

## The case for keeping Air Passenger Duty

21<sup>st</sup> September 2016

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Air Passenger Duty was introduced in 1993 as a means of raising revenue without damaging the economy, and designed to go some way to making up for the anomaly that aviation is otherwise tax-free, paying neither VAT nor fuel duty<sup>i</sup>. The Scottish Government currently plans to cut APD in a bid to increase the number of long-haul business routes to Scottish airports. Here's why AEF opposes cuts to APD.

### 1. It's already a very modest tax on a sector that gets off lightly

APD is often portrayed by the industry as a blisteringly high tax. In fact:

While APD rates vary depending on seat class and journey length, 78% of the trips attracting APD are taxed at the lowest rate, £13<sup>ii</sup>. In April 2015 tax rates on the longest flights were cut by up to a quarter, and children are now exempt, while freight traffic and transfer flights have always been excluded as have flights departing from airports in the Scottish Highlands and Islands<sup>iii</sup>.

- On average APD comprises only 7.7% of a total air fare<sup>iv</sup>. Aviation is meanwhile exempt from VAT (charged at 20%) and fuel duty for motorists (charged at over 50%).
- In terms of the total cost of holidays, APD is an even smaller proportion. Lloyds Bank has estimated the total cost of a foreign holiday as £1404 per person<sup>v</sup>. The average APD paid represents less than 1% of this cost<sup>vi</sup>.
- APD rates have always been set low enough not to present a critical barrier to growth. Passenger demand at Scottish airports has grown by almost 5% per year on average over the past 40 years, despite APD. In fact, in the decade immediately after the tax was introduced (from 1993 to 2003) the annual average growth rate was over 7%<sup>vii</sup>.
- Some of the airlines complaining about the damage done by to the UK economy as a result of APD dampening demand continue to apply passenger surcharges of hundreds of pounds that were originally introduced in 2006 in response to unusually high fuel prices, suggesting that they in fact take the view that small cost increases can be absorbed by passengers without significantly impacting demand.

### 2. It's already a very modest tax on a sector that gets off lightly

APD was never designed as an environmental tax and attempts to align it more closely with environmental objectives (shifting from a passenger tax to a per-plane tax, for example, and varying the rate according to environmental performance) have stalled. As a result the rates charged have never been high enough – or smart enough – to solve the problems presented by aviation's environmental impacts. As a result:

- Noise annoyance from aircraft has increased and now affects 1 in 3 people in the UK<sup>viii</sup>, and the evidence that aviation noise threatens public health has also been growing<sup>ix</sup>. Airspace changes have prompted strong complaints on the basis of noise impacts, yet there is no Government policy specifying at what point noise disturbance becomes unacceptable.
- Aviation CO<sub>2</sub> meanwhile remains problematic. In order to hit the 2030 carbon target under the Climate Change (Scotland) Act all sectors will need to be on a 'high ambition' path, CCC

has advised, with no room for any sector's emissions to be higher than currently modelled. At a UK level, aviation emissions are set to exceed the maximum compatible with the UK Climate Change Act even assuming that APD is retained, that aviation is successfully included in carbon markets, and that no new runways are built. Scotland's commitment under the Paris Agreement extends beyond 2050 to achieving a zero carbon future by the latter half of the century. Even relatively small increases in aviation CO<sub>2</sub> as result of reduced aviation tax could prove problematic in the context of such an ambitious target.

Boosting aviation growth through further tax concessions in the absence of specific compensatory measures will only increase the scale of these challenges.

### **3. The evidence that cutting APD will boost trade links is not strong**

Studies commissioned by the aviation industry have often argued that cutting APD would boost the economy at a national level and Scotland has said it plans to cut APD in an attempt to attract more trade with business destinations especially in China. But the argument that an APD cut would generate economic benefit derives from assumptions about spillover effects throughout the economy as a result of increased aviation activity. Such assumptions have repeatedly been called into question.

- There is in fact little if any evidence that increasing aviation results in increases in trade (rather than the other way round).
- Business travel is largely insensitive to price<sup>x</sup>, with decisions instead being taken on the basis of need and time pressures, and long-haul routes from Scotland to the US and Asia are particularly price inelastic<sup>xi</sup>.
- The evidence from Northern Ireland, where APD was abolished on long haul routes in 2013, is not persuasive. One of the justifications for the move had been the concern that Dublin was attracting passengers away from Belfast on one of its busiest long-haul routes to New York (Newark). Following the abolishment, passenger numbers on this route rallied slightly to in 2013 before falling to their lowest level in 5 years in 2014 and further declining in 2015<sup>xii</sup>.

### **4. Cutting APD would boost outbound tourism at last as much as inbound tourism**

Cutting APD is also sometimes described as a means to boost tourism, again assumed to bring economic benefits. But this overlooks the fact that alongside any increase in inbound tourism there would also be an increase in outbound tourism, with more Scots encouraged by lower fares to take foreign rather than domestic holidays. At a UK level a significant tourism deficit (worth £16.9 billion in 2015<sup>xiii</sup>) exists as more money is spent abroad by British people going on holiday than is spent by incoming holidaymakers to the UK. The issue deserves careful consideration when assessing the financial impact for Scottish tourism of the planned APD cut.

### **5. Any cut would create a hole in public finances**

APD generated just over £3billion in the UK for the last financial year<sup>xiv</sup> and it is one of the cheapest and simplest taxes to collect. While any economic benefits (beyond those to the aviation industry itself) from cutting APD in the UK are uncertain, the immediate impact for the

Treasury of removing or reducing it is clear. Any lost revenue would either have to be raised through another means or cutbacks would be required in terms of public expenditure.

## REFERENCES

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