of eligibility for business users of the ADS was only partially successful. Whilst it appears that Scottish Government are now accepting of the legal argument for its reinstatement, the unaffordability of what is proposed remains a currently unsurmountable hurdle.

**PUBLIC SERVICE OBLIGATIONS IN THE EU**

6.1 In the context of air services, a Public Service Obligation is “any obligations imposed upon an air carrier to take, in respect of any route which it is licensed to operate by a Member State, all necessary measures to ensure the provision of a service satisfying fixed standards of continuity, regularity, capacity and pricing, which standards the air carrier would not assume if it were solely considering its commercial interest”.

6.2 The scale and nature of current air service PSOs across the EU is included as Appendix 1 to the Report and are summarised in Table 1 below:
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<th>Country</th>
<th>No of PSO Air Services</th>
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<td>Greece</td>
<td>28</td>
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<td>France</td>
<td>40</td>
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Table 1: PSO Air Services

6.3 Of the 22 PSO Air Services in the United Kingdom, 18 are within Scotland operated by Transport Scotland and local authorities including the Comhairle Orkney, Shetland and Argyll and Bute Councils. Two PSO air services are operated in England and Wales and a single PSO air service operates between Dundee and London Stanstead.

GLASGOW – BENBECULA AIR SERVICE

7.1 Whilst the responsibility for inter-island air services, such as that between Stornoway and Benbecula, lies with the respective local authority, the responsibility for regional air services, ie those between the islands and the mainland, lies with Scottish Government.

7.2 A number of parties continue to press Scottish Government to establish a Public Service Obligation (PSO) air service on the Glasgow to Benbecula route. A copy of the most recent response from the Minister for Transport and the Islands to Dr Alasdair Allan MSP is included as Appendix 2 to the Report and from this it can be seen that “given the commercial nature of the current service, [Scottish Government] have no plans to impose a Public Service Obligation (PSO) on the Benbecula to Glasgow service”.

7.3 The Minister confirms that a PSO would only be considered if the existing commercial operator, Loganair, ceased to operate the service and an alternative operator could not be found.