



Northern Ireland  
Assembly

Committee for Finance and Personnel

# OFFICIAL REPORT (Hansard)

Air Passenger Duty:  
Briefing from PricewaterhouseCoopers

24 April 2013

# NORTHERN IRELAND ASSEMBLY

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**Members present for all or part of the proceedings:**

Mr Daithí McKay (Chairperson)  
Mr Dominic Bradley (Deputy Chairperson)  
Mrs Judith Cochrane  
Mr Leslie Cree  
Ms Megan Fearon  
Mr Paul Girvan  
Mr John McCallister  
Mr David McIlveen  
Mr Mitchel McLaughlin  
Mr Peter Weir

**Witnesses:**

Dr Esmond Birnie	PricewaterhouseCoopers
Dr Jonathan Gillham	PricewaterhouseCoopers

**The Chairperson:** I welcome you to the Finance Committee. Obviously, the Committee has looked at the issue of air passenger duty (APD) before. I think that this is rather timely given the recent developments in regard to corporation tax. I met the Chamber of Commerce yesterday, and this is certainly very high up on its agenda as well as that of a number of other organisations associated with local business. Esmond, do you want to make a few opening remarks, and we will take it from there?

**Dr Esmond Birnie (PricewaterhouseCoopers):** OK. Thank you very much, Chair. Good morning, everybody. My colleague Dr Jonathan Gillham is an economist with PricewaterhouseCoopers (PwC) in London and is the main author of the UK-wide study on APD, which was commissioned by some of the major airlines, and which was published by PwC in February this year. Jonathan is happy to take questions on the technical side of that and APD in a general UK-wide context. I am the chief economist with PwC here in Northern Ireland, and I have been in that role for just over three years. I will handle questions related more particularly to APD in a Northern Ireland context and, indeed, any issues related to fiscal variation and devolution.

I will hand over to Jonathan at this point, who will give a synopsis of the report's contents, and then I will say a little bit about what we feel about APD in respect of NI in particular.

**Dr Jonathan Gillham (PricewaterhouseCoopers):** I am very pleased to be here. Thank you for inviting me.

We were approached by four airlines — British Airways, easyJet, Virgin Atlantic and Ryanair — which commissioned this independent report. Although the airlines financed the report, a key contractual

stipulation was that we maintained our independence throughout. So, although the airlines supplied data and verified some facts for the report, they had no substantial input.

We have written the report in the context of a set of tax principles that have been set out by the UK Parliament's Treasury Select Committee. Although those principles carry that brand, they are not unique to it. They stretch back to the time of Adam Smith, and they are a fairly common set of characteristics for assessing the different economic properties of a tax.

We looked at APD from the perspective of competition, its economic properties, its distributional properties and effects on different types of households, and what we call its procedural principles and how the tax operates, such as whether it is easy to comply with and administer. Our key finding was that if the UK Government abolished APD, which was the proposal that we modelled but which we did not put forward ourselves for the April 2013 Budget, the tax cut would effectively be self-financing. What we mean by that is that cutting the tax would generate increased levels of economic activity across the UK. More tax receipts would come in from other sources — VAT income tax, corporate taxes, etc — and the equivalent amount that comes in from those other taxes would offset the cost to the Government of the lost APD receipts. That is the general principle.

That was quite a surprising finding. It is not consistent with a lot of previous studies of tax cuts, but there have been similar findings in the past. For a finding like this to occur, the context has to be unique. We feel that the case of UK-level APD has that context for two main reasons: it is at a high level internationally, because UK APD is the highest of its type of tax in the world by some considerable margin; and we have found strong links between the performance of the aviation sector and the UK economy. That link is brought about through the connectivity that the aviation sector brings and there are associated benefits to UK trade, modes of transportation and business.

That combination of the high level of the tax, the strength of connectivity in the UK and the importance of the UK as an international airline hub drives that result. You would not necessarily find that result without those characteristics.

I will boil down some of the specifics. Our report suggests that there would be an initial short-term boost of around 0.45% to the level of UK GDP in the first 12 months. Our estimates suggest that if APD is abolished, an additional 60,000 jobs could be created across the UK economy, not just in the airline sector. The majority of jobs would be created outside of the UK airline industry. Overall for industry, I think there would be a net positive UK gain to the Exchequer of around 0.25%, which is £0.25 billion per annum.

**Dr Birnie:** Thank you very much, Jonathan. There are reasons to be particularly concerned about APD for Northern Ireland specifically, which is obviously the Committee's main concern. First, there are fewer readily available alternatives to air travel. Secondly, there is the potential for a growth in tourism. Thirdly, if APD is removed and does have a strong relationship to either exports or foreign direct investment, there is scope to realise the goals of the Executive's broader economic strategy and, indeed, the goals in the Programme for Government. Fourthly, as you will know, in the past, the NI airports have experienced tax competition relative particularly to Dublin Airport. Those are all reasons to lean in the direction of reducing or removing APD.

However, Jonathan referred to the extent to which increased connectivity in aviation relates to higher economic performance. We do not know for sure that that relationship is as strong for NI as a region as it seems to be for the UK in general, but it probably has a disproportionate effect on NI, as the Department of Finance and Personnel (DFP) argued in its submission on the consultation on APD. So, does this mean that we should seek total devolution of the tax, bearing in mind that the direct long-haul bit has been devolved? There is certainly a strong case, but there are several caveats to bear in mind.

The first is the precedent of the 10 airports in the Highlands and Islands of Scotland. They are exempt from APD on grounds of peripherality, which is an interesting approach that NI could consider. Obviously, we would have to see whether the European Commission or perhaps, ultimately, the European Court of Justice would buy that, but it is an approach — it avoids reducing the block grant in other words.

Secondly, the PwC report argues that, for the UK as a whole, a decrease in APD would probably lead to more than compensating increases in other tax streams like income tax, VAT and national insurance contributions. However, the argument of a devolved Administration that does not control most of those tax streams has to be different.

Thirdly and lastly, if the big challenge is indeed air route connectivity — and that is obviously the subject of investigation by the Department of Finance and Personnel and the Department of Enterprise, Trade and Investment (DETI) — it raises broader issues over and above APD, such as whether the route development fund of the past represents a model for the future or whether there are other ways of looking at improving connectivity.

Thank you very much, Chair. We are both very happy to take any questions.

**The Chairperson:** Thank you. You put forward the argument that the abolishment of APD effectively washes its own face for the extra taxation, jobs and economic activity that will come into the area. The report states that 60,000 jobs will be created between here and Britain. Is there not more of a case for here? You cited the Dutch example of €1 billion essentially seeping out through its borders a result of the policy that was put in place. Surely there is more of an argument for here, as we are already perhaps losing hundreds of millions of pounds in economic activity. That is because we are not in the same situation as Britain: people there do not have the option of driving down the road to somewhere with a lower rate of APD.

**Dr Gillham:** There are arguments on both sides. What is very much driving our finding is the strong linkage between the airline sector and the UK economy. What we have not made an assessment of as part of this report is the regional level. For us to qualify that finding at the Northern Ireland level, we would have to understand more about the links between the aviation industry and the Northern Ireland economy.

You are right to point to the issue of people being able to drive to Dublin, where there is no APD. There is precedent in that regard in the case of Schiphol, which is the main airport in Amsterdam. One of the case studies that we looked at as part of this report found that when an equivalent to APD was introduced at that airport, people would drive over the border or to other regional airports where the tax was not as high or not imposed. A wide range of cases point to the damaging effects that you mentioned. I emphasise that more would need to be done to understand the links between businesses and the aviation sector in Northern Ireland. However, I would qualify that with the potential for that to occur. Again, that is something that we just do not know enough about yet, but we assume that there would be quite considerable potential.

**Dr Birnie:** We can, with a fair degree of certainty, draw certain conclusions relating to the UK as a whole. However, Jonathan and I argue that, to have the same confidence in respect of NI, you would need to repeat the exercise with a Northern Ireland-based economic model. Having said that, in a sense, we could look more quickly at sectors, for example, tourism. The issue would be that DETI and DFP would have to make some assessment of how sensitive tourist volumes flying into NI — staying and spending here — are to variations in price; hence, what uplift there would be were APD to come down. To some extent, that argument has already been accepted in the overwhelming support that there was to reduce the rate on direct long-haul flights and the impact that doing so would have on the volume of transatlantic visitors. You could widen that exercise. Ideally, however, you could use a Northern Ireland economic model and repeat what we did for —

**The Chairperson:** Just on that point: is it your view that DFP and DETI should be doing that now in their report on air connectivity?

**Dr Birnie:** Sorry, Chair, do you mean should they be producing a model?

**The Chairperson:** Is that the kind of work that they should be doing in the report on air connectivity that they are to publish in a few months' time?

**Dr Birnie:** There is the art of the possible. For a short-term report, they should certainly look at sectors that appear particularly sensitive to the impact of air passenger duty, notably tourism. They should also look at all the available international and domestic evidence, some of which we reference in our report, as to how connectivity impacts on things such as greater inward investment in an economy and, moving the other direction, on stimulating greater exports from that economy to the rest of the world. All of those are, of course, key targets for the Executive's economic strategy and Programme for Government. However, in principle, they should think about some sort of modelling exercise, but, of course, that cannot be done in a couple of months.

**The Chairperson:** How long would that take?

**Dr Birnie:** I will let you take this one, Jonathan. *[Laughter.]*

**Dr Gillham:** Models exist that fit the Northern Ireland economy. We spent time getting an understanding of that link between aviation and the UK economy. If the model that they develop captures that link in a robust way, it is not too difficult or beyond the realms of possibility for a model like that to be constructed to produce a suitable estimate that you could make a good decision on.

**The Chairperson:** There has obviously been some local debate about the benefits of devolving APD, taking on some degree of cost locally and abolishing the duty. There has also been lobbying of the British Government for APD to be abolished across the board. Are there any signals that the British Government are of a mind or even considering abolishing APD?

**Dr Gillham:** It is difficult for us to speak on behalf of the British Government. *[Laughter.]* I can reflect the feedback that we have had on the report and, to be honest, I do not think that they are considering it at the moment. We had good feedback on the quality of our work. They were very engaged about the findings, and we had some substantial discussions with the UK Treasury and HM Revenue and Customs on this issue. There are some points of disagreement between us and the Treasury about the strength of the relationship between connectivity and the UK economy. The feedback that we have had is that they would suggest that it is perhaps weaker. However, a look at recent reports published by the Airports Commission, which was recently set up by the Department for Transport to look at the expansion of UK airport capacity, show that there is a very strong link. So, I think that there is plenty of evidence to support our case. There were some points of contention. Is it at the top of the policy agenda at the moment? I would say no.

**The Chairperson:** I have one final question before I open it up to members. How beneficial would that be in comparison to the corporation tax issue that we have discussed locally? There are interesting statistics on page 18 of the more recent report. Table 5 shows how much extra GDP results from a £1 tax cut in a number of different areas. It is interesting that corporation tax has a benefit of 55p, APD a benefit of 59p, and, actually, fuel duty is top of the list with a benefit of 63p. Will you comment on that?

**Dr Gillham:** We have to be a bit cautious about spurious accuracy, but I think that table shows quite clearly that APD is one of the more economically damaging taxes. It is on a par, in the economic effects or distortions that it causes, with corporation tax or fuel duty, and those are two taxes that are actively being cut by the UK Government as part of their growth agenda. We argue through the report that there is certainly a role for APD to play in the growth agenda and we think that its contribution to the UK economy could be significant, as the report's findings clearly show.

**The Chairperson:** Do you have anything to add to that, Esmond, about the local context?

**Dr Birnie:** No. The general point, as you are well aware, is that, in either case — reduction of corporation tax or a proposed reduction of APD — it is a balancing act, because, under European law, there would be a reduction in the block grant paid from the Treasury in London to the Assembly and the Northern Ireland Government. In the case of APD, we believe that it would be in the order of roughly £60 million per annum. In the case of corporation tax, a lot of different figures have been quoted over the past two years, but it could be anything between £250 million and £400 million-plus per annum.

I suppose you are really asking in which case you are more likely to get more stimulus to the rest of the economy, and, hence, compensating growth to set aside that impact on the resources to the public sector in NI. As Jonathan said, it is very hard to be precise, but my instinct would be to favour APD rather than corporation tax, but, in any case, as we well know, any decision about corporation tax is now well postponed into the future, so there is perhaps an opportunity or, arguably, a need to consider other forms of tax devolution. I think that APD, for some of the reasons that have been mentioned this morning, is one of the prime candidates. It is not the only tax that could be considered for devolution, and obviously it is worth looking at what is being said in Scotland and Wales, but it is certainly one of them.

**Mr Mitchel McLaughlin:** Thank you very much. You are most welcome. The report is timely and very interesting. For the decision that was taken with our single long-haul flight, clearly a principle was

accepted or established, because it did in fact, in a very immediate sense, save the flight. It was clearly a significant issue. More than just prestige, it was a huge issue for our local economy and that connectivity. My concern has been that, when we discussed the devolution of powers to the Assembly, people tended to talk about abolition across the board and the global cost of that as something that was beyond us. There was also the principle of selectivity or an incremental approach. That is what I am very interested in exploring. There are a number of key airports in the UK that have linkages to the international community. It would be very much in the interest of our priority of rebalancing and growing our economy if we had the best possible connections, too. If you were taking that selective approach, the global cost of simply abolishing APD across the board would not apply. There is no cost if you do not take a decision. You have the power, but it does not cost you anything to have that power. It is about how you apply it.

Jonathan, you said that you did not reduce this to a regional study. Have you encountered that type of selective, targeted approach in international examples, where specific routes were encouraged and stimulated, with there being subsequent stimulus to the local economy and a cost-neutral option?

**Dr Gillham:** I cannot say that I have, but that is largely because that was not the direction that we —

**Mr Mitchel McLaughlin:** It was not in your remit.

**Dr Gillham:** Having said that, in our discussions with them, the airlines said that APD has been a significant barrier to setting up some new routes. That barrier can exist on a range of fronts. Some of the Asian markets flying from anywhere in the UK found it quite difficult to get a foothold. Moreover, in Europe, there are some routes that are simply not viable at the moment because of the level of taxation, so it is both a short-haul and long-haul issue. The other thing that comes out quite clearly from the report is the burden of taxation for UK airlines relative to international airlines. For example, a non-UK carrier that operates more routes outside of the UK has a lower passenger tax burden than the UK airlines. That allows it to have more viable routes and activity. Although we have not looked at it in the incremental way that you described, there are some quite substantial lessons that you can take from the report that point to — *[Inaudible.]*

**Mr Mitchel McLaughlin:** Esmond, because we are taking a more regionalised perspective, if we were to apply APD in a selective way, what would be the practical effect of flying into UK airports where the policy would continue? Would that encourage the development of routes into mainland Europe, where there are examples of where you can avoid that reciprocal kind of tax?

**Dr Birnie:** I will make two points. The first is that the practical effect of the initial decision to exempt and then the subsequent formal devolution of APD on direct long-haul flights is to assist one firm at the moment. Although, in legal terms, it assists any airline operating in that context, in practical terms it currently assists a single airline. That creates a bit of a question mark for European Union competition law. The fact that there could be a vulnerability to challenge is something always to be kept in mind. However, that is like a lot of policy measures. Somebody could take a case in the European Court of Justice, and so on, so keep that in mind.

As for APD and encouraging connections selectively, be they to GB, continental Europe or further afield, at this stage we probably do not know enough about how price-sensitive the airlines are. As Jonathan said, they will say that APD has been a barrier to setting up new connections. Obviously, however, there are lots of other cost factors involved. A key issue, which itself is influenced by APD, is the perspective volume of traffic on any given route. I would expect that the Department's consideration of connectivity, and, presumably, this Committee's consideration, will look at whether the best way forward is to reduce APD across the board or to use the money that would be involved for a more targeted approach, as was the case in the past with the route development fund.

We have an open mind on that, because, based on the report at this stage, we could not say which approach is more likely to be cost-effective. However, something should be done. That is almost certainly the case.

**Mr Mitchel McLaughlin:** Would the competition from Dublin tip the balance in favour of either of those two options?

**Dr Birnie:** It certainly did previously for the direct long-haul flight, in the sense that it was being said — it is very hard to prove this one way or the other — that the airline that operated that route was on the verge of pulling out. It may well have been, because that would have made sense.

**Mr Weir:** Thank you, gentlemen. The Chairperson has covered a lot of the runway so far, so perhaps my comments will have to be limited.

**Mr Cree:** You take off anyway. *[Laughter.]*

**Mr Weir:** So long as I do not crash into the walls.

I want to follow up on the previous point and ask about the level of research that has been done on a differentiated approach that would show the impact of a UK-wide abolition. There is a very clear case to be made for that. No one would have any difficulty in lobbying for a UK-wide abolition and the impact of that.

Things become more difficult in the case of the much more differentiated approach, which is more within our remit. To follow up on Mitchel's point, has there been much research done on the impact of the abolition of APD on long-haul flights as opposed to an across-the-board approach and on the differentiation between the impact of long-haul APD abolition and that of the abolition of APD on short-haul flights?

In a UK context and from a regional point of view, what assessment has been done of the extent to which the abolition of APD on short-haul internal flights would arguably result in people spending more money in London rather than generating more income for the region, because there would obviously be a loss? There is an issue about whether, from a retail point of view, there is a net gain or loss, or at least about the extent of the gain. Will you comment on that?

You have given reasons why abolition, from a local point of view, may logically follow through with a degree of advantage, but you have highlighted that with a note of caution, largely because you are basing your views on a logical extrapolation rather than an evidence-based interpretation of a local business case.

The Department will be analysing the issue. What advice can you give to us or the Department about how we can take an evidence-based approach forward, based on the research? Everyone can buy into the abolition of APD on long-haul flights, but to my mind, from an evidence point of view, the jury is still out on whether the abolition of APD on short-haul flights produces more bang for your buck.

**Dr Birnie:** Others have raised the issue of whether we would just be encouraging people to take more cheap holidays in Spain, which would not benefit the economy here. There are a number of answers to that.

Jonathan referred to the general principles of taxation, one of which is equity, or fairness. It is interesting to note that APD actually bears down relatively heavily on families with less than average income. That might surprise some people, but when you look at the figures, that is the case. What is happening is that all the members of families on average incomes or below-average incomes who go on a package holiday are paying that rate of tax, which, as Jonathan says, is high compared with European standards. Although in a very abstract economic sense you might say that it is bad for the economy that those people are having a holiday in Spain, from the point of view of equity and fairness, the tax on them is arguably unfair.

**Mr Weir:** The point that I am making is more to do with regional redistribution. Looking at it very specifically in the Northern Ireland context, there is no doubt that there may well be some level of economic spin-off. Both the issues that you identified carry a price tag of £60 million. There is that particular benefit, particularly on the short-haul side of it.

**Dr Birnie:** Yes, I was going to come to that. We have to keep that equity issue in the background. It is important. As to the economy, I feel confident that, given the potential for further growth in tourism, even if the abolition of APD encouraged some NI-based people to take more holidays overseas rather than stay at home, there would be more traffic coming in the other direction. One of the things that we considered is that there is a cost to businesses here. In so many of our businesses — whether in construction or in the sector that I work in, business services — so many of our staff spend a considerable amount of their time working in the south-east of England, or in other parts of England or GB, that flights from Belfast to GB make up part of business costs. Anything that reduces the tax on air travel represents a reduction in the operating costs of Northern Ireland service, construction and manufacturing firms. There would be an benefit to the economy here from that.

Your point, Mr Weir, about the long-haul/short-haul differential is important, and Jonathan is more knowledgeable about that than I am. Intuitively and instinctively, most economists would probably agree that the responsiveness or elasticity would be greater on long-haul tickets, which, after all, are the more expensive ones. I hope that I am right about that. It is an empirical issue, and it might be disputed. I hand over to you, Jonathan.

**Dr Gillham:** It is worth distinguishing between short-haul flights within the UK and short-haul flights to Europe. One thing that we find in the report is that, if you abolish APD, there will be more outbound travel. People will go on more holidays. You are right to raise the issue that there could be a redistribution of activity within the UK. We have also found that if you have that extra weekend in Barcelona or go from Belfast to London for a weekend's shopping, that is money lost from the region, and the economic multiplier of that is quite significant. That is factored into our report and balanced out. We have found that the business benefit, or, as Esmond described APD, business cost, significantly outweighs that negative effect. That is quite a strong and well-tested finding in our report.

I add that a lot of the short-haul flights carry business passengers. A lot of businesses use short-haul providers such as easyJet and Ryanair much more than you might think. There are statistics that will attest to that. Those routes are carrying a lot of business activity. The flight that I was on yesterday from Belfast to London was full of business passengers in suits, and there are huge flows and levels of activity that a reduction in APD would boost. One small addition would be to look at the way in which businesses buy flights. Larger businesses buy them in bundles, so if APD were abolished, you would probably get 10% more bang for your buck in your budget for buying flights. As such, you would probably travel 10% more. You would keep your pot of money and perhaps do a few extra client visits a year. That is where the benefits from abolishing APD really come in.

**Mr Weir:** I am open-minded in the local context, so I certainly would not take issue with anything that you have said about the overall concept of the abolition of APD across the board across the UK. I can clearly see where there are economic advantages. My concern, which you have acknowledged, is about the evidential-based analysis of the impact in Northern Ireland and the variation downwards or abolition of APD locally. So far, there has not been that evidence base, and, to some extent, it is either on the basis of extrapolation or APD. The issue is being closely examined by the Department and, by inference, by ourselves. Is there any advice from an evidential gathering point of view to guide us or the Department in how to go about assessing that? People will feel that this will be a lot more focused if it is clearly based on evidence of actions that could then be taken, notwithstanding the wider argument of a general abolition across the UK.

**Dr Gillham:** I do not think that I need to give you any advice, because you have already framed the question in exactly the right way, in that you are looking at the trade-off from activity that moves out of Belfast into other parts of the country. You need a technique to measure that, and you then need to look at the balance of the business benefit coming back in. If you conclude that the business benefit is more significant, you will perhaps want to think about taking action on cutting your APD rates. That is the trade-off that you want to look at. We looked for evidence for that across the UK at the national level in previous studies that have been undertaken. We felt that our search was comprehensive, and we did not find anything of substance.

**Mr D McIlveen:** What degree of stress test was put on the research for changing environment? I mean more the environment of competition, bearing in mind that, at the minute, we have roughly 1.7 million people in Northern Ireland, at least two thirds of whom are not more than two hours' drive from Dublin Airport. Competition is virtually closed if you are outside the easyJet network, if I might put it that way. I know that there are other carriers in Northern Ireland, but I mean within that broad network. Bearing in mind that the flights that operate out of Dublin that are outside the easyJet network have had virtually no competition until this point, what would happen if we found ourselves in a position that we were able to compete? What degree of stress test has there been on a drop in passenger numbers in Northern Ireland if greater competition were to be applied to the market?

**Dr Gillham:** We have not undertaken a stress test at the regional level. Using the model, we have examined changes in surrounding economic conditions, and our central finding is unaffected by that. On shifts in the underlying competitive scene, our results are perhaps strong enough to be insulated. I cannot necessarily attest to your description of airports such as Dublin Airport not facing any competition in recent times. It may feel that it does have a lot of competition, so I cannot answer in that context. However, if you were to boost the level of connectivity coming through Belfast, the



spillover effects to the wider economy would be quite significant. That is perhaps *[Inaudible.]* when considering the policy option.

**Mr D McIlveen:** I will move on. To what extent was research done on the market's ripeness for more routes into Northern Ireland? My understanding of the airline industry is limited, but I would expect that if a new route is to be introduced from, for example, Berlin, whoever operates that flight will want to make sure that there is some two-way traffic. Although we would welcome a plane full of German businessmen into Northern Ireland with open arms, that flight may go back practically empty owing to there being very little demand from people in Northern Ireland. Is the market viability there for those increased routes? I expect that that would have an impact on the amount of, I expect, bang for buck when it comes to the tax receipts.

**Dr Birnie:** I will start. It is really the same answer: those sorts of issues were not considered in the report about the UK-wide situation. I think that there has to be a presumption of market ripeness, to use your word. Hitherto, the market has not been very ripe, and we are living in a world where some sort of policy intervention is probably necessary to overcome the initial cost burden of setting up a route and to help make that decision easier for one of those prospective airlines. You are entirely right: those airlines will be thinking about those sorts of issues. In that context, a lower rate of APD would help with the prospective volumes in the reverse direction from the UK out to the Gulf, continental Europe, India, Brazil, the United States or wherever it might be. However, that is not the only option. We also have the route development fund, which is a more targeted use of money. It remains to be seen which would be better.

**Dr Gillham:** I think that you have a bit of a chicken-and-egg situation, in the sense that a lot of the establishment of new routes is demand-driven. You used the example of a route from Belfast to Berlin. If the trade links were there, I am sure that the airlines would put that route in. Conversely, airlines will often put in routes to try to establish a link where they think that trade will pick up. Their forecasts determine that. The airlines have said that a barrier to them putting in such new routes is APD, because it affects the short-term viability, and hits their margins, and they cannot necessarily carry those losses in the current economic environment. It is a difficult one; it is a conundrum.

**The Chairperson:** Esmond, to follow on from the point that you made, how would an air route development fund work in practice? How much would need to be committed to make it effective? I do not have any detail on the previous fund.

**Dr Birnie:** That is a good question. My understanding is that the previous route development fund had a very strong influence on what was then Continental Airlines setting up a route between Belfast International Airport and Newark. I think that the sums of money were several millions, so —

**The Chairperson:** What did that go towards, specifically?

**Dr Birnie:** I am not sure what was paid for or how. However, in effect, it was an enticement to get the route started. Obviously, there are set-up costs. In the early period of a certain route starting, it takes time for volumes of traffic to build up. Offering a sum of money upfront to an airline is attractive to overcome all that. How such a fund might operate in the future merits investigation, and a more detailed consideration of how the previous development fund operated would be beneficial.

**The Chairperson:** During what period did the previous fund operate?

**Dr Birnie:** I could not answer that.

**The Chairperson:** We can look at that.

**Mr D Bradley:** Good morning. I think that nearly all the questions have been asked at this stage, but I am sure that I will find one for you somewhere.

This measure was originally part of the EU directive to reduce carbon emissions. Is that right?

**Dr Birnie:** That is a very interesting one. If I remember correctly — correct me if I am wrong, John — APD was introduced in the mid-1990s, I think in 1994. You are right, Mr Bradley: at that time it was very much sold as an environmental tax, the whole principle being that where there is pollution, the polluter should pay. That was the initial rationale behind the tax. I am probably anticipating your

question, so I should stop. I guess that you could say that that may well be the initial justification, but subsequent statements by UK Governments suggest that they have conceded. It is not clear that it is an environmental tax any more. In other words, it is seen as a revenue raiser.

**Dr Gillham:** In its 2011 APD consultation, the Treasury said that it is now primarily a revenue-raising duty, but it acknowledged that it gives rise to secondary environmental benefits.

**Mr D Bradley:** So it is not associated with any EU directive?

**Dr Birnie:** Not directly. Similar to Jonathan's answer, I suppose that it could be said to be compatible with the general emphasis of EU and UK Government policy, where the polluter pays towards taxing carbon emissions. Of course, there is now an entirely different system of taxing carbon emissions that the airlines are, to some degree, being brought into. That begs this question: if it is — arguably it is not — an environmental tax, why have APD on top of the emission trading system that the EU is trying to develop, and carbon pricing?

**Mr D Bradley:** You say that its effects on the environment are secondary. What do you base that on?

**Dr Gillham:** It is a Treasury principle that the tax is not there effectively to reduce emissions. It is not necessarily stopping flights, encouraging substantial changes in airline fleets or plane sizes. You could argue that the price of jet fuel had a much stronger impact on the airlines that fly at the moment. Therefore, the tax affects the establishment of routes, some of the load factors and aspects that will determine the set-up of a particular flight or a flight plan. There are also other fundamental drivers.

**Mr D Bradley:** You say that there are better-targeted tools. What are they?

**Dr Gillham:** For reducing emissions?

**Mr D Bradley:** Yes, for airlines in particular.

**Dr Gillham:** Our firm's policy is that tax can be used to reduce the level of emissions. However, we would advocate a global emissions solution. Part of the problem with the level of aviation tax is its high level of differentiation, even at airport level, let alone at country level. It is hard to get a coherent policy response with such a high level of differentiation. We would certainly not rule out a tax solution, but it would have to be consistent and not bring in serious competitive distortions between airlines and different routes.

**Mr D Bradley:** Your estimate is that the removal of APD would create an extra 60,000 jobs across the UK, although not necessarily at the airports. One would think that tourism would be the natural destination for those jobs. Is that correct? Would there be a greater spread than jobs for tourism only?

**Dr Gillham:** It would be quite a broad spread actually. Most of the benefit comes through business connectivity, so we found that many of the jobs would come through the manufacturing sector and that they would have quite a strong regional dimension. If you look at the spread of the UK manufacturing sector, you will see that it is well distributed across the UK, and you would expect job growth to reflect that distribution.

**Mr D Bradley:** Is that related to the £500 million cost to businesses that is being reinvested in the businesses themselves?

**Dr Gillham:** They would either reinvest it or spend it on more flights to get to their clients more regularly.

**Mr D Bradley:** OK. That is grand. Thank you very much.

**Mr Cree:** Good morning, gentlemen. Dominic said that nearly all the questions have been asked; he managed to mop up all my environmental questions. *[Laughter.]* You mentioned the penalty of working in GB as far as Northern Ireland is concerned. Indeed, we have taken evidence from small businesses that send teams over there on a Monday morning and back on a Friday evening. It is a significant cost for them. When you compare that with the situation in GB, where there has been

major investment recently in the rail system for commuters' benefit, you see that we do not have all of that. Therefore, in my view anyway, we tend to link more towards the peripherality of the Highlands and Islands that Esmond mentioned. We were told that the main platform in that argument is not just peripherality, but density of population. Have you any comments on that?

The next section that interested me was the deadweight loss from APD to welfare to society. However, I did not quite understand — and certainly do not agree with — the table that you have in which you compare weightings. You have fuel costs at the extreme right-hand most-expensive end. Does that take into account APD as also being on fuel? You have the VAT element as well at the bottom. The fuel figure does not include VAT, does it? Therefore, it distorts the figure.

**Dr Gillham:** The airline sector does not bear VAT or fuel charges; that goes back to the Chicago convention. In our analysis, we looked at the average effective tax rate that could be paid by the airline sector should it be charged fuel duty and VAT in line with the wider economy. We found that the effective tax rate that the airline sector bears is actually much higher. Therefore, perhaps there is an element of APD or taxation that needs to be drawn from the sector to cover its fuel and to put it on a level playing field with other commodity purchases that households make. As it stands, that linkage is, in effect, broken. The tax rate is very high; it is much higher than you would perhaps find for a standard fuel duty.

**Mr Cree:** OK. I was also amused. There was a funny bit in your report when you referred to the Treasury principle that tax should be internationally competitive; yet, we have the highest tax of all. I found that very interesting.

My final question, gentlemen, arises from the deadweight loss and its effect: surely corporation tax has to be more beneficial, bearing in mind the more direct effect than APD that it can have on foreign investment? Are you just being argumentative when you say that APD is, perhaps, more useful than corporation tax?

**Dr Birnie:** It is complicated because, as I said earlier, it is about whether you think you should take the gamble on the reduction in the block grant, which could be proportionately more. It is bigger in absolute terms than corporation tax. It is also bigger because it looks as though, under European law, that the Northern Ireland block would have to be reduced to allow for what happens to corporation tax receipts in England, Scotland and Wales. I do not think that there would be similar effects in the case of APD. We have no direct strong economic modelling for this. However, based on some of the points that Jonathan referred to that are in the model, I have a sense that it could be defensible to say that the impact on exports, the manufacturing sector and foreign direct investment may mean that the "gamble" of reducing a tax would be more viable for APD than for corporation tax.

You mentioned the Highlands and Islands, which are not only a peripheral region but have a low-density population. There is an idea that NI could try, although the European Commission could reject it and tell us to go away. Nevertheless, it is worth trying. We could say that we are peripheral and that we also have a low-density population. The advantage of exemption is that reduction to the block grant does not come into play, and that is the best scenario to be in for reducing APD.

**The Chairperson:** Thank you, Esmond and Jonathan.