

# ECONOMICS BRIEFING

7<sup>th</sup> December 2006

## IMPACT OF THE RISE IN UK AIR PASSENGER DUTY

- The doubling of UK Air Passenger Duty from February 2007 will add **4.4% to the average short-haul economy fare** in Europe and 3.8% on long-haul journeys. The impact on business fares are a little less;
- Evidence on the sensitivity of passenger demand to the cost of travel<sup>1</sup> indicates that the APD increase **will cause 6.1 million fewer passengers to fly** from the UK next year, including 152,000 fewer business trips;
- **Airlines will see revenues £1.1 billion lower** than they would have been. Moreover, the loss of business passengers could **reduce long-run GDP** in the UK by over £400 million;
- The Chancellor estimates that this will generate a reduction in carbon emissions of 0.3 million tonnes annually. He multiplies this by 2.5 to suggest total greenhouse gases will be 0.75 million tonnes lower. Even if we accept this controversial multiplier and use the UK Treasury's valuation of a tonne of carbon at £70 that implies an **annual climate benefit worth only £53 million**;
- Climate benefits of £53 million versus GDP losses of £400 million plus losses to air travellers suggest this **policy has not been put to a cost-benefit test**. It may provide the Chancellor with an extra £1 billion in revenues and enhances his green credentials but it makes little economic sense.

	UK-EU	UK long-haul	UK-total
<b>APD increase, £<sup>1</sup></b>			
Economy	5	20	
Premium	10	40	
<b>Return fare, scheduled, £<sup>2</sup></b>			
Economy	115	523	218
Premium	336	1750	821
<b>APD % of return fare</b>			
Economy	4.4	3.8	
Premium	3.0	2.3	
<b>Passengers forecast, 2007, million<sup>3,4</sup></b>			
Economy	65.2	22.2	87.4
Premium	6.2	3.3	9.5
Other charter	13.1	0.0	13.1
Total	84.5	25.5	110.0
<b>Loss of passengers, 2007, 000s</b>			
Economy	4270	850	5120
Premium	130	22	152
Other charter	857	0	857
Total	5257	872	6129
<b>Loss of airline revenue, £ million</b>			
Economy	489	444	933
Premium	44	39	83
Other charter	98	0	98
Total	631	483	1114
<b>Loss of long-run UK GDP, £ million<sup>5</sup></b>			408
<b>Gain in Exchequer APD revenues, £ million</b>			1028

<sup>1</sup> Source: Pre-Budget Report 2006    <sup>2</sup> Source: IATA PaxIS Plus database 2005

<sup>3</sup> Source: IATA PaxIS Plus database and DfT    <sup>4</sup> Source: IATA Passenger Forecasts 2006-2010

<sup>5</sup> Estimated using <http://www.oxfordeconomics.com/free/pdfs/aviation2006final.pdf>

<sup>1</sup> Source: Gillen, Morrison & Stewart (2003) 'Air Travel Demand Elasticities: Concepts, issues & Measurement'. [http://www.fin.gc.ca/consultresp/Airtravel/airtravStdy\\_e.html](http://www.fin.gc.ca/consultresp/Airtravel/airtravStdy_e.html).

## KEY POINTS

- ↗ Taxing passengers with APD will only reduce greenhouse gas emissions by discouraging travel. There is no direct financial incentive for efficiency or technological improvements. APD is a very blunt instrument with which to tackle aviation's climate change impacts;
- ↗ By discouraging travel there is also a cost to economic development. The Oxford Economics study (see footnote 5 to the table above) recently published showed that for every 10% gain in business travellers there is a long-run boost to GDP of 0.6% due to the benefits from increased investment and productivity. The business travel discouraged by this rise in APD is estimated to cause a loss to UK GDP of over £400 million;
- ↗ Airline passengers and shareholders will also lose. Passengers will pay an extra 2.3-4.4% on top of their fare. Airline shareholders will face a £1.1 billion loss of revenues as a result of the consequent loss of passengers;
- ↗ We estimate that passenger numbers will be 4.3 million lower next year on UK-EU markets than they would otherwise have been, a 6.2% loss. On long-haul markets the estimated loss of 0.9 million passengers represents 3.4% of the market. Economy passengers will be most price sensitive and we estimate these passengers to be 5.1 million lower next year, a 5.9% reduction. Premium passengers will be less affected with a 152,000 reduction, a loss of 1.6%;
- ↗ The loss to airlines and their shareholders will vary according to market and class:
  - Short-haul revenues will suffer more than long-haul because of the larger percentage rise in APD over average fares. We estimate short haul revenues will be cut over 6% from where they would otherwise have been in 2007. Long-haul will be down over 3%;
  - Economy revenues will also suffer far more than business because of their greater sensitivity to price. We estimate that economy revenues will be down over 5% compared to a loss of just over 1% for premium revenues;
  - Low fare airlines will also suffer more since the percentage rise in the cost of travelling with them will be proportionately higher. Ryanair's average return fare last year was £61 which implies a 8% rise in the cost of travel facing its passengers, compared with the average 4.4% rise on the average £115 return fare on UK-EU routes. Low fare airline passengers are also likely to be more price sensitive so there will be more than twice the loss of passengers and revenues, all other things being equal, than for the average airline.

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