



# IATA ECONOMIC BRIEFING

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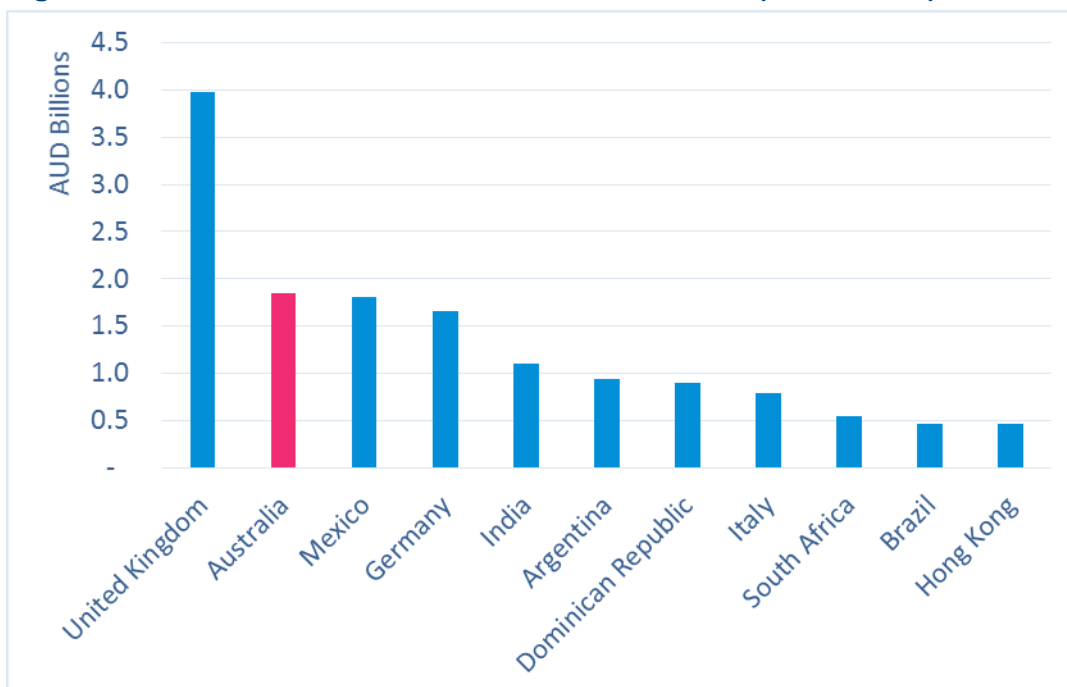
## THE ECONOMIC IMPACT OF INCREASING THE PASSENGER MOVEMENT CHARGE IN AUSTRALIA

In September 2016, the Australian Government announced an increase of AUD5 in the Passenger Movement Charge (PMC) which is levied on passengers departing Australian airports on international flights. The increase would take the PMC from a level of AUD55 to AUD60 per departing international passenger.

Even at its current level of AUD55 per passenger, the PMC is the already second highest departure tax in the world after the UK Air Passenger Duty (APD). Indeed, because it does not vary with distance, the PMC is in fact higher than APD on short-haul sectors such as Trans-Tasman routes where it represents nearly 10% of an average return fare.

**Figure 1** shows the estimated revenue from ticket taxes for the 10 countries with the highest ticket tax burden in 2014:

**Figure 1: Estimated Revenue from Ticket Taxes, 2014 (AUD Billion)**



Source: IATA

Economic modelling carried out by IATA suggests that increasing the PMC would create significant harm for consumers in the form of higher fares; and significant harm for Australian exporters through higher travel costs and reduced competitiveness; and lastly will act as a brake on the Australian aviation sector. We estimate that



the reduction in aviation-related Gross Value Added (GVA) compared with a scenario where the PMC were abolished could total AUD375 million with 3,800 fewer jobs supported.

## Consumer Impacts

Increasing the level of the PMC would increase the cost of flying and reduce passenger demand.

- As shown in Table 1 below, increasing the level of the Passenger Movement Charge would increase the cost of international travel to/from Australia by approximately 0.35%, and a total of 4.07% compared to a scenario in which the PMC were abolished.

**Table 1: Impact of proposed increase on travel cost**

Impact on cost of travel	Proposal	vs Current	vs Removal
Average return international airfare, AUD	1,282	1,346	1,346
Fees and charges, AUD	69	69	69
Passenger movement charge, AUD per departure	60	55	0
Total travel cost, AUD	1,411	1,406	1,351
Difference in travel cost (vs Increase)		+ 0.37%	+4.44%

Source: Pax-IS

As already noted, the impact of the PMC is relatively much greater on short- and mid-haul routes. If it were to increase to AUD60, the PMC would represent more than 9% of the average return fare on Trans-Tasman routes and 5% on routes between Australia and the rest of Asia.

- The increased cost of travel for passengers will – all else remaining constant – impact demand. We estimate that a 4.4% increase in average travel cost would drive a reduction in passenger traffic of around 4.2% annually compared to the abolition of the PMC, as shown in Table 2.

**Table 2: Impact of proposed increase on passenger volumes**

Impact on international passenger volumes	vs Current	vs Removal
Change in travel cost for international passengers	+0.37%	+4.44%
Average elasticity of demand	0.7	0.7
Increase in international passenger traffic, %	-0.35%	-4.22%

Source: IATA calculations

- The expected reduction in demand as a result of the increase in the PMC is equivalent to 30,000 fewer international passenger return journeys each year (i.e. an arrival and a departure counts as one trip) as a result of the increase, and 350,000 fewer trips compared to a scenario in which the PMC were abolished.
- The analysis in this briefing note focuses on the direct consumer impacts of the proposed increase in the PMC. However, the increase may also result in a supply response from airlines. If the forecast decrease



- in passenger demand causes load factors to drop below breakeven levels the airline could be forced to cut frequencies or even cancel routes entirely. Due to the lumpiness of aircraft seat capacity, airlines are unable to adjust capacity continuously. Similarly, airlines' flexibility to use smaller aircraft is generally limited and minimum flight frequency levels are important for operating competitively in a market.

At hub airports, the typical characteristics of the airline hub operation can lead to a 'domino effect' when the hub airline decides to rationalize its route network at the hub. Closure of routes at the hub results in less passenger feed to other routes to/from the hub. If the hub carrier cannot sustain other routes anymore, there will be again less feed for another set of routes, etc.

## Impacts on the Australian economy

- Over 99% of inbound tourists to Australia currently arrive in the country by air. Inbound tourism expenditure accounts for 2.2% of Australia's Gross Domestic Product (GDP); this a reduction of 50% since 2008 when inbound tourism represented 3.3% of total GDP. Increasing the PMC would damage the competitiveness of Australia as a tourism destination.
- Increasing the PMC would also raise the cost to Australian firms of doing business overseas, in particular travelling to win new business and maintain existing client relationships. For Australian firms, the PMC is therefore effectively a tax on exports. Not only is it a cost that is not faced by their competitors in international markets, unlike most sales taxes for example, it is also non-recoverable. Increasing the PMC would make Australian businesses less competitive in the increasingly competitive Asian marketplace.
- 30% by value of Australia's two-way international trade is shipped by air, equating to AUD200bn worth of goods. While air cargo will not be directly affected by the increase of the PMC, research has shown that face-to-face meetings, facilitated by business travel are important for winning new customers and retaining existing clients. For example, a survey of U.S. businesses found that the conversion rate of potential clients to firm orders was 40% with face-to-face meetings compared with 16% without<sup>1</sup>. By reducing the ease and value for money of air travel, increasing the PMC will make it harder for Australian exporters to compete in key international markets.
- Inflows of Foreign Direct Investment (FDI) into Australia totalled AUD 30bn in 2015. 82% of executives reported that international air connectivity is an important factor in determining the location of headquarters and new investment. Increasing the PMC will also make Australia a less attractive place to do business, providing a hit to key business hubs such as Sydney and Melbourne.
- In addition to its crucial role in providing market access and facilitating economic activity, air transport is an important economic sector in its own right. The aviation industry and its supply chain contributed over AUD18bn to Australian GDP and 175,000 jobs in 2014<sup>2</sup>. In addition, the sector supported a further AUD66bn in GDP and 450,000 extra jobs in the wider economy.
- The reduced demand for air transport resulting from the increase of the PMC would negatively impact the airlines and airport operators serving the Australian market. This impact will also ripple out through the broader economy along the air transport supply chain and via reduced wage spending from industry employees on goods and services they consume privately.

<sup>1</sup> Oxford Economics, *The Return on Investment of U.S. Business Travel*, 2009

<sup>2</sup> ATAG, *Aviation Benefits Borders*, 2014



- Increasing the PMC would also be expected to provide a hit to the tourism sector. Inbound and outbound tourism are relatively evenly balanced in Australia, and so the net impact will be less than the total reduction in inbound travel.
- The reduction in outbound travel will also have an impact on spending by Australian travelers heading overseas. Research in the UK<sup>3</sup> found that domestic spending in advance of and in preparation for outbound travel (for example on items of clothing, cameras, sunglasses or toiletries as well as on travel related expenditure such as surface transport, accommodation and car parking contributed as much as 1.6% to UK GDP.

## Estimating the macro-economic impacts

- Estimating the macro-economic impact of tax policy is complex and controversial. As taxation of any sector is, by its very nature, distortionary; changes that affect one sector invariably have impacts on other sectors. These effects are complicated to model in a comprehensive manner.
- One approach to model tax policy changes is to use Computable General Equilibrium (CGE) models. CGE attempt simulate how an economy could be expected to respond to changes in policy or other parameters. Changes in relative prices are used to model how changes in one sector might be expected to affect the economy as a whole.
- Two recent attempts to use CGE tools to model the effect of aviation taxes and charges came out with very different conclusions:
  - Forsyth et al.<sup>4</sup> modelled the impact of the 2012 increase of the PMC on the Australian economy. Their study is therefore of considerable relevance to the current consultation. They found that, while the tourism industry would lose out, the Australian economy as a whole would gain, largely due to the increased tax revenue. However, the Forsyth analysis did not account for the distortionary impact of taxation policy nor the crowding out of private sector activity by public sector spending – the assumption of a 1:1 pass through to GDP as a result of increased Government spending is critical to the model results. Moreover, the findings of the Forsyth study are heavily dependent on assumptions regarding the substitution by Australian residents of domestic tourism for foreign trips as well as, importantly, the assumption that the Australian economy is at, or even above, full employment.
  - In contrast, PWC<sup>5</sup> examined the UK's APD and found that abolishing the tax would lead to a permanent increase in the level of UK economic output. While the PWC study captured the benefits to UK consumers and foreign visitors to the UK (analogous to the impacts considered in the Forsyth study) it found that the biggest gain would be for UK exporters who would be able to spend more time with overseas customers as a result of cheaper air fares. This was forecast to lead to business expansion and an increase in productivity. Moreover, the resulting increase in output and employment was expected to lead to increases in revenues from general taxation that more than offset the loss in APD revenues. In other words, abolishing the tax would more than pay for itself.
- IATA has used input-output tables to estimate the impacts of abolishing the PMC; at its simplest this approach assumes a 'counterfactual' economy with unemployed resources, such that all jobs and GDP

<sup>3</sup> CEBR, *The economic value of outbound travel to the UK economy*, 2012

<sup>4</sup> Forsyth et al., *The Impacts of Australia's Departure Tax: Tourism versus the Economy?*, 2013

<sup>5</sup> PWC, *The Economic Impact of Air Passenger Duty: A study by PWC*, 2013



- created by PMC abolition would be additional and would not crowd out existing employment. In reality, while some of the activity will be additional, some of it will be redistributed or displaced from other sectors.
- In order to estimate the net impact, a set of assumptions needs to be made about what might be additional:
  - The UK Government has published guidance on the treatment of additionality in impact assessments<sup>6</sup>. Although this guidance is intended for use in assuming policy at a local or national level, and therefore assumes a closed economy, we have used it as the basis of our modelling assumptions. For analysis of PMC abolition, we have set a high displacement level of 80% (i.e. only 20% of impacts being additional). We consider that this a valid assumption given OECD estimates of a relatively small GDP output gap for Australia of 2% in 2015<sup>7</sup>.
  - The resulting estimates of the GDP and employment impacts of removing the PMC may be conservative, as they do not account for the fact that jobs in the aviation sector are estimated to be 3.5 times more productive than the average across the economy as a whole. However, we have taken a cautious approach in our modelling.
- Table 3 summarizes the combined impact to the Australian economy flowing from the reduction in international passenger traffic. As a result of increasing the PMC, the industry's economic footprint would be expected to be AUD377.3m lower than if the tax were abolished, with 3,840 jobs fewer jobs supported.

**Table 3: Impact macro-economic impact of proposed increase**

<b>Impact on economic footprint</b>	<b>vs Current</b>	<b>vs Abolition</b>
Reduction in annual contribution to GDP, AUD million	31.4	377.3
Reduction in employment, jobs	320	3,840

*Source: IATA calculations, using Input-Output model developed by Oxford Economics:*

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<sup>6</sup> English Partnerships, *Additionality Guide: A standard approach to assessing the additional impact of interventions*, 2008

<sup>7</sup> <http://stats.oecd.org/Index.aspx?QueryId=48222>