An analysis of duty-free sales in the Baltic Sea region's transportation system

An economic game

Today, the Åland Islands play an important role in maritime transport in the Central/Northern Baltic Sea region as business thrives on board the ferry traffic to and from Sweden, Finland and Estonia as well as recently to Russia, all due to tax-free sales. Who would win and who would lose if Åland were deprived of its tax exemption?

A permanent exemption from the European VAT rules, included in Åland's accession protocol to the EU, made the autonomous region one of the few EU territories permitting duty-free sales on board ships. The latest TransBaltic report, on which this article is based, highlights the major consequences for transnational and interregional transport in the BSR if the tax-free sales on ferries travelling via Åland were abolished.

Doing business

Sea shipping of both goods and passengers is a significant means of transport for the BSR. According to Eurostat (2009), about 120 mln passengers travel by sea between countries in the area. In total, as many as 880 mln tonnes of goods were short sea shipped via the Baltic Sea in the year 2009. The BSR's logistics system is mainly based on car/cruise/cargo ferries, connecting countries within the region and providing a link with the EU, thus functioning as a motorway of the sea. Duty-free sales on the routes via Åland play an essential part of seaborne transport, contributing to economic sustainability in the Central Baltic Sea region.

Tax-free ferry traffic in the Central BSR is built around four business areas: passenger/car transportation, short cruises, freight, and conference/business meetings, which together form a business model of economically efficient transport. Business in the summer is dependent upon passenger and car shipping, which in autumn and winter is complemented by transportation of cargo. This flexibility along with a well-thought-out timetable and high frequency of departures sustains traffic on the main sea routes all year round.

Åland's capital city Mariehamn has become the geographical, logistical and commercial centre of duty-free based traffic in the Central Baltic region. Several regular ferry lines between Sweden (Stockholm), Finland (Turku, Helsinki) and Estonia (Tallinn) via the Ports of Åland make up the so-called Central Baltic Triangle (CBT) of tax-free supported transport. Although the route between Finland and Estonia is not tax-free, passenger flows are high, primarily due to the lower prices of alcohol in Estonia. Recently, a regular weekly cruise to Russia (St. Petersburg) via Mariehamn has also become available.

Importance of tax-free sales

For the ferry and cruise segment, the possibility of on-board duty-free sales is a recipe for success. Today's sales on board ferries travelling between EU Member States are characterised by two tax exemptions, which contribute to almost 70% of the cruise ferry companies' profits: the Åland tax exemption and the tax-free restaurant services. According to top executives interviewed by the authors of the report, "a tax-free supported logistical system provides high capacity, low fare travelling and frequent sailings." In other words, cheap and flexible sea transport of people, cars and cargo is possible within the Central BSR.

Tax-free supported passenger traffic plays a fundamental role in today's seaborne transportation system in the Central/Northern BSR. The annual flow of passengers on duty-free routes in the CBT reached 15 mln in 2010. These sea lanes "represent the backbone of the seaborne transports between Sweden and Finland, transporting more than 9 mln passengers a year." More than a third of the passenger shipping in Sweden, and more than half in Finland, is sustained by tax-free sales along the routes via Åland. What is more, a significant share of cargo is transported by ferries on these routes – about one seventh of goods are shipped from Sweden to Finland and one sixth from Finland to Sweden.

For the Baltic Sea region, the CBT is a "highway of the sea", linking the east side (Finland, Russia and Estonia) with the west and the central part of the region. On a wider scale, the Åland tax-free corridor functions as "a connecting link between the flows in

the Nordic Triangle and on the two main routes to the wider European and international markets" – the Eastern (Via Baltica) and Western route which run between continental Europe and the BSR. The duty-free links in the Baltic Sea area are, therefore, a crucial element of the wider transportation and logistics structure in Northern Europe.

For Åland alone, the tax-free exemption is a gold mine. The social and economic benefits it brings, such as employment, household income and population growth all contribute to the region's welfare. Moreover, the Åland Islands are also very dependent upon the well-developed and cheap transport to and from mainland Finland and Sweden offered by the tax-free based ferry traffic.

A non-duty-free scenario

The abolition of tax-free sales on the sea routes via Åland would affect transnational transport logistics and business. Åland's tax-free exemption is not just a question for the Baltic Sea region. It is much more important than that, since it concerns other regions and other infrastructural solutions in the EU as well.

Photos: Visit Åland

For the cruise ferry sector, the profitable system of combining the transport of people and cargo would lose its meaning. A non-tax-free situation would mean fewer departures, higher fares and what follows - a notable decrease in passenger traffic between Sweden, Åland and Finland. To stay competitive on the market, surviving shipping companies would have to consider abandoning passenger services for the transport of cargo and cars and switching to ro-ro/pax traffic. What is more, new logistics solutions based on the most cost-effective way of transporting goods would have to be developed. This would include new routes and would influence the kind of vessels operating in the BSR. Cargo type, the time frame and the most efficient routing would determine the transport services offered.

A strengthened eastern part of the Baltic Sea region would be the general outcome of the abolished duty-free supported transport in the CBT. An increase in passenger flows to Tallinn and Riga (where excise tax is lower) and St. Petersburg (where on-board tax-free sales are still possible along the way) as well as a decline in ferry capacity on the sea lane between Sweden and Finland would reinforce the further development of the Eastern route's ports, terminals and roads. What is more, a new possible direct sea route between Russia and the European markets via Germany and Poland would be a strong competition for the existing routes in the Central Baltic Sea region by providing cost-effective transport due to cheaper fuel.

Yet, the Western route with its well-developed transport infrastructure would not undergo "dramatic" changes due to the abolition of duty-free sales. The logistics system is organized around strategic points, i.e. hubs, harbours and terminals (e.g. Stockholm, Turku) which handle large volumes of traffic. Although some shipments to/from the Central BSR's eastern parts (which are now sustained by the tax-free supported ferry traffic) would no longer be available, the routing of the main cargo flows would probably stay the same. The main change would be in redirecting traffic to the route between ports: Kapellskär (Stockholm) and Naantali (Turku), which is the fastest sea transport connection between Sweden and Finland.

The winners and the losers

The potential winners in the game are ro-ro/pax companies as well as cargo ports and terminals located near the shortest possible sea routes between important strategic points in the BSR. Cruise ferry companies able to compete on the remaining duty-free lanes by expanding their operations and on routes to destinations offering lower on-shore prices would also prosper.

In general, the main ports in the eastern part of the Central BSR along the Via Baltica route would benefit from an abolishment of duty-free sales. Tallinn (Estonia), Riga (Latvia) as well as St. Petersburg (Russia) are already popular passenger and cruise destinations in the northern part of the Eastern corridor with their potential not yet fully exploited. Also, the ports and terminals in south-west Finland and in the Stockholm area specializing in ro-ro cargo handling would gain more traffic.

The losers are the group of companies and individuals who economically benefit the most from the transport and logistics services in the Central Baltic area that the duty-free exemption offers. Firms operating the tax-free ferry business as well as the related suppliers and logistics companies specializing in tax-free shipping would be "very hard hit", as alternatives to their existing operations would be difficult to find. Individuals travelling on the duty-free ferries for leisure and transport purposes and companies using the tax-free routes for regular shipments would also be hurt.

Geographically, the areas negatively affected by the abolition of tax-free supported transport would be located in the centre of the CBT, between the two main corridors: the Western and Eastern route. Today's economic and logistics centre of ferry traffic in the BSR, the Åland Islands, would undergo a complete breakdown, and hence be the biggest loser of all. Since approx. a quarter of Åland's GDP comes from the tax-free supported transport sector, the region's economy and inhabitants would suffer enormously if the business situation suddenly changed.

The report "The significance of duty-free sales on the transnational transport system in the BSR" is available on TransBaltic's website, www.transbaltic.eu. ■

Monika Mikołajczyk

This article is based on the report "The significance of duty-free sales on the transnational transport system in the BSR". The document can be downloaded from www.transbaltic.eu.

Project part-financed by the European Union (European Regional Development Fund)

Baltic Sea Region Programme 2007-2013

SKÅNE

A regional approach to future transport planning

In hopes of a good start

Photo: DAF

A future vision of the transportation system in the southeast Swedish region of Blekinge, presented in a recent TransBaltic report, provides 'food for thought' for the BSR's decision makers on how clear goal-setting and wise planning could help reach the so often mentioned idea of sustainable transport, being efficient, reliable and environmentally safe.

Region Blekinge, a partner in the EU co-funded transport project TransBaltic, has developed together with important public and private stakeholders, a 'green' future scenario for a sustainable transport system by the year 2030 with an outlook for 2050, which intends to provide inspiration for an action plan for the region itself as well as other regions in the BSR. The report is a valuable contribution to the development of the Baltic Sea region transport action plan, which is to be created within the TransBaltic project and published in September 2012.

Towards 'green' transport

When talking about green transport we are really talking about sustainability. The common view of the future transportation system is that it must be sustainable in all areas of human life, including both social and environmental aspects. Today, increasing traffic and what follows growing GHG emissions (transport is currently responsible for 22% of all GHG) are the main issues of global concern. The EU Member States have agreed on 20-20-20 targets for the present decade. By 2020, a 20% reduction in GHG emissions is planned along with an increase in energy efficiency by 20% and 20% of energy will come from renewable resources. The EU believes that these targets will lead to a decrease of 70% in fossil oil usage, which implies a revolution regarding fuels and the way we travel. According to research presented by the European Commission (EC) in 2011, the largest share of GHG emissions of all transport modes within the EU derives from road transport. The EU transport policy document (e.g. White Paper) addresses this issue by prohibiting regular fossil-fuelled cars in cities by 2030 and shifting 50% of road transport to rail and sea. The Trans European Transport Network (TEN-T) priorities have also gone through a review, now designed as a network connecting all parts and modes of the EU. The Motorways of the Sea (MoS) project is part of the TEN-T and an important initiative especially for the BSR.

However ambitious all of the above goals may be, it is vital to look at them from a wider perspective so as to avoid blind alleys and sub optimizations. All aspects need to be investigated in a long-term perspective, seeing that quick fixes might lead to moving the problem elsewhere. Hence, reasonable thinking towards transport sustainability is the key to success. Effective planning for the BSR unquestionably involves knowledge integration between decision makers and reaching consensus about important issues. Hence, joint action and reasonable thinking towards transport sustainability is the key to success.

Region Blekinge

Region Blekinge is situated in the south-eastern part of Sweden and has a favourable position regarding direct sea transport to the South and East Baltic states as well as further away to the east and the south. The importance of the region's location and harbours as transit

nodes location as a transit node has been acknowledged by the EU and funds have been granted for the development of two sea links connecting Karlshamn-Klaipėda and Karlskrona-Gdynia, defined as an MoS.

Blekinge transport flows are currently dominated by road transport. Road transits to and from Port of Karlshamn in 2005 accounted for 80%, while as much as 87% of road transits went from Port of Karlskrona. Both ports are expecting an increase in freight and the new railway link *Sydostlänken* in southern Sweden is considered as an important investment to decrease road transport directed north. Yet, still more railway developments are needed.

Region Blekinge, now in the making of a sustainable regional transport system for 2030 with an outlook to 2050, has decided to test an approach to the process in an innovative manner for inspiration and recommendations for the final future transport plan. Together, regional goods transport operators and private sector and regional authorities discussed a preferable future and co-created a plan for sustainable transport in Blekinge. By applying the Framework for Strategic Sustainable Development – FSSD via the ABCD-method (a specific four-step process of planning from the future, i.e. setting the desirable outcome first and then finding solutions to reach it) and guidance of the four sustainable principles sustainability principles – SPs (to be further explained) they reached a common understanding on the concept of sustainability and a common vision was created with the EU and national environmental objectives as a backbone for the discussions.

A stepwise approach to planning

There are two major planning methodologies: forecasting and backcasting. In forecasting current trends are used to project the future, while in backcasting you start off by defining the desirable future and then draw strategic conclusions on how to get there. The so-called ABCD-method is based on backcasting and is the main strategy for using the FDDS.

The FSSD provides a common understanding of the concept of sustainability as well as insight into planning and decision making in a clear and rigorous manner. The five levels: System, Success, Strategy, Actions and Tools ensure that basic principles of ecological and social sustainability are used as boundary conditions for any planning endeavour or organization, followed by analysis and planning, and choice of tools to stepwise get there, while optimising financial outcomes.

The ABCD method is used to apply backcasting from the four SPs – sustainability principles for transport which are derived from the basic conditions for a sustainable society within the biosphere. The method has four logical steps: Awareness, Baseline Mapping (Current Reality Analysis), Compelling Measures and Prioritization.

A future scenario for the transportation system in Blekinge was planned, analysed and refined stepwise accordingly: creation of a sustainable vision which includes the core purpose, values and strategic goals (BHAGs) and analysis of the current transport situation (including a SWOT analysis) in relation to the vision which gave a starting point for solutions, measures and objectives.

An example to follow…

This way of tackling the challenges to future transportation, by making plans through backcasting (ABCD-method) and under the guidance of the FSSD, resulted in many good outcomes which are the first step to success in reaching the desired sustainability. Five BHAGs were identified and from those goals numerous immediate measures were drawn with a timeline for implementation. A number of SMART objectives were then listed on how to reach each BHAG.

The envisioned future of Blekinge – BHAGs:

By 2050, Blekinge shall through a sustainable (green) transport system…

1. have not increased the risk regarding future negative climate consequences by focusing on lowered GHG emissions;
2. have increased the share of rail-bound traffic;
3. have increased the share of inter-modal freight;
4. be attractive as a transit region with good transport possibilities to Poland and the Baltic states, and the Black Sea region, Russia and Asia, including China;
5. enhance business prosperity and growth within the region.

One important solution to reach the BHAG is introducing the usage of bio-fuelled engines and hybrids for road and sea transport. Here, the hope is in electrical motors powered by renewable resources, produced from sustainable (natural) resource bases (sun, wind, water, and waste). Another way to achieve the goals is to promote the use of and improve the services and infrastructure of more sustainable alternatives to road transport such as sea and rail. In order to diminish the environmental impact of road shipping in general, a management system should be established based on the "polluter-pays" concept. Last but not least, increased collaboration is needed among stakeholders to ensure that the goals consider the effects on all subsystems.

General impacts for the BSR

The suggested sustainable transport system in Blekinge brings to light some significant effects on the Baltic Sea region in general.

First of all, the assumed increase in the share of rail and sea transport will lead to numerous changes in today's transport pattern. More frequent use of sea transport will mean bigger tonnage and hence, larger ships heading for Poland and the Baltic States. A rise in road shipping is inevitable and capacity problems will occur, especially on route E22, due to the lack of sufficient funds for road improvements. New and modified routes for the railway system (e.g. Sydostlänken) are promised as an increase in freight is foreseen on existing rail tracks. Intensive traffic via terminals used for intermodal transport may require changes in freight routing in order to cope with the heavy loads and fulfil the environmental demands. Also, flexibility of routing is necessary to meet customers' needs. The use of electric hybrid vehicles will require a new infrastructure pattern of refuelling stations. More land use will be required in the development of terminals, ports, connections to present infrastructure and natural energy production facilities.

As stressed in the report, "co-creation" is crucial for achieving sustainable transport systems. Politicians, decision makers and experts should together agree upon responsibilities and ownership of agreed measures, conclude milestones and shape activities to fulfil the action plan. The increased collaboration among stakeholders will then have a positive effect on integration and cohesion between regions/countries in the BSR. This will be seen by enhanced commuting across the Baltic Sea, an increase in freight as well as the establishment of new companies. As a result, the quality of life for both visitors and inhabitants of the regions will improve thanks to new employment possibilities, better accessibility by rail and sea and tourism attractiveness.

To be continued…

The highlighted goals and solutions are in line with the EU's ambitions and, when broken down to a regional level, show that even more ambitious targets may be possible. Region Blekinge has found that their ambition should be: GHG neutrality by 2050; including maritime transport in the 99% fossil-free fuel target for 2030, and shifting 50% of road freight transport on distances over 200 km (compared to the White Paper's 300 km) to rail by 2050. Authors of the report hope that the results of their work will be part of the proposal for a future transport system designed for the Baltic region and provide knowledge for future territorial planning on both a local and regional level. ■

Monika Mikołajczyk

This article is based on the report "Development of sustainable transport in the South East Baltic – Food for thought to achieve green transport in Blekinge 2030". The document can be downloaded from www.transbaltic.eu.