



## Is air transport a necessity for social inclusion and economic development?

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Aviation policy makers are faced with the challenge of facilitating growing air travel in such a way that it meets environment objectives and the need to provide socially necessary air services. Various incentives have been offered to encourage the launch of new air routes or sustain existing services, such as public service obligations and the Route Development Fund. This paper provides an overview of an independent evaluation of the funding mechanism in Scotland and highlights the difficulties faced analysing the effects of the scheme and challenges faced by policy makers in making robust policy intervention decisions, given the uncertainty surrounding their effects. The results suggest that the Fund has significantly increased passenger flows and travel conditions for business and leisure passengers, and increased the gross value added impact to the wider Scottish economy.

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### 1. Introduction

With the rising chorus of calls for policy makers to implement measures to reduce the demand for air travel it might appear perverse for Governments to be seen to promote air transport. One consequence of deregulating Europe's airline industry has been the need to provide direct subsidies to ensure the continuation of air services to remote communities, previously cross-subsidised by profits from busier routes of the same airline. This situation was brought to an end by the introduction of the EU "Third Package" in 1993 and its extension to domestic services in 1997 (Williams, 2005). Policy makers addressing the needs of more remote regions are faced with conflicting pressures to provide opportunities for air travel.

Provisions exist for EU governments to tender air services which are deemed to be socially necessary but are not provided commercially. The package of measures also includes provision for the member states to impose 'public service obligations' on low-density routes which were deemed necessary for the purposes of economic and regional development (Reynolds-Feighan, 1995a). In the UK this has been a feature of policy for many years for markets that focus on socially necessary services. The designation of Public Service Obligation (PSO) status has become increasingly common in Europe since 1993 following establishment of the Essential Air Services (EAS) was introduced in the US in 1978. Provisions exist for

governments to tender for air services deemed socially necessary which cannot be provided commercially. Within the European Union these are subject to rules on subsidies to air transport.

Regulation, nevertheless, increasingly restricts the opportunity for providing such support. A recent scheme is the Route Development Fund (RDF), implemented in Scotland and then in other parts of the UK. The difference between RDF and other support mechanisms such as the designation of Public Service Obligation (PSO) status is its focus on underpinning development of new potentially viable routes. In contrast, a key objective of PSO support is to promote social inclusion. The overall aim of the RDF has been to provide incentives to initiate new direct links that benefit the overall economic development of the region. While new routes are ultimately expected to be financially self-supporting the RDF facilitates initial sharing of risk between airports and airlines. The overall objective of this paper is to provide evidence of the robustness of the case for the RDF scheme within the wider context of support mechanisms generally. The paper is informed by an independent evaluation of the RDF routes in Scotland.

### 2. Impact of direct air services

#### 2.1. Connectivity and economic growth: key considerations

Numerous studies have confirmed a link between the provision of connectivity through transport networks and economic growth, although few have strictly examined the path of causality. Inter-urban and international connections enable the development of new production processes and, being able to nationally or

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internationally trade, regions and/or countries will benefit from the increase specialisation in the production of goods and services (Eddington, 2006).

Air transport drives and facilitates wider economic activity through connectivity. McQuaid et al. (2004) on the basis of a comprehensive review of literature on business location worldwide claim, "...that good air connectivity is vital to businesses operating on an international scale, and for the development of 'world cities' as business locations".

A significant factor influencing the propensity for travel is 'affordability'. Low cost carriers (LCC's) in particular have widened inclusion, access and have created opportunities to travel. In some cases air transport is the only realistic means for a person from a small community to travel. Reconciling these claimed benefits with the challenges posed by climate change as well as the implications for competition posed by such policy interventions are ones that the paper will explicitly address. It includes a commentary on the sustainability of such an initiative and observations on its performance compared to other related policy levers in the air transport sector.

## 2.2. Connectivity, aspirations for direct routes and environmental concerns

Although major cities, such as London, are able to support a wide network of air services other locations may have a more limited offering. This means that for many city pairs without direct air services either long surface journeys are needed to access an airport with a suitable operation or a connection is required between two flights at an intermediate hub. For example, Scotland's Aberdeen airport offers services to the London airports, Manchester and a few European centres. To travel to New York or Rome requires a surface journey (e.g. to Edinburgh or Manchester) or a transfer connection over Heathrow or Schiphol. For an even smaller location, such as Kirkwall (Orkney), it is typically necessary to travel first to a location, such as Aberdeen, before accessing the wider air network that may, therefore, require two changes of aircraft producing negative time and price penalties that create a deterrent to travel.

For this reason, airports, communities and governments have been anxious to see the establishment of more direct air services from airports serving remote settlements, peripheral regions and locations in the 'traffic shadow' of larger neighbours (Pagliari, 2005). This typically requires financial or other incentives to be offered to airlines to address the limited viability of a commercial operation (Pagliari, 2003).

There is, however, much controversy surrounding growth in air travel and its implications for the environment, in particular climate change, but also local air quality and noise disturbance around airports (Eddington, 2006). The outcome of this debate in terms of policy and regulation will have significant implications, particularly for those locations dependent on air for access for business and tourism, as well as social needs. Failure to adequately address the potential losses attributable to not accommodating the growth in air travel would have serious ramifications for tourism and business that rely on world markets (Shaw and Thomas, 2006).

## 2.3. The macro-economic case for enhancing network connectivity

Air transport is not only a substantial employer but also an important enabler for businesses to operate in an increasingly globalised marketplace. Access to air services is can be an requirement for communities to preserve and enhance their economic standing. Air transport also drives and facilitates wider economic activity through connectivity.

Air transport underpins international trade, promoting growth and raising living standards by allowing countries to specialise goods and services for which they enjoy a comparative advantage (Oxford Economic Forecasting, 2006). Nearly two-thirds of UK companies report that passenger services are either vital or very important for sales and marketing. Air services are particularly important for the UK's trade with the fastest-growing regions of the world economy, including India and China, and are likely to become even more important to UK's competitiveness in the world economy. Fifty-five percent of the UK's exports by value of manufactured goods to countries outside the EU are transported by air. Many imports depend on air services. More than 60% of imports of machinery, mechanical appliances and electric equipment from outside the EU are carried by air. Aviation also supports the tourism sector with nearly three-quarters of international visitors to the UK arrive by air; 87% in the Scottish case (Strategic Research Department, 2007). Spending by visitors who arrive by air is equivalent to 1.1% of UK GDP and generates around 170,000 jobs across the country. Tourism accounts for 9.2% of all employment in Scotland. Increased air services are likely to be needed if the government is to achieve growth in tourism by a third by 2010 and a 50% growth by 2015 for Scotland.

## 2.4. Social inclusion and network expansion

A significant factor influencing the propensity for travel is 'affordability'. Baum (2006) has reviewed the claim that LCCs have widened inclusion, access and have created opportunities to travel. In some cases air transport is the only realistic means for a person from a small community to travel. There are some peripheral regions that are highly dependent on the provision of air transport (Pagliari, 2003). Omitting such services could inhibit movement, keep families apart, and suppress business and tourism growth (COSLA, 2002). Air travel has raised people's expectations; therefore failure of markets and lack of state intervention would raise fares and reduce availability to low income groups either for holidays/short breaks, visiting friends and relatives, education, culture/religion and other personal travel (Shaw and Thomas, 2006).

'Affordability' is an issue not only for social inclusion but is also of significance for businesses, in particular small businesses and tourism. A UK Civil Aviation Authority (2006) report showed that approximately a fifth of low fare airline passengers are business travellers, indicating that they are also taking advantage of lower fares and the increased choice of routes from regional airports (Mason, 2000; York Aviation, 2007).

## 3. Air transport and state intervention: overview of support mechanisms

### 3.1. Support mechanisms: Public Service Obligation designation

There are a range of mechanisms which have been employed to secure provision of air services to enhance regional and economic development, particularly in more remote areas. Throughout the history of air transport airports and public bodies have offered various incentives to encourage the launch of new air routes. Financial incentives and mechanisms tend to be publically funded. For instance the PSO (Reynolds-Feighan, 1995a; Williams, 2005). The designation of PSO status has become increasingly common in Europe since 1993 following establishment of the Essential Air Services (EAS) in the US in 1978. Williams identified the extent to which the PSO mechanism was used in each of these countries (Williams and Pagliari, 2004). The authors noted how the case for a PSO mechanism was interpreted and employed differed considerably.

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