

## TaxPayers' Alliance representation – Budget 2018

### Executive summary:

1. Air Passenger Duty (APD) should be abolished. In the meantime, a reduction of at least 50 per cent should be introduced.
2. APD reduces tourism, trade and investment. This has been compounded by regular increases in the tax. The UK is at a competitive disadvantage to neighbouring states which have a lower aviation tax, or none at all.
3. It is a Pigouvian tax, but owing to the relative price inelasticity of commercial air travel, has had a limited impact on journey numbers since its introduction in 1994. Load factors have been steadily rising for domestic and international flights.
4. A 50 per cent reduction could reduce the need for the public service obligation on certain routes. Airport expansion, and the new routes that could arise from that, would also be more viable.

### Objections to Air Passenger Duty:

5. APD was initially introduced to correct a perceived under-taxation of the aviation sector. The government in 2003 also noted that “APD was introduced in 1994 as a measure whose principal purpose was to raise revenue from the aviation industry but with the anticipation that there would be environmental benefits through its effect on air traffic volumes.”<sup>1</sup> Yet APD has not had the anticipated reduction in these volumes.
6. Although indirect taxes such as APD can deliver a substantial source of tax revenue, its impact on demand is limited. Passenger numbers on scheduled international and domestic flights rose by 32.7 per cent between 2006 and 2016. At the same time, scheduled transport movements rose from 1.653 million to 1.767 million.<sup>2</sup>
7. Additionally, flights within the European Economic Area are already covered by the EU emissions trading scheme (ETS). Any reduction in emissions from discouraging air travel would simply be replaced by another emitter buying the freed-up permit. This indicates that there is no emission-based reason to maintain APD in its current form.
8. APD is the highest European aviation tax for short and long-haul flights. Several near neighbours, including Ireland, the Netherlands and Belgium have eliminated their aviation tax.
9. APD puts the UK at a competitive disadvantage for trade, tourism and investment. The UK is ranked 133 out of 136 countries in the World Economic Forum’s Travel and Tourism Competitiveness Report for air ticket taxes and airport charges.<sup>3</sup>

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<sup>1</sup> House of Commons Library, *Air Passenger Duty: introduction*, 19 September 2012, <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN00413#fullreport>, (accessed 25 September 2018).

<sup>2</sup> Department for Transport, *Air traffic by type of service, operator and airport (AVI0102a and AVI0102b)*, 23 November 2017, <https://www.gov.uk/government/statistical-data-sets/avi01-traffic-passenger-numbers-mode-of-travel-to-airport>, (accessed 25 September 2018).

<sup>3</sup> World Economic Forum, *The Travel & Tourism Competitiveness Report 2017*, [http://www3.weforum.org/docs/WEF\\_TTCR\\_2017\\_web\\_0401.pdf](http://www3.weforum.org/docs/WEF_TTCR_2017_web_0401.pdf), (accessed 26 September 2018).

## Effectiveness and revenue implications for the Exchequer:

10. APD is forecast to raise £3.5 billion in 2018-19, and increase to £4.1 billion in 2022-23.<sup>4</sup> A 50 per cent cut in the rate of would deliver a loss of revenue of approximately £1.75 billion in the short term.
11. However, a portion of this reduced Exchequer revenue could be regained through airport expansion and lower state aid. The final report of the Airports Commission suggested that “without specific measures to support domestic connectivity even an expanded Heathrow may accommodate fewer domestic routes in future.”<sup>5</sup> A reduction in APD could save taxpayers’ money by removing the need for state aid to make domestic routes viable. Additionally, higher passenger numbers at London Heathrow, and better south east England connectivity, would also ameliorate some of the revenue loss.

## Wider macroeconomic implications, sectoral impacts and distributional effects:

12. Abolition of APD could provide a substantial boost to regional airports and increase the number of domestic routes.
13. A reduction in APD could make existing routes more viable, and lower the viability threshold for new ones. This is especially true for domestic travel. Passenger seat occupancy for scheduled domestic routes has been lower than for international routes. Between 2005 and 2015, it averaged 67.8 per cent for UK airlines. For international routes it was 79.7 per cent.<sup>6</sup> At Heathrow Airport alone, a recent estimate suggested that the total cost savings to UK passengers could be £12 million per annum under the 50 per cent reduction scenario, and stimulate a 4 per cent increase in demand.<sup>7</sup>
14. Concern has also been raised about the devolution of APD to Scotland. A July 2015 consultation considered the option of providing aid directly to affected airports in England. This would be a poor policy option, and simplifying the system by reducing APD by at least 50 per cent would be a much fairer way of boosting regional airports and enhancing growth. This would help ameliorate the Scottish Government’s mooted plans to reduce APD and prevent the competitive disadvantage which northern English airports would face.
15. Parliamentary committees have alluded to this benefit. In July 2011, the Northern Ireland Affairs committee recommended that APD should be abolished for flights both to and from airports in Northern Ireland. This is in part because of competition from Republic of Ireland airports, which do not levy an equivalent of the APD.<sup>8</sup> The abolition by the Northern Ireland Executive of APD on long-haul flights in 2013 is welcome, but an outright abolition or reduction should be extended to all flights.
16. The opening of new domestic routes could see a concomitant reduction in the public service obligation (PSO) requirement on some Scottish and Welsh routes.

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<sup>4</sup> Office for Budget Responsibility, *Public finances databank*, 25 September 2018, <http://obr.uk/download/public-finances-databank/>, (accessed 25 September 2018).

<sup>5</sup> Airports Commission, *Airports Commission: Final Report*, 1 July 2015, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/440316/airports-commission-final-report.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/440316/airports-commission-final-report.pdf), (accessed 26 September 2018).

<sup>6</sup> Department for Transport, *Activity by UK airlines (AVI0201)*, 23 November 2017, <https://www.gov.uk/government/statistical-data-sets/avi02-employment-and-flight-destinations>, (accessed 25 September 2018).

<sup>7</sup> Frontier Economics, *The benefits of reducing domestic APD*, September 2017, <https://www.frontier-economics.com/media/2245/benefits-reducing-domestic-apd.pdf>, (accessed 25 September 2018).

<sup>8</sup> House of Commons Library, *Air passenger duty: recent debates and reform*, 8 July 2018, <http://researchbriefings.files.parliament.uk/documents/SN05094/SN05094.pdf>, (accessed 25 September 2018).

17. In terms of APD's distributional effects, it is regressive. As a proportion of wages and salaries, APD is twice as high for the bottom quintile of earners compared to the top in 2016-17.<sup>9</sup> Cutting APD would benefit all those who take scheduled flights, but more so for those who are on lower incomes.

#### Recommendations and conclusions:

18. In the 2019-20 financial year, APD should be cut in half on the reduced rate, standard rate and higher rate. Airport expansion, and the reduced requirement for state aid to sustain existing and new domestic routes, would help to circumvent the negative impact on the Exchequer.
19. HM Treasury should conduct a study and model the effects of a 50 per cent reduction of APD. This should assess, inter alia, the impact on GDP growth, employment at regional airports, and how lower APD could improve domestic and international connectivity.
20. After the UK leaves the European Union, the ambition should be outright abolition. In the medium term, however, a 50 per cent reduction provides the opportunity to assess the merits of an expanded route network, and its consequent positive effects on growth, employment, tourism, trade and investment.

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<sup>9</sup> Office for National Statistics, *Effects of taxes and benefits on household income, Table 2*, 20 June 2015, <https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/theeffectsoftaxesandbenefitsonhouseholdincomefinancialyearending2014>, (accessed 25 September 2018).