

# **UK Emissions Trading Scheme: Island Communities Impact Assessment (ICIA)**

**November 2023**

# UK Emissions Trading Scheme: Island Communities Impact Assessment (ICIA)

## 1. Purpose

The Islands (Scotland) Act 2018 introduced a requirement for Scottish public authorities to undertake an Island Communities Impact Assessment (ICIA) to determine the impacts that policies, strategies, or services which, in the authority's opinion, are likely to have an effect on an island community which are significantly different from the effect on other communities (including other island communities) in the area in which the authority exercises its functions. This duty is often referred to as 'Island Proofing'.

The Scottish Government has, therefore, produced a full ICIA covering changes to the aviation and maritime sectors under the UK Emissions Trading Scheme (UK ETS), as described in the Government Response<sup>1</sup> to the "Developing the UK ETS" consultation.<sup>2</sup>

This full ICIA is structured following the steps set out in the Scottish Government's ICIA guidance,<sup>3</sup>

- Step one – Develop a clear understanding of the objectives.
- Step two – Gather data and identify stakeholders.
- Step three – Consultation.
- Step four – Assessment.
- Step five – Preparing the ICIA.
- Step six – Making adjustments.

The Scottish Government will update this ICIA with any further information and analysis as required.

## 2. Step one - Develop a clear understanding of the objectives

### 2.1 Policy objectives and possible impact on island communities

The UK ETS was established on 1 January 2021 by the UK ETS Authority (the "Authority") –formed by the Scottish, UK and Welsh Governments and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland.

The UK ETS aims to incentivise cost-effective decarbonisation across energy-intensive industries, the non-renewable power sector, and aviation<sup>4</sup> to support ambitious climate targets across the UK. When establishing the UK ETS, the

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<sup>1</sup> [Government Response to the Developing the UK ETS consultation](#)

<sup>2</sup> [Developing the UK ETS consultation](#)

<sup>3</sup> [Island Communities Impact Assessment: guidance and toolkit](#)

<sup>4</sup> Domestic flights, flights from the UK to EEA countries, the UK to Gibraltar and Great Britain to Switzerland flights. The return flights are covered by the EU and Swiss ETS schemes.

Authority committed to increasing the climate ambition of the scheme and therefore published the “Developing the UK ETS” consultation with proposals to further develop and strengthen the UK ETS, including through better alignment with net-zero targets.<sup>5</sup> The Authority has published two Government Responses and associated impact assessments setting out its policy intentions in response to that consultation.<sup>6</sup>

This ICIA covers policy changes included in the final Government Response, published in July 2023, which may have an effect on island communities or impact these differently compared to other communities.

The changes to the UK ETS that have the potential to impact island communities differently are:

- **The phasing out of aviation free allocation (AFA) of allowances by 2026:** Companies in the scope of the UK ETS are required to purchase an allowance for each unit of emissions they produce. The Authority auctions most of these allowances every scheme year, but some are given for free to industries at risk of carbon leakage.<sup>7</sup> Aircraft operators are among the participants that receive a percentage of the allowances for free. Under current UK ETS legislation, free allocations can only be used for mitigating carbon leakage.<sup>8</sup> However, independent research commissioned by the UK Government showed that for aviation there is a limited risk of carbon leakage under the current scope of the UK ETS.<sup>9</sup> Therefore, after thorough consideration, the Authority considered it disproportionate to maintain free allocations for the aviation sector. Ensuring free allocations are used where most needed for mitigating carbon leakage is essential as we are reducing the number of free allowances in line with the new net zero cap trajectory. This decision means that aircraft operators will have to start buying all their UK ETS allowances instead of receiving a percentage for free, which has the potential to impact operators’ costs, including those operators providing some services to island communities (some operators and island services are not currently in the scope of the UK ETS, as shown later in this document).
- **The inclusion of domestic maritime in the UK ETS from 2026 for vessels over 5000GT:** The UK ETS represents one part of a wider policy mix necessary to address barriers to maritime decarbonisation. The UK ETS could incentivise the adoption of low-carbon fuels, support the deployment of fuel-efficient technologies and introduce more efficient operating practices. Therefore, the Authority is including the maritime sector in the UK ETS from 2026, with the intention for this to apply to vessels over 5000GT. That threshold will capture some of the lifeline ferry services to island communities, meaning that they, along with other maritime operators under the UK ETS, will

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<sup>5</sup> [Developing the UK ETS consultation - March to June 2022](#)

<sup>6</sup> [Government Response to the Developing the UK ETS consultation](#)

<sup>7</sup> ‘Carbon leakage’ is defined as “where production and associated greenhouse gas emissions are displaced in ways that would not have happened if the pricing of emissions across jurisdictions was implemented in an equivalent way.”

<sup>8</sup> [The Greenhouse Gas Emissions Trading Scheme Order 2020 \(legislation.gov.uk\)](#)

<sup>9</sup> <https://www.gov.uk/government/publications/impacts-of-carbon-pricing-on-the-uk-aviation-sector>

need to either reduce their emissions or purchase allowances to cover their vessels' emissions, which could impact their operating costs. The Authority will be consulting further on the implementation of the UK ETS for domestic maritime, to finalise remaining policy details.

These UK ETS changes have the potential to impact operators providing services to island and mainland communities. Given the absence of road and rail transport options to most of the island communities, air and maritime routes play a more important role in ensuring their connectivity and viability. That means these UK ETS changes may impact some island communities differently, compared to other communities across the UK (including other island communities).

Though neither of the changes noted above will directly impact island communities, they are likely to impact operators who serve those communities. That may influence those operators' commercial decisions, which could, in turn, impact Scottish island communities. Cabinet Secretary for Transport, Net Zero and Just Transition, Màiri McAllan, wrote to her counterpart Ministers across the UK to secure commitment that the Authority would work together to mitigate any negative outcomes to island communities due to UK ETS policy changes. All nations replied, acknowledged this risk, and agreed for the Authority to identify and address any negative impacts on these communities. The Scottish Government will therefore work with the rest of the Authority and the Department for Transport on this risk and share possible mitigations in due course.

The Scottish Government does not believe any other changes to the UK ETS would have a different effect on island communities. Therefore, this ICIA does not cover any other decisions in the Government Response. For maritime, this ICIA focuses only on the potential impact on lifeline ferry services to island communities. We have not identified any areas where the inclusion of the wider maritime sector (above 5000GT) could impact island communities differently to other communities.

Please refer to the UK ETS Business and Regulatory Impact Assessment (BRIA) for an analysis of the impact on businesses of the changes to the UK ETS outlined in the Government Response.<sup>10</sup>

### **3. Step two – Gather data and identify stakeholders**

#### **3.1 Phase-out of AFA by 2026**

##### **3.1.1 Data available on current situation and stakeholders**

The phase-out of AFA will capture operators that provide services to the Highlands and Islands. Hence, there is potential for this decision (alongside the maritime changes below) to negatively impact island communities, especially as there are no alternative modes of transport available (i.e., road and rail) for most of these communities compared to other regions in the UK.

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<sup>10</sup> [UK ETS Business and Regulatory Impact Assessment \(BRIA\)](#)

The Authority and the Scottish Environment Protection Agency (SEPA) have data about the compliance obligations and the impact of free allocations for the one aircraft operator regulated in Scotland under the UK ETS. The Scottish Government has not published any of this data or analysis as it is commercially sensitive information for that one operator. The Scottish Government does not hold any information about businesses' commercial decisions or other factors impacting them.

### **3.1.2 Ways the public sector currently supports aviation across island communities**

The Authority has already ensured that flights performed by an aircraft with a certified maximum take-off mass of less than 5,700 Kg are exempt from the UK ETS. Based on public information on operators' websites, the following scheduled passenger flights to island communities are currently exempt under this requirement. The UK ETS therefore does not currently impose any costs on airlines for operating these services:

- Tingwall-Fair Isle
- Tingwall-Foula
- Kirkwall-Papa Westray
- Kirkwall-North Ronaldsay
- Kirkwall-Westray
- Kirkwall-Sanday
- Kirkwall-Stronsay
- Kirkwall-Eday
- Oban-Coll
- Oban-Tiree
- Oban-Colonsay
- Coll-Tiree
- Oban-Islay (service due to stop in September 2023)
- Glasgow-Tiree
- Glasgow-Barra

Additionally, the following support is already provided for the associated costs of some island services:

- **Public Service Obligations (PSOs):** Government can use PSOs to subsidise the provision of an air service under certain circumstances. Currently the Scottish Government funds PSOs between Glasgow and Tiree/Barra. Local authorities fund other PSOs, including Benbecula-Stornoway and those within the Shetland and Orkney archipelagos. All the services currently operated under PSOs to and from Scottish islands use aircraft under the 5700kg exemption limit, meaning they are exempt from the UK ETS (with the exception of the Benbecula-Stornoway service).
- **Air Passenger Duty (APD):** All scheduled passenger services departing from airports in the Highlands and Islands are exempt from paying APD, which is set by the UK Government.

- **Highlands and Islands Air Discount Scheme (ADS):** The Scottish Government funds the ADS, which provides residents of Shetland, Orkney, the Western Isles, Islay, Jura, Colonsay, Caithness, and north-west Sutherland with a 50% discount on the core airfare on eligible services. The scheme aims to tackle high airfares and improve social inclusion in the most peripheral parts of the Highlands and Islands.

### 3.2 Inclusion of domestic maritime in the UK ETS

#### 3.2.1 Data available on current situation and stakeholders

This scope expansion would capture 11 vessels currently operating in Scotland, which provide an essential lifeline service for island connectivity.

As of the publication of this ICIA, the operating lifeline ferries that would be covered by this inclusion are:

<b>Motor Vessel Name:</b>	<b>Gross Tonnage:</b>
Hjaltland	11,720
Hrossey	11,720
Hamnavoe	8,780
Loch Seaforth	8,680
Helliar	7,606
Hildasay	7,606
Isle of Lewis	6,753
Finlaggan	5,626
Hebrides	5,506
Clansman	5,499
Caledonian Isles	5,221

#### 3.2.2 Ways the public sector currently supports maritime transport across island communities

Most island ferry services in Scotland are provided under public service contracts, or similar, and adequate service and fare levels are dependent on high levels of support from the Scottish Government and local authorities. One example of the existing support is the freezing of fare levels on the Northern Isles and the Clyde and Hebrides ferry networks - now extended for a further six months from October 2023 until the end of March 2024 - and supported directly by Scottish Ministers. This policy follows an initial freeze introduced for the first three months of 2023.

The Scottish Government is aware that UK ETS policy changes to the aviation and maritime sectors increase risks to island communities. Therefore, we are establishing, with the rest of the Authority and the Department for Transport, a working group to identify adequate mitigation strategies either with policies within or outside of the UK ETS, including changes to the existing support models to ensure island communities are not put at a disadvantage from these changes.

## **4. Step three – Consultation**

### **4.1 Developing the UK ETS consultation**

The Authority delivered the public consultation “Developing the UK ETS” between 25 March and 17 June 2022.<sup>11</sup> As part of the consultation process, and aiming to gather as much feedback as possible, the Authority delivered 47 UK-wide stakeholder engagement sessions with current and future UK ETS participants, cross-sector business groups, trade associations, think tanks, academics, and environmental NGOs. These sessions included high-level summaries of the consultation and topic-specific workshops, which covered proposals on AFAs and the inclusion of maritime in the UK ETS, among others. Approximately 350 stakeholders attended these engagement sessions, including Scottish stakeholders.

A total of 300 stakeholders responded to the consultation, of which around 120 were identified as particularly relevant for Scotland by policy teams across the Scottish Government.

The responses to this public consultation included a variety of stakeholders, including those from the aviation, chemical, oil and gas, refining, transport, manufacturing, power, food and drink, and steel sectors, as well as other trade associations, local authorities, consultancies, think tanks, academics, and environmental NGOs.

The Authority has produced and published an [early and final Government Response](#) to the consultation.

While the “Developing the UK ETS” consultation was open to everyone to contribute, the Scottish Government did not directly consult with island communities at that stage, as changes to the UK ETS are technical and directly impact commercial operators, who did engage in the consultation, rather than members of island communities. Any impacts on island communities will be a result of commercial decisions taken by those operators.

## **5. Step four – Assessment**

As set out above, the aviation and maritime sectors might face additional financial pressures as:

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<sup>11</sup> [Developing the UK ETS consultation document](#)

- For the aviation sector, the phase out of AFA will require operators to purchase all their UK ETS allowances for their verified emissions instead of receiving a percentage for free; and
- For the maritime sector, the inclusion of vessels over 5000GT in the UK ETS means that those lifeline ferry operators that meet the threshold will have to start complying with the UK ETS (i.e., by purchasing allowances equivalent to their verified emissions).

### **5.1 Impacts on flight services**

Flight services are decided and operated on a commercial basis, and any possible changes to services in the short to medium term will be influenced by a range of commercial factors, which could include UK ETS compliance costs. The Scottish Government has no visibility or control over such commercial decision-making, and it would be inappropriate to speculate on how operators will react to the changes.

It is therefore not possible to assess the exact impact due to the phase-out of the AFA but, in general, operators respond to increased operating costs by:

- Seeking to reduce their UK ETS compliance costs, by lowering their emissions through investment in sustainable aviation fuel and technological and operational efficiencies.
- Absorbing the costs without changing their operations.
- Changing the frequency, timings, ticket pricing or operations of certain services.

The Scottish Government, together with the rest of the Authority and the Department for Transport, will continue to monitor any changes that the phase out of AFA could have on service availability and pricing and will implement mitigation strategies as appropriate. Further analysis of the impacts on the aviation sector can be found in the Scottish Government BRIA on the UK ETS (see footnote 7) and the Authority's impact assessment on the back of the Government Response publication.<sup>12</sup>

### **5.2 Impacts on ferry services**

Regarding the changes to the maritime sectors, the operators of Scotland's publicly funded lifeline ferry services are decoupled from commercial considerations, given the high level of government subsidy support in place to enable these services. The contractual arrangements between the ferry operators and Scottish Ministers mean that all additional costs to lifeline ferry operators arising from the UK ETS would be passed on to the Scottish Government. A range of measures would require consideration in order to cover the additional costs, such as raising fares above the standard CPI-linked measure, or potential cuts to ferry services.

### **5.3 Assessment conclusions**

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<sup>12</sup> [Developing the UK ETS: impact assessment \(publishing.service.gov.uk\)](https://publishing.service.gov.uk)



Given the above, it is difficult to conclusively assess the impact of these UK ETS changes on island communities. This is because the primary impact is on operators, and the impact on communities would depend on commercial decisions those operators take. Those decisions will be influenced by a range of factors wider than these policy decisions.

However, due to the potential effect on island communities, the Scottish Government has raised with the Authority the possible risks to these communities. As such, the Authority has agreed to establish a working group to identify adequate mitigation strategies within and outside of the UK ETS to protect island connectivity, besides the existing policies and programmes in place that support the island communities more broadly.

Should the Scottish Government become aware of any significant effects, consideration will be taken on whether this ICIA can be reviewed and updated, or a further ICIA will need to be produced.

## **6. Step five – Preparing the ICIA**

### **6.1 Future possible mitigations**

Màiri McAllan, Cabinet Secretary for Transport, Net Zero and Just Transition for the Scottish Government, has raised the potential risk to regional connectivity and the Authority has agreed to work with the relevant parts of the UK Government to address any possible negative impacts to island communities due to UK ETS policies.

### **6.2 Phase out of AFA by 2026**

In the final Government Response, the Authority acknowledged the possible risk to island communities from the AFA phase-out and agreed to consider which policies could be put in place to mitigate these risks. This could include further exemptions within the UK ETS or adopting policies outside of the UK ETS such as expanding the existing government support to the aviation sector (described earlier in this ICIA). The Scottish Government, as well as the Authority, will share more information on these as soon as practicable.

### **6.3 Inclusion of domestic maritime in the UK ETS**

As the Authority has not yet finalised detailed implementation of this policy, the Scottish Government will continue to work with the other UK nations and departments to explore mitigation strategies for the island connectivity risk posed by this scope expansion. The Authority acknowledged in the Government Response the risk this policy could have on crucial services to the areas of the UK that depend on these services and to consider how to address these risks in the second maritime consultation.

The Scottish Government will update this ICIA with any agreed mitigations on either of the policies or any further information as required.

## **7. Step six – Making adjustments**

### **7.1 Future steps and adjustments**

Different island communities rely on air and ferry services to different extents. Additionally, different services are impacted by the UK ETS in different ways (for example, because some services on both modes of transport are below the weight threshold for inclusion in the UK ETS). This means the impact of these policies, and policies to mitigate those impacts, may vary between communities.

Specific island circumstances have been discussed across the Authority; and any possible mitigations will be developed through the Authority working group to identify and address any negative impacts on island communities due to these UK ETS changes.

We will continue to assess if any changes to the UK ETS may impact island communities differently and will engage with these communities as necessary.



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