



ECONOMIC IMPACT OF HM TREASURY PROPOSALS ON UK AIR PASSENGER DUTY

KEY CONCLUSIONS

- The existing APD structure is unfair, with long-haul passengers subsidizing short-haul;
- Largest burden falls on travel to key economic destinations of band C (inc. the BRICs and Japan)
- All four proposals in the HMT consultation paper produce a fairer structure, between short and long-haul;
- Short-haul passengers in band A will face higher travel costs, but only +0.3%, while passengers on other bands will benefit from a reduction of between 1% to 1.3% - correcting the previous distorted structure;
- The net impact on consumer benefits is positive in all four options, and we estimate there would be a net increase in passenger numbers in three out of four of the options proposed;
- The wider impact on the economy is also positive in all four options. The GVA of the air transport sector would be improved and increased activity would have positive multiplier effects through the UK economy, boosting GDP by £66-123 million, jobs by up to 2,200, and raising non-APD tax revenues by £24-45 million;
- Tourism receipts would also benefit under all four options, since band A visitors stay only 6 nights (compared to 8.6-15.8 nights for other origins) and spend significantly less than visitors from longer-haul origin countries;
- The options also support Heathrow's function as a hub airport, with long-term economic benefits to business.

ANALYSIS

	Band A	Band B	Band C	Band D	Average B-D	Average total
2011-12 existing structure						
Average APD, £ per passenger	12.62	71.23	85.76	100.39	79	26.81
Average return fare + surcharge, £	191	1061	1038	1560	1109	387
APD as % travel cost	6.2%	6.3%	7.6%	6.0%	6.6%	6.5%
% of passengers in band	79%	12%	7%	2%	21%	100%
% of airlines revenues in band	39%	34%	18%	10%	61%	100%
Average price elasticity in band	1.20	0.92	0.75	0.72	0.84	1.12
Option 1						
Average APD, £ per passenger	13.15	66.73			66.73	24.61
Average return fare + surcharge, £	191	1109			1109	387
APD as % travel cost	6.5%	5.7%			5.7%	6.0%
% of passengers in band	79%	21%			21%	100%
% of airlines revenues in band	39%	61%			61%	100%
Average price elasticity in band	1.20	0.84			0.84	1.12
Option 1a						
Average APD, £ per passenger	13.14	66.53			66.53	28.40
Average return fare + surcharge, £	180	899			899	387
APD as % travel cost	6.8%	6.9%			6.9%	6.8%
% of passengers in band	71%	29%			29%	100%
% of airlines revenues in band	33%	67%			67%	100%
Average price elasticity in band	1.20	0.92			0.92	1.12
Option 2						
Average APD, £ per passenger	13.15	61.69	73.69		67.31	24.62
Average return fare + surcharge, £	191	1061	1175		1109	387
APD as % travel cost	6.5%	5.5%	5.9%		5.7%	6.0%
% of passengers in band	79%	12%	9%		21%	100%
% of airlines revenues in band	39%	34%	28%		61%	100%
Average price elasticity in band	1.20	0.92	0.74		0.84	1.12
Option 2a						
Average APD, £ per passenger	13.14	61.38	73.69		65.79	28.05
Average return fare + surcharge, £	180	771	1175		899	387
APD as % travel cost	6.8%	7.4%	5.9%		6.8%	6.8%
% of passengers in band	71%	20%	9%		29%	100%
% of airlines revenues in band	33%	39%	28%		67%	100%
Average price elasticity in band	1.20	1.01	0.74		0.92	1.12

Source:
PaxIS ticket database,
HMT consultation paper,
InterVISTAS elasticities
study, IATA estimates

Fairness

- The existing UK Air Passenger Duty structure in the 2011-12 tax year penalises long-haul passengers (bands B-D) by cross-subsidizing short-haul (band A) passengers:
 - Existing band A passengers travelling to destinations up to 2000 miles from the UK pay an average APD of £12.62, which is 6.2% of their travel cost (fare + surcharges + APD). This band captures 79% of passenger departures.
 - However, passengers travelling to destinations between 4001 and 6000 miles from the UK, in band C, pay a higher 7.6% of their fare costs in APD. This band includes all the key economic destinations for the UK economy except Europe and the US: Japan, the BRIC economies, and Africa. The current tax structure penalizes travelling to those economies whose trade and inwards investment are critical for the success of the UK economy.
 - The average of bands B-D pay 6.6% of their fare costs, which is 6% higher than the average short-haul band A passenger. Band C passengers pay 22% more than band A passengers.
- The proposals in the HM Treasury consultation document 'Reform of Air Passenger Duty' March 2011 all produce a fairer structure:
 - Option 1 produces a structure where 79% of passengers departing for destinations up to 2000 miles from the UK pay 6.5% of their fare costs, compared with 5.7% for the 21% long-haul passengers.
 - Option 1a limits band A to the EEA countries, which reduces the proportion of passengers to 71%. With slightly lower average fares this means short-haul passengers pay 6.8% of their fare costs, compared with 6.9% paid by long-haul passengers.
 - Option 2 is not as simple with three bands rather than two, but nevertheless is simpler than the existing four bands. Short-haul passengers in band A pay 6.5% of their fare costs as in option 1. Passengers flying between 2001 and 4000 miles face costs of 5.5% of travel costs. Passengers in band C (flying to Japan, the BRICs) face slightly higher costs at 5.9%.
 - Option 2a limits band A to EEA countries, placing a number of non-EEA short-haul destinations into band B. This leads to these passengers (20% of the total) paying 7.4% of their fare costs.

Travel impact

Change vs existing APD structure	Option 1			Option 1a			Option 2			Option 2a		
	Band A	Bands B-D	Total	Band A	Bands B-D	Total	Band A	Bands B-D	Total	Band A	Bands B-D	Total
Change in APD rate, £	0.54	-12.27		0.52	-12.47		0.54	-11.69		0.52	-13.21	
Change as % travel cost	0.26%	-1.03%		0.27%	-1.27%		0.26%	-0.98%		0.27%	-1.35%	
Impact on passenger numbers, %	-0.32%	0.87%		-0.33%	1.17%		-0.32%	0.83%		-0.33%	1.24%	
Impact on passenger numbers, 000s	-231	173	-58	-217	312	95	-231	165	-66	-217	331	114
Impact on airlines revenues, £ million	-44	192	148	-39	281	242	-44	183	139	-39	298	259

Source: IATA Economics

- All of the options raise APD rates for band A passengers, but by only 0.3% of current travel cost (fare+surcharge+APD). Since 79% of passenger numbers are covered by band A it only requires a small increase in short-haul APD rates to make a large enough revenue-neutral change in the APD structure producing a fairer allocation of the tax burden across bands. The long-haul bands in all four options see APD reductions of between 1% and 1.3% of travel costs.
- Passenger numbers will decline, all other things being equal, on band A markets as a result of the proposed APD restructuring. We estimate this impact using the route area price elasticities estimated by InterVISTAS in the study for IATA (2007) 'Air Travel Demand'. Longer haul markets in bands B to D do have lower price elasticities as shown in the first table, and so are less responsive to the travel cost changes than short-haul markets. However, the travel cost reduction for these passengers is higher. In fact the estimated net impact is that passenger numbers would be increased by options 1a and 2a.

Impact on the UK economy

- But it is not passenger numbers that matter for the economic impact of the proposed APD changes. The impact on consumer benefits (what economists call consumer surplus) are usually proportional to airlines revenues. Although 79% of passengers are flying in band A, they represent only 39% of total consumer spending on air travel (or equivalently 38% of airline passenger revenues). The reduction in consumer benefits for short-haul passengers, due to the APD options is more than offset by the increase in consumer benefits for long-haul passengers. Moreover, this change corrects for an existing distortion to the welfare impact of APD.

- The impact on Gross Value Added or GVA of the air transport sector is also correlated to changes in airline revenues. Since this change is a net positive, with the deterioration in the short-haul business being more than offset by an improvement in long-haul, there would be a net benefit to the size of the sector's economic footprint.
- Add to the direct improvement in air transport GVA the multiplier effects of spending through the value chain and through the wider economy it is apparent that all four options will provide a positive net boost to the UK's GDP or national income, ranging from £66 million under option 2 to £123 million for option 2a.
- Over 1,000 jobs are generated by these options compared to the current APD structure. Option 2a generates an estimated 2,270 new jobs and £77 million of wage income.
- Although these options are designed to be broadly APD revenue neutral, the positive boost to UK GDP will generate additional tax revenues through payroll, corporate and expenditure taxation. It is estimated that these additional tax revenues would be between £24 million and £45 million.

Impact of options compared to existing APD structure

	Option 1	Option 1a	Option 2	Option 2a
Gross Value Added (£ million)				
Airlines	17	27	16	29
Airports	13	21	12	23
Indirect	23	37	21	40
Induced	18	29	17	31
Total	70	114	66	123
Employment				
Airlines	286	467	272	502
Airports	160	262	152	281
Indirect	479	783	455	841
Induced	368	601	350	646
Total	1,293	2,112	1,229	2,270
Wage income (£ million)				
Airlines	11	18	11	20
Airports	9	15	8	16
Indirect	13	22	13	24
Induced	10	17	10	18
Total	44	72	42	77
Tax revenues (£ million)				
Direct	11	18	10	19
Indirect	8	13	8	14
Induced	6	10	6	11
Total	25	42	24	45

Source:
Oxford Economics I-O
model for IATA

- Not included in these estimates are the positive impacts of the changes on tourism spending. Band A passengers from European origins typically spend 6 nights in the UK and spend around £415 per visit (see http://www.statistics.gov.uk/downloads/theme_transport/travel-trends09.pdf). Band B-D longer haul passengers stay longer and spend more in the UK. Typically North American visitors stay 8.6 nights, while visitors from other origin countries stay an average 15.8 nights i.e. more than twice as long as Band A passengers. Moreover, the average trip spend from these other origin countries is around £1,125, again more than twice Band A passengers. We have not explicitly modelled the tourism impacts but the UK government numbers described above would suggest that, even in option 2 where the fall in band A numbers is greater than the rise in band B and C passengers, the greater spending and longer stay of long-haul passengers will produce a rise in UK tourism receipts.
- The options will also provide some support at the margin to London Heathrow airport's hub status and the range of frequencies and destinations that can be offered to business and economic activity clustered in London and the SE of England. These economically important business travel services are dependent on more price-sensitive long-haul passengers providing the route density to make the economics work. The existing APD structure, which produces a travel cost penalty for long haul travel is one factor that has contributed to the relative decline of Heathrow as a hub airport compared to Frankfurt and Paris. The location of key industry and service clusters in London rather than another European location will be improved by the APD options proposed.