



Scottish Council for  
Development and Industry

## POLICY SUBMISSION

## SCOTTISH FERRIES REVIEW

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SCDI is an independent and inclusive economic development network which seeks to influence and inspire government and key stakeholders with our ambitious vision to create shared sustainable economic prosperity for Scotland.

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## Scottish Ferries Review

1. SCDI is an independent membership network that strengthens Scotland's competitiveness by influencing Government policies to encourage sustainable economic prosperity. SCDI's membership includes businesses, trades unions, local authorities, educational institutions, the voluntary sector and faith groups.
2. The Government Economic Strategy says that the Scottish Government will "accord greater priority to achieving more balanced growth across Scotland" to "ensure the most remote areas of Scotland can contribute to, and benefit from, economic growth". This will require significantly higher economic growth in the regions served by ferry services in Scotland. Gross Value Added per person for the Outer Hebrides, Orkney and Shetland all lag behind the Scottish average. Many areas of the islands and west Highlands are community regeneration priorities. Population projections for most island and peninsular communities are for major reductions, most critically in the Western Isles. More positively, as the Scottish Government consultation *Speak Up for Rural Scotland* highlights "increasingly, our rural communities will shape our economy and quality of life for the whole nation in the 21<sup>st</sup> century. Our rural resources can help meet the food, energy and environmental challenges of the future". Another key growth opportunity is the Highlands and Islands' world-renowned visitor economy.
3. The European Union classifies the Northern and Western isles, north and west Highlands, and Argyll and Bute as extremely or very peripheral. The promotion of these new investment, exporting and employment, educational and life opportunities will depend on combating this remoteness. Connectivity will be critical and there are often no viable alternatives to links which ferries provide.
4. SCDI believes that ferry services should be seen as an enabler rather than purely a lifeline and are crucial not only for passengers but for goods. While fully recognising the fiscal context, SCDI calls for a long-term plan for a step change with regard to fare levels, capacity and frequency, with the utilisation of new vessel technology to cut journey times, improve services and cut CO<sub>2</sub> emissions.

## Funding and Procurement

5. The Scottish Ferries Review consultation document and the associated work packages underline the scale and urgency of the investment requirements. The average vessel age will reach 22 years by 2013, double that of 1980. The length of time between commissions of new vessels has been growing in recent years. Eight vessels are now at or beyond their useful economic life, with a further five approaching the end, and the Stornoway freight route will have to close in 2013. Life extensions would have implications for safety, additional maintenance expenditure as it is harder to source spare parts, further increase fuel consumption and costs from £30m per annum, and increase the likelihood of catastrophic failure. The temporary failure of MV Clansman demonstrates the potential consequences for island and peninsular economies and communities.

Investment in extra capacity is also needed because fare reductions have successfully increased demand and vessels are now full in the summer season.

6. The investment requirements for ferries over the next 12 years are estimated by Caledonian Maritime Assets Limited (CMAL) at £604m and £290m for ports. This is far higher than existing £10m per annum of capital DEL for CMAL. If this is not increased, CMAL could not afford to replace 15 of the larger vessels, almost half of the fleet, when it is necessary. Nor can CMAL fund major port redevelopment within its current grant level. Harbour capital DEL was cut to zero for 2010/11. Given the length of procurement for this infrastructure, replacement vessels need be ordered soon. If investment is delayed for another four years, £95m would be required immediately and no new vessels could be delivered until at least 2016. There is a need for a long-term programme which replaces one vessel per year, stabilising the average age at current levels over period of the Ferries Review.
7. SCDI fully appreciates the pressures on the Scottish Budget. Scotland's Chief Economic Adviser has projected that it will not return to the current expenditure level in real terms until 2025. Local authorities face even greater challenges than the Scottish Government in meeting large peaks in capital funding. A legacy of underinvestment urgently needs to be redressed when public sector budgets will experience a prolonged period of austerity and are least able to support it. However, replacement of no longer fit-for-purpose fleet and port infrastructure must be understood as essential cyclical expenditure, not an optional priority. Ways must be found to fund economically vital services for their communities. Moreover, as ferry vessels generally have an economically useful life of 30 to 35 years, cost minimisation should not be the only consideration in procurement and innovation should still be a priority. There is concern that the proposal for a single, 15% larger new vessel on the Stornoway-Ullapool may not meet the diverse needs of users as well as two new vessels. The STAG appraisal should be openly and widely discussed with the community, with frequency, flexibility, capacity to accommodate future growth and service continuity in the event of a failure considered alongside greater capital and operating costs, journey times and CO<sub>2</sub> emissions and reduced individual vessel reliability for two smaller ships.
8. Significant cost savings in vessel procurement and operation could be achieved through collaboration, aggregation and standardisation. It is estimated that multiple orders could save £95m. Standardisation would allow for interchange between routes when breakdowns occur - reducing disruption to lifeline services - and provision of a relief vessel. The Small Ferries Project offers the opportunity to create further economies of scale through joint procurement of vessels with Ireland and Northern Ireland. This would also encourage Scottish shipyards to invest in their infrastructure, establishing a lead in building new "eco-ferries".
9. Vessels and harbour expenditure should also be planned together. Harbour developments could open up the network for use of more conventional vessels. SCDI has supported master-plans for developing port and harbour facilities. These must be funded by the most appropriate mechanisms, with a progressive move to more funding from users with investment from Government where it is needed to support the sustainability of or improvements to services. An Annual

Harbours Grant should be introduced combining the grants from CMAL and the funding which was formerly ring-fenced in the annual local authority settlement.

10. Even so, total investment requirements seem unlikely to be considered affordable by the Scottish Government or local authorities from traditional capital expenditure. SCDI therefore welcomes the consideration which is being given to private funding through conversion of CMAL into a Community Owned Public Interest Company, greater use of Operating Leases or Non Profit Distributing PPP. SCDI looks forward to the outcome of this work. Decisions should be based on appraisals of the model's capacity to support capital investment at the higher levels necessary and of value for money benefits to the Scottish Government.
11. Conversion of CMAL to a Public Interest Company with access to private capital which would be repaid by the Scottish Government through revenue budgets, could meet the investment needs for ferry and harbour infrastructure in a more affordable way. The upfront funding requirements on the Scottish Government would be reduced and scarce capital resources freed-up for other infrastructure. SCDI understands that potential external funders are interested in this approach. Any profit could be reinvested into lifeline transport assets or community projects.
12. Governance arrangements would need to be drawn up in a way which establishes the autonomy of the Public Interest Company, while ensuring appropriate representation of the Scottish Government's interests, affordability of CMAL's investment programme for the Scottish Budget, a veto for the Scottish Government over any sale and step in rights in the event of financial problems. The Scottish Government would continue to be responsible for ferry policy. Community Ownership would increase the amount of local input into decisions.
13. The top priority in questions on how ferries should be funded and procured must be meeting the needs of users and the local and national economies. Where there is competition, the evidence suggests that it can work in the interests of passengers and businesses. Western Ferries and Pentland Ferries both successfully compete with and complement the public sector operator on individual corridors, helping to reduce prices and add more capacity. The freight only service operated by Streamline on the same routes as NorthLink between the Northern Isles and Aberdeen has also ensured that there is competition.
14. A single ferry network has a number of key advantages. Services for users are more easily integrated. There are economies of scale, for example with ticketing and marketing overheads, which are not available to operators for a single route. Cherry-picking of higher revenue earning routes would undermine the rest of the network. Vessels and crews can be cascaded to cover lifeline services elsewhere in the network when there is a failure, as there was with MV Clansman, or problem with a port. When breakdowns occur or during maintenance, standalone operators have to access a replacement vessel at short notice, charter a vessel at commercial rates or suspend operating. Chartering a replacement in the summer is impossible as no vessels are available in the Northern Hemisphere. Operators on unbundled routes may supply their own vessels, but CMAL does not expect that this would significantly reduce the overall need for investment.

15. SCDI, therefore, continues to support larger bundles as the basis for tendering. Consideration by the Scottish Government of whether to test the market by tendering some routes on a single basis must include the cost implications of a fragmented network, such as in breakdown events, over the full tender period.
16. The evidence from other European countries suggests that tendering for ferry services tends to attract very few bidders. Larger packages are likely to attract more competition, be a more efficient process for bidders and government and maximise any cost-benefits. However, it is clear that the Scottish Government's focus should not be simply trying to generate competition by further tendering.
17. Alternative ways should be found to promote innovation. The incumbent operators are presently too tightly constrained in the changes that they can make. Route development funds and rewards for service improvements, efficiency gains and control of operational costs should be considered. The Scottish Government has decided that it must continue to tender ferry services, but it should seek to avoid defining the process so tightly that innovation is stifled. Longer, more flexible contracts with greater incentives for higher levels of services and performance would encourage creative ways of growing the business, more effectively utilising capacity and reducing public subsidies. Longer contracts also give more certainty to communities about future services.
18. National initiatives are needed to promote seafaring careers and invest in skills.

## **Fares**

19. The rationale for, and purpose of, fares policy cannot be limited to one outcome. It must balance the diverse needs of a wide range of users, operators and funders. Fares must support economic, community and tourism development to enable "opportunities for all of Scotland to flourish", but also because economic and community decline will substantially increase other costs to government.
20. The fares structure should be made more flexible to enable ferry operators to utilise their capacity more effectively and efficiently, and offer greater choice to users over what ticket products they purchase. Any differentiation in fares between islanders/ residents of peninsular communities and other ferry users must not be a disincentive to visitors and development in the vital tourism sector, or unfairly increase costs for freight transportation, which is an essential lifeline and enabler for the same island and peninsular economies and communities.
21. SCDI welcomed the Road Equivalent Tariff (RET) to the Outer Hebrides. The evidence suggested that costs were a serious burden to islanders and visitors, and a dead-weight on the economy, and a disincentive to businesses transporting goods to the mainland and onwards markets in Scotland and the rest of the world. SCDI believes that the particularly acute economic and demographic challenges in the Outer Hebrides support this intervention. While the duration and scale of the RET pilot has been designed to enable a full analysis of its economic impact, greater certainty about its long-term future is

required to stimulate additional investment in the tourism infrastructure of the Western Isles, while the length of study has been a disadvantage to islands not involved and there is a lack of clarity about how it would be applied to them.

## **Routes and Services**

22. The Scottish Government has said that the Scottish Ferries Review is aligned with the Strategic Transport Projects Review (STPR). When it was published in late 2008, the STPR was said to set out the future investment programme for transport in Scotland over the next 20 years, with a number of recommendations likely to take even longer to deliver. However, the Ferries Plan will only be up to 2022. Ferry vessels generally have an economically useful life of 30 to 35 years, which is similar to Treasury economic appraisals for capital expenditure, and the Scottish Government's climate change targets are for 2050. The Scottish Ferries Review and Ferries Plan should therefore look beyond 2022 and set out high level appraisals over 30 years. Over this longer period, there is the potential for hubs to be developed - either at existing ports or on new sites - alongside the introduction of larger or faster ferry services, and improved transport infrastructure on land. This would allow the consolidation of existing ports and services, while improving service frequency and overall journey times for all ferry users. Thorough research, consultation and piloting of this would be needed.
23. Clear, long-term investment plans would give businesses confidence to invest, and existing and potential residents confidence in the future of the communities.
24. There have been few substantial changes in ferry routes over the last 30 years. While the current services generally seem to serve the needs of their existing users, evidence of suppressed demand, including the potential for much higher usage of new transport options than were projected, has been identified. This strongly suggests that previous STAG appraisals of new investment in infrastructure and services inadequately capture the potential demand. The true economic advantages of developing improved services, reduced fares and fixed links should be fully reflected in the assessments of future investment options.
25. Service needs, rather than demands, can thereafter be prioritised and investment programmed. Needs for connectivity will, of course, change over time, as new economic opportunities arise, and there is a need for flexibility in long term plans.
26. Greater innovation within the period of the Clyde and Hebrides, and Northern Isles contracts should be encouraged. The procurement of a new ferry or improved port infrastructure should be seen as an opportunity to look closely at the route, vessels, frequency and timetabling, not simply to replace like with like.
27. The frequency and timetabling of services should be flexible enough to accommodate changes in demand. More flexibility for the operators would enable them to better respond to seasonal and growth industry needs. A balance has to be struck between all users' needs and integration with other transport modes maintained. Operators are best placed to consult and agree changes with them.

28. Long-term investment should be prioritised in those areas that have the most potential to contribute to Scotland's economic growth. However, in the short to medium term it must be remembered that - as a result of the legacy of underinvestment - if communities do not benefit directly or indirectly from future investment, they will experience increasing economic challenges/ disadvantages. Such decline would not "reduce the disparity between the regions of Scotland" and would be likely to increase the need for higher public spending to address it.
29. Research published recently has found that tourist spending in Scotland will grow from £9.2bn this year to £14.8bn in 2020, with its total economic contribution rising from £11.1bn to £17.3bn. Scotland's islands are one of the country's major attractions. VisitScotland's 2007 Visitor Experience Survey showed that 12% of visitors travelled by ferry during their trip to Scotland and its research found that two thirds of islands hoppers used ferries for their vehicles. Tourism growth will impact on ferry capacity and the needs of visitors should be a priority. Ferries are part of the visitor experience and its quality should continue to be improved.
30. Future freight needs of key sectors of the economy should also be a high priority. Scotch Whisky distillers on the islands are looking forward to a period of strong and sustained growth, and new distilleries may also be developed on islands where none exist at present. Ferry services are essential in getting products to market. This needs to be factored into planning future timetabling and capacity decisions. Constraints have previously disrupted the operations of some distillers on Islay. A new, direct freight Islay to Glasgow service should be considered.
31. Reliable ferry services are an essential part of the supply chain for fish farming and fish and shellfish processing sectors, which are expecting significant growth in the next five years driven by international demand for fresh, premium products.
32. Modern vessel tonnage for the freight-only vessels between the Northern Isles and Aberdeen should be considered by the Scottish Government, with possible integration into a Northern Isles/Norway/Baltic cargo distribution network.
33. The supply of fuel oil and other commodities is vital for island life and the smoothing functioning of their economies. Highlands and Islands Enterprise and HITRANS have previously suggested that a small, general cargo vessel could be procured by the Scottish Government to import bulk commodities to the islands.
34. Decisions on and investments in services and routes should take into account links between areas, such as for access to healthcare and educational and cultural ties, and maximise the benefits of previous investments in port facilities.
35. Efficient access to and integration with other modes of transport to facilitate the intermodal transfer of goods and passengers and encourage greater international connectivity should be a major consideration. The seasonality of demand, infrequency of service, timetabling changes between summer and winter, and variable franchise conditions between modes can impede the integration of timetabling with other transport modes, but there must be scope to better join up journeys. Transport operators should work out their timetables in concert with



each other and in close consultation with people and businesses in the communities. There should be some flexibility for services at specific locations.

## **Responsibilities**

36. Overall, greater consistency in responsibility for ferries provision would be more efficient. Local authorities have varying capacity and capability to deliver ferry services. SCDI would support an approach which involves an increased amount of local input from users into tender specifications on their needs and from funders on outputs - aligned with Single Outcome Agreements and regional transport strategies - with longer, more flexible contracts which enable operators to determine how best to deliver them. Local authorities or Regional Transport Partnerships should also be able to fund higher levels of service or targeted fares policies which they consider to be beneficial for users and the local economy.
37. SCDI has recommended that the strategic policies for Clyde and Hebrides Ferry Services routes should be agreed in consultation with HITRANS and for Northern Isles Ferry Services with HITRANS, NESTRANS and ZetTrans, thereby corresponding to and being integrated with their regional transport strategies.

## **Environmental Issues**

38. Over the current tender period, ferry services can only make a limited contribution to Scotland's climate change targets. Most significantly, better utilisation of vessel capacity would reduce per passenger CO<sub>2</sub> emissions. More flexibility over pricing and timetabling when demand is low would support this.
39. The Scottish Government's National Transport Strategy prioritises shorter journey times because it is recognised that they are economically beneficial. Longer journey times for ferry services would, therefore, economically disadvantage islands and peninsular economies and are not supported by SCDI. They would also disrupt integration with other modes of transport. The fuel cost savings of slower services would be reduced by the higher costs for crewing.
40. Procurement of new larger ships could include LNG and efficient hull designs. Alternative fuels should be evaluated, with upfront costs weighed against longer-term efficiency and environmental benefits. SCDI understands that LNG supply and distribution networks in the UK are underdeveloped and availability is low.
41. Scotland has the opportunity to develop leadership in small, hybrid powered ferry vessels. These are already technically feasible and there is a supply chain of Scottish shipbuilders and battery manufacturers which could collaborate in their design and construction. This generation of batteries could provide 20% of power, but with technology improving at the rate of 200-300% every three years, replacement with new batteries after five years might supply 50%. Hybrid engines would improve efficiency and reliability. Average CO<sub>2</sub> production per kilowatt is already at least 30% lower from the national grid than that produced from marine diesel engines. Supply of electrical power from the shore would allow hybrid vessels to recharge their batteries and shut down their diesel

engines overnight. Batteries might also have a role in transmitting emergency power to islands at times when the variability of local electricity generation from windfarms has resulted in a shortage. Initially, the upfront costs of hybrid engines would be higher, but costs will fall significantly. Public procurement of these vessels on behalf of the Scottish Government would support innovative Scottish companies and high-skilled jobs in the low carbon sector, with prospects to export vessels and technology, and supply large markets such as canal boats. SCDI has been supporting discussion of this opportunity by potential partners.

42. The provision of electrical power at ports would need to become more common. There may be opportunities to maximise the benefits of investment in port infrastructure through incorporation of wave energy technology. Scottish wave energy technology has been incorporated into new port developments in Spain.
43. The role of air services on the same routes and their relative pricing and environmental impact should be considered. Given concerns about current carbon emissions from transport, use of environmentally friendly modes should be encouraged and pricing structures should send the right signals to travellers.

#### **Draft Ferries Plan**

44. The Scottish Government is proposing to consult for six weeks on the Draft Ferries Plan. Given the length of time it has taken to publish the Scottish Ferries Review, mixed levels of community engagement in the current three month consultation and the specific details expected in the Draft Plan over where it is proposed that investment will - and will not - be focussed, it is not clear why an unusually short, six week consultation is planned. This is likely to be inadequate.
45. The current timetable for the tender of the Northern Isles bundle would mean that it is issued before the Ferries Plan is finalised. North Isles services would, therefore, be unable to benefit from recommendations for six years of this ten year Plan. A short delay in the tender would allow it to take into account all recommendations and is likely to be preferable for operators to a short contract.

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