

The Impact of APD charges on the UK's Tourism Earnings and Targets

Summary

1.0 Introduction

In March 2011, the World Economic Forum has released a detailed report on the international competitiveness of 139 countries in the global tourism market. This report showed that the UK was well positioned at 6th in the global competitiveness table – a position that correlates with the UK's ranking by the UN World Tourism Organisation that the UK is the sixth most popular tourism destination in the world as measured by visitor numbers.

However, within the WEF report, it concludes that the UK ranks 134th out of the 139 countries in terms of ticket taxes and airport charges. The only countries found to be less competitive than the UK on this measure were Senegal, Côte d'Ivoire, Mali and Chad (one country, Timor-Leste, did not complete the questionnaire)

With the Government setting a target of increasing inbound tourism by 4m visitors over the next four years, this paper looks at the impact that increased APD charges have had on the UK's tourism earnings and the impact that the proposed double inflation increase will have if it is introduced in 2012.

2.0 Background

The UK tourism industry is seventh largest in the world. It is also the fifth largest industry in the UK, generating £114bn per annum and supporting 3.01m jobs.

Tourism is one of the largest and fastest growing industries in the world, averaging 4.2% per annum over the last 20 years. The growth of tourism in the UK over the last 20 years has averaged only slightly less at 3.8% per annum. This rate of growth is continuing through the global recession.

Inbound Tourism

2010 was a record year for the UK inbound tourism industry. Expenditure in the UK by visitors reached £16.8bn, making it the UK's sixth largest export earner, after Chemicals, Financial Services, Intermediate Manufactured Goods, Capital Goods, and Transportation. Inbound tourism now accounts for 12.1% of UK service sector exports and 5.0% of total UK exports. In addition, UK carriers gained approximately £3bn in fares from overseas visitors.

Despite the current economic conditions, growth in revenue from inbound tourism is tracking at 4% higher than 2010.

If the growth in inbound tourism continues at the current rate until the end of the year,

the sector will generate an additional £670m in revenue during 2011. This equates to the generation of around 13,000 jobs.

The UN World Travel Organisation (UNWTO) predicts that global tourism growth for 2011 will be 4-5% and will reach 1.6 billion international visitors by 2020. They predict that the major source markets for future international tourism growth will be the large emerging countries of India, China and Brazil, with outbound tourism from China alone increasing from 57m to 100m by 2020.

It is this growth in tourism from emerging markets such as China and India that the UK Government is focusing efforts to achieve the inbound tourism growth targets set on the Tourism Policy

2.1 Air Passenger Duty

Air Passenger Duty was introduced in 1994 ostensibly as an environmental levy, although it is generally acknowledged that its primary purpose is to raise revenue rather than to reduce climate change. While there are a large number of countries that impose airport taxes, the UK is one of the few countries in the world to impose a pure revenue raising tax – ie., where the revenue raised is not hypothecated and used to pay for the services and facilities provided to customers at the airport.

An aviation tax of this type has either been introduced or considered by a number of other European countries and, almost without fail, it has been abandoned after it was realised that such a tax is damaging to national aviation and tourism sectors. Denmark scrapped its flight tax in 2007, while in 2008 the Netherlands scrapped their aviation tax after only six months and Sweden and Belgium abandoned their plans to introduce a tax. Most recently, the Irish Government has announced that it is scrapping Air Travel Tax in order to stimulate tourism growth and help rebuilt the Irish economy.

In the UK, APD rates were initially low when the tax was first introduced - £5 for visitors from the EU and £20 for those travelling from destinations outside the UK in economy class and twice this for other classes of travel.

However, the rates have increased significantly since 2006, first doubling in 2007 and, in 2009, being replaced by a new charging scheme based upon concentric 2000km bands from London. This new scheme will see the charges increase to £12 for European visitors and up to £85 for long-haul visitors in economy class and twice this for other classes. This represents a 140% increase for European visitors and an increase of up to 325% for long-haul visitors in four years.

It should be noted that in developing the new charging scheme, HM Customs and Revenue's statutory impact assessment did not consider the impact of APD charges on the UK's tourism industry <http://www.hmrc.gov.uk/ria/apd-reform-ia.pdf>.

2.2 Impact of APD on Tourism to the UK

To calculate the impact that Air Passenger Duty has had on the UK's inbound tourism industry it is necessary to consider the following factors.

1. How big a component of tourism expenditure is APD

The greater the proportion of the total cost of travelling to the UK that is attributable to APD, the higher the impact it will have on the decision-making process of visitors.

2. The elasticity of demand for travelling to the UK

The greater the elasticity of demand, the greater the impact of increasing APD will be.

3. The marginal cost of employment in the tourism sector

The lower the cost of creating employment in tourism, the greater the impact of reducing or increasing revenue will be on employment levels

2.2.2 How big a component of tourism expenditure in APD

Average Cost of APD

The Office for Budget Responsibility estimates that the Government will raise £2.6bn in APD during 2011/12. Domestic flights are estimated to contribute £270m of this total, meaning that around £2.33bn was paid by people undertaking international journeys. As an estimated 68m international journeys will be taken by air in 2011/12, the average APD charge per traveller will be approximately **£34.26**

Average Cost of Travel to the UK

It is estimated that the average return airfare to the UK is approximately £250. Adding this to the £567 that the average visitor spends once in the UK gives the average expenditure on a trip to the UK of £817.

This means that, without these additional charges, the cost of visiting the UK would otherwise be £782.74

The £34.26 average cost of APD therefore increases the total cost of a trip to the UK for the average visitor by 4.4%

2.2.3 The elasticity of demand for travelling to the UK

The National Tourism Board, VisitBritain, has undertaken a study on the elasticity of tourism demand for the UK. This study, *Sensitive Tourists - The effect of changes in exchange rates and income levels on the UK's international tourism earnings* found that the price elasticity for tourism to the UK is -1.3. This means that for every 1% increase in the cost of travelling to the UK, there is a 1.3% decrease in the UK's earnings from inbound tourism. Conversely, if the cost of travel to the UK decreases by 1%, the UK will experience a 1.3% increase in tourism revenue.

Therefore, the 4.4% increase in the cost of visiting the UK caused by imposing APD, has resulted in a 5.7% reduction in the UK's annual inbound tourism earnings. This means that, if it weren't for the imposition of APD, the UK's earnings from inbound tourism would be £17.82bn rather than £16.8bn. That is a decrease of just over £1.0bn per annum. In addition there is a decrease in the level of revenue gained by UK carriers bringing people to the UK of a further £153m.

Together, therefore, UK businesses are foregoing £1.15bn per annum in revenue due to the imposition of APD.

2.2.4 The marginal cost of employment in the tourism sector

The impact on employment of forgoing £1.15bn in revenue as a result of APD can be calculated using VisitBritain's 2003 study on tourism employment, **Employment Generated by Tourism in Britain**. This study indicated that the marginal cost of a Full Time Equivalent job in the inbound tourism sector is £41,700. To take account of inflation since the production of the report, the Government now uses figure of £50,000 as the marginal cost of a tourism job.

Using this calculation, the UK has foregone 23,000 full time jobs in tourism industry over the last seven years directly as a result of Air Passenger Duty.

3.0 Impact of increasing APD by double the rate of inflation

Using the above methodology, if the Government increases APD charges by twice the current inflation rate (5%), the average cost of APD will rise by £3.43 to £37.69. This increase will reduce the UK's tourism earnings by a further £575m over the next 5 years and increase the number of jobs lost as a result of APD to 25,300.

If the Government maintains a policy of increasing Air Passenger Duty in line with inflation with 4% rises over the five years following the 2012 increase, the average cost of APD will increase to £45.86 by 2017. This additional cost of £11.60 per visit to the UK, compared to 2011, will result in a cumulative loss of earnings of £1.1bn by 2017, and the overall loss of 29,200 jobs as a result of the introduction of Air Passenger Duty.