

DEVOLUTION OF AIR PASSENGER DUTY

1. About Flybe

1.1 Flybe welcomes the opportunity to submit a response to the Assembly Finance & Personnel Committee's scrutiny of the proposals for a Legislative Consent Motion (LCM) on the UK Finance Bill 2012 regarding the devolution of Northern Ireland Air Passenger Duty for direct long-haul flights. Headquartered in Exeter, Flybe is proudly and determinedly a regional airline and is both Europe's largest regional airline and the UK's number one domestic airline. Employing around 3,300 staff, we currently operate 84 aircraft on 195 routes from 35 UK and 58 European airports (*all routes on sale Apr'12-Oct'12*) in 17 countries and carried more than 7 million passengers in 2011. CAA statistics show that, during 2011, Flybe was responsible for 120,383 air movements, nearly 13% of the total for the UK. This made us the third largest airline in terms of departures from UK airports, behind only British Airways and Easyjet.

1.2 Flybe has established a comprehensive regional route network and our spread of airports is intended to offer customers a convenient point-to-point network operating from regional airports which are a preferable alternative to having to travel to more distant major hub airports. In addition, the domestic route network does not attempt to compete with surface transport where alternative road or rail options give journey times of three hours or less. As such, and because we offer three times more domestic routes than our nearest competitor, Flybe can legitimately claim to understand the needs of the UK's regions better than any other airline.

1.3 Since October 2008 Flybe has also operated a franchise arrangement with the Scottish airline Loganair, under which 16 Loganair aircraft fly using the Flybe brand across 28 routes, serving island communities such as the Shetland and Orkney Islands and other transport-isolated areas.

2 Flybe in Northern Ireland

2.1 Flybe has been operating out of George Best Belfast City airport since it opened in 1983. Flybe has the largest domestic network offering flights to 18 destinations.



CAA passenger numbers for 2011 show Flybe as the biggest scheduled airline at George Best Belfast City, as follows:

| Airline | Total Passengers 2011 |
|---------|-----------------------|
| Flybe | 1,419,807 |
| bmi | 454,368 |
| bmibaby | 348,607 |
| easyJet | 81,321 |

3 Air Passenger Duty

3.1 Air Passenger Duty is a barrier to economic growth. It is well documented that the UK has the highest aviation tax in the world – a seriously short-sighted policy for an island nation. As can be seen from the table below, the numbers of UK domestic air passengers has fallen by nearly 20% since 2007-08. While this drop has clearly been in part the product of the recession and continuing economic challenges, the fact that APD for a domestic flight was £5 per passenger per flight in 2007-08 and is now £13 per passenger per flight has undoubtedly had an impact.

Table 1

| | 2007/08 | 2008/09 | 2009/10 | 2010/11 | VAR 2010/11 - 2007/08 |
|----------------|------------|------------|------------|------------|-----------------------|
| Total Domestic | 23,823,789 | 21,756,515 | 20,226,330 | 19,656,739 | -17.5% |

3.2 Flybe commissioned an economic analysis by Oxera of the regional impact of APD which showed that a reduction in the tax for the regions but not London has relatively little impact on London itself - mainly because the proportionate impact on regional airports of a small percentage of passengers switching from London is quite substantial.

3.3 Flybe argued strongly in our response to the Treasury's consultation that any reform of the banding structure of APD must remove the inherent unfairness that means UK domestic passengers pay the tax on both legs of their journey, while those flying abroad pay just once because APD is a departure tax and only applies to outbound flights from the UK. The fact that a return passenger travelling between George Best Belfast City and Glasgow (208 miles) pays *double* the tax that someone flying between Glasgow and Dalaman in Eastern Turkey does (4,086 miles) is not just inequitable - it is scandalous. Although the Westminster government decided against such an amendment, Flybe still believes that this 'double hit' must be addressed in order to safeguard UK domestic aviation and UK regional economic competitiveness.

3.4 The Westminster government recognised, both in its APD consultation document and response, the important role played by aviation in supporting regional economies. The economic development of any region is dependent upon the access and communications into and out of that region. Any reform of taxation must take into account the needs of the UK regions and not fall for media spin that all domestic aviation is bad. The Government must strive to protect communities and businesses where flying is a necessity, not a luxury. The vast majority of domestic flying (some 70%) is time-sensitive business travel and Visiting Friends and Relatives (VFR). Such flying is essential to the UK regional economies both directly in business travel and through the support to employment mobility and social cohesion in VFR traffic and is patently more important than 'fly away' tourism that contributes nothing to 'UK plc'.

3.5 Flybe supports the devolution of APD to Northern Ireland, Scotland and Wales. Should such devolution happen, Flybe would recommend checks and balances being in place to safeguard regional services ahead of tax breaks for 'vanity routes' to long-haul destinations that would otherwise not be economically viable.

4 The impact of APD on Regional Economies.

4.1 Aviation makes a real and measurable impact on the UK's regional economies. Research conducted in 2011 by Oxford Economics found that aviation employed 352,000 jobs directly and a further 344,000 jobs indirectly through the aviation sector's supply chain. They also found that aviation contributed £53.4 billion to UK GDP, 3.8% of the overall economy in 2009.

4.2 The study also pointed out that the average air transport service employee generates £55,512 in Gross Value Added (GVA) annually, which is over 75% more productivity than the average in the UK

4.3 We welcome the Government's recognition in the consultation document of the important role played by aviation in supporting regional economies. The economic development of any region is dependent upon the access and communications into and out of that region. Air travel plays a key role in delivering this.

4.4 Any reform of taxation must take into account the needs of the UK regions and not fall for media spin that all domestic aviation is bad. The Government must strive to protect communities and businesses where flying is a necessity, not a luxury. The vast majority of domestic flying (some 70%) is time-sensitive business travel and Visiting Friends and Relatives (VFR). Such flying is essential to the UK regional economies both directly in business travel and through the support to employment mobility and social cohesion in VFR traffic and is patently more important than 'fly away' tourism that contributes nothing to 'UK plc'.

4.5 Flybe understands that for some shorter trips road and rail can offer a more convenient alternative for many passengers, especially when the journey time is less than two and a half hours. However, it is a London-centric view to suggest that there are always realistic alternatives to aviation for passengers – particularly for time-sensitive business and VFR passengers. For example, a trip from Southampton to Newcastle by train takes up to 6 hours, including a tube journey through London. By contrast this would take 80 minutes on a Flybe flight and can be flown as a day return journey. The following table shows a small selection of routes from the UK regions and the comparative price and travel times of rail, ferry and air. It clearly shows why passengers rely upon air services to and from the UK regions that cannot be replicated, either in terms of speed or comfort, by train, car or ferry.

Table 2 Train vs. plane comparison for UK travel.

| Route | Flight Time with Flybe | Train Time - Fastest | Train Time – Average |
|-----------------------|-------------------------------|---|-----------------------------|
| Aberdeen-Birmingham | 1hr 5mins | 6hrs 30mins* | 7hours |
| Newquay-London | 1hr 5mins | 5hrs 11mins* | 5hrs 50mins |
| Inverness-London | 1hr 50mins | 8hrs 47mins | 8hrs 30mins |
| Manchester - Exeter | 1hr 5mins | 4hrs 15mins* | 4hrs 18mins |
| Belfast - Manchester | 60 mins | Ferry & Train 9hrs 42mins (4 changes) | 9hours |
| Norwich - Edinburgh | 1hr 25mins | 6hrs 29mins* ** | 6hours |
| Southampton-Newcastle | 1hr 15mins | 6hrs 21mins* | 5hours 30mins |

***1 change ** 2 changes**

Notes: Data from The TrainLine.com website. 13.03.12

4.6 Oxera has evaluated the impact of APD on the UK's regions by assessing the current APD levels against a counterfactual of no APD. In order to quantify the impact of changes in air passenger volumes caused by changes in APD on regional economies answers to the following questions are required:

- What is the contribution of the aviation sector to the UK economy? In other words what is the UK aviation GVA?
- What is the regional distribution of the UK aviation GVA?

4.7 The model designed by Oxera uses the contribution of UK aviation to GVA from its 2009 report for the Airport Operators Association (AOA), 'What is the economic contribution of aviation to the UK economy?' It then computed the proportion of aggregate UK passengers flows associated with each region, and distributed the UK aviation GVA across the regions using the proportion of aggregate UK passengers flows associated with them.

4.8 Using the above methodology, Table 3 below presents estimates of the effects on UK regional economies if APD were to be implemented at its current levels against a counterfactual of no APD. Clearly the counterfactual is unlikely to be a realistic proposition but for the purposes of comparison, the conclusions are very clear.

Table 3. Estimated change in aviation contribution to GVA, against the counterfactual of no APD

| | Estimated change in GVA (£m) | Estimated % change in GVA contribution |
|--------------------------|------------------------------|--|
| Channel Islands | -12 | -6.2% |
| East | -205 | -8.5% |
| East Midlands | -32 | -8.9% |
| Isle of Man | -9 | -16.0% |
| North East | -699 | -8.1% |
| London ¹ | -32 | -8.1% |
| North West | -191 | -9.6% |
| Northern Ireland | -100 | -16.3% |
| Scotland | -117 | -6.8% |
| South East | -9 | -6.2% |
| South West | -50 | -7.7% |
| Wales | N/A | N/A |
| West Midlands | -52 | -7.0% |
| Yorkshire and the Humber | N/A | N/A |

Note: N/A reflects data unavailable to perform the calculation. ¹ London airports are defined as Heathrow, Gatwick and City.

Source: Oxera.

4.9 It can be observed that the introduction of APD at its current levels against a counterfactual of no APD has a significant impact on the GVA of regional economies throughout the United Kingdom. In percentage terms, the impact is highest for Northern Ireland where, at current levels of APD, the contribution of aviation to GVA is 16.31% less, against the counterfactual of no APD. The average loss of GVA across the regions modelled is 9%, or £1.5bn.

5 Regional Differentiation

5.1 The consultation document raised the issue of regional differentiation of APD. By way of starting point, it is worth noting that estimates exist that suggest that if the UK's regions had been able to grow at the same rate as London and the South East over the past decade the UK as a whole would be £38billion better off.

5.2 Using the framework set out in section above, this section is a review of the impact of differentiating APD across the UK's regions. The form of this differentiation is unclear, but, for the sake of comparison, Oxera tested three separate scenarios, as follows:

- Scenario 1: 20% reduction in APD for regional airports, unchanged in London airports;
- Scenario 2: 25% increase to APD in London, other regions unaffected; and
- Scenario 3: uniform reduction in APD for domestic travel.

The impacts of these scenarios are shown in the following pages.

5.3 Scenario 1: Decrease in APD at regional airports

Table 4 below shows the estimated impact of regional differentiation of APD on average fares and passenger flows under scenario 1.

Table 4. Scenario 1: Aviation impacts

| | Assumed change in APD | Estimated change in average fare ¹ | Estimated change in passengers |
|---------------------------------|-----------------------|---|--------------------------------|
| Channel Islands | -20% | -6% | 22,375 |
| East | -20% | -8% | 363,186 |
| East Midlands | -20% | -6% | 55,478 |
| Isle of Man | -20% | -8% ² | 13,709 |
| London | 0% | 0% | -60,560 |
| North East | -20% | -6% | 56,111 |
| North West | -20% | -6% | 303,719 |
| Northern Ireland | -20% | -8% | 147,975 |
| Scotland | -20% | -5% | 214,157 |
| South East | -20% | -6% | 18,058 |
| South West | -20% | -6% | 89,940 |
| Wales | N/A | N/A | N/A |
| West Midlands | -20% | -5% | 91,833 |
| Yorkshire and the Humber | N/A | N/A | N/A |

Note: ¹This column presents the average change in yields across the four APD distance bands for each region. ² Due to data limitations, the yield increase for the Isle of Man has been assumed to be the same as that prevailing for Northern Ireland.

Source: Oxera.

Using the framework for analysing impacts on the economy described above, the GVA impacts on the regions would be as follows.

Table 5. Scenario 1: Economy impacts

| | Estimated change in GVA (£m) | Estimated % change in GVA contribution |
|---------------------------------|---------------------------------|---|
| Channel Islands | 2 | 1.02% |
| East | 32 | 1.31% |
| East Midlands | 5 | 1.35% |
| Isle of Man | 1 | 2.09% |
| London | -5 | -0.06% |
| North East | 5 | 1.23% |
| North West | 26 | 1.33% |
| Northern Ireland | 13 | 2.09% |
| Scotland | 19 | 1.09% |
| South East | 2 | 1.02% |
| South West | 8 | 1.20% |
| Wales | N/A | N/A |
| West Midlands | 8 | 1.07% |
| Yorkshire and the Humber | N/A | N/A |

Source: Oxera.

5.4 Scenario 2: 25% increase to APD in London, other regions unaffected

Table 6, below, shows the estimated impact of regional differentiation of APD on average fares and passenger flows under scenario 2, representing a situation where there is a 25% increase in the APD in the London; while other regions are unaffected.

Table 6. Scenario 2: Aviation impacts

| | Assumed change in APD | Estimated change in average fare ¹ | Estimated change in passengers |
|--------------------------|-----------------------|---|--------------------------------|
| Channel Islands | 0% | 0% | 0 |
| East | 0% | 0% | 15,855 |
| East Midlands | 0% | 0% | 2,345 |
| Isle of Man | 0% | 0% | 0 |
| London | 25% | 8% | -1,426,484 |
| North East | 0% | 0% | 1,830 |
| North West | 0% | 0% | 10,610 |
| Northern Ireland | 0% | 0% | 0 |
| Scotland | 0% | 0% | 0 |
| South East | 0% | 0% | 993 |
| South West | 0% | 0% | 4,295 |
| Wales | N/A | N/A | N/A |
| West Midlands | 0% | 0% | 5,622 |
| Yorkshire and the Humber | N/A | N/A | N/A |

Note: ¹This column presents the average change in yields across the four APD distance bands for each region.

Source: Oxera.

5.5 Using the framework for analysing impacts on the economy described above, the GVA impacts on the regions would be as follows.

Table 7. Scenario 2: Economy impacts

| | Estimated change in GVA (£m) | Estimated % change in GVA contribution |
|--------------------------|---------------------------------|---|
| Channel Islands | 0 | 0.00% |
| East | 1 | 0.06% |
| East Midlands | 0 | 0.06% |
| Isle of Man | 0 | 0.00% |
| London | -124 | -1.43% |
| North East | 0 | 0.04% |
| North West | 1 | 0.05% |
| Northern Ireland | 0 | 0.00% |
| Scotland | 0 | 0.00% |
| South East | 0 | 0.06% |
| South West | 0 | 0.06% |
| Wales | N/A | N/A |
| West Midlands | 0 | 0.07% |
| Yorkshire and the Humber | N/A | N/A |

Source: Oxera.

5.6 Scenario 3: Uniform reduction in APD for domestic travel

Table 8, below, shows the estimated impact of regional differentiation of APD on average fares and passenger flows under scenario 3, representing a situation where the APD is reduced by 20% across all the regions, including London.

Table 8. Scenario 3: Aviation impacts

| | Assumed change in APD | Estimated change in average fare ¹ | Estimated change in passengers |
|--------------------------|-----------------------|---|--------------------------------|
| Channel Islands | -20% | -6% | 22,375 |
| East | -20% | -8% | 363,186 |
| East Midlands | -20% | -6% | 55,478 |
| Isle of Man | -20% | -8% | 13,709 |
| London | -20% | -6% | 1,141,188 |
| North East | -20% | -6% | 56,111 |
| North West | -20% | -6% | 303,719 |
| Northern Ireland | -20% | -8% | 147,975 |
| Scotland | -20% | -5% | 214,157 |
| South East | -20% | -6% | 18,058 |
| South West | -20% | -6% | 89,940 |
| Wales | N/A | | N/A |
| West Midlands | -20% | -5% | 91,833 |
| Yorkshire and the Humber | N/A | N/A | N/A |

Note: ¹This column presents the average change in yields across the four APD distance bands for each region. ² Due to data limitations, the yield increase for the Isle of Man has been assumed to be the same as that prevailing for Northern Ireland.

Source: Oxera.

5.7 Using the framework for analysing impacts on the economy described above, the GVA impact on the regions would be as follows.

Table 9. Scenario 3: Economy impacts

| | Estimated change in GVA (£m) | Estimated % change in GVA contribution |
|--------------------------|------------------------------|--|
| Channel Islands | 2 | 1.02% |
| East | 32 | 1.31% |
| East Midlands | 5 | 1.35% |
| Isle of Man | 1 | 2.09% |
| London | 99 | 1.14% |
| North East | 5 | 1.23% |
| North West | 26 | 1.33% |
| Northern Ireland | 13 | 2.09% |
| Scotland | 19 | 1.09% |
| South East | 2 | 1.02% |
| South West | 8 | 1.20% |
| Wales | N/A | N/A |
| West Midlands | 8 | 1.07% |
| Yorkshire and the Humber | N/A | N/A |

Source: Oxera.

5.8 From the above, it is clear that differentiation of APD by region could help to rebalance growth to the UK's hard-pressed regional economies. Flybe's preference, given the needs of the regional airports and economies outside of the London, is for scenario 1; a 20% reduction for regional airports and a status quo for London airports.

5.9 It is notable that, relatively speaking, reducing APD for the regions but not London has relatively little impact on London itself - mainly because the proportionate impact on regional airports of a small percentage of passengers switching from London is quite substantial.

6 Devolving APD

6.1 Flybe supports the devolution of APD to Northern Ireland, Scotland and Wales.

6.2 Flybe welcomes the Government's decision to reduce the APD charges for long haul international flights from Northern Ireland to the domestic rate. However, this represents a tiny fraction of flights into or out of Northern Ireland. The policy change that would most benefit the Province, and genuinely give Stormont powers to determine its own economic future, would be the devolution of Band A APD to Northern Ireland. Although this consultation is focussed

on long-haul, Flybe firmly believes that the Committee should press strongly for such an extension.

6.3 Northern Ireland in particular, given the decision by the government in Dublin to scrap its aviation tax, needs to remain competitive with airports in the Republic of Ireland that will seek to attract passengers from the Province. Flybe sees this as a similar issue to the proposed devolution of Corporation Tax in Northern Ireland. Such a move will give Northern Ireland's airports a chance of maintaining their passenger base in the face of what is likely to be aggressive marketing from airports in the Republic. In short, Northern Ireland passengers will travel by surface transport to the likes of Galway, Knock, Shannon and most obviously Dublin to avoid paying APD unless this is amended. Precedent exists for such behaviour through the experience of the Netherlands when they introduced, briefly, a form of APD only to see passengers move in their thousands to Dusseldorf and Brussels to fly from airports with no APD.

6.4 Should such devolution happen, Flybe would recommend checks and balances being in place to safeguard regional services ahead of tax breaks for 'vanity routes' to long-haul destinations that would otherwise not be economically viable.

5 EU Emissions Trading System (ETS)

5.1 We do, however, welcome the Government's acceptance of the forthcoming EU Emissions Trading System (ETS) as the principle mechanism for delivering on its goals for reducing the global CO2 emissions impact of aviation. It has long been our belief that Air Passenger Duty does not represent the best mechanism to promote sustainable growth in the aviation industry. However, given that the ETS will produce an extra burden for aviation, Flybe, and to the best of our knowledge every other operator in the UK, would expect a commensurate reduction in APD after 2012.

6 Other Issues

The timing of any APD rate change

6.1 The airline industry needs at least 12 months notice of any change to rates or banding structure in order to make the necessary changes to booking processes and to be able to pass the correct level of duty onto passengers. An announcement by Government in the autumn of 2011 setting out the changes to take effect only 6 months later from April 1st 2012 does not provide sufficient or fair notice for airlines or indeed passengers. Along with the rest of the industry, Flybe would urge that any changes in rates or banding needs at least a 12 month notice period for introduction. The alternative to this approach would be a re-run of the chaotic situation of March 2007 where the government doubled APD and back-dated it, causing airlines to engage in the fiasco of contacting all passengers to collect the extra tax ahead of their flight.

- ENDS -