www.stopstanstedexpansion.com
info@stopstanstedexpansion.com

PO Box 311
Takeley
Bishops Stortford
Herts CM22 6PY
Tel: 01279 870558
Fax: 01279 870786

17 June 2011

APD Consultation
2/N1
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

By email to apd@hmtreasury.gsi.gov.uk

Dear Sirs

Reform of Air Passenger Duty

Stop Stansted Expansion ('SSE') welcomes the opportunity to respond to your consultation on the reform of air passenger duty ('APD'). We represent some 7,500 members and registered supporters including over 150 parish and town councils, residents' groups, national and local environmental groups and other organisations.

A significant part of your consultation document ('CD') is devoted to describing the contribution of aviation to the UK economy and while we fully acknowledge that the aviation industry makes an important economic contribution to the UK, it also gives rise to some adverse economic impacts. We find it surprising that there is no reference to aviation's adverse economic impacts in the CD particularly since this is an HMT consultation and there is a considerable body of evidence which indicates that the adverse impacts of aviation would be reduced by raising APD. Indeed, higher rates of APD would benefit the UK economy in three ways:

- by reducing the UK trade deficit on international travel;
- by diverting business, jobs and investment to the UK's domestic economy including – but not limited to – the domestic tourism industry; and
- by allowing other taxes to be lowered or government borrowing to be reduced.

HMT would presumably agree that reducing the UK trade deficit on international travel (£13.3bn in 2009[1]) would be good for the UK economy, especially if the UK's domestic tourism industry were to reap some of the benefit – i.e. the 'staycation' as an alternative to a foreign holiday. As the CD states: *'around 1.5 million jobs in the UK (5% of employment) are directly dependent upon tourism'.*[2] We therefore regard the absence of any analysis of the economic impact of raising APD as a significant weakness in the CD. We attach some analysis of our own at Annex A but

[1] *'Travel Trends 2009'*, ONS. Note that the £13.3bn figure excludes the trade deficit arising from the expenditure difference between air tickets bought from non-UK airlines by UK residents (imports) and air tickets bought from UK airlines by non-UK residents (exports). This amounted to a £1.9bn deficit in 2009 (Pink Book, Table 3.2) giving a combined international travel deficit of £15.2bn.

[2] CD, para 2.10.

our central point – that higher rates of APD would reduce the UK trade deficit on international travel – should not be contentious. The Department for Transport ('DfT') acknowledges that, for leisure air travel the price elasticity of demand is significantly higher for UK residents than for foreign visitors:

> *'The UK leisure sector showed a strong price elasticity of -1.0, while the foreign leisure market was found to be lower, at -0.2.'* [3]

Clearly, UK leisure travellers are significantly more price sensitive with regard to air fares than foreign visitors to the UK and so even if inward and outward leisure tourist numbers were equal, increasing APD would have a favourable impact upon the UK's trade balance on international travel. But the inward and outward tourism numbers are far from being equal: 7.7m international tourists holidayed in the UK by air in 2009 whereas 30.5m UK residents holidayed abroad by air – i.e. four times as many. In more detail the comparative statistics are as follows:

Table 1: International air travel 2009

Purpose of trip	*UK residents' visits abroad ('000)*	*Overseas residents' visits to the UK ('000)*
Holiday	30,458	7,685
Business	5,627	4,753
Visiting friends & relatives	9,592	7,203
Miscellaneous	980	2,439
Total	46,657	22,080

Source: Travel Trends 2009, ONS, Tables 2.07 and 3.07

Applying the price elasticities provided by the DfT to the above data it is clear that higher air fares have a far greater dampening effect on UK demand than foreign demand while lower air fares stimulate UK demand for outbound visits to a far greater extent than foreign demand for UK visits.

Taking holiday trips as an illustrative example[4], a 10% increase in the cost of air travel would (with price elasticity of -1) result in 10% (3.05m) fewer visits abroad by UK residents. However a 10% price increase would (with price elasticity of -0.2) result in only 2% (0.15m) fewer visits to the UK by overseas residents. Based on 2009 data the effect would have been a £1.8bn reduction in the UK's trade deficit on international travel from £13.3bn[5] to £11.5bn.[6]

Although only illustrative, the above analysis clearly supports our contention that higher rates of APD would reduce the UK trade deficit on international travel. In addition, any diversion of UK consumer expenditure to the domestic economy would stimulate growth, jobs and investment in the UK. The CD's *Foreword* states: *'the Government is therefore keen to stress its requirement for revenue'.* This makes it all the more surprising that HMT did not take the opportunity afforded by this consultation to examine the optimum scale of revenues from APD as well as its scope and methodology. The opportunity should also have been taken to examine the option of different rates of APD for different UK airports as a means of achieving better alignment between capacity and demand and of contributing towards other Government policy objectives.

We now turn to your specific consultation questions where we wish to respond only to questions 'a' and 'b'.

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[3] *'UK Air Passenger Demand & CO_2 Forecasts'*, DfT, Jan 2009, para 2.17. See also Table 2.1, para 2.18 & Box 2.3.

[4] The ONS definition of UK holiday travel is not the same as the DfT's definition of the UK leisure travel sector but it is considered sufficiently comparable for the purposes of this illustrative example.

[5] '*Travel Trends* 2009', comparing Tables 2.08 and 3.08.

[6] £11.5bn is arrived at by applying average spend per trip (*Travel Trends 2009*, Tables 4.01 & 5.01) to the adjusted total trips reflecting 10% fewer overseas holiday trips by UK residents and 2% fewer holiday trips to the UK by foreign visitors. Note that the £11.5bn figure excludes the deficit on passenger air transport services, referred to in footnote 1.

(a) Extending the scope of APD

We would suggest a slightly simpler approach where the starting point is to introduce a minimum APD charge on *every* departing aircraft above a prescribed authorised take-off weight ('MTOW')[7] and we would propose that the minimum level of APD payable should be 20 times the standard rate. At present APD is only payable where the aircraft has more than 20 passenger seats with the result that almost all business jets are exempt because very few have more than 20 seats.

A minimum charge of 20 times the standard rate of APD would – at current APD rates – equate to £480 for a Band A flight – i.e. the vast majority of business jet flights. Based on HMT's estimate of 80,000-90,000 business jet flights becoming liable for APD in 2012/13[8], a minimum charge of £480 would generate £40m-£45m, i.e. 1.4%-1.6% of the £2.8bn total projected APD revenue for 2012/13[9], which virtually mirrors business jets' 1.5% share of total UK aviation CO_2 emissions.[10]

However, a minimum APD charge on every departing aircraft above a prescribed MTOW would not only bring business jets into the scope of APD but also:

- cargo aircraft movements;
- training and testing movements;
- positioning movements;
- emergency services/public services;
- official, diplomatic and military flights.[11]

Exemptions would then need to be considered on a case by case basis. In our view the current exclusion of cargo aircraft from the aviation tax regime is anomalous and unjustifiable – a point recognised by the Government when the 'duty per plane' alternative to APD was proposed last year – a proposal which the Government unfortunately later felt it had to abandon in the light of legal advice. A £480 charge on cargo aircraft departures would raise only about £12m a year[12] which is a relatively small sum given that cargo aircraft account for about 2.5% of commercial aircraft departures from UK airports (and for a far higher percentage of aviation CO_2 emissions[13]). It is also worth noting that £12m is just one fiftieth of one per cent of the estimated £60bn[14] of goods carried to/from the UK by cargo aircraft in 2009.

We would also question whether training, testing and positioning movements should be exempt. There are no such tax exemptions for road users.

Finally, with regard to exemptions, we acknowledge that an assumed minimum payload of 20 passengers (for tax purposes) would have a particularly adverse effect on routes serving remote areas of the UK. We note, however, that HMT already has powers to grant exemption from APD on flight departures from airports in any region of the UK where the population density is not more than 12.5 persons per square kilometre.[15] Thus the Scottish Highlands and Islands already have a blanket exemption from APD and it would not be difficult to extend this to other remote parts of the UK if a persuasive case for so doing were to be made.

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[7] While not disagreeing with the proposed threshold of 5.7 tonnes MTOW a simpler alternative might be to make the minimum level of APD payable on all aircraft departures other than departures by aircraft powered by Avgas or any other form of fuel which is subject to fuel duty.

[8] CD, Table B2.

[9] Budget 2011, Table C2.

[10] CD, Table B2.

[11] We have not included general aviation on this list on the assumption that this category would fall below the 5.7 tonne MTOW threshold and would also be outside the scope of APD under the alternative proposed in footnote 7 above.

[12] CAA airport statistics 2010 (Table 6) shows 51,766 cargo ATMs = 25,883 departures @ £480 = £12.4m.

[13] A high proportion of cargo aircraft are large (Code E) air freighters on long haul routes.

[14] This 2009 estimate assumes that (i) one third by value of the UK's visible exports and imports (£540bn combined) is shipped by air and (ii) one third of all air cargo is carried by dedicated aircraft (the remainder being bellyhold).

[15] Finance Act 2000, s19.

(b) How many bands of APD?

In response to HMT's 2008 consultation on aviation duty, we strongly supported replacing APD with 'duty per plane', underpinned by a multi-band system. However, now that the duty per plane proposal has been abandoned, we believe that a multi-band system for APD is unduly complex and gives rise to numerous anomalies and we agree with HMT's view, as stated in the CD, that '*the APD regime should be as simple as possible'*. In keeping with this objective, we believe that a good case can be made for a single band system (while maintaining the standard rate and reduced rate tariffs). Self-evidently, this would be the simplest approach and we believe there are five additional reasons for choosing a single band system:

i) Any mileage-based banding regime for APD will always give rise to anomalies at the margin leading to complaints about unfairness. This is equally true of any boundary-based banding, for example, based on the EU/EEA/ECAA;

ii) Rail can often be a suitable alternative for short haul flights but it is not an alternative for transatlantic and other long haul flights. Therefore, while higher air taxes may be helpful in encouraging mode switching from air to rail for short haul journeys, higher air taxes cannot be used as a tool for encouraging behavioural change with regard to long haul journeys. Overall therefore – for the same level of APD revenue – a single band will be a more effective means of encouraging behavioural change;

iii) The environmental impact of air travel is not directly proportionate to the distance travelled; rather, it contains a significant fixed element arising from landing and take off (LTO). For example, on a 600km journey, LTO accounts for about a third of carbon emissions and about the same proportion of NOx emissions. In addition, aircraft noise impacts on local communities are almost entirely attributable to the LTO element of the flight. Admittedly long haul aircraft tend to have more and/or larger engines and as a result are noisier and more polluting but they also tend to carry significantly more passengers per aircraft and so, even on the basis of a single band of APD, long haul aircraft would provide significantly more APD revenue per flight than short haul aircraft.

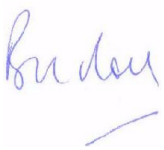
iv) The CD [Chart 2.C] highlights a number of developing countries – almost all small Commonwealth countries in the Caribbean – where international tourism accounts for over 15% of their GDP, namely: Jamaica (16%), Belize (20%), Antigua & Barbados (28%), Bahamas (30%), St Lucia (32%) and Barbados (33%). A single band system would clearly be advantageous – and fairer – to such countries and to the many UK residents who travel to these countries to visit friends and relatives.

v) The aviation industry frequently claims that the UK 'loses out' on long haul travel as a result of high rates of APD because UK residents have an incentive to take a short haul flight to a continental hub airport and make their long haul connection from there. A single band would remove that incentive.

We acknowledge that adopting a single band system would amount to a radical change in approach but we believe that the weight of argument fully justifies going down this route.

We would welcome an opportunity to discuss any aspect of this submission with you.

Yours faithfully



Brian Ross
Economics Adviser

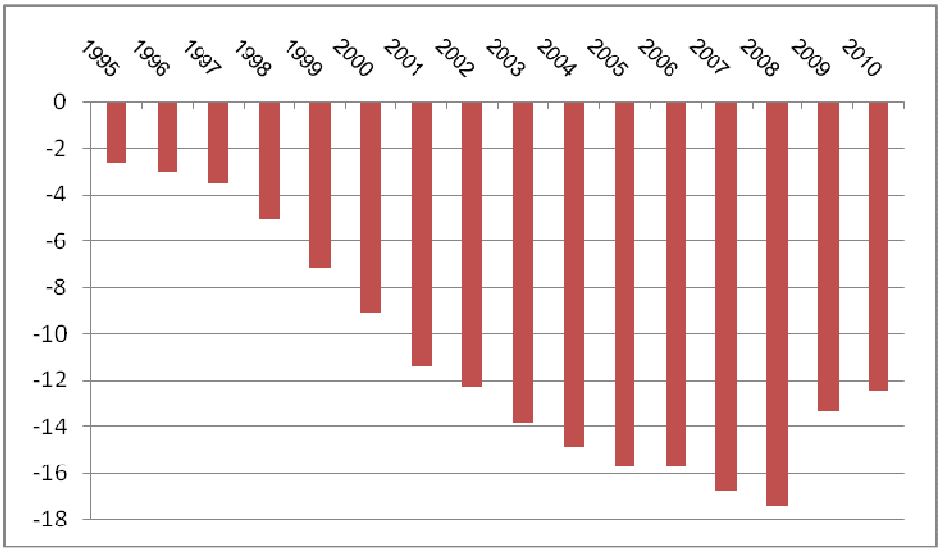
Price of Air Travel and Impact of Air Travel on UK Economy

The CD highlights the £14bn spent in the UK in 2009 by international tourists who arrived by air but makes no mention of the other side of the equation, namely the £27bn spent by UK residents on international trips by air in 2009, resulting in a £13bn trade deficit for the UK on international air tourism. The ONS commented as follows:

> *'In 2009 travel expenditure by non-residents visiting the UK accounted for 12 per cent of total exports of services, while expenditure by UK residents travelling abroad accounted for 30 per cent of total imports of services. The travel deficit grew significantly from the late 1990s to 2008, when the deficit peaked at £17.7 billion, before falling to £13.0 billion in 2009. Exports of travel services to non-resident visitors to the UK decreased by 1.6 per cent in 2009 to £19.3 billion, while imports by UK residents travelling abroad decreased by 13.3 per cent to £32.3 billion.'* [16]

The following chart shows the increase in the travel deficit since the mid-1990s and the improved position in 2009 and 2010, which corresponded to a downturn in air travel and a greater tendency for UK residents to holiday at home, the so-called 'staycation'.

Chart 1 – UK International Travel Deficit 1995-2010[17]



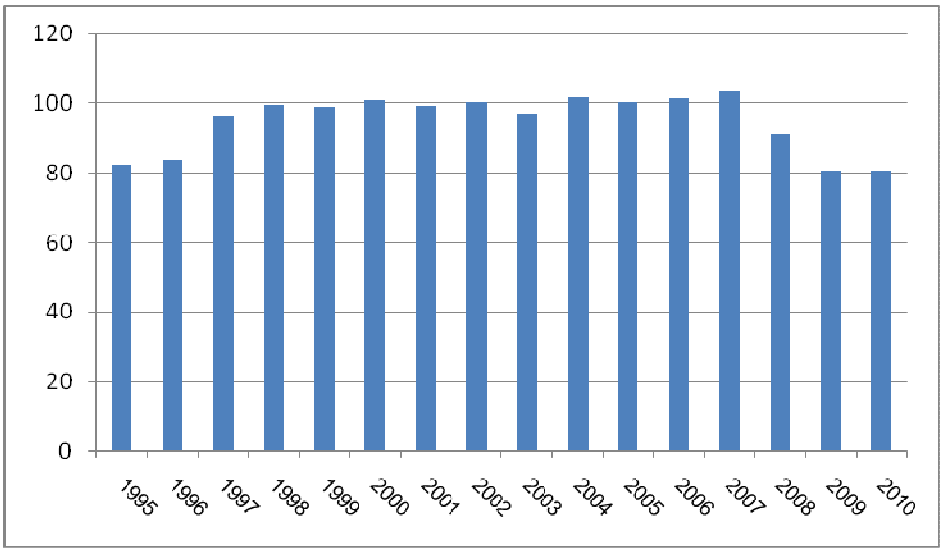
We are surprised by HMT's reluctance to address the UK tourism trade deficit on air travel in the CD because, looking at the way the deficit has moved over the past 15 years, there does appear to be a close relationship between the cost of air travel and the size of the deficit. The rapid growth in cheap flights from the late 1990s until about 2008 led to a mushrooming of the deficit – from £2.3 billion in 1996 to £19.6 billion in 2008.

[16] Pink Book 2010, p44.
[17] Ibid for 1995-2009 data and ONS provisional data for 2010.

It is also significant to note that the reversal of the trend over the past two years – initiated by the global economic downturn – has had a far greater impact upon outward visits than upon inward visits. Outward visits by UK residents declined by 20.4% from 2008 to 2010 while inward visits to the UK by non-UK residents declined only 7.1%.

The decline in the international value of sterling since 2008 may have contributed to the reduction in the UK trade deficit on international travel in 2009 and 2010 because it will have influenced the volume of outbound and inbound trips. The exchange rate is however a double-edged sword in relation to the trade deficit because a decline in the international value of sterling means that each trip abroad by a UK resident becomes more expensive in sterling terms and each visit to the UK by a foreign visitor generates less in sterling terms. Of course, the converse also applies and it is noteworthy that the trade deficit tripled in the late 1990s – a time when sterling appreciated by about 20%. In short, there is no clear correlation between the exchange rate and the trade deficit on international travel, as can be seen when Chart 2 below is compared to Chart 1 above. We submit that a far stronger correlation exists inversely between the cost of air travel and the trade deficit on international travel.

Chart 2 – Sterling Effective Exchange Rate 1995-2010[18]



In its January 2009 *'UK Air Passenger Demand and CO_2 Forecasts'*, the DfT provided the following analysis of income and price elasticities for air travel.[19]

[18] Bank of England: 2005=100.
[19] Table 2.1, p17.

Long run price and income elasticities of UK terminal passenger demand

Sector	Share of passenger demand 2005	Elasticity of demand with respect to	
		Income	Air Fares
UK Business	8%	1.4	-
UK Leisure	29%	1.5	-1.0
UK Charter	16%	0.4	0.4
Foreign Business	6%	0.6	-
Foreign Leisure	11%	0.7	-0.2
International to International Interliners	11%	0.7	-0.3
Domestic	17%	2.1	-0.3
Overall	100%	1.3	-0.5

The key comparison in the above table is between the price (of air fares) elasticity for the UK leisure sector (-1.0) and the price elasticity for the foreign leisure sector (-0.2). It is difficult to understand why the difference should be so large but the above analysis is broadly supported by other studies quoted by the DfT:

> *"... the price elasticity of UK national leisure travel is found to be in the range -0.7 to -0.8 (outbound) by* [the] *CAA, -0.6 by Dargay & Hanley, and -0.8 (-1.0 short haul, -0.4 long haul) by Dargay, Menaz & Cairns. These results lie within the 90% confidence range around our finding of -1.0 +/-0.5. Both studies conclude that they cannot find significant fare effects for UK business travel, although Dargay & Hanley find a small price effect for Foreign Leisure and Business travel of -0.3, similar to our Foreign Leisure elasticity (-0.2)."*[20]

The five-fold difference in price elasticity between the UK leisure travel sector and the foreign leisure travel sector is amplified by the fact that the UK leisure sector is almost three times as large as the foreign leisure sector (29% of the total market *vs* 11% of the total market). Thus an increase in the cost of air travel to/from the UK – whether the result of higher APD or otherwise – has a far greater impact (mathematically, 13 times greater[21]) upon the number of outbound UK leisure residents than upon the number of foreign visitors to the UK.

[20] *UK Air Passenger Demand & CO_2 Forecasts'*, DfT, Jan 2009, Box 2.3.

[21] (29x0.1)/ (11x0.2) = 13.2.