

# IATA ECONOMIC BRIEFING

**MARCH 2014**

## IMPACT OF UK APD REDUCTION

### Summary and key points

- The move to a two band APD structure will reduce average travel costs to and from the UK by 0.4%, which in the short-term could lead to an annual boost in industry's overall contribution to GDP by about £205 million and an additional 4.3 thousand jobs supported.<sup>1</sup>
- The revised UK APD will continue to be the world's highest air passenger tax while still placing a disproportionately heavy burden on long-haul passengers –on average the APD will comprise between 5.7 – 7.9% of round trip travel costs for long-haul passengers compared to 5.2% for short-haul.
- Abolishing the APD would make the UK economy on net larger by around £16 billion than it otherwise would be in the first three years following abolition, according to a recent study by PwC.<sup>2</sup>

### The existing and revised APD regimes place a disproportionately high burden on long-haul passengers

- Table 1 summarizes the current APD regime and shows that the current APD rates place the largest relative burden on long-haul passengers, especially on passengers to band C destinations, which include key economies such as Brazil, China, India, South Africa and Japan.<sup>3</sup>

**Table 1: Overview of current APD regime (up to April 2015)<sup>4</sup>**

Bands	A	B	C	D	Avg.Total
Distance, miles	0-2000	2001-4000	4001-6000	over 6000	All
Avg. Return fare + fuel surcharge, £	268	1,004	1,013	1,424	476
Avg. APD rate, £	14.6	83.7	101.3	118.3	35.4
Total travel cost, £	282	1,087	1,114	1,542	511
APD share of travel cost, %	5.2%	7.7%	9.1%	7.7%	6.9%
Avg. price elasticity <sup>5</sup>	-1.19	-0.92	-0.75	-0.73	-1.10

Source: *Departing international passengers (UK CAA, PaxIS), Fare data (PaxIS), Elasticity (InterVISTAS, 2006), fuel surcharge (modelled as 25% of base fare), IATA calculations.*

- The UK Budget 2014 simplifies the APD structure applicable from April 2015 by retaining two bands (A and B) for commercial aviation, instead of the current four bands.<sup>6</sup> Table 2 presents average rates based on the revised APD structure within the 'old' four bands, it also presents the 'new' band B category. Despite the revised structure, long-haul operations (those over 2000 miles) continue to shoulder a relatively higher share of the tax burden. The biggest relative reduction in travel costs will benefit band D passengers (travelers to countries such as Australia, Chile and Indonesia), to a lesser extent band C passengers will also benefit (travelers to locations such as the Caribbean, China and India). Passengers traveling to 'old' band B countries (such as the United States and most of the Middle East) will be slightly worse off due to an increase in APD rates.

<sup>1</sup> Estimated impacts on GDP, employment and wider economy are based on an Input-Output model built for IATA by Oxford Economics with incorporated updates from latest available data on air transport market developments (i.e. fares and passenger levels). Estimating GDP benefits using input-output tables assumes a 'counterfactual' economy with unemployed resources, so all jobs and GDP created by tax abolition are additional and do not crowd out existing employment. We consider that given the GDP output gap of 1 – 1.5% and unemployment at 7.1%, as identified by the Monetary Policy Committee of the Bank of England in its forward guidance update of Feb 2014, it is reasonable to expect that most, if not all, of the identified benefits will be realized: <http://www.bankofengland.co.uk/publications/Documents/inflationreport/2014/ir14febeconrec.pdf>

<sup>2</sup> PwC, The Economic Impact of Air Passenger Duty, February 2013.

<sup>3</sup> Further supported by previous IATA analysis: <http://www.iata.org/whatwedo/Documents/economics/UK-APD-Consultation-Analysis-Jun11.pdf>

<sup>4</sup> The table aggregates information across all bands in the last column based on the weighted average of passenger volumes. Similarly, average elasticities, APD rates and airline fares are calculated based on a weighted average of relevant passenger traffic at the country pair level.

<sup>5</sup> Country level elasticities are estimated based on the InterVISTAS elasticity study "Estimating Air Travel Demand Elasticities" 2006.

<sup>6</sup> Under the APD structure approved in the Budget and Finance Bill of 2013 there are four bands (A, B, C, and D) and within each band rates include a standard rate applicable to non-economy class (premium) travelers and a reduced rate applicable to economy class travelers. The revised APD structure in the HMT Overview of Tax Legislation and Rates published on March 19, 2014 presents two bands (A and B). The rates for band A remain the same with a standard rate of £26 for non-economy and a reduced rate of £13 for economy class passengers. The new standard rate for band B is set at £142 (up from £134) and a reduced rate of £71 (up from £69); the scope of band B is expanded to cover all distances over 2000 miles, effectively folding the current bands C and D into band B

**Table 2. Overview of revised APD regime (from April 2015)**

Bands	A	old B	old C	old D	new B	Avg. Total
Distance, miles	0-2000	2001-4000	4001-6000	over 6000	over 2000	All
Avg. Return fare + fuel surcharge, £	268	1,004	1,013	1,424	1,053	476
Avg. APD rate, £	14.6	86.2	84.6	86.6	85.7	33.5
Total travel cost, £	282	1,090	1,097	1,510	1,138	509
APD share of travel cost, %	5.2%	7.9%	7.7%	5.7%	7.5%	6.5%
Avg. price elasticity	-1.19	-0.92	-0.75	-0.73	-0.84	-1.10

Sources: See Table 1.

- Table 3 summarizes the impacts on travel demand from the revised APD regime. The decrease in travel costs for bands C and D passengers is partially offset by the rise in travel costs for those in band B. Despite the lower rates for band C and D, the cost burden of the APD for passengers in key developed and emerging markets remains exceptionally high, with the APD continuing to be the highest passenger tax in the world. As an illustration, a delegation of four leisure travelers or business people from China will pay nearly £300 when traveling in economy and over £550 when traveling in premium. That constitutes the equivalent spending of an inbound foreign tourist to the UK over a four to seven day period.<sup>7</sup>

**Table 3. Impact on travel from revised APD regime (from April 2015)<sup>8</sup>**

Bands	A	old B	old C	old D	new B	Avg. Total
Distance, miles	0-2000	2001-4000	4001-6000	over 6000	over 2000	All
Avg. change in cost of travel, £	0	2.4	-16.7	-31.7	-7.3	-1.9
Avg. change in cost of travel, %	0	0.2%	-1.5%	-2.1%	-0.6%	-0.4%
Share of pax, %	73%	15%	8%	3%	27%	100%
Annual change in pax (round trip), thsd	0	-30	90	42	102	102

Sources: See Table 1.

- On average the revised APD regime is expected to reduce travel costs for international travelers by 0.4%, leading to an annual increase in about 102 thousand round trip passenger journeys per year. The decrease in travel costs for old band C and D passengers of 1.5% and 2.1% respectively will likely generate important long-term supply-side benefits to trade and investment.<sup>9</sup> For the more immediate demand-side impacts we have used an input-output model to trace the ripple effects of additional passenger journeys on incomes and spending in the supply chain and the wider economy, we estimate that the revised APD could<sup>10</sup> lead to an annual rise in industry's overall contribution to GDP by about £205 million and an additional 4.3 thousand jobs supported.

#### **Abolishing the APD entirety can strengthen trade competitiveness and boost GDP and employment**

- An analysis of the economic impact of abolishing the APD by PwC<sup>11</sup> concluded that:
- Abolishing the APD would provide an initial short-term boost to the level of UK GDP of around 0.45% in the first year, averaging to just under 0.3% per annum between 2013 and 2015 - expected to make the UK economy on net larger by £16 billion than it otherwise would have been in the first three years following abolition.
  - British businesses stand to be the biggest gainers, as lower fares allow business to spend more time with key overseas customers leading to business expansion and an increase in productivity. Increased investment in the air transport sector to meet higher demand is another key factor expected to have a favorable impact on the economy.
  - Increases in GDP would raise the level of UK economic output permanently, with the rise in output making it potentially possible to create almost 60,000 jobs between now and 2020.
  - Abolishing the APD would generate additional sources of government revenue, making it possible for abolishing APD to pay for itself, primarily from increased UK business growth achieved through better trade linkages and more employment in the UK economy.

<sup>7</sup> Foreign inbound tourists to the UK spent £84.37 (2009) according the UK Office of National Statics and calculations made by PwC analysis (2013).

<sup>8</sup> This analysis incorporates the impact on travel demand in response to changes in travel costs but for ease of comparison it does not vary the underlying demand for air transport services between the two time periods (pre and post APD revision). Figures in Table 3 use as inputs calculations provided in Table 1 and 2.

<sup>9</sup> IATA Economics Briefing 9, Aviation Economic Benefits, 2007.

<sup>10</sup> Estimated impacts on GDP, employment and wider economy are based on an Input-Output model built for IATA by Oxford Economics with incorporated updates from latest available data on air transport market developments (i.e. fares and passenger levels). Estimating GDP benefits using input-output tables assumes a 'counterfactual' economy with unemployed resources, so all jobs and GDP created by tax abolition are additional and do not crowd out existing employment. We consider that given the GDP output gap of 1 – 1.5% and unemployment at 7.1%, as identified by the Monetary Policy Committee of the Bank of England in its forward guidance update of Feb 2014, it is reasonable to expect that most, if not all, of the identified benefits will be realized: <http://www.bankofengland.co.uk/publications/Documents/inflationreport/2014/ir14febeconrec.pdf>

<sup>11</sup> PwC, The Economic Impact of Air Passenger Duty, February 2013.